

Implementation of the Virtual Asset Service Providers Licensing Regime in Hong Kong

December 2022

Introduction

On 7 December 2022, the Legislative Council passed the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (**'Amendment Bill'**) which introduced, among other things, a mandatory licensing regime for virtual asset service providers (**'VASP Licensing Regime'**). The Bills Committee of the Legislative Council (**'Bills Committee'**), on the same day, published a [report](#) (**'Report'**) under which the Government clarified its position in relation to certain issues (namely, the provision of services to Professional Investors (**'PIs'**), and the applicability of the VASP Licensing Regime to non-fungible tokens (**'NFTs'**)), and postponed the commencement of the VASP Licensing Regime.

In this update, we will provide a summary of the Report and some insights into what it means for market participants. For a review of the VASP Licensing Regime under the original Amendment Bill, please refer to our [News Flash](#) issued in July 2022.

Provision of services to Professional Investors only

Although the Bills Committee confirmed in the Report that licensed VASPs can only offer services to PIs and not retail investors at the initial stage, such PI requirement will be imposed by the Securities and Futures Commission (**'SFC'**) as licensing conditions and as such, the SFC has room to adjust the PI requirement in the future without amending the law. In addition, SFC would conduct consultation on the detailed regulatory requirements of the VASP Licensing Regime upon the passage of the Amendment Bill and during which, the SFC would consider the possibility of allowing licensed VASPs to provide services to non-PIs provided that additional investor protection measures are in place.

Will NFTs be regulated?

In our previous [News Flash](#), we noted that there was some ambiguity under the Amendment Bill as to whether NFTs and certain trending VAs such as Metaverse tokens would fall within the definition of 'VA' and be subject to the VASP Licensing Regime. In the Report, the Bills Committee emphasised that whether an NFT would be regarded as a VA depends on the 'nature and functions' of the NFT in practice, rather than the marketing terminology used. In general, NFTs will not be regulated under the VASP Licensing Regime if they

- (i) merely represent a 'genuine digital representation of a collectible';
- (ii) are not capable of being replicated; and
- (iii) are not intended by their issuer to be 'convertible into money or another medium of exchange accepted by the public'.

NFTs with the features above will either (a) be captured by the exception of 'limited purpose digital token' or (b) fall outside the definition of 'VA'.

However, an NFT may qualify as a 'VA' if its terms and features goes 'beyond the boundary of a collectible' and satisfy the conditions under s53ZRA(1) of the Amendment Bill. In particular, the Bills Committee stated that NFTs may be considered as VAs if they have the following features:

- (a) contain fungible elements;
- (b) allow holders to vote on its arrangements; or
- (c) are cryptographically secured digital representation of value that (i) can be used to save and allocate capital, and (ii) are capable of being bought, sold, or auctioned on trading platforms.

Nevertheless, the Report expressly provided that the trading of NFTs on a peer-to-peer basis (e.g. those traded on OpenSea) would not require a VASP licence (even if those NFTs qualify as VAs) since such trading would not be done through the operation of an exchange, and the activity would not be deemed to be 'VA service'.

On a side note, the Bills Committee also reminded market participants that an NFT which evolves into or takes in the form of a collective investment scheme will be subject to the SFO. Where necessary, the SFC will issue guidance regarding the regulatory treatment for specific tokens.

New timetable for implementation of the VASP Licensing Regime

The Bills Committee also proposed a 3-month delay to the implementation of the Amendment Bill and the VASP Licensing Regime.

In respect of the VASP Licensing Regime, the updated timelines are as follows:

	New Commencement Date	New Deadline
Effective date of the VASP Licensing Regime (' VASP Licensing Regime Effective Date ').	1 June 2023 ¹	N/A
12-month transitional period for corporations that have been operating a VA exchange in Hong Kong immediately before the VASP Licensing Regime Effective Date (' Existing VASPs ') to carry on VA exchange business without a VASP licence (' 12-month Transitional Period ').	1 June 2023	1 June 2024
9-month transitional period for Existing VASPs to apply to the SFC for a VASP licence which can be deemed to take effect on the day immediately following the first 12 months (' 9-month Transitional Period ') ² .	1 June 2023	1 March 2024

Actions required from market participants

While the commencement of the VASP Licensing Regime and its transitional periods have been deferred for three months to allow market participants more time to prepare for the new licensing and compliance requirements, the SFC is likely to expect applicants to be better prepared as and when their applications under the VASP Licensing Regime are lodged. As such, we anticipate that the SFC will have less tolerance for incomplete applications, or where their expectations in relation to requirements such as RO qualifications, internal compliance and build-out, policies and procedures, are not fully met at the outset.

We would recommend that existing VASPs take note of the new deadlines of the transitional periods and undertake a thorough review of their existing management structure and list of existing clients to ensure they are fully compliant with the licensing conditions under the VASP Licensing Regime. Non-compliance may result in the refusal by the SFC to grant a VASP licence and if such refusal is made after the 12-month Transitional Period, any Existing VASP without a VASP licence must cease to carry on its activities, failing which, it would be committing an offence.

For participants that are not currently providing a VA exchange service but that wish to do so after 1 June 2023 ('**New VASPs**'), careful planning should be made as early as possible. As transitional periods do not apply to New VASPs, New VASPs must have

¹ <https://www.info.gov.hk/gia/general/202212/07/P2022120700263.htm>.

² Any VASP licence applied under the 9-month Transitional Period will end on the day on which its application is withdrawn by the applicant or rejected by the SFC, or a VASP licence is granted by the SFC.

obtained (not merely have applied) a VASP licence from the SFC in order to provide VA exchange services. To avoid delay in the grant of the VASP licence due to possible follow-up queries from the SFC for non-compliant issues, New VASPs should ensure that the required internal policies and procedures are properly implemented and fit-and-proper ROs and directors are duly appointed at the time of the VASP licence application.

Finally, it also goes without saying that all existing and New VASPs should undertake a simple assessment based on the pointers provided in the Report to determine whether any NFTs being, or proposed to be, traded constitute a 'VA', and if so, whether to include those within the scope of any VASP Licensing Regime application (or to have them delisted).

Next steps

The soft consultation initiated by the SFC in relation to the VASP Licensing Regime has only recently been wrapped up, with a public consultation to follow. We anticipate that the public consultation conclusions will be published in early 2023. In the meantime, we will continue to monitor and report on any further clarifications from the Government on the Amendment Bill, pending finalisation of the VASP Licensing Regime by the SFC.

Let's talk

For a deeper discussion of how this impacts your business, please contact us.

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The materials contained in this document were assembled in December 2022 and were based on the law enforceable and information available at that time.