Charltons - Hong Kong Law - 19 November 2021

[online version](https://www.charltonslaw.com/sfcs-julia-leung-gives-update-on-hong-kong-crypto-regulation)

SFC’s Julia Leung Gives Update on Hong Kong Crypto Regulation

In her keynote address at Hong Kong’s FinTech Week, “[Fintech: Metamorphosis of the financial industry](https://www.sfc.hk/-/media/EN/files/COM/Speech/DCEO-at-HK-FinTech-Week-2021.pdf)”,[1](#footnote-7625-1) Ms. Julia Leung provided a welcome update on Hong Kong’s regulatory approach to Fintech and the SFC’s latest thinking on Hong Kong crypto regulation. Ms. Leung, the Hong Kong SFC’s Deputy Chief Executive Officer and Executive Director (Intermediaries), noted the accelerated use of technology in the financial industry, particularly the role of online platforms in selling investment products, and commented on the benefits of technological advances for consumers in terms of lower fees and greater efficiency. Turning to the paradigm shift in financial services resulting from developments in the crypto (i.e. virtual asset) industry, Ms. Leung explained how the SFC has adopted a light touch regulatory approach to facilitate the industry’s development while protecting investors.

Noting the rapid evolution of crypto-related activities as they edge towards mainstream finance, Ms. Leung explained that the SFC is currently reviewing its regulatory initiatives of the past few years to assess whether they remain fit for purpose. The SFC is considering whether retail investors should be allowed access to crypto exchange-traded funds (**ETFs**) through online brokers, and if so, whether the SFC should impose additional knowledge requirements or risk disclosures.

Recap of Hong Kong SFC’s Crypto Regulation

Ms. Leung first outlined the regulations adopted by the SFC dating back to 2017 when so-called initial coin offerings (**ICOs**) first came within its regulatory radar. Given the prevailing view of international regulators (e.g. the Financial Stability Board) that crypto had no inherent value, the SFC was reluctant to effect legislative change to regulate these emerging instruments which could prove to be a passing fad. Falling outside the existing definitions of “securities” and “futures contracts”, the SFC also had concerns that: (a) regulation could give crypto the legitimacy they otherwise lacked; and (b) regulation risked stifling crypto development.

However, these concerns had to be weighed against the risks of not regulating. Holders’ anonymity gave rise to serious concerns in relation to money laundering and terrorist financing. Trading on unregulated platforms also gave rise to serious consumer protection issues in relation to cybersecurity, market manipulation and the safe custody of assets.

SFC’s 2018 Opt-in Crypto Regulation

Concerns around money laundering, terrorist financing and investor protection provided the impetus for the SFC’s 2018 [Statement on Regulatory Framework for Virtual Asset Portfolio Managers, Fund Distributors and Trading Platform Operators](https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-regulatory-framework-for-virtual-asset-portfolios-managers)[2](#footnote-7625-2) setting out requirements for:

* SFC-licensed managers of funds investing 10% or more of their assets in virtual assets (irrespective of whether or not they are “securities” or “futures contracts” within the statutory definitions);
* Distributors of crypto funds; and
* Operators of trading platforms providing trading in at least one virtual asset constituting a security under the SFO.

Under this framework, licensed firms are only permitted to provide crypto services to professional investors as defined in Schedule 1 to the SFO and the Securities and Futures (Professional Investor) Rules. Please see Charltons’ newsletter, [Hong Kong SFC Issues Crypto Fund Licensing Conditions for Hong Kong Crypto Fund Managers](https://www.charltonslaw.com/hong-kong-sfc-issues-crypto-fund-licensing-conditions-for-hong-kong-crypto-fund-managers/) for details of the Regulatory Framework Statement.[3](#footnote-7625-3)

The SFC refers to its 2018 requirements as an “opt-in” approach to regulation. In reality, if a firm provides services constituting a regulated activity under the SFO (e.g. dealing in or advising) in relation to a virtual asset which is a security under the SFO (e.g. a tokenised share to take a simple example), licensing under the SFO would be mandatory and not optional, as suggested by the “opt-in” tag.

SFC’s 2019 Crypto Regulation

In November 2019, the SFC published its [Position Paper on Regulation of Virtual Asset Trading Platforms](https://www.sfc.hk/-/media/EN/files/ER/PDF/20191106-Position-Paper-and-Appendix-1-to-Position-Paper-Eng.pdf)[4](#footnote-7625-4) officially adopting its 2018 regulatory framework for crypto trading platforms which applies much the same regulatory requirements to crypto trading platform operators as apply to traditional securities brokers and automated trading systems. Again, licensed platform operators can only provide trading services to professional investors.

The 2019 framework addressed all key aspects of investor protection, covering custody and safekeeping, know-your-client (**KYC**) requirements, anti-money laundering (**AML**), market manipulation, risk management and cybersecurity. Licensed platforms are required to comply with essentially the same regulatory requirements that apply to automated trading platforms and dark pools supervised by the SFC.

SFC Licensing of Firms Engaged in Crypto-related Activities

To date, the SFC has licensed just one crypto exchange, OSL Digital Securities Limited,[5](#footnote-7625-5) but is apparently considering a number of applications from several others. The SFC also licensed a number of virtual asset fund managers and is considering more applications from other candidates.

Recent Developments in Crypto Regulation

FATF Requirement for VASP Licensing

In 2018, the Financial Action Task Force (**FATF**) revised its recommendations to require member jurisdictions to license or register virtual asset service providers (**VASPs**) (which include crypto trading platform operators) and to subject them to the anti-money laundering (**AML**) obligations which apply to financial institutions. Most overseas regulators have now introduced some form of AML regime for virtual assets. In Hong Kong, the Government will extend the anti-money laundering legislation to require all centralised virtual asset trading platforms that trade virtual assets that are not securities to be licensed with the SFC and comply with the AML and CTF obligations set out in Schedule 2 to Hong Kong’s Anti-Money Laundering and Counter-Terrorist Financing Ordinance.[6](#footnote-7625-6) For details of the new regime, please see Charltons’ newsletter [FSTB Concludes Consultation on Licensing Regime for Hong Kong Virtual Asset Exchanges](https://www.charltonslaw.com/fstb-concludes-consultation-on-licensing-regime-for-hong-kong-virtual-asset-exchanges/).[7](#footnote-7625-7)

IOSCO Recommendations for Regulating Crypto Exchanges

Given market integrity and investor protection concerns, the International Organisation of Securities Commissions (**IOSCO**) published a report on key issues, risks and considerations for regulating crypto-asset trading platforms. The SFC has taken these concerns into account in developing its regulatory regime for crypto trading platforms.

Recommendations for Stablecoin Regulation

In response to the proposals relating to Diem (previously called Libra), the Bank for International Settlements’ Committee on Payments and Market Infrastructures and IOSCO recently issued a joint report advocating the regulation of stablecoins as a financial market infrastructure similar to conventional payment, clearing and settlement systems. The report also recommended that jurisdictions should evaluate the systemic importance of stablecoin arrangements.

According to Ms. Leung, these latest regulatory developments validate the SFC’s 2018 adoption of a “same business, same risks, same rules” approach to virtual asset regulation.

Issues Relating to SFC Licensed Corporations Trading or Distributing Crypto ETFs

There have also been significant changes in the virtual asset market over the past three years. As cryptocurrency pushes into mainstream finance, many different types of virtual asset investment products are now available, an example of which is crypto ETFs. These now trade on conventional exchanges overseas, for example in Canada where they trade primarily on the Toronto Stock Exchange. The SFC has also received a number of enquiries from financial institutions wanting to provide services in virtual assets to their private bank customers or professional investors.

Ms. Leung noted that questions such as this often involve complicated issues because the regulatory landscape is still uneven. For example, licensed corporations want to provide cryptocurrency trading services to clients either by acting as an introducing agent or via an omnibus account management opened at a virtual asset platform.

The questions being looked at by the SFC are:

* Would firms expose clients to unacceptable risks if the virtual asset platforms are unregulated or regulated only for limited purposes?
* Whether under an omnibus arrangement, the licensed corporation would directly onboard the clients and trade for them?
* Whether the regulatory obligations that apply to a licensed virtual asset trading platform should also apply to firms acting as introducing agents or via omnibus accounts?
* Whether the SFC should expect the licensed firm to conduct a knowledge assessment before providing virtual asset trading services to clients?

Another area of interest is distribution of crypto investment products. The SFC has already issued guidance on the distribution of investment funds exposed to crypto, but has not dealt with the regulation of distributing products such as crypto ETFs traded on conventional exchanges.

This raises questions as to whether retail investors should be allowed to access these products via online brokers and, if so, whether additional knowledge requirements or risk disclosures should apply.

The SFC is conducting a review of its regulatory regime for virtual assets to see if it is still compatible with its objective of providing a clear regulatory environment to foster innovation, market development and investor protection.

[1](#footnote-7625-1-backlink) <https://www.sfc.hk/-/media/EN/files/COM/Speech/DCEO-at-HK-FinTech-Week-2021.pdf>

[2](#footnote-7625-2-backlink) <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-regulatory-framework-for-virtual-asset-portfolios-managers>

[3](#footnote-7625-3-backlink) Available at: <https://www.charltonslaw.com/hong-kong-sfc-issues-crypto-fund-licensing-conditions-for-hong-kong-crypto-fund-managers/>

[4](#footnote-7625-4-backlink) <https://www.sfc.hk/-/media/EN/files/ER/PDF/20191106-Position-Paper-and-Appendix-1-to-Position-Paper-Eng.pdf>

[5](#footnote-7625-5-backlink) OSL Digital Securities Limited. “[OSL Receives Licence from Hong Kong Regulator, becomes World’s First SFC-Licensed, Listed, Insured & Big-4 Audited Digital Asset Trading Platform](https://osl.com/en/press-release/bc-technology-group-enters-into-agreement-to-raise-hkd697-million-in-share-placement-with-morgan-stanley-appointed-as-sole-placing-agent-2/)”

[6](#footnote-7625-6-backlink) Financial Services and Treasury Bureau. “[Public Consultation on Legislative Proposals to Enhance Anti-Money laundering and Counter-Terrorist Financing Regulation in Hong Kong](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf)”

[7](#footnote-7625-7-backlink) Available at: <https://www.charltonslaw.com/fstb-concludes-consultation-on-licensing-regime-for-hong-kong-virtual-asset-exchanges/>

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