

Consultation Conclusions: regulatory regimes for virtual asset exchanges and dealers in precious metals and stones



On 21 May 2021, the Financial Services and the Treasury Bureau ("**FSTB**") issued its consultation conclusions (the "**Conclusions**") on the introduction of a new regulatory framework in Hong Kong under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) ("**AMLO**") to regulate virtual asset services providers ("**VASPs**") and dealers in precious metals and stones ("**DPMSs**"). The Conclusions adopted most of the proposals set out in the FSTB's consultation paper issued in November 2020, which we have summarised in our article "[Two new regulatory regimes: virtual asset services providers and dealers in precious metals and stones](#)".

Whilst the Conclusions also discuss some technical amendments to AMLO, this update will focus on the new (1) licensing regime for VASPs; and (2) two-tier registration regime for DPMSs.

VASP licensing regime

In the Conclusions, the FSTB proposed to establish a new regime for VASPs as follows.-

Scope of regulated activity of operating a VA exchange

- The business of operating a virtual asset ("**VA**") exchange will be a "regulated virtual asset activity" under AMLO and persons seeking to operate a VA exchange in HK must apply for a VASP licence from the Securities and Futures Commission (the "**SFC**").
- A "VA exchange" will be defined as any trading platform which is operated for the purpose of allowing an offer or invitation to be made to buy or sell any VAs in exchange for any money or VAs, and which comes into custody, control, power or possession of, or over, any money or any VA at any point in time during its course of business. It, however, excludes peer-to-peer trading platforms¹, provided that VA transactions are conducted outside the platform and the platform is not involved in the underlying transaction by coming into possession of any money or VA at any point in time. VA exchanges that are already regulated as a licensed corporation under the voluntary opt-in regime by the SFC (i.e. exchanges that facilitate trading in at least one VA that is a "security"²) will also be exempted from the VASP licensing requirement.
- A VA is defined to mean a digital representation of value that: (a) is expressed as a unit of account or a store of economic value; (b) functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services or for the discharge of a debt or for investment purposes; and (c) can be transferred, stored or traded electronically. The definition applies equally to virtual coins that are stable (i.e. "stablecoins") or not and irrespective of the purporting form of underlying assets.
- The VA definition excludes fiat currencies (including digital currencies issued by central banks), financial assets regulated under the Securities and Futures Ordinance (Cap. 571) (the "**SFO**") (e.g. security tokens), stored value facilities³ and certain non-transferrable, non-exchangeable and non-fungible closed-loop, limited purpose items (e.g. air miles, credit card rewards, gift cards and gaming coins, etc.).

¹Peer-to-peer trading platforms refer to platforms that only provide a forum where buyers and sellers of VAs can post their bids and offers, with or without automatic matching mechanisms, for the parties themselves to trade at an outside venue.

²"securities" as defined in the SFO.

³"Stored value facilities" are regulated by the Hong Kong Monetary Authority under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584).

Given the fast-evolving nature of VAs, the definition can be expanded from time to time by the SFC and the HK Secretary for Financial Services and the Treasury.

- A VA exchange which is not a licensed VASP is prohibited from actively marketing, whether in Hong Kong or from elsewhere, its services to the HK public, regardless of the location of the platform. This will be similar to section 115 of the SFO which prohibits offshore securities-related service providers from actively marketing their securities-related services to the Hong Kong public.

Regulatory requirements

- A licensed VASP will be subject to the AML/CTF requirements, including the customer due diligence ("**CDD**") and record-keeping requirements set out in Schedule 2 to the AMLO, and other regulatory requirements aimed at market integrity and investor protection⁴.
- Licensed VASPs can offer their services to "professional investors" only. Retail investors (i.e. non-professional investors) are not permitted to trade in VAs under this new regime. The SFC will continue to monitor the market and reconsider its position as the market becomes more mature in future.

Eligibility criteria

- The Conclusions have expanded the eligibility criteria of VA exchanges that can apply for a VASP licence. Companies incorporated outside HK but registered with the HK Companies Registry (the "**CR**") under the Companies Ordinance (Cap. 622) (the "**CO**") as a non-HK company may apply for a VASP licence. Hence, offshore VA exchanges can choose to establish a place of business in HK with their existing offshore entity, register such entity with the CR as a non-HK company and apply for a VASP licence.
- A VASP licensing applicant must appoint at least two responsible officers for ensuring the VASP's compliance with AML/CTF requirements and other regulatory requirements. The applicant must be a "fit and proper" person as determined by the SFC⁵.

Some issues to consider

- There are some issues that existing VA exchanges should consider: -
 - VA exchanges should consider whether to: (a) cease business; or (b) obtain a VASP licence. However, all retail clients should be off-boarded in an orderly fashion within the transition period even if a VA exchange intends to apply for a licence.
 - Offshore VA exchanges should consider whether by making their VA exchange available to HK investors under their current business models (such as through a website or a mobile application accessible by the HK public) could amount to active marketing of a regulated VA activity to the HK public.
 - Offshore VA exchanges that have been marketing, or intend to market, their VA exchanges to the HK public should consider how they should re-structure their future business model and apply for a VASP licence if necessary.

⁴ The SFC will conduct a separate consultation on these regulatory requirements before the commencement of the new VASP regulatory regime.

⁵ The SFC will determine whether a person is fit and proper based on whether the person: (a) has been convicted anywhere of a money laundering or terrorist financing offence, or another offence in which such person was found to have acted fraudulently, corruptly or dishonestly; (b) has failed or may fail to observe AML/CTF requirements applicable to licensed VASPs; (c) has the experience and qualifications; and (d) is of a good standing and financial integrity.

DPMS registration regime

The key aspects of the new DPMS registration regime under the Conclusions are as follows.

Scope and coverage of the DPMS registration regime

- The AMLO will be amended to introduce a two-tier registration regime for DPMS. Any person who wishes to carry on a business in any of the designated DPMS regulated activities in HK will need to be registered with the Customs & Excise Department (the "**C&ED**") under either of the two categories (categories A or B).
- DPMSs are those that carry on a business in HK in any one or more of the following regulated activities: (a) trading in, importing or exporting precious metals, precious stones or precious products; (b) manufacturing, refining, or carrying out value-adding work on precious metals, precious stones or precious products; (c) issuing, redeeming or trading in precious-asset-backed instruments; or (d) acting as an intermediary for (a), (b) or (c) above.
- The FSTB proposes to define "precious metals", "precious stones", "precious products" and "precious-asset-back instrument" as follows:
 - "precious metals" will cover gold, silver, platinum and any other metals in the platinum group;
 - "precious stones" will cover diamond, sapphire, ruby, emerald, jade or pearl;
 - "precious products" will include any jewellery, watch, apparel, accessory, ornament or other finished product made up of, containing or having attached to it any precious metals or precious stones or both, and at least 50% of its value is attributable to the precious metals or precious stones or both. Such value threshold should be determined based on the retail price of the precious product; and
 - "Precious-asset-backed instruments" will cover any certificate or instrument backed by one or more precious metals, precious stones or precious products that entitles the holder to such assets (but excluding securities, futures contracts, collective investment schemes or authorised structured products regulated under the SFO).

Two-tier registration for DPMS

- The DPMS registration regime are as follows:
 - *Category A registration:* it is required for persons who do not intend to and will not engage in cash transactions at or above HK\$120,000 in the course of carrying on a DPMS business. Category A registrants will not be subject to the AML/CTF obligations under Schedule 2 of the AMLO. Such registration will remain valid so long as the DPMS remains in business.

To register under category A, a person must file an application and submit a valid business registration certificate, addresses of all premises in HK pertaining to the place of business and a declaration that the registration is obtained for lawful purposes. A category A registrant will only be subject to the requirement to notify the C&ED of any changes in particulars.
 - *Category B registration:* in line with the Financial Action Task Force (FATF) requirement for DPMS engaging in large cash transactions to be subject to more rigorous AML/CTF scrutiny, persons who intend to or may engage in cash transactions at or above HK\$120,000 must apply for category B registration. These registrants must observe the AML/CTF obligations under Schedule 2 of the AMLO. A category B registration will be valid for 3 years and may be renewable upon expiry provided that the fit-and-proper requirements are met, as determined by the C&ED.

To register under category B, a person must meet the fit-and-proper test and submit a valid business registration certificate and addresses of all premises in Hong Kong pertaining to the place of business.

- The following businesses will be exempted from the DPMS registration requirement:
 - *Financial institutions* that are already regulated under AMLO (e.g. banks, licensed corporations, insurance intermediaries, etc.) where they conduct DPMS regulated activities ancillary to their main business.
 - *Licensed pawnbrokers*⁶ and those engaging in the manufacture of medical devices or industrial equipment where the use of precious metals and precious stones is incidental to their main business.
 - *Non-domestic dealers*⁷ carrying out DPMS regulated activities in HK for no more than 60 days in any given year. However, such dealers will still be required to file cash transaction reports with the C&ED if they engage in cash transactions at or above HK\$120,000 in HK.

Closing Remarks

- The FSTB will prepare an amendment bill to the AMLO based on the Conclusions, which is expected to be introduced into the Legislative Council during the 2021-22 legislative session (from October 2021 until July 2022).
- The Conclusions state that upon commencement of the VASP licensing regime and the DPMS registration regime, market participants will be given a transitional period of 180 days (from the date on which the amendments take effect) to file for a VASP licence or apply for registration as a DPMS.
- However, it remains to be seen how the transitional arrangement will be implemented for VASP licensing applicants. If they are only required to file an application within 180 days, but not obtain a licence within 180 days, they may need permission to carry on their VA exchange business beyond those 180 days while waiting for their licences to be granted. We believe that there will be more clarity on this once the amendment bill to the AMLO is released.
- Both VA exchanges and DPMSs should start considering how they may be impacted under the applicable new regime and take necessary actions to deal with the upcoming changes.

Please get in touch if you are interested in discussing any of the above.

⁶ Pawnbrokers licensed under the Pawnbrokers Ordinance (Cap. 166).

⁷ A Non-domestic dealer qualified for exemption will be a person who: (i) does not ordinarily reside in HK (or is a legal person incorporated outside HK and is not registered under the Companies Ordinance as a non-HK company); (ii) does not have a permanent place of business in HK; and (iii) carries out a DPMS regulated in HK for no more than a total of 60 calendar days in any given year.

Get in touch



Katherine Liu

Partner

T: +852 2533 2717

Email: Katherine.Liu@shlegal.com



Conrad Lam

Associate

T: +852 3166 6946

Email: Conrad.Lam@shlegal.com

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