

Two new regulatory regimes: virtual asset services providers and dealers in precious metals and stones



On 3 November 2020, coinciding with Hong Kong's fintech week, the Financial Services and the Treasury Bureau ("**FSTB**") launched their public consultation on legislative proposals to enhance anti-money laundering and counter-terrorist financing measures in Hong Kong (the "**Consultation**").

In short, the government proposes to introduce:-

- (i) a new licensing framework for virtual asset services providers ("**VASPs**"), under which the Securities and Futures Commission ("**SFC**") would be the responsible regulatory body; and
- (ii) a new two-tier registration regime for dealers in precious metals and stones ("**DPMSs**"), under which the Customs & Excise Department ("**C&ED**") would be the responsible regulatory body.

The two new regimes will be introduced under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance ("**AMLO**"). The government has also proposed various other reforms to the AMLO under the Consultation, but we will focus our discussion here on the two new regimes.

VASPs

At present, virtual asset trading platforms are regulated only by a voluntary opt-in regime (sometime referred to as a sandbox), outlined by the SFC in a position paper in November 2019. One of the many limitations of the opt-in regime is that it only applies to platform operators that enable clients to trade virtual assets ("**VAs**") that fall within the definition of "securities" (as defined in the Securities and Futures Ordinance ("**SFO**"). Activities involving only non-securities VAs such as bitcoin and utility tokens are not capable of being regulated under the SFO. Our experiences have also shown that, due to the nascent and experimental nature of the opt-in regime, prospective applicants should be prepared that the whole application process can be quite long.

The Consultation has been launched in large part due to findings by the FTSB that (a) the nature of VA-related activities inherently presents a very high degree of AML/CTF risk, and (b) VAs and related services are becoming increasingly popular and prevalent.

The key aspects of the proposal under the Consultation in relation to VASPs are as follows:-

- (1) VAs will be defined as "a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes", but will not include (i) digital representations of fiat currencies, (ii) other SFO-regulated financial assets, or (iii) any closed-loop limited purpose items that are non-transferrable, non-exchange and non-fungible;
- (2) operating a VA exchange will constitute a "regulated VA activity" and any person seeking to do so would need to obtain a VASP licence from the SFC;
- (3) the grant of a VASP licence will be subject to the fit-and-proper test, and in the usual course of demonstrating fitness and properness, the licensee must appoint at least 2 responsible officers;
- (4) service providers carrying out other VA-related activities outside of operating a VA exchange (for which the FSTB notes are not prevalent in Hong Kong) do not need to be, and in fact cannot be, licensed under the new regime;
- (5) licensees must be locally incorporated companies with a permanent place of business in Hong Kong;
- (6) licensees will be required to observe the AML/CTF requirements under the AMLO;
- (7) the SFC will be empowered to impose various licensing conditions (which we note are not dissimilar to those currently applicable under the opt-in regime), including but not limited to (i) restricting the offer of services to professional investors only, (ii) segregating client assets and (iii) implementing and enforcing robust rules for the listing and trading of VAs;
- (8) the VASP licence will remain valid until revoked by the SFC;
- (9) a transitional period of 180 days from the date on which the amendments take effect will be afforded to give VASPs time to become properly licensed;
- (10) it will be an offence for any person, whether in Hong Kong or elsewhere, to actively market a regulated VA activity to the Hong Kong public; and
- (11) no exemptions from licensing will be available.

DPMSs

DPMSs do not currently require any registration to carry on their trade. However, following findings by the Financial Action Task Force ("**FATF**") as to how susceptible the precious metals and stones industry was to money laundering, primarily because of the frequent involvement of large cash-based transactions, the Consultation puts forward a two-tier registration regime for DPMSs.

The key aspects of the Consultation in relation to DPMSs are as follows:-

- (1) the (i) trading, importing or exporting of precious metals, precious stones or precious products, (ii) manufacturing, refining, or carrying out value-adding work on precious metals, precious stones or precious products, (iii) issuing, redeeming or trading in precious-asset-backed instruments or (iv) acting as an intermediary in any of the above, will become "regulated activities" for which a person carrying out the same will need to be registered. Registration is divided into 2 categories – category A and category B;
- (2) category A registration is 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. These registrants are not subject to AML/CTF obligations in the AMLO and registration will be almost automatic;
- (3) category B registration is for persons who do intend to or will engage in such transactions at or above HK\$120,000. An application for Category B registration will not be automatic, and will be subject to the fit-and-proper test;
- (4) financial institutions already regulated under the AMLO will be exempted from registration where they conduct DPMS activities as an ancillary part of their business (such as the trading and issuing of paper gold);
- (5) non-domestic dealers such as foreign persons attending a precious metals trade fair in Hong Kong will, subject to certain restrictions, also be exempt from registration; and
- (6) the C&ED will be empowered to, amongst other things, enter a registrant's place of business for routine inspection.

Closing Remarks

Following the Consultation which ends on 31 January 2021, a bill containing proposed amendments to the AMLO is expected to be introduced into the Legislative Council for its consideration. Whilst the FSTB gathers public opinion on the Consultation and it may take some time for the two new regimes to be put in place, we would advise current and prospective VASPs and DPMSs to keep abreast of ongoing developments and start considering how they may be impacted under the two new regimes. The legislative proposals are intended to bring Hong Kong's regulatory regime up to date in line with the latest international requirements, as promulgated by FATF. In terms of VASPs, we would specifically suggest that prospective applicants consider the benefits of being regulated under a strong, innovative and transparent legal framework in a jurisdiction that has continued to fully embrace this new technology.

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