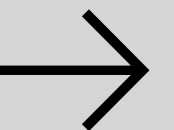


CHARLTONS

HONG KONG REGULATION OF VIRTUAL ASSET TRADING PLATFORMS OVERVIEW + UPDATE

2024



2 LICENSING REGIMES FOR VATPS

- Securities and Futures Ordinance (SFO)
 - Requires licensing of VATPs trading virtual assets (**VAs**) that are “securities” (as defined in Schedule 1 to SFO)
- Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO)
 - Licensing regime effective 1 June 2023 for VATPs trading VAs that are not “securities”
- SFC encourages dual-licensing



FINANCIAL ACTION TASK FORCE (FATF) REQUIREMENTS

OCTOBER
2018:

FATF Recommendation 15
update: AML + CTF
requirements extended to
VAs and VASPs

JUNE
2019:

Recommendation 15
Interpretative Note:
Competent authority to
license or register
VASPs + regulate their AML
+ CTF compliance

OCTOBER
2021:

Updated FATF
Recommendation 16:
Travel Rule applied to VA
transfers

AMLO LICENSING REQUIREMENTS

- An entity carrying on a business of providing a virtual asset service (VA service) in HK, or holding itself out as doing so, must be licensed (AMLO s. 53ZRD)
- “Actively marketing” (from in or outside HK) any VA service provided offshore to the HK public is prohibited (AMLO s. 53ZRB(3))
- Offences carry maximum penalties of:
 - HK\$5 million fine
 - 7 years’ imprisonment
 - HK\$100,000 daily fine for continuing offences

SFC FAQs ON ACTIVE MARKETING

- “Active marketing” includes:
 - frequently calling on HK investors to market services (incl. offering products)
 - mass media programmes + internet activities targeting HK investors
- Non-exhaustive factors in determining if services are actively marketed to HK public:
 - existence of detailed plan to promote
 - services being extensively advertised in HK
 - packaging of services to target the HK public – written in Chinese, denomination in HK\$

But note *Ng Chiu Mui v the SFC*

- SFC argument “active marketing” means ‘no more than marketing in the primary sense of pro-actively advertising the service to the Hong Kong public’.



PROVIDING A VA SERVICE

- Defined as “operating a VA exchange”
- Secretary for Financial Services and the Treasury can amend

Operating a VA exchange = providing services through means of electronic facilities whereby:

- offers to sell or purchase VA are regularly made or accepted to form or result in a binding transaction or
- persons are regularly introduced, or identified to other persons, in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude, sales or purchases of VAs forming or resulting in a binding transaction (AMLO Schedule 3B)

VATP licensing regime applies to centralised platforms providing:

- VA trading services to clients using an automated trading engine which matches client orders +
- custody services as an ancillary service to the trading service

VA services provided without an automated trading engine + ancillary custody services (e.g. OTC VA trading activities + VA brokerage activities) do not need a licence

VIRTUAL ASSETS DEFINITION

Virtual assets definition = a cryptographically secured digital representation of value that:

- is expressed as a unit of account or a store of economic value
- either:
 - is used, or intended to be used, as a medium of exchange accepted by the public for payment for goods or services, for the discharge of a debt and/or for investment; or
 - provides rights, eligibility or access to vote on the management, administration or governance of the affairs in connection with, or to vote on any change of the terms of any arrangement applicable to, any cryptographically secured digital representation of value:
and
- can be transferred, stored or traded electronically” (AMLO s. 53ZRA(1))

VA include Bitcoin, altcoins, governance tokens + stablecoins, but stablecoins should not be accepted for retail trading until they are regulated in HK

EXCLUSIONS FROM VIRTUAL ASSET DEFINITION

- Digital representations of fiat currencies
- Central bank digital currencies
- Financial assets already regulated under the SFO (e.g. securities and futures contracts)
- Stored value facilities regulated under the Payment Systems and Stored Value Facilities Ordinance and
- “limited purpose digital tokens” including non-transferable, non-exchangeable + non-fungible closed-loop, limited purpose items (e.g. air miles, credit card rewards, gift cards, customer loyalty programmes + gaming coins)



SFO LICENSING

An entity carrying on a business of dealing in VAs that are securities + providing automated traded services in those VAs (or holding itself out as doing so) must be licensed for regulated activities Type 1 (dealing in securities) + Type 7 (providing automated trading services)

Licensing is required only for centralised VATPs, i.e. trading platforms providing VA trading, clearing + settlement services + having control of clients' assets

No licensing needed for platforms providing peer-to-peer VA trading where trades occur off-exchange + clients retain custody of VAs

REGULATORY REQUIREMENTS FOR LICENSED VATP OPERATORS

- AMLO + SFO
- SFC Guidelines for Virtual Asset Trading Platform Operators (VATP Guidelines)
- SFC Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers)
- SFC FAQs on licensing + conduct-related matters

ELIGIBILITY FOR LICENSING UNDER AMLO + SFO

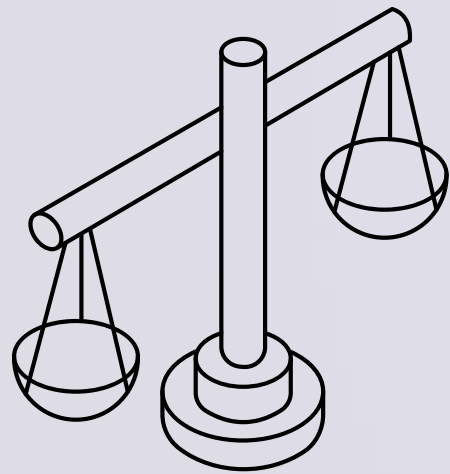
ENTITIES ELIGIBLE FOR VATP LICENSING ARE:

- HK incorporated companies having a permanent place of business in HK
- overseas companies registered in HK under the Companies Ordinance

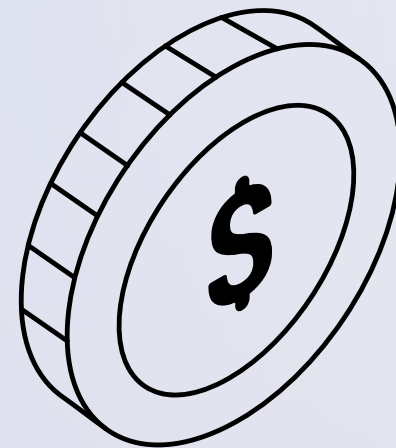
Businesses without a separate legal personality (e.g. partnerships + sole traders), individuals + overseas companies not registered in HK are not eligible for HK VATP licensing

PLATFORM OPERATORS' FITNESS + PROPERNESS

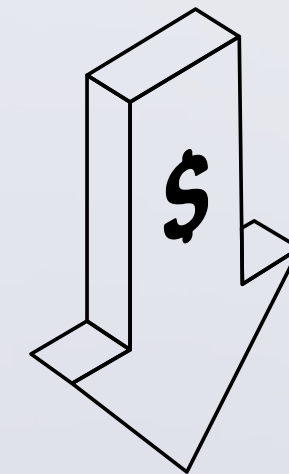
PLATFORM OPERATOR CANNOT:



- be subject to any receivership, administration, liquidation or similar proceedings



- have failed to meet any judgment debt



- be unable to meet any applicable financial or capital requirements

LICENSED VATP: FINANCIAL RESOURCES REQUIREMENT

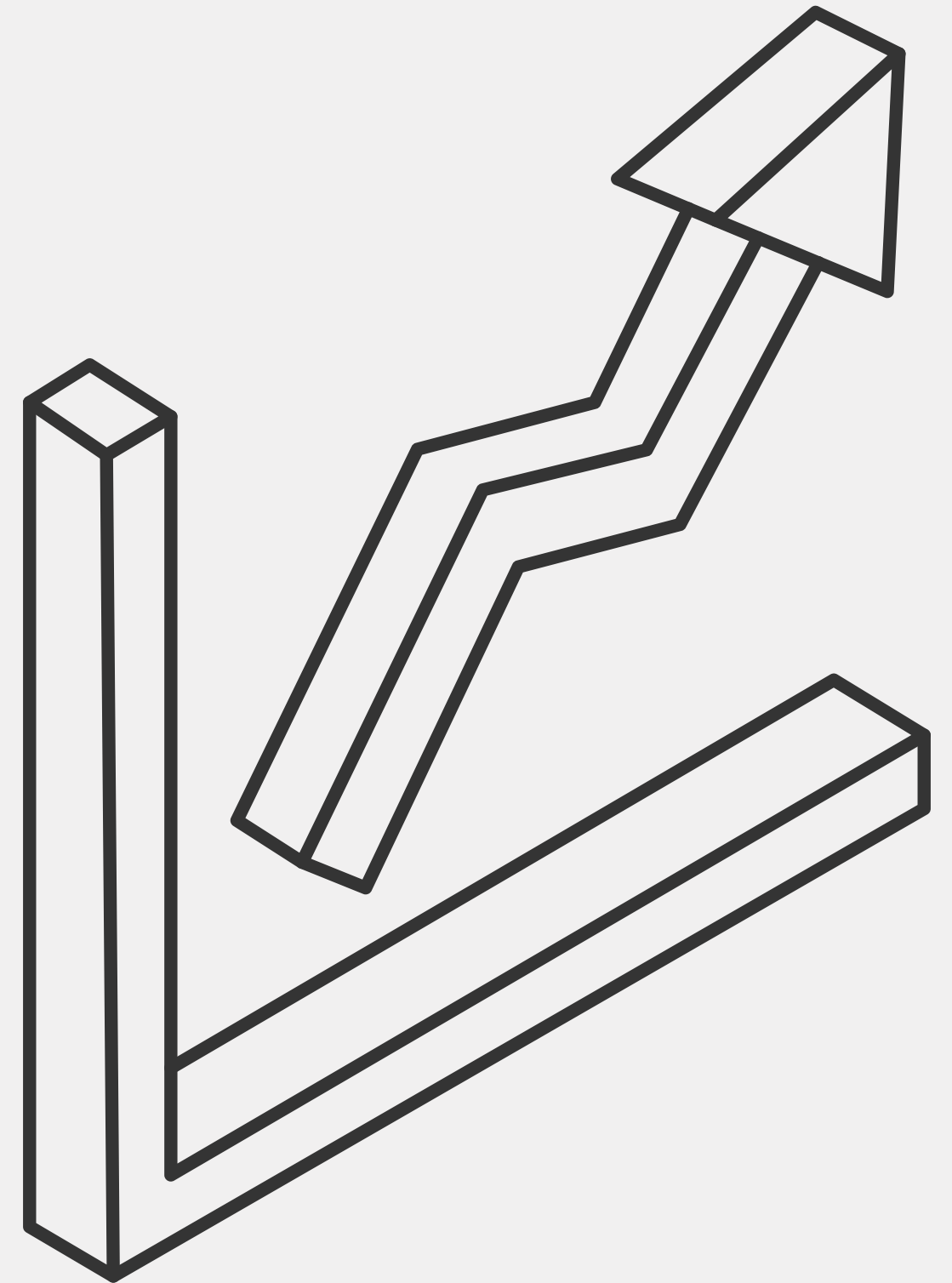
LICENSED VATPS MUST:

- maintain paid-up share capital of \geq HK\$ 5 mln
- maintain liquid capital of the higher of HK\$ 3 mln + the basic amount as defined in Division 2 of Part 4 of the Securities and Futures (Financial Resources) Rules
- beneficially own assets that are sufficiently liquid (e.g. cash, deposits, treasury bills and certificates of deposit (but not VAs)) equivalent to \geq 12 months of actual operating expenses calculated on a rolling basis (VATP Guidelines at paragraphs 6.1-6.3)

PLATFORM OPERATORS' COMPETENCY REQUIREMENTS

LICENSING APPLICANTS NEED:

- a clear business model, detailing their modus operandi + target clientele
- written policies + procedures to ensure continuous compliance with legal/ regulatory requirements
- to demonstrate a proper business structure, good internal control systems + qualified personnel to ensure proper risk management

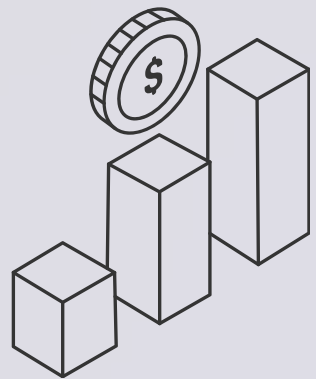


RESPONSIBLE OFFICER REQUIREMENTS

- ≥ 2 two responsible officers (ROs) to supervise conduct of each SFO regulated activity / VA service business
- At least one RO must be an executive director
- If more than one executive director, must all be ROs
- At least one RO must be:
 - ordinarily resident in HK
 - available at all times to supervise each SFO regulated activity / VA service business
- Dual-licensed platforms need 2 (not 4) dual-licensed ROs to meet minimum statutory requirement

RESPONSIBLE OFFICERS' FITNESS AND PROPERNESS

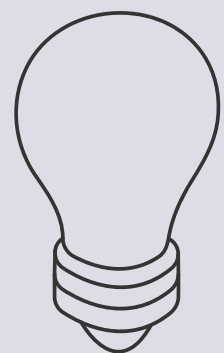
RELEVANT FACTORS INCLUDE INDIVIDUALS':



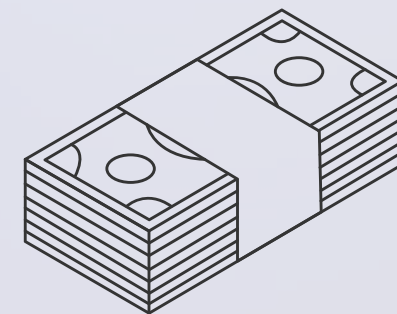
- financial status and solvency



- ability to carry on regulated activities competently, honestly and fairly



- educational or other qualifications + experience



- reputation, character, reliability + financial integrity.

RESPONSIBLE OFFICERS' EDUCATIONAL QUALIFICATIONS AND EXPERIENCE

3 ROUTES TO SATISFYING REQUIREMENTS:

1) Person with relevant university degree (degree in accounting, business administration, economics, finance and law, or internationally-recognised professional qualifications)

- 3 years' direct relevant industry experience in past 6 years
- 2 years' management experience + passed HKSI Papers 1 + 2
- Passed HKSI Papers 1 + 2

2) PERSON WITH DEGREE IN OTHER SUBJECT:

- 3 years' direct relevant industry experience in past 6 years
- 2 years' management experience + passed HKSI Papers 1 + 2
- Passed HKSI Papers 7 + 8 or completed additional 5 hours CPT in past 6 months

RESPONSIBLE OFFICERS' EDUCATIONAL QUALIFICATIONS AND EXPERIENCE (CONT'D)

3 ROUTES TO SATISFYING REQUIREMENTS (CONT'D):

3) Persons who have attained Level 2 in English or Chinese + Maths in HKDSE exams or equivalent overseas qualifications

- 2 years' management experience + passed HKSI Papers 1 + 2

and

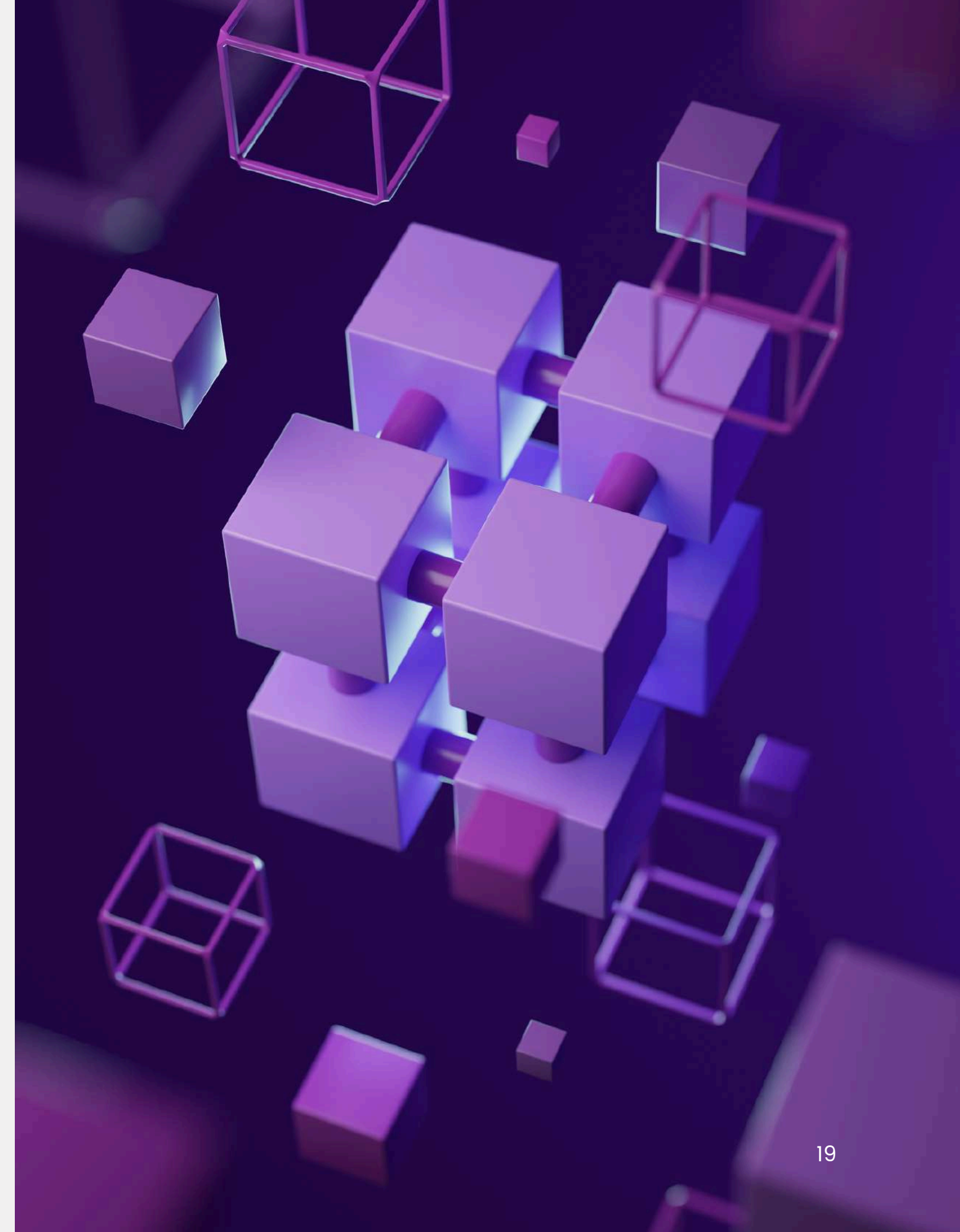
- 3 years' direct relevant industry experience in past 6 years or 5 years' relevant industry experience in past 8 years
- Passed HKSI Papers 7 + 8 or completed additional 5 hours CPT in past 6 months

RESPONSIBLE OFFICERS' INDUSTRY EXPERIENCE

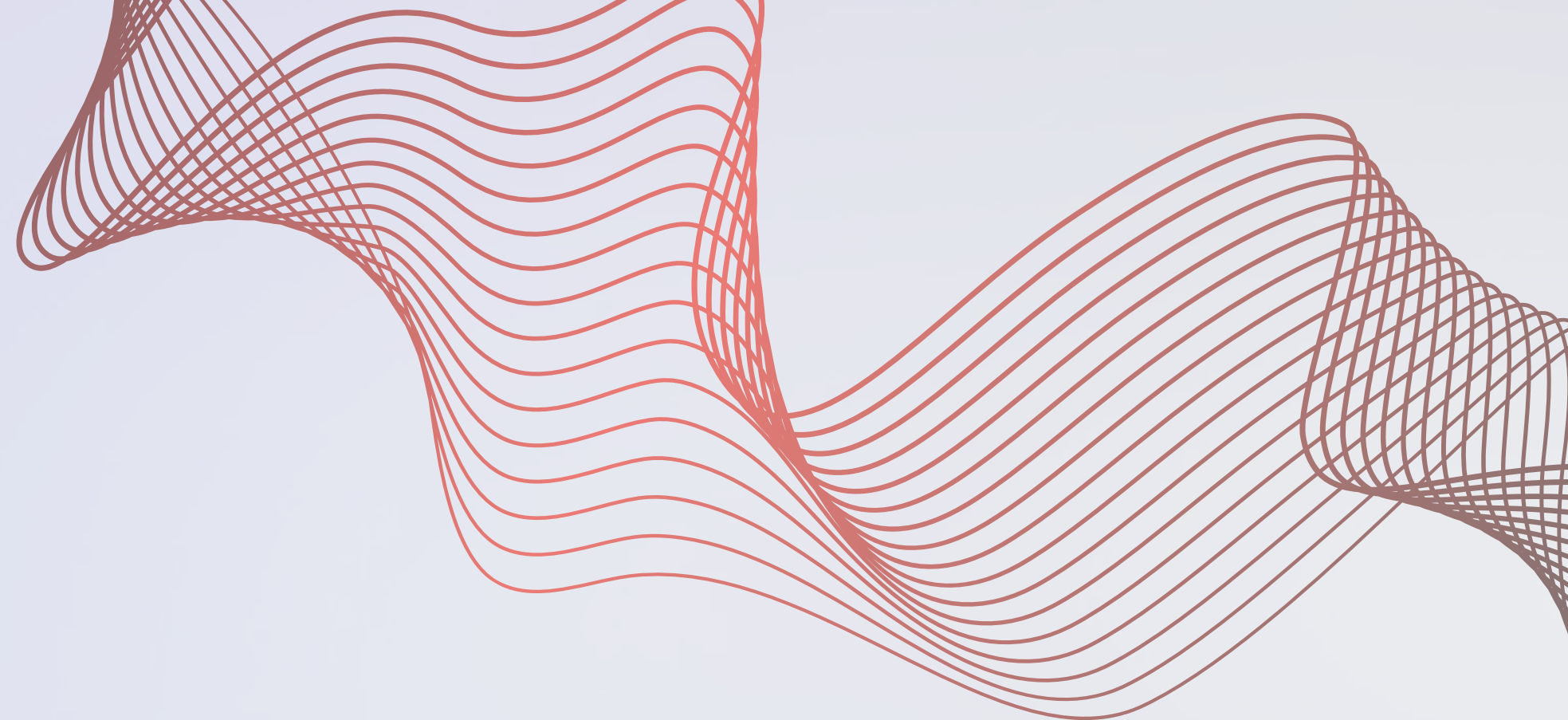
Where an RO applicant's industry experience largely relates to non-security VA and person has no experience of dealing in securities (or vice versa), SFC will consider:

- industry experience dealing in non-security VA as industry experience relevant to RA Type 1 (dealing in securities) – subject to a licensing condition that the person can only provide Type 1 regulated activity services for an SFC-licensed VATP
- industry experience of RA Type 1 (dealing in securities) as industry experience relevant to the provision of a VA service under the AMLO, subject to imposition of a “non-sole” condition

This is a temporary measure subject to SFC review



LICENSED REPRESENTATIVES



Individuals (including ROs) must be licensed representatives accredited to a VATP to conduct regulated activities on its behalf

On ceasing to act for their principal, the principal must notify the SFC through WINGS-LIC within 7 business days

The licensed representative can apply to transfer their accreditation to another platform operator within 180 days

LICENSED REPRESENTATIVES' REQUIRED EDUCATIONAL QUALIFICATIONS + EXPERIENCE

3 ROUTES TO SATISFYING REQUIREMENTS:

1) Person with relevant university degree (degree in accounting, business administration, economics, finance and law, or internationally-recognised professional qualifications)

- Passed HKSI Paper 1

2) Person with degree in other subject:

- Passed HKSI Paper 1
- 2 years' relevant industry experience in past 5 years or
- Passed HKSI Papers 7 + 8 or completed additional 5 hours CPT in past 6 months

3) Persons who have attained Level 2 in English or Chinese + Maths in HKDSE exams or equivalent overseas qualifications:

- Passed HKSI Paper 1
- 2 years' relevant industry experience in past 5 years
- Passed HKSI Papers 7 + 8 or completed additional 5 hours CPT in past 6 month

SUBSTANTIAL SHAREHOLDERS AND ULTIMATE OWNERS

VATP operator's substantial shareholders + ultimate owners must be:

- fit and proper
- approved in writing by the SFC

“Substantial shareholder” = a person

- with $\geq 10\%$ of the VATP operator's issued shares
- with control of $\geq 10\%$ of the voting power at VATP operator's general meetings or
- control of $\geq 35\%$ of the voting power at general meetings of another company having 10% of the voting power at VATP operator's general meetings

(s. 6 of Part 1 of Schedule 1 to the SFO)

“Ultimate owner” = an individual who:

- owns / controls $> 25\%$ of VATP operator's shares
- controls $> 25\%$ of the voting rights at VATP operator's general meetings or
- controls VATP operator's management

(s. 53ZRJ AMLO)

SFC APPROVAL OF A VATP'S ULTIMATE OWNER

- VATP's ultimate owner must obtain the SFC's prior written approval
- SFC must be satisfied that the VATP will continue to be fit + proper after the ultimate owner's approval
- SFC can impose conditions on the licensed VATP or ultimate owner
- Offence to become ultimate owner of VATP without prior SFC approval - penalties HK\$1 mln fine, 2 years' imprisonment + daily HK\$5,000 fine for every day the offence continues

MANAGERS-IN-CHARGE OF CORE FUNCTIONS (MICS)

- VATP operators need to appoint one or more MICS as individuals principally responsible, alone or with others, for managing each of the VATP Operator's "Core Functions"
- MICS of Overall Management Oversight + Key Business Line should be ROs
- VATP operator's board must ensure each MIC acknowledges appointment as MIC + Core Function(s) for which they are responsible
- 8 Core Functions: Overall Management Oversight; Key Business Line; Operational Control + Review; Risk Management; Finance + Accounting; Information Technology; Compliance; + AML + CTF

(SFC's FAQs on Measures for Augmenting Senior Management Accountability in Platform Operators)



VATP COMPLAINTS OFFICER + EMERGENCY CONTACT PERSON

VATP OPERATORS NEED TO APPOINT:

- a Complaints Officer to deal with complaints (VATP Guidelines, para 3(b) of Part 1 of Schedule 4)
- an Emergency Contact Person to be contacted by the SFC in case of market emergency (VATP Guidelines at paragraph 3(a) of Part 1 of Schedule 4)

SFC APPROVAL OF PREMISES

- VATP operator applicants need SFC approval of their premises for keeping records or documents
- Premises must be non-domestic and suitable for document + record storage

VATP LICENSING APPLICATION PROCESS

UNLICENSED CORPORATIONS NEED TO SUBMIT:

- Form 1 (Corporation's Application for Licence);
- Form 5 (New Licence Application for Licensed Representatives and Responsible Officers) for at least 2 proposed ROs;
- Questionnaire 1 (General Business Profile and Internal Controls Summary);
- Questionnaire 2 (VA Trading Platform Operator);
- External assessment report; and
- Application fee

Application forms, supplements + questionnaires should be submitted to the SFC through WINGS-LIC

EXTERNAL ASSESSMENT REPORTS

VATP licence applicants have to engage an External Assessor to assess their business and submit 2 assessor's reports

- External assessor's "Phase 1 Report" must:
 - be submitted with the licence application:
 - cover design effectiveness of VATP's proposed structure, governance, operations, systems and controls, with a focus on key areas (e.g. governance + staffing, token admission, virtual asset custody, KYC, AML/CTF, market surveillance, risk management + cybersecurity)
- External assessor's "Phase 2 Report" must:
 - be submitted after the SFC grants approval-in-principle of the licence
 - assess the effectiveness + implementation of the adopted policies, procedures, systems + controls
 - Deviation from the planned policies/ procedures must be clearly set out + explained

SFC will only grant its final licensing approval when satisfied with Phase 2 Report

SUBMISSION OF PLATFORM OPERATORS' BANK ACCOUNT INFORMATION

- VATP operators need to submit their bank account details to the SFC before approval of their licensing applications
- HKMA issued Circular to banks – “Access to banking services for corporate customers” in April 2023 encouraging them to provide banking services to SFC-licensed VATPs

SFC REGULATORY SANDBOX

- Licensed VATPs initially enter SFC's Regulatory Sandbox
- SFC assesses + monitors VATPs' delivery of services + internal controls systems
- Aims to facilitate dialogue + enable identification + addressing of risks
- Additional licensing conditions may apply to VATPs in the Sandbox – e.g. periodic SFC supervisory audits

VATP LICENSING CONDITIONS

VATP licences granted subject to conditions including that they must:

- comply with the VATP Guidelines;
- immediately notify the SFC and cease operating a VATP if they become aware that they cannot maintain (or ascertain whether they maintain) the required liquid and paid-up share capital;
- provide the SFC with monthly reports on their business activities within 2 weeks of each calendar month-end;
- engage an independent professional firm acceptable to the SFC to conduct annual reviews of their activities + operations, + prepare a report confirming compliance with the licensing conditions + all legal + regulatory requirements
- 1st report must be submitted within 18 months of the VATP licence approval
- subsequent reports must be submitted within 4 months of each financial year-end
- the SFC's prior written approval is needed for introducing /offering a new or incidental service or activity, or making a material change to an existing service or activity (including long suspension or termination of an existing service or activity)

VATP licences restrict platform operators to:

- operating a centralised online platform for trading VA
- carrying on off-platform VA trading + incidental services +
- activities relating to their off-platform business

TOKEN ADMISSION AND REVIEW COMMITTEE REQUIREMENTS

- SFC-licensed VATPs must set up a Token Admission and Review Committee
- Composition: senior management members principally responsible for managing the key business line, compliance, risk management and information technology functions (members “principally responsible” include VATPs’ MICs for relevant functions)

RESPONSIBILITIES INCLUDE:

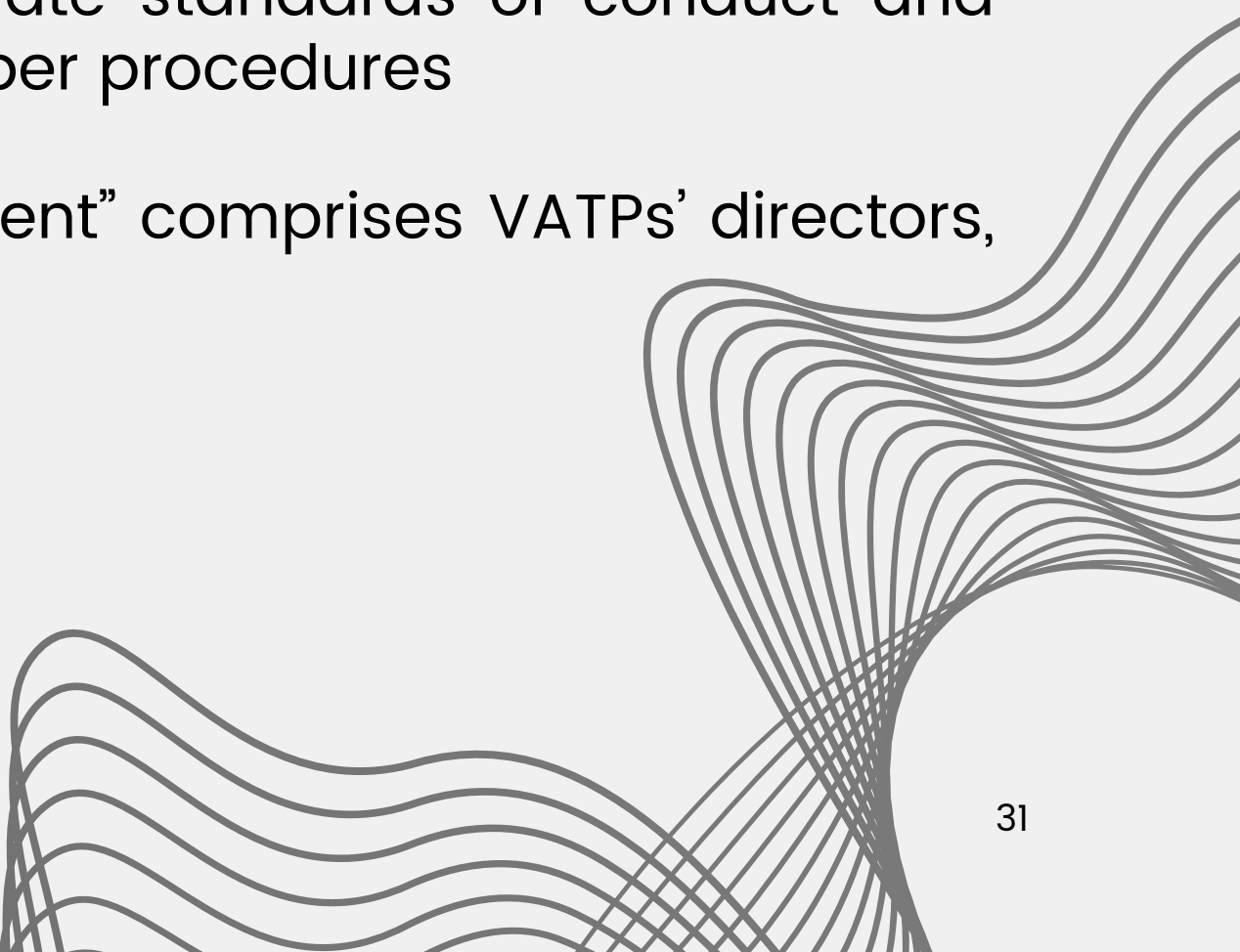
- establishing, implementing + enforcing criteria for admitting, suspending + withdrawing VA for or from trading + rules setting out VA issuers’ obligations + restrictions
- making final decision on admitting, suspending or withdrawing VA to/ from trading
- regularly reviewing criteria for admitting, suspending + withdrawing VA and the rules governing VA issuers’ obligations + restrictions
- reporting at least monthly to the VATPs’ board of directors (reports must include (at a minimum), details of VA made available for retail trading)



VATP OBLIGATIONS

- VATPs need to monitor each VA traded and consider whether to allow its continued trading
- If the Token Admission + Review Committee suspends or withdraws a VA from trading, the VATP must notify clients as soon as practicable, inform clients holding that VA of the available options, + ensure clients are fairly treated

RESPONSIBILITY FOR CONDUCT + ADHERENCE TO PROCEDURAL REQUIREMENTS

- VATPs' senior management are responsible for ensuring appropriate standards of conduct and adherence to proper procedures
 - "Senior management" comprises VATPs' directors, ROs + MICs
- 

GENERAL TOKEN ADMISSION CRITERIA

- VATPs must perform reasonable due diligence on all virtual assets (whether available for retail trading or not) before admitting them for trading to ensure they meet the token admission criteria set by platforms' Token Admission and Review Committee

FACTORS THAT VATPS MUST CONSIDER (AT A MINIMUM) INCLUDE:

- the background of the virtual asset's management or development team or any of its known key members
- the virtual asset's regulatory status in Hong Kong and whether it would affect the VATP's regulatory obligations
- the virtual asset's supply, demand, maturity and liquidity, including its track record period which for non-security tokens must be at least 12 months
- the virtual asset's development, technical aspects, market and governance risks
- the legal risks associated with the virtual asset + its issuer
- whether the virtual asset's offered utility, novel use case, innovation or administrative control "clearly appears" to be fraudulent or illegal, or whether its continued viability depends on attracting continuous inflow into the virtual asset;
- the enforceability of rights extrinsic to the virtual asset (e.g. rights to any underlying assets)
- the potential impact of trading activity in the virtual asset on the underlying markets; and
- the ML + TF risks associated with the virtual asset

(Paragraph 7.6 of the VATP Guidelines)

SPECIFIC TOKEN ADMISSION CRITERIA FOR RETAIL TRADED VAS

- VAs for retail trading must meet specific token admission criteria
- “Retail investors” = investors other than professional investors (defined in s. 1 of Part 1 of Schedule 1 to SFO (Professional Investors)) (VATP Guidelines para 7.6)
- Key requirement = VA must be “highly liquid”
- “Highly liquid” = VA must be “eligible large-cap virtual asset” - i.e. included in minimum of 2 acceptable indices issued by ≥ 2 independent index providers
- “Acceptable index” = index measuring performance of largest VAs in the global market
- Index providers must be independent of each other, VATP + VA issuer
- At least one index provider must comply with IOSCO’s Principles for Financial Benchmarks + have experience of publishing indices for conventional securities market
- Inclusion in 2 acceptable indices is a minimum (not the sole) criterion for retail trading. VATPs must conduct additional due diligence to ensure that eligible large-cap VAs are in fact highly liquid

SFC’s prior written approval is required for the admission of any VA for retail trading and the suspension of trading or removal of such VA

PROVIDING VA TRADING SERVICES TO RETAIL INVESTORS

- VATPs must implement additional measures when serving investors other than institutional professional investors (IPIs) (defined in paras (a) to (i) of Professional Investors definition) + qualified corporate professional investors (QCPIs)
- QCPIs = corporate professional investors (i.e. trust corporations, corporations or partnerships meeting thresholds under ss. 4, 6 or 7 of the Securities and Futures (Professional Investor) Rules), which VATP has assessed to meet 3 criteria:
 - CPI has appropriate corporate structure + investment process + controls
 - person(s) responsible for CPI's investment decisions have sufficient investment background +
 - CPI is aware of risks involved (considered in terms of person(s) responsible for investment decisions)
- VATPs' assessment of whether investor is a QCPI must be in writing + records kept to demonstrate basis of assessment
- If QCPI ceases to trade in VA for > 2 years, VATP must conduct a new assessment
- VATPs must apply the requirements applicable to retail investors to individual professional investors (as defined in s. 5 of the Securities and Futures (Professional Investor) Rules) and non-QCPIs

PROHIBITION ON TRADING VIRTUAL ASSET DERIVATIVES + OTHER RESTRICTED ACTIVITIES

Licensed VATPs cannot:

- offer, trade or deal in VA futures contracts or related derivatives
- provide financial accommodation for clients to acquire VAs (also applies to VATP group companies)
- use clients' VAs to generate returns
- post adverts for specific VAs or provide algorithmic trading
- engage in proprietary trading, except off-platform back-to-back transactions
- conduct market making on a proprietary basis (also applies to VATPs' group companies)
- open multiple accounts for a single client (except sub-accounts)
- offer gifts to clients (except discount to fees or charges) for trading a specific VA



PROTECTIONS FOR RETAIL INVESTORS

- SFC's written approval is required for including any VA for trading by retail clients and suspending trading of or removing any VA available to retail clients

RETAIL CLIENTS' KNOWLEDGE OF VA

- Before opening account for investors other than IPIs + QCPIs, VATPs must assess investor's knowledge of VA and risks of investing in them (VATP Guidelines para 9.4)
- VATPs can only provide services to retail investors lacking knowledge of VA if they have provided adequate training to the investor

Example criteria for assessing whether a Retail Investor has knowledge of virtual assets:

- has investor undergone training or attended courses on VA
- has investor got current or previous VA work experience or
- has investor got prior trading experience in VA



CLIENTS' SUITABILITY FOR TRADING VIRTUAL ASSETS

Except for IPIs + QCPIs, VATPs must ensure suitability of their services for particular client and:

- obtain information on their financial situation + investment experience + objectives +
- assess client's risk tolerance level, determine client's risk profile + assess their suitability to trade VAs

VIRTUAL ASSET EXPOSURE LIMITS FOR VA RETAIL CLIENTS

Except for IPIs + QCPIs, VATPs need to:

- set limit on each client's exposure to VAs to ensure it is "reasonable" given client's financial situation (including its net worth) + personal circumstances
- notify clients of the limit assigned to them +
- regularly review clients' exposure limits to ensure they remain appropriate



SUITABILITY OBLIGATIONS

- When making a recommendation or solicitation re. VAs, VATPs must (except when dealing with IPIs + QCPIs) ensure the suitability of the recommendation or solicitation for the client is reasonable, having regard to information about the client of which the VATP is or should be aware through the conduct of due diligence
- VATPs need to establish a mechanism for assessing VAs' suitability for clients
- The suitability assessment should be made on a holistic basis (taking into account clients' personal circumstances + concentration risk) + the risk return profile of the recommended VA should match clients' personal circumstances

SUITABILITY OBLIGATIONS IN THE CONTEXT OF COMPLEX PRODUCTS

- Except when dealing with IPIs + QCPIs, VATPs must ensure that transactions in VAs that are “complex product” are suitable for the relevant client (even if there has been no recommendation or solicitation)
- A complex product is a VA whose terms, features and risks are not likely to be understood by a retail investor because of its complex structure

Factors relevant to whether a VA is a complex product include:

- whether the VA is a derivative product
- whether a secondary market is available for the VA at publicly available prices
- whether there is adequate and transparent information about the VA available to retail investors
- whether there is a risk of losing more than the amount invested
- whether any of the VA’s features or terms could fundamentally alter the nature or risk of the investment or pay-out profile, or include multiple variables or complicated formulas to determine the return (e.g. where the investment carries the right for the issuer to convert it into a different investment) and
- whether the VA’s features might render the investment illiquid, difficult to value or both

VATPs need to provide prominent and clear warnings about complex products before and reasonably proximate to the point of sale of, or advice regarding, complex products

VATPS' DISCLOSURE OBLIGATIONS

RISK DISCLOSURE

Except for IPIs + QCPIs, VATPs must prominently disclose:

- nature of VAs
- risks of trading VAs
- risk disclosure statements in Schedule 2 to VATP Guidelines

VATPS' WEBSITE DISCLOSURE OBLIGATIONS

VATPs must disclose information on their websites including:

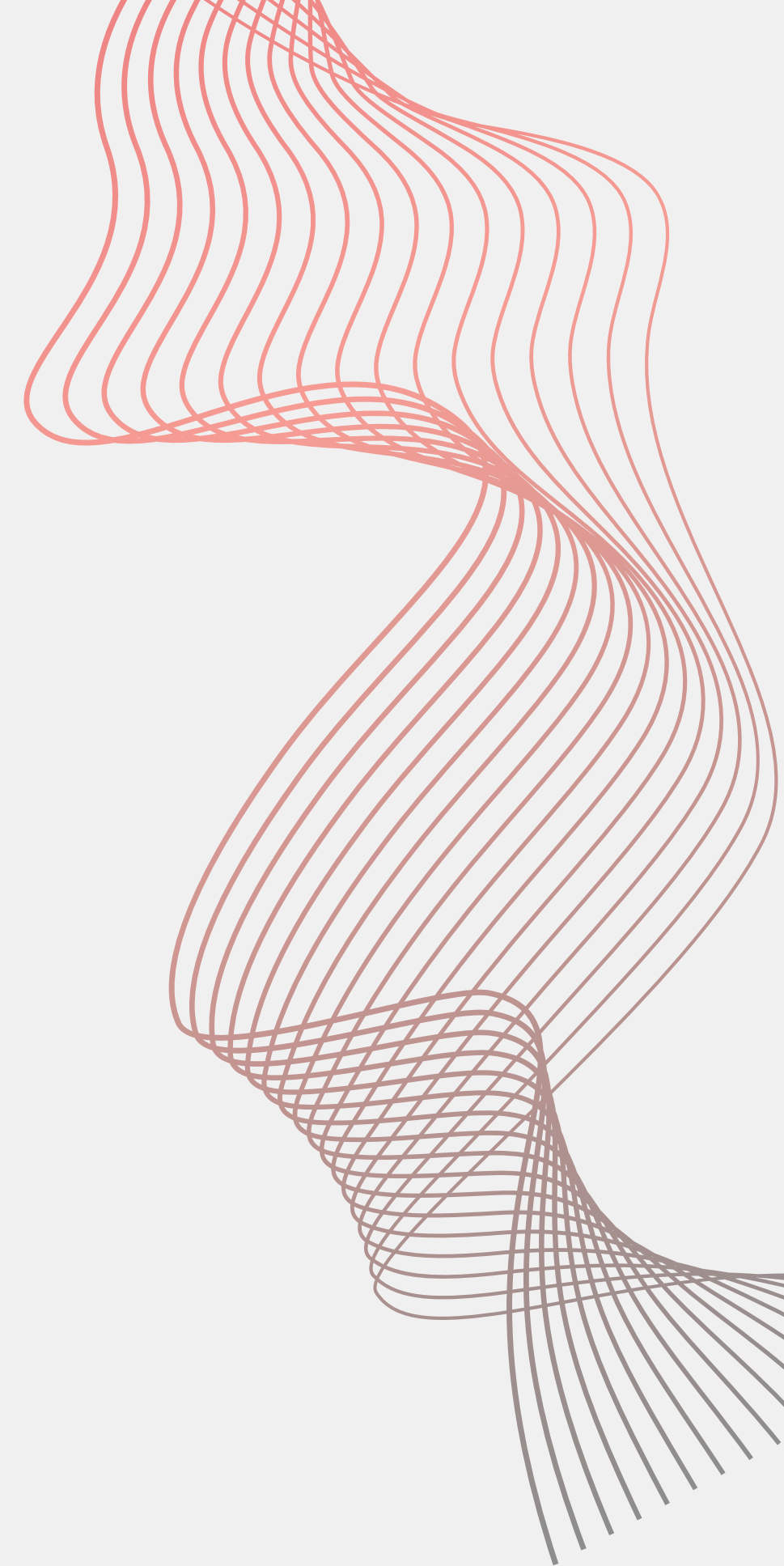
- information about the platform's business, the services offered to clients + their contact details
- their trading + operational rules, token admission + removal rules + criteria (including criteria for admitting, suspending + withdrawing a VA for/from trading and "acceptable indices" referenced for admitting VAs for retail trading)
- their admission + trading fees + charges
- services only available to professional investors
- rights + obligations of VATP + client under the client agreement (required for clients other than IPIs + QCPIs)
- clients' liability for unauthorised VA transactions
- when VATP can disclose clients' personal information to 3rd parties (including regulators + auditors)
- dispute resolution mechanisms, including complaints procedures

DISCLOSURE OF INFORMATION FOR EACH VIRTUAL ASSET TRADED

VATPs need to post information about each VA traded on their platforms including:

- the VA's price and trading volume on the platform, e.g. in the last 24 hours + since its admission for trading on the platform
- background information about the VA's management or development team or any of its known key members
- the VA's issue date + material terms + features
- the VATP's affiliation with the issuer + its management or development team (or any of its known key members)
- a link to the VA's official website + Whitepaper (if any)
- a link to the VA's smart contract, audit report + other bug reports (if any) +
- if the VA has voting rights, how VATP will handle them

VATPs must take all reasonable steps to ensure product-specific + other information on their platforms is not false, misleading or deceptive



VATPS' OBLIGATIONS RE. HANDLING CLIENT VAS

- VATPs must hold client assets (client VAs + money) through an associated entity, i.e. an HK-incorporated wholly-owned subsidiary of the VATP licensed as a trust or service company provider under AMLO, that has notified SFC that it is an associated entity of the VATP under AMLO s.53ZRW and/or SFO s.165

Client VAs must be:

- held in wallet address(es) established by VATP's associated entity +
- segregated from the assets of the VATP + its associated entity
- >98% of client VAs must be held in cold storage (except in limited circumstances allowed by the SFC)

VATPs must establish SFC-approved compensation arrangement to cover potential losses of:

- 50% of client VAs held in cold storage and
- 100% of client VAs held in hot and other storages

Compensation arrangements can include any or a combination of:

- 3rd-party insurance
- funds (held as a demand deposit or time deposit maturing within 6 months) of the VATP or its group companies, set aside on trust + designated for that purpose +
- bank guarantee of an HK authorised financial institution

VATPs must monitor the total value of client VAs under their custody daily

- On becoming aware that the total value of client VAs under custody exceeds the amount covered under approved compensation arrangement, VATP must inform SFC if it expects the situation to continue, + take prompt remedial action to re-comply with the VATP Guidelines

LICENSED PLATFORM OPERATORS: INSURANCE AND COMPENSATION PROVISION



ANTI-MONEY LAUNDERING + COUNTER-TERRORIST FINANCING OBLIGATIONS

- VATPs are subject to AMLO's AML + CTF requirements, including customer due diligence + record-keeping requirements of Schedule 2 to the AMLO
- Non-compliance with statutory AML and CTF obligations is an offence for VATP + its responsible officers. Maximum penalties are HK\$1 mln fine + 2 years' imprisonment (or 7 years' imprisonment if the non-compliance committed with intent to defraud)
- VATPs must also comply with VA-specific AML/CTF requirements in Ch. 12 of Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers)
- New Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities of Licensed Corporations and SFC-licensed Virtual Asset Service Providers requires VATPs' associated entities to comply with the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers)

APPLICATION OF THE TRAVEL RULE TO VA TRANSFERS

- Financial institutions – defined in the AMLO to include VATPs licensed under the AMLO and/or SFO – must comply with s. 13A of Schedule 2 to the AMLO which applies the requirements for wire transfers under FATF Recommendation 16 (the Travel Rule) to transfers of virtual assets

Ch. 12 of the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers) requires that:

- when acting as an ordering institution of VA transfers, a VATP must obtain, record and submit the required information of the originator and recipient to the beneficiary institution immediately and securely
- when acting as a beneficiary institution, a VATP must obtain + record the required information submitted by the ordering institution or intermediary institution
- Licensed VATPs also have to conduct due diligence on VA transfer counterparties (i.e. the ordering institution, intermediary institution or beneficiary institution involved in a VA transfer) to identify + assess the associated ML/ TF risks so as to apply risk-based AML/CTF measures
- Ch. 12 also sets out requirements relating to identifying suspicious transactions + conducting sanctions screening of all relevant parties involved in a VA transfer

AUDITOR APPOINTMENT AND SUBMISSION OF AUDITED ACCOUNTS/ FINANCIAL RESOURCES RETURNS

Licensed VATPs + their associated entities (i.e. their Hong Kong incorporated wholly-owned subsidiaries that receive or hold client assets) must:

- appoint an auditor within 1 month of the grant of the VATP licence and
- file audited financial statements with the SFC within 4 months of their financial year-end
- submit monthly financial resources returns to the SFC

LICENSED VATPS' ONGOING REPORTING + NOTIFICATION OBLIGATIONS

- Notifications, regulatory filings + annual returns should be submitted through the WINGS website

CHANGES TO VATP LICENCES REQUIRING PRIOR SFC APPROVAL

- Prior SFC approval is required for various changes to VATP licences
- Application for approval is made on Form VA2, except for approval of changes to a VATP's substantial shareholders + ultimate owners, for which Form VA4 is used

TYPE OF CHANGE/EVENT	STATUTE	NOTIFICATION REQUIREMENT	APPLICABLE TO
Change or waiver of licensing condition	s.134 SFO		VA trading platform operator
Change of financial year and/or adoption of period exceeding 12 months as financial year	s.155(3) SFO +/or s.53ZSB(5) AMLO		VA trading platform operator + its associated entity
Extension of deadline for submission of audited accounts where there are special reasons for doing so	156(4) SFO +/or s.53ZSC(4) AMLO	If the platform operator or its associated entity anticipates that it will need to apply for an extension, it should submit its extension application at least 1 month before the relevant deadline	VA trading platform operator + its associated entity

TYPE OF CHANGE/EVENT	STATUTE	NOTIFICATION REQUIREMENT	APPLICABLE TO
New premises to be used for keeping records or documents	s.130 SFO +/- or s.53ZRR AMLO	See SFC FAQs Premises for business or record keeping address	
Cessation of business	s.195(1)(d) SFO +/- or s.53ZSQ(2)(d) AMLO	At least 7 business days before the intended cessation of business	VA trading platform operator + licensed representatives
Becoming / continuing to be a substantial shareholder +/- or an ultimate owner of a VA trading platform operator	s.195(1)(d) SFO +/- or s.53ZSQ(2)(d)	SFC's approval must be obtained before a person (who may be a corporation) becomes a substantial shareholder or an ultimate owner of a VA trading platform operator. Approval is conditional on the person being "fit and proper"	

CHANGES AND EVENTS REQUIRING NOTIFICATION TO THE SFC

TYPES OF CHANGE/EVENTS	NOTICE PERIOD	APPLICABLE TO
Ceasing to act as a licensed representative	Within 7 business days	Licensed representative
Ceasing to act as a responsible officer	Within 7 business days	Responsible officer
Change in name	Within 7 business days	VATP, substantial shareholder + ultimate owner
	Within 7 business days	Associated entity
Change in business address	At least 7 business days before the intended change in business address	VATP + its associated entity

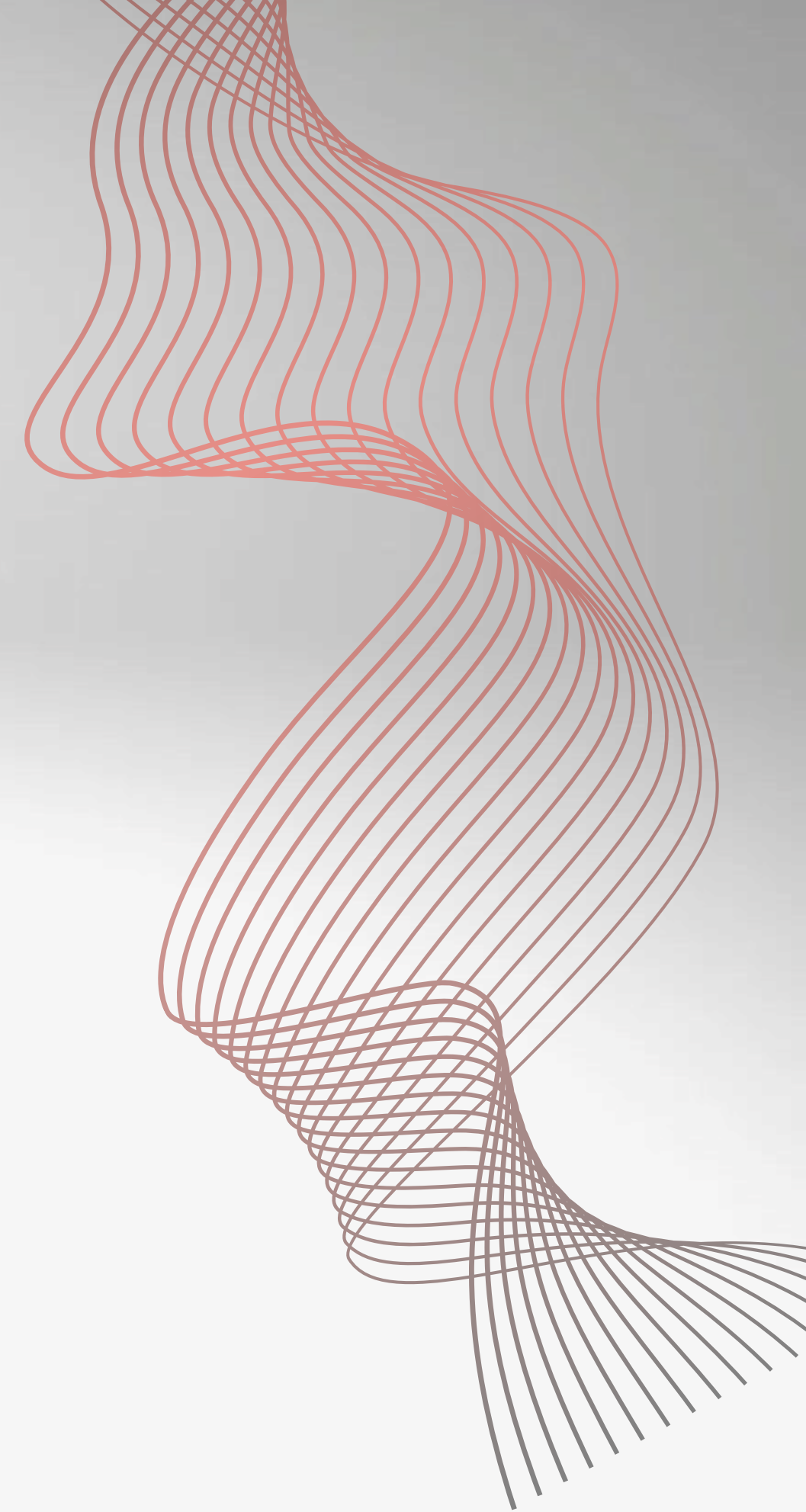
TYPES OF CHANGE/EVENTS	NOTICE PERIOD	APPLICABLE TO
CHANGE IN DIRECTOR OR HIS/HER PARTICULARS	Within 7 business days	VATP + its associated entity
CHANGE IN COMPLAINTS OFFICER OR HIS/HER PARTICULARS	Within 7 business days	VATP
CHANGE IN EMERGENCY CONTACT PERSON OR HIS/HER PARTICULARS	Within 7 business days	VATP
CHANGE IN SHARE CAPITAL OR SHAREHOLDING STRUCTURE	WITHIN 7 BUSINESS DAYS	VATP, its substantial shareholder(s) + associated entity
CHANGE IN CONTACT INFORMATION	Within 7 business days	VATP, licensed representatives, substantial shareholders, ultimate owner + associated entity
SIGNIFICANT CHANGES IN NATURE OF BUSINESS CARRIED ON + TYPES OF SERVICES PROVIDED	Within 7 business days	VATP

TYPES OF CHANGE/EVENTS	NOTICE PERIOD	APPLICABLE TO
Significant changes in business plan	Within 7 business days	VATP
Inclusion of any virtual asset for trading by professional investors only, or suspension of trading in, or removal of, any such virtual asset		VATP
Changes in Managers-In-Charge of Core Functions (MICs)	Within 7 business days	VATP
Changes in certain particulars of MICs	Within 7 business days	VATP
Change in bank accounts	Within 7 business days	VATP + its associated entity
Change in associated entity or its particulars	Within 7 business days	VATP + its associated entity

TYPES OF CHANGE/EVENTS	NOTICE PERIOD	APPLICABLE TO
CHANGE IN AUDITOR'S NAME	WITHIN 7 BUSINESS DAYS	VATP
GIVE NOTICE OF A MOTION TO CHANGE AUDITOR IN A GENERAL MEETING, ETC. UNDER S.154 SFO AND/OR S.53ZSE AMLO	WITHIN 1 BUSINESS DAY	VATP
CHANGE IN EXECUTIVE OFFICER OR HIS/HER PARTICULARS	WITHIN 7 BUSINESS DAYS	ASSOCIATED ENTITY
CHANGE IN STATUS OF ANY AUTHORISATION TO CARRY ON ANY REGULATED ACTIVITY BY AUTHORITY OR REGULATORY ORGANISATION IN HONG KONG OR ELSEWHERE	WITHIN 7 BUSINESS DAYS	VATP + LICENSED REPRESENTATIVES
CHANGE IN PARTICULARS IN RELATION TO WALLET ADDRESSES	WITHIN 7 BUSINESS DAYS	VATP + ITS ASSOCIATED ENTITY

CONTINUOUS PROFESSIONAL TRAINING REQUIREMENTS FOR LICENSED INDIVIDUALS

- SFC-licensed VATPs are responsible for planning + implementing a continuous education programme appropriate to the training needs of their licensed employees
- Licensed VATPs need to assess their training programmes annually to determine whether any adjustments are necessary
- Responsible officers need to complete 12 CPT hours per calendar year, of which 2 CPT hours should cover regulatory compliance topics
- Licensed representatives need to complete 10 CPT hours per calendar year



THE MARKET MISCONDUCT REGIME UNDER THE AMLO

- AMLO creates offences in relation to activities in non-security VAs

Fraudulently or Recklessly Inducing others to Invest in VA

- Making a fraudulent or reckless misrepresentation to induce an acquisition or disposal of a VA is an offence, whether the transaction takes place on a licensed VATP or not (AMLO s. 53ZRG)
- Offence carries maximum penalties of HK\$1 mln fine + 7 years' imprisonment

MARKET MISCONDUCT REGIME OFFENCE INVOLVING FRAUDULENT OR DECEPTIVE DEVICES ETC, IN TRANSACTIONS IN VA

Offence involving Fraudulent or Deceptive Devices etc. in Transactions in VAs

- In a transaction involving VAs, it is an offence to employ any device, scheme or artifice with intent to defraud or deceive or engage in a fraudulent or deceptive act, practice or business (AMLO s. 53ZRF)
- Maximum penalties - HK\$10 mln fine + 10 years' imprisonment

Offence to Issue Advertisements relating to an Unlicensed Person's Provision of a VA Service

- Offence for an unlicensed person to issue, or possess for the purpose of issue, an advertisement which holds the person out as prepared to provide a VA service (s. 53ZRE AMLO)
- Maximum penalties - HK\$50,000 fine + 6 months' imprisonment

THE SFO'S MARKET MISCONDUCT REGIME

- Comparable offences exist under the SFO in relation to the same conduct in VAs that are securities within the statutory definition

Offence to Fraudulently or Recklessly Induce others to Invest Money

- Offence under s. 107 SFO to make a fraudulent or reckless misrepresentation to induce another person (among others) to deal in securities
- Maximum penalties – HK\$1 mln fine + up to 7 years' imprisonment

Offence Involving Fraudulent or Deceptive Devices

- s. 300 SFO makes it an offence in a transaction involving securities, including an offer or invitation, to employ any device, scheme or artifice with intent to defraud or deceive or engage in any act or practice which is fraudulent or deceptive
- Maximum penalties – HK\$10 mln fine + up to 10 years' imprisonment

OFFENCE TO ISSUE ADVERTISEMENTS TO THE HK PUBLIC TO ACQUIRE, DISPOSE OF, SUBSCRIBE FOR OR UNDERWRITE SECURITIES

- Offence under s. 103 of the SFO for a person to issue, in Hong Kong or elsewhere, a document containing an invitation to the Hong Kong public to enter into, or offer to enter into, an agreement to acquire, dispose of, subscribe for or underwrite securities, unless the document's issue has been authorised by the SFC under section 105(1) of the SFO or an exemption applies

Exemptions most commonly relied on are those for invitations with respect to securities that are or are intended to be disposed of:

- only to professional investors or
- only to persons outside Hong Kong



SFC SANCTIONING POWERS: S53ZSP AMLO + S194 SFO

- SFC can sanction “regulated persons” who are:
 - guilty of misconduct or
 - considered “not fit and proper”
- A regulated person is a person who is or was at the relevant time:
 - a licensed VA trading platform;
 - a licensed representative or responsible officer or
 - a person involved in the management of the business of a licensed VA trading platform (whether licensed or not) (s53ZSO AMLO + s194 SFO)
- Misconduct is:
 - breach of any provision of the Ordinance
 - breach of terms or conditions of a person’s licence +
 - an act or omission in carrying on regulated activity or VA service which the SFC considers to be, or likely to be, prejudicial to the investing public or the public interest (s53ZSR(2) AMLO + s193 SFO)

SFC SANCTIONING POWERS: S53ZSP AMLO + S194 SFO

- Sanctions include:
 - private or public reprimand
 - fine up to greater of:
 - HK\$10 mln
 - 3 x profit gained or loss avoided
 - revocation or suspension of licence
 - revocation or suspension of approval as responsible officer
 - remedial action
 - order prohibiting application for licensing or approval as responsible officer for specified period
- SFC published Disciplinary Fining Guidelines under SFO + AMLO





INDIVIDUALS' LIABILITY: S53ZSR(5) AMLO + S193(2) SFO

- If VATP is or was guilty of misconduct, responsible officers + persons involved in management deemed guilty of misconduct if VATP's misconduct:
 - occurred with their consent or connivance
 - was attributable to neglect on their part

S53ZTH AMLO + S213 SFO

- SFC can apply to Court of First Instance to grant orders against a person in breach of:
 - the relevant Ordinance
 - a licence condition
 - other condition or requirement imposed or notice given under the Ordinance
- Under AMLO only, SFC can apply for orders where AMLO codes + guidelines are breached
- Court can impose orders against persons who:
 - assisted, aided or abetted, or conspired or
 - were knowingly involved, in commission of the breach

S53ZTH AMLO + S213 SFO (CONT'D)

- Court of First Instance can grant (among others):
 - freezing orders
 - restoration orders to restore parties to transactions to their position before the transaction was entered into
 - injunctions prohibiting contravening conduct
 - orders appointing administrator of property
 - declaration that contract relating to VA is void
 - ancillary orders
- SFC has used s213 to obtain orders for compensation of victims of insider dealing (eg in Tiger Asia)

SFC POWERS WITH RESPECT TO LICENSED VATP OPERATORS

SFC HAS BROAD POWERS UNDER THE SFO + AMLO TO:

- enter the business premises of licensed VATPs and their associated entities to conduct routine inspections
- request production of documents + records
- investigate breaches +
- sanction licensed persons involved in the breaches

Possible sanctions include a reprimand, an order for remedial action, a fine + suspension or revocation of a person's licence

SFC can also appoint an auditor to conduct an investigation into the affairs of a licensed VATP + its associated entity if it has reason to believe that there has been a breach of the AMLO or any code or guideline published under it

SFC has intervention powers to impose restrictions + prohibitions on the operations of a licensed VATP + its associated entity in certain circumstances, e.g. where it is necessary to protect client assets

TRANSITIONAL ARRANGEMENTS FOR VA EXCHANGES OPERATING IN HK BEFORE 1 JUNE 2023

- AMLO licensing regime commenced 1 June 2023
- Transitional arrangements allowed VATPs operating + having meaningful + substantial presence in HK before 1 June 2023 to continue operating without a licence until 31 May 2024

Relevant Factors for whether a VATP had a “meaningful and substantial presence in HK”, SFC considered, (among others):

- whether it was incorporated in HK
- whether it had a physical office in HK
- whether its central management + control + key personnel were based in HK
- whether the trading platform was live with a considerable number of clients + volume of trading activities in HK

Operators of pre-existing trading platforms which applied online for a licence between 1 June 2023 + 29 February 2024 eligible for deemed licensing from 1 June 2024 until the earlier of approval, withdrawal or refusal of their licence application

END OF TRANSITIONAL PERIOD

- Pre-existing platforms not applying for AMLO licence by 29 February 2024 had to close down by 31 May 2024
- Only VATPs allowed to operate in HK: 2 formally licensed VATPs + 11 “deemed-to-be-licensed” VATPs

SFC STATEMENT ON END OF NON-CONTRAVENTION PERIOD

- Investor warning that “deemed-to-be-licensed” VATPs are not + may not be licensed
- Reminders for “deemed-to-be-licensed” VATPs
 - must comply with all requirements for licensed VATPS
 - must not actively market services or accept new retail clients until licensed
 - must prevent Mainland Chinese residents from accessing VA services + procure controlling entities + related parties to do so

SFC LISTS OF VATPS

29 September 2023 – SFC published lists of:

- licensed VATPs
- VATP licence applicants
- VATP licence applicants whose applications have been returned, refused or withdrawn
- VATPs closing down
- Suspicious VATPs

Lists show licensing status of VATPs operating, or actively promoting their services to investors, in HK



SFC LISTS OF VATPS (CONT'D)

- List of licensed VATPs – includes details including business address, names of responsible officers, complaints officer etc.
- List of VATP applicants – presence on this list does not mean applicant complies with VATP regulatory requirements or that it will be licensed
- List of VATP applicants whose applications were returned, refused or withdrawn – SFC can return applications that are incomplete and applications by VATPs that are not “fit and proper”
- List of closing-down VATPs – VATP operators required to close down by law
- List of suspicious VATPs – unlicensed platforms believed to be targeting HK investors

Licensed VATPs: 2

Applicants: 17

Deemed to be licensed: 11

Withdrawn or returned: 13

SFC WARNING: VATPS ENGAGING IN IMPROPER PRACTICES – 7 AUGUST 2023

SFC warning statement of:

- platforms' false claims to have applied to the SFC for licensing
- platforms' conducting activities prohibited under the AMLO, eg. offering
 - retail investors VA that are unsuitable
 - services in VA derivatives +
 - VA “deposits”, “savings” + “earnings”
- risks of trading on unregulated VATPs, e.g.
 - VATPs' collapse
 - hacking
 - other VA misappropriation

SFC WARNS PUBLIC OF ALLEGEDLY FRAUDULENT CRYPTO-RELATED ACTIVITIES

- SFC's Suspicious Virtual Asset Trading Platforms Alert List
 - 42 crypto businesses
- SFC has issued warning statements to the public on its website:

Investors are urged to trade virtual assets ONLY on SFC-licensed virtual asset trading platforms. Investors are reminded that deemed-to-be-licensed virtual asset trading platform applicants are NOT formally licensed by the SFC.

- Recent SFC warnings of entities suspected of engaging in fraudulent activities related to virtual assets
- Investor complaints of difficulty withdrawing VA from accounts, high fees for withdrawing VA

POLICE ARRESTS RELATING TO UNLICENSED VATP – JPEX

- HK police reportedly arrested >70 people in JPEX case
- Allegedly, 2,600 victims suffered losses \geq HK\$1.6 billion
- March 2022 – SFC starts investigating JPEX
- July 2022 – JPEX put on SFC alert list
- 13 September 2023 – SFC issues “Warning Statement on Unregulated Virtual Asset Trading Platform”
- 20 September 2023 – SFC issues ‘Warning on JPEX’
- False claims to be a regulated platform on JPEX website + advertisements
- JPEX is not + has not applied to be licensed in HK as a VATP
- JPEX is not licensed outside HK for VA services
- JPEX offering prohibited services + products
- False claims by social media influencers + OTC VA money changers that JPEX has applied for VATP licence



SFC + HK POLICE JOINT WORKING GROUP

- 4 October 2023, announcement of joint working group with HK Police Force
- Purpose – to exchange information re. suspicious activities + VATPs' breaches of SFO or AMLO

SFC INVESTOR EDUCATION ON VATPS

- 25 September 2023, SFC announces campaign to raise public awareness of VA risks and potential fraud
- Encourages public to file complaints with SFC online complaint form