

## Hong Kong's New Virtual Asset Licensing Regime

### Keynote speech at executive dinner organised by the Hong Kong Economic and Trade Office in Bangkok, Office for Attracting Strategic Enterprises and InvestHK

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Good evening, ladies and gentlemen.

It is a pleasure to be here tonight to meet you all. I would like to thank the Hong Kong Economic and Trade Office in Bangkok, Office for Attracting Strategic Enterprises and Invest Hong Kong (InvestHK) for organising this event in partnership with the Thai Fintech Association and Thai Digital Asset Association.

I am delighted to have this opportunity to share with you the Securities and Futures Commission's (SFC) approach to virtual asset regulation over the years and some of the key aspects of our new virtual asset licensing regime.

By way of introduction, the SFC is a principles-based regulator which oversees Hong Kong's securities and futures markets, and we adopt a technology-neutral regulatory approach. We believe the use of innovative technology can help make the delivery of financial services more efficient, robust and cost-effective. To facilitate the use of technology whilst maintaining resilience, the SFC strives to ensure that our rules—designed for investor protection, and orderly and fair markets—also apply in digital environments.

There are many useful applications of distributed ledger technology (DLT) in global finance, and many financial institutions are now exploring how to tokenise financial assets, or develop their own tokens on private blockchains, in order to drive efficiency, provide transparency and resolve some decades-old frictions in clearing, settlement and payments.

But the collapse of Luna and Terra in May last year, together with the “crypto winter”, led to a series of defaults and bankruptcies, such as those of Three Arrows and FTX. These incidents have highlighted the high risk of loss and volatility in crypto-asset markets. Investor confidence in this space is undermined by the spillover of excessive risks taken on by a few firms, causing knock-on effects in the wider virtual asset industry. Bringing virtual asset service providers into a well-balanced regulatory fold is the only pathway to embrace innovation, instilling trust in the virtual asset ecosystem.

#### When innovation meets regulation

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Note: This is the text of the speech as drafted, which may differ from the delivered version.

Up to now, many jurisdictions have adopted a light-touch approach to regulating crypto asset service providers, ie, by regulating from a payments or anti-money laundering perspective. But the “crypto winter” has strengthened the resolve of global financial regulators to regulate virtual asset service providers.

The Financial Stability Board, an international body, of which Hong Kong is a member, established by the G20 to promote financial stability, issued a statement in July last year to call for an effective regulatory framework to ensure that virtual asset activities posing similar risks to traditional financial activities are subject to the same regulatory outcomes. The International Organization of Securities Commissions, a network of capital market regulators which the SFC participates in, has recently issued a consultation paper (on the same day as the SFC issued its consultation conclusion paper) to set out recommendations to its member jurisdictions for how to regulate virtual asset service providers.

At a time when the global regulatory landscape is uncertain, the SFC has come up with a comprehensive policy response to virtual asset-related activities to provide regulatory clarity and consistency. Adhering to the concept of “same business, same risk, same rules”, our regulatory framework seeks to capture all the dimensions of the public’s interface with virtual assets so that investors are protected, and also to address the prudential risks to financial institutions. These rules provide guidance to banks, brokers and fund managers who manage or distribute virtual asset funds. By adopting this approach, we are supportive of the underlying innovative technology, ie, DLT, and welcome the growth of the fintech community in Hong Kong.

As early as 2017, we were debating what regulatory approach to take to virtual assets. Basically, we could ban the trading of it altogether, ignore it because at the time Bitcoins and many other crypto tokens fell outside the SFC’s regulatory remit, or regulate. However, to regulate could be seen as “legitimising” Bitcoins and the like. On the other hand, banning them would not be consistent with our open capital market when investors can still trade on an overseas online platform. We chose regulation because we see investor harm if platforms are left unregulated. So we had to be creative in extending our regulatory remit over non-security tokens.

We were one of the first major jurisdictions to regulate this space from an investor protection perspective, applying the “same business, same risks, same rules” principle. As early as 2018, the SFC introduced an opt-in regime for platforms which volunteer to come under our regulatory remit by trading at least one securities token. The requirements range from safe custody of assets, cybersecurity, anti-money laundering (AML), private key management, internal audit and controls. Two platforms have been granted licences under this opt-in regime.

Last year, amendments were passed to Hong Kong’s AML Ordinance to make it mandatory for all centralised trading platforms trading non-security tokens to obtain a licence from the SFC. The regime commenced two weeks ago on 1 June. The guidelines we issued encompassed all the protection measures mentioned above with slight modifications for insurance coverage. The regulatory requirements for virtual asset trading platforms are based on the regulatory requirements in the existing regime under the Securities and Futures Ordinance, the legislation which the SFC administers, and are comparable to those for licensed securities brokers and automated trading venues.

The key change is for retail investors to be able to access these platforms for trading. This is premised on the basis that the platforms must comply with a range of robust investor protection measures. These cover ensuring suitability in the onboarding process, token due diligence, and admission and disclosure. These measures are necessary to ensure retail investors can reasonably assume the risks and bear the potential trading losses in virtual assets before they are allowed to trade. Prior to this, trading was only for professional investors.

To ensure robust governance and transparency, licensed platform operators should establish a token admission and review committee. The SFC expects that licensed platform operators perform reasonable due diligence on the virtual assets to be admitted for trading, and to ensure that they satisfy the admission criteria on an ongoing basis. Virtual assets to be made available to retail clients should be large cap virtual assets of high liquidity. This would reduce the risk of market manipulation.

Another key aspect is our emphasis on safeguarding assets. Fundamentally, as with all SFC licensees, virtual asset trading platforms are required to segregate client assets from house assets. Other robust safe custody requirements are imposed, such as private key management to prevent collusion and misappropriation by employees. The SFC also requires platform operators to put in place a compensation arrangement through a combination of insurance and funds set aside on trust and designed for such purpose.

### **Virtual asset ecosystem**

In terms of virtual asset products, the SFC set up a regime to authorise ETFs providing exposure to mainstream virtual assets primarily through futures contracts traded on the Chicago Mercantile Exchange for public offering in Hong Kong. These virtual asset futures ETFs (for Bitcoin and ether futures) are listed and traded on the Stock Exchange of Hong Kong. Meanwhile, the Hong Kong Monetary Authority has announced its intention to authorise stable coins established in Hong Kong.

At the time we announced the regulatory regime for retail access to virtual assets and virtual asset futures ETFs, the government issued a statement at FinTech Week in Hong Kong welcoming the fintech community and the development of virtual assets. It was regarded as a game changer and the clearest signal yet that Hong Kong pursues “One Country, Two Systems”, given that Mainland China still bans the trading of crypto.

The announcements created a buzz in the fintech community worldwide, as other jurisdictions, which used to welcome the crypto community, were shaken by the fallout from FTX and tightened their rules. Still others are regulating by enforcement. But here in Hong Kong, our regime might be regarded as tough, but we have been transparent, consistent and predictable.

We are not aiming to be a crypto trading hub but we recognise crypto trading as an important part of the virtual asset ecosystem. We also embrace the application of DLT technology in the realms of financial services, ranging from tokenisation of bonds to investment funds. We know Hong Kong has a long way to go in terms of building its ecosystem. But we believe that the clustering of the virtual asset fintech community in Hong Kong, already a fundraising center in the listed market and private equity fund market, would speed up the development of this ecosystem.



If you are interested in exploring the opportunity for listing in the Specialist Tech market or setting up in Hong Kong, our Economic and Trade Office here, working closely with InvestHK, would offer the assistance.

In concluding, we believe that having a strong, robust regulatory framework is key to ensuring sustainable development of a crypto ecosystem and will help to build trust among the public and counterparties in Tradfi. So, my final message today is to embrace both innovation and regulation as the pathway to the future of finance. Thank you.