
RE: CIRCULAR ON TRANSITIONAL ARRANGEMENTS OF THE NEW LICENSING REGIME FOR VIRTUAL ASSET TRADING PLATFORMS

BACKGROUND & OVERVIEW

On 31 May 2023, the Securities and Futures Commission (“SFC”) published the “Circular on transitional arrangements of the new licensing regime for virtual asset trading platforms” (the “Circular”), providing clarifications on the applicable requirements and procedures in relation to the transitional arrangements (the “**Transitional Arrangements**”) under the new virtual asset service provider (“**VASP**”) licensing regime, which took effect on 1 June 2023.

In this Client Alert, we highlight the key points of note in relation to the Transitional Arrangements and provide our observations on the subject.

TRANSITIONAL ARRANGEMENTS UNDER THE NEW VASP LICENSING REGIME

The Transitional Arrangements are provided by Schedule 3G to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the Laws of Hong Kong) (the “**AMLO**”) and consist of:

- (i) a 12-month non-contravention period running from 1 June 2023 to 31 May 2024 (the “**Non-Contravention Period**”), during which virtual asset trading platforms (the “**VATPs**”) operating “with meaningful and substantial presence” in Hong Kong immediately prior to 1 June 2023 (the “**Pre-Existing VATPs**”) may continue to provide operate in Hong Kong without having obtained a VASP licence from the SFC; and
- (ii) a deeming arrangement (the “**Deeming Arrangement**”), commencing from 1 June 2024, under which a Pre-Existing VATP is deemed to be licensed until the date on which a Pre-Existing VATP’s application for a VASP licence is either approved, rejected or withdrawn.

It is important to note that the Transitional Arrangements are only applicable to VATPs which provide trading services in non-security tokens¹ only, as the provision of trading services in security tokens is regulated under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the “**SFO**”), under which no transitional arrangement is available.

Qualification as Pre-Existing VATP

In considering whether a VATP qualifies as a Pre-Existing VATP, in addition to the VATP’s place of incorporation, location of physical office, centre of management and control, location of key personnel, number of Hong Kong clients and their volume of trading activities as previously mentioned in the SFC’s Consultation Paper dated 20 February 2023 (the “**Consultation Paper**”),² the SFC will also consider whether there are other factors, such as the VATP’s trading system set-up, trading arrangements and organisational structure, which can support that the VATP was operating in Hong Kong immediately before 1 June 2023. The SFC also emphasised in the Circular that the VATP’s business and presence in Hong Kong must be “genuine”, including but not limited

¹ “Non-security token” refers to virtual assets which do not fall within the definition of “securities” under the SFO.

² “Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission”, 20 February 2023.

to having independent clients with genuine trading volume. Merely setting up a local entity or having “shell” operations would not suffice.

Deeming Arrangement from 1 June 2024 onwards

Pre-existing VATPs may be deemed to be licensed from 1 June 2024 upon satisfying prescribed requirements

To be eligible for the Deeming Arrangement, a Pre-Existing VATP must submit its fully completed application for the VASP licence³ on or before **29 February 2024**. Crucially, a VATP will be required to confirm in its licence application and prove to the satisfaction of the SFC that: (i) it has been operating in Hong Kong immediately before 1 June 2023; and (ii) it will, upon being deemed to be licensed, comply with all regulatory requirements⁴ applicable to a licensed VATP.

To demonstrate that it has the capability to comply with the applicable regulatory requirements by 1 June 2024, a VATP will be required to submit, together with its licence application, its internal policies and procedures covering areas such as the VATP’s proposed structure, governance and staffing, operations, token admission, custody of VAs, know-your-client procedures, anti-money laundering and counter-terrorist financing, market surveillance, risk management and cybersecurity. In addition, an external assessment report issued by a suitably qualified external assessor⁵ analysing the design effectiveness of these policies and procedures should also be submitted at the time of the licence application.

In the event that a VATP fails to satisfy any conditions for the Deeming Arrangement, the SFC may issue a “no-deeming notice”, with the result that the VATP must close down its business in Hong Kong by **31 May 2024** or by the expiration of the three months beginning on the date of issuance of the notice, whichever is the later. Its staff members should also cease to perform any regulated function⁶ (or hold themselves out as performing any regulated function) for the VATP.

Proposed LRs and ROs may be deemed to be licensed from 1 June 2024 upon satisfying prescribed requirements

An individual may apply to be a licensed representative (“**LR**”) and/or a representative officer (“**RO**”) of a Pre-Existing VATP and be deemed to be licensed to perform regulated functions for the Pre-Existing VATP from 1 June 2024 onwards until the individual’s licence application is approved, rejected or withdrawn. The proposed LR or RO must be performing a regulated function in Hong Kong for the Pre-Existing VATP at the time of his or her application. In the case of application of a proposed RO, the individual must also show that he or she has been performing a regulated function in Hong Kong for a VATP (whether operating in Hong Kong or elsewhere)

³ As mentioned in our previous Client Alerts dated 28 February 2023 and 29 May 2023, VATPs are required to apply for both the VASP licence under the AMLO and the Type 1 and Type 7 licences under the SFO concurrently in view that the classification of VAs as “securities” or “non-securities” may be uncertain and subject to change.

⁴ These include the Guidelines for Virtual Asset Trading Platform Operators (the “**VATP Guidelines**”) and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers) (the “**AML Guideline**”) published in the Gazette on 25 May 2023.

⁵ A capability statement of the external assessor should be submitted to the SFC together with the external assessment report. See Q3 of the SFC’s FAQ entitled “External assessment reports for licence applications” (31 May 2023), accessible on the SFC’s website.

⁶ A “regulated function” is defined in Section 53ZRB of the AMLO to mean any function performed for and on behalf of or by arrangement with a VATP in relation to the provision of the VATP’s VA trading services, excluding any work ordinarily performed by an accountant, clerk or cashier.

immediately prior to 1 June 2023. Similarly to the VATP itself, the LR or RO applicant will also be required to demonstrate that he or she will be capable of complying with all the applicable regulatory requirements upon being deemed to be licensed.

At least 2 RO applications must be submitted together with VATP's licence application

The SFC requires that at least two RO applications should be submitted together with the VATP's licence application. At least one of the proposed ROs must be a director supervising the business of the VATP and at least one of them must be an onshore RO who ordinarily resides in Hong Kong. In addition, one of the ROs must have least three years of direct industry experience in the operation of a VATP or the provision of automated trading services (for example, by being a key person in the development and operation of a technology or system which is central to the operation of the VATP which is his or her principal).⁷ The proposed ROs must also have complied with all applicable competence requirements, including but not limited to passing local regulatory framework papers (unless exempted).⁸

ROs with only VA-related experience or only securities-related experience may be dually licensed

Recognising that there may currently be a shortage of RO candidates possessing both securities-related experience and VA-related experience in the market, the SFC will adopt a pragmatic approach under which a proposed RO with only VA industry experience or securities industry experience may nevertheless be dually licensed under both the AMLO and the SFO subject to certain conditions. In the case of a RO applicant who only has industry experience in dealing in VAs, a licensing condition will be imposed on his or her licence for Type 1 regulated activity under the SFO (if granted) such that he or she can only carry on the regulated activity of dealing in securities for the business of a SFC-licensed VATP. In the case of a RO applicant who only has industry experience in dealing with securities, he or she will be subject to a "non-sole" condition on his or her licence to provide VA trading services under the AMLO (if granted).⁹

Pre-Existing VATPs and proposed LRs and ROs subject to full scope of SFC's supervisory, disciplinary, intervention and other powers under Deeming Arrangement

Once a Pre-Existing VATP and its proposed ROs and LRs are deemed to be licensed, the provisions of the AMLO will apply as if the Pre-Existing VATP and its proposed ROs and LRs were formally licensed, such that they will be required to comply with all applicable legal and regulatory requirements under the AMLO, including but not limited to the VATP Guidelines and the AML Guideline. The SFC has made it clear it will not hesitate to take appropriate actions (including disciplinary actions) against any non-compliance.

OUR OBSERVATIONS

Whilst Schedule 3G of the AMLO merely stipulates that a VATP must be "carrying on the business of providing the VA service in Hong Kong immediately before 1 June 2023",¹⁰ the SFC has

⁷ Please refer to the SFC's FAQ entitled "Competence requirements for individuals" (31 May 2023), accessible on the SFC's website.

⁸ For the RO competence requirements, please refer to paragraph 3.16 of the VATP Guidelines.

⁹ That is, he or she must, when actively participating in or directly supervising the business of the VATP in the provision of the trading of non-security tokens, do so under the advice of another RO who is not subject to such non-sole condition.

¹⁰ "VA service" is defined in Schedule 3B to mean "operating a VA exchange".

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consistently imposed additional requirements as to qualification as a Pre-Existing VATP in the Consultation Paper and the Circular by setting out an increasing list of factors it will take into account. Although the SFC has not made clear what types of trading system set-up and trading arrangements may support that a VATP is operating in Hong Kong, the location of the VATP's servers and matching engine will likely be relevant considerations. A VATP that intends to rely on the Deeming Arrangement should be prepared to submit as part of its licence application adequate information and documents in respect of each of the factors listed in the Circular which can to prove to the satisfaction of the SFC that it qualifies as a Pre-Existing VATP.

Further, given that a VATP will be required, when making its licence application, to demonstrate to the SFC that it has the capability to comply with all the applicable regulatory requirements by 31 May 2024, VATPs should start taking steps to proactively prepare all internal policies, procedures and controls required under the VATP Guidelines in consultation with their legal advisors and suitably qualified external assessors. As applications for at least two ROs who have been performing a regulated function for a VATP immediately before 1 June 2023 and who have complied with all the relevant competence requirements will also need to be submitted together with the VATP's licence application, it will be advisable for a Pre-Existing VATP to have on board more than two proposed ROs who have a reasonable prospect of satisfying the aforementioned conditions by the time of its licence application.

Additionally, as a VATP that intends to rely on the Deeming Arrangement must submit a fully completed licence application by the deadline of 29 February 2024, for which no extension can be granted, Pre-Existing VATPs should aim to submit their licence applications as soon as practicable ahead of the deadline to allow for sufficient time to rectify any fundamental issue which may be raised by the SFC in its requisitions on the VATP's and/or its proposed ROs' licence applications, particularly given that a large number of applications are expected to be submitted by different VATPs and their proposed LRs and ROs with a view to obtaining a deemed licence.

Should you have any queries regarding the above or would like to further discuss any of the issues raised in this Client Alert or the Circular, please do not hesitate to get in touch with our team at hyu@lylawoffice.com or by telephone at (+852) 2115-9525.

HENRY YU & ASSOCIATES
6 June 2023



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