

Virtual Asset Service Providers: HongKong formalises regime

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On 24 June 2022, the Hong Kong SAR Government gazetted the Anti-Money Laundering (“AML”) and Counter-Terrorist Financing (“CTF”) (Amendment) Bill 2022 (“Amendment Bill”), shaping the much anticipated licensing and regulatory regime for Virtual Asset Services Providers (“VASPs”) in Hong Kong. In this brief, KPMG outlines the regulatory agenda and highlights the impact on VASPs.



The Amendment Bill introduces changes to the AML and CTF Ordinance (Cap. 615) (“AMLO”), including introduction of a licensing regime for and AML/ CTF obligations on VASPs. The proposed licensing regime is expected to take effect on 1 March 2023, and VASPs will have nine months (until 1 December 2023) to comply.

The new VASP regime includes more elements of investor protection than equivalent regimes in Singapore, United Kingdom, and Japan including assessment of applicants’ company and management structure, and a requirement for applicant’s business model to be sound, with detailed risk management policies and other listing and counter-market manipulation measures.



The key difference between the new VASP regime and the existing regime for operators of Virtual Asset Trading Platforms (“VATP”) to apply for SFC’s Type 1 and 7 licences is that the existing regime only applies to VATPs that trade at least one security token. As such, the existing regime is voluntary in nature and VATPs opt-in by trading a security token in order to bring themselves into scope of the SFC’s supervision. The changes to the AMLO introducing the new VASP regime grant additional supervisory powers to the SFC to bring all VASPs within scope of the regulations.



Scope

Virtual Asset Exchange

Any person seeking to operate a virtual asset (“VA”) exchange is required to apply for a VASP license. Schedule 3B of the Amendment Bill defines operation of a VA exchange as provision of services through means of electronic facilities,

- whereby-
 - offers to sell or purchase virtual assets are regularly made or accepted in a way that forms or results 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 virtual assets in a way that forms or results in a binding transaction; and
- where client money or client virtual assets comes into direct or indirect possession of the person providing such service.

Virtual Asset

In scope:

- Bitcoin
- Altcoins
- Stablecoins
- Certain government tokens

Out of scope:

- Digital representations of fiat currencies (including CBDCs)
- Financial assets already regulated under the SFO (VA Trading Platforms which trade at least 1 security token are already covered by the existing SFC Type 1, 7 Licensing Regime for VATP)
- Stored value facilities already regulated under Payment Systems and Stored Value Facilities Ordinance
- Closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible in nature

To be determined*:

- NFTs

** Secretary for Financial Services and the Treasury have been appointed to prescribe by notice whether an asset will be deemed as a VA under the AMLO)*



Licensing requirements for VASPs

Place of Business:

- The applicant must be either locally incorporated with permanent place of business in Hong Kong; or
- Incorporated elsewhere but registered in Hong Kong under the Companies Ordinance (Cap. 622)

Fit and Proper Test

- The applicant must be a fit and proper person to be licensed to provide the VA service;
- Must have at least two persons fit and proper to be responsible officers (“ROs”), each of whom are of sufficient authority within the applicant and at least one of whom must be an executive director;
- Each director of the applicant must be fit and proper; and
- The ultimate beneficial owner of the applicant must also be fit and proper.

AML and CTF requirements

- Specific requirements will be introduced for customer due diligence

Professional Investors

- Licensed VASPs are only allowed to provide services to professional investors (hence must block access to the platform for any investors who do not meet the professional investor criteria)



Additional regulatory requirements and conditions that the SFC is expected to impose

- Financial resources
- Knowledge and experience
- Risk management policies and procedures
- Management of client assets
- Soundness of the business
- Financial reporting and disclosure
- Virtual asset listing and trading policies
- Prevention of market manipulation and abuse policies
- Avoidance of conflicts of interest
- Keeping of accounts and records by licensed providers and their associate entities
- Provision of contract notes, receipts, statements of account and notifications by licensed providers and their associate entities
- Financial statements and other documents, and the auditor’s report
- Business conduct of licensed providers and their licensed representatives
- Notification of changes
- Cybersecurity



Key Impacts for Existing VASPs

If a VASP is **operating an exchange in Hong Kong**, it must obtain a license from the SFC. If it does not obtain a license it **is expected to cease operations by 1 March 2024**.

If a VASP without SFC license **operates an exchange outside Hong Kong but actively markets its services to customers in Hong Kong** it will be considered to **have breached the AMLO**.

Licensed VASPs will have to **offboard all retail customers**, as they **may only provide services to professional investors**.

Licensed VASPs will likely have to offboard customers located in **jurisdictions which prohibit cryptocurrency activities** in order to avoid potential cross-border regulatory issues.



Based on our experience helping Virtual Asset Trading Platforms (VATPs) apply for the Type 7 licence from the SFC, we expect that applicants for the new VASP licence will need to **provide evidence to the SFC** on:

Stable and secure business model

SFC compliant technology platform

Background & financial soundness

Robust, well documented processes and internal controls

Well structured risk management framework



KPMG is working with VASPs in Hong Kong to help them assess the impact of the upcoming regulatory requirements. Our Risk and Technology Consulting teams can advise across all areas of the new VASP regime, including:

- 1 Gap analysis and readiness assessment of VASP's existing systems, architecture, features, and policies and procedures against the expected licensing requirements
- 2 Support drafting the required depth and detail for policies and procedures to ensure sufficient formal process documentation is in place
- 3 Define system target state and a roadmap of IT initiatives required
- 4 Design Hong Kong-based custody vault for VAs, and support vendor assessment and selection
- 5 Perform cybersecurity assessment through vulnerability scans and penetration tests
- 6 Design customer risk assessment, set up the customer risk monitoring framework, develop integrated KYC and AML workflow tools, and define policies and processes for AML / KYC / CDD / ATF
- 7 Set up internal and external reporting frameworks, and implement reporting systems

References

Hong Kong Government, Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, June 2022

<https://www.cr.gov.hk/en/publications/docs/es32022262516-e.pdf>

Contact us



Tom Jenkins
Partner, Head of Banking and Asset Management Risk Advisory and Head of Financial Risk Management
KPMG China

T: +852 2143 8570
E: tom.jenkins@kpmg.com



Paul McSheaffrey
Partner, Financial Services
KPMG China

T: +852 2978 8236
E: paul.mcsheaffrey@kpmg.com



Barnaby Robson
Partner, Transaction Services
KPMG China

T: +852 2826 7151
E: barnaby.robson@kpmg.com



Nigel Hobler
Partner, Tax
KPMG China

T: +852 2978 8266
E: nigel.hobler@kpmg.com



Chad Olson
Partner, Head of Forensic Services
KPMG China

T: +852 3927 5576
E: chad.olsen@kpmg.com

kpmg.com/cn/socialmedia



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