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Asia-Pacific Alert

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Hong Kong amends anti-money laundering law to cover virtual asset service providers

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The Amendment gives Hong Kong's Securities and Futures Commission direct regulatory oversight over cryptocurrency exchanges operating in Hong Kong.



What's the Impact?

- / The Amendment is effective on 1 April 2023, and its licensing and enforcement provisions come into operation on 1 June 2023
- / Only Hong Kong-formed corporations or registered non-Hong Kong companies with permanent place of business in Hong Kong are eligible for licensing
- / Applicants must meet certain standards to be eligible for licensure, and anyone marketing or providing virtual asset services without a proper license is in breach of the Amendment

Hong Kong's Legislative Council passed the anticipated "Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022" (Amendment) on 7 December 2022. The legislation was published on 16 December and will come into operations on 1 April 2023. As its name suggests, this bill amends the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO) currently in operation in Hong Kong.

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The stated reason for the Amendment was to fulfill Hong Kong's anti-money laundering and counter-terrorist financing (AML/CTF) obligations under the Financial Action Task Force (FATF). Hong Kong made a commitment to upgrade its AML/CTF standards following a mutual evaluation on Hong Kong conducted by the FATF with the Hong Kong government. The practical immediate effect of the Amendment is to give Hong Kong's Securities and Futures Commission (SFC) direct regulatory oversight over cryptocurrency exchanges operating in Hong Kong.

The Amendment made SFC the regulatory authority over virtual asset service providers (VASPs) for AML/CTF compliance matters. This plugs a hole in SFC's regulatory reach since the Securities and Futures Ordinance (Cap. 571) (SFO) only provides it with authority over "securities" and arguably, most cryptocurrencies do not fit under the definition of "securities" as defined in the SFO.

The Amendment also expanded regulations of dealers in precious metals and stones under the authority of the Hong Kong's Customs and Excise Department, the traditional regulator of AML/CTF activities in Hong Kong.

Please note this client alert covers the impact of the new law on cryptocurrency exchanges only.

How VASPs are regulated under the Amendment

The Amendment requires VASPs to be licensed by the SFC. Initially, only cryptocurrency exchanges are covered, but the definition may be expanded in the future to cover other service providers.

Definition of "virtual assets"

Essentially, virtual asset (VA) is defined as an encrypted digital representation of value that may be used as a medium of exchange by the public for paying for goods or services, discharge of debt or investment. It can be traded, transferred, or stored electronically. The definition also includes governance tokens, which are tokens with a right to vote on the management, administration, or governance of the affairs of a token.

Excluded from the definition of VA are (i) central bank digital currency (CBDC) issued by governments, central banks, or other entities authorized by a central bank; (ii) tokens which are already subject to authority of other regulators; and (iii) "limited purpose digital tokens" such as loyalty tokens and tokens used for online gaming.

VA exchanges (commonly referred to as cryptocurrency exchanges) are electronic facilities which provide multiple services. They are defined as trading platforms where (i) offers to sell or purchase VA are regularly made or accepted that results in binding transactions **or** (ii) where sellers and purchasers are regularly introduced or identified to each other with the reasonable expectation that they will negotiate or conclude in binding transaction for transferring VA **and** where client money or client VAs come into possession of the cryptocurrency exchange or person providing VA services on its behalf.

Provision of services

Provision of VA services refers to the operation of a cryptocurrency exchange by a company and the individuals involved in offering such services on behalf of the company. Under the Amendment, providing VA services is considered a regulated function which requires licensing from the SFC. Anyone who carries on a business of providing any VA services must be licensed unless exempted. This includes entities operating as cryptocurrency exchanges as well as individuals offering to provide cryptocurrency exchange services. It is also an offense to advertise the offering of such services.

Anyone who markets or provides VA services or any regulated function without a proper license issued by the SFC is in breach of the Amendment. In addition, anyone actively advertising to the Hong Kong public of such VA services, within or outside of Hong Kong, without a license is also in breach of the Amendment even if no actual VA services are actually provided.

Only Hong Kong-formed corporations or registered non-Hong Kong companies with permanent place of business in Hong Kong are eligible for licensing. In addition, individuals providing VA services on behalf of a cryptocurrency exchange must also have "licensed representative" registration.

Although the Amendment is effective on 1 April 2023, the new licensing and enforcement provisions will only come into operation on 1 June 2023. Since the government recognizes that there are cryptocurrency exchanges currently operating in Hong Kong, the Amendment provides for a transitional period for existing eligible cryptocurrency exchanges to comply with the licensing requirements under the new regime. Any cryptocurrency exchange providing VA services in Hong Kong before 1 June 2023 that continues to offer such services thereafter may continue to operate for the first twelve months from 1 June 2023 provided that they apply for licensing with the SFC and have a reasonable chance of getting licensed. Likewise, individuals providing VA services on behalf of these cryptocurrency exchanges may continue to provide such services for the first twelve months after 1 June 2023 provided that they apply to be licensed representatives with the SFC within nine months of 1 June 2023 and have not received notice that they are ineligible for such licensing during the transitional period.

Application requirements

Applicants must pass a "fit and proper" test required of applicants for other SFC registrations or licensing. They must also comply with other regulatory requirements on investor protection, such as safe custody of client assets, financial soundness, and avoiding conflicts of interest. As part of the fit and proper test, applicants cannot be convicted anywhere of any AML/CTF offence or have acted fraudulently, corruptly, or dishonestly or failed to observe any AML/CTF requirements anywhere.

In addition, corporate applicants, and their officers, must be able to show relevant experience and qualifications as VASPs, be of good standing and financial integrity, and have at least two responsible officers with general responsibility for overseeing operations and compliance of the exchange. Corporate applicants must also employ licensed representatives and only such

licensed representatives may carry out regulated functions for the VASP. Both responsible officers and licensed representatives are also subject to passing fit and proper tests to be eligible for licensing and registration.

Once licensed, the VASP is subject to compliance with AML/CTF requirements, notably customer due diligence and record-keeping requirements. They may only offer services to professional investors with sufficient VA knowledge and experience and they must impose rigorous criteria for inclusion of VAs to the exchange, meet requirements concerning financial resources, have sufficient knowledge and experience of VAs, soundness of business, risk management, impose segregation for management of client assets, comply with financial reporting and disclosure obligations, prevent market manipulative and abusive activities, and prevent conflicts of interest. Furthermore, the VASP and their wholly owned subsidiaries are required to regularly submit audited accounts and financial information to the SFC. Once granted, a license is open-ended and valid until revoked.

The penalties for breach or non-compliance with AML/CTF requirements are HK\$5,000,000 fine and/or seven years imprisonment. There is also a HK\$100,000 per day fine for continuing offence.

Impact on cryptocurrency exchanges

Here are some implications the Amendment will have on the cryptocurrency exchanges:

- / licensing will be required for all cryptocurrency exchanges operating in Hong Kong, even if they exclude Hong Kong residents from trading on their platforms
- / only professional investors may trade on exchanges, no retail trading is allowed
- / application process seems substantially the same as other SFC intermediary licensing—essentially treating cryptocurrencies as “securities” reflecting Hong Kong’s regulatory attitude
- / no need for cryptocurrency exchange to trade any security tokens, hence it may make the opt-in sandbox licensing [regime announced in November 2019](#) obsolete
- / covers centralized cryptocurrency exchanges but excludes over-the-counter (OTC) transactions if neither tokens nor funds are handled by the exchange
- / platforms issuing native tokens may have to be licensed since such tokens necessarily reside on a blockchain and may be traded regularly thereby fitting the definition of providing VA services
- / the definition of “regulated function” excludes accountants, clerks, and cashiers but may cover coders and technical support personnel so if strictly enforced, coders and technical support personnel may need to be “licensed representatives” for performing a “regulated function in relation to a business of providing a VA service”
- / provides pathway for regulatory compliance for cryptocurrency exchanges and other VASPs as definition of VA services expand in the future
- / the Amendment is a big step by the Hong Kong government to make its imprint as a regional

hub for the cryptocurrency industry hub

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