

LCQ7: Regulation of virtual asset trading

Following is a question by the Hon Carmen Kan and a written reply by the Secretary for Financial Services and the Treasury, Mr Christopher Hui, in the Legislative Council today (February 21):

Question:

It has been reported that earlier on, some suspected fraud cases involving virtual asset trading platforms (VATPs) have aroused wide public concern, and the Chief Executive has subsequently pointed out that it is the Government's policy to implement an effective regulatory regime to protect investors. In this connection, will the Government inform this Council:

(1) given that the aforesaid platforms involved in fraud cases are on the list of suspicious VATPs posted on the website of the Securities and Futures Commission (SFC), whether it knows the follow-up actions taken by SFC in respect of such platforms;

(2) of the number of suspected fraud cases involving VATPs in the past three years, and set out in a table the following information in respect of each case: the number of persons arrested, the number of persons prosecuted, the amount of money involved in the fraud, and the progress of investigation;

(3) given that the Hong Kong Police Force and SFC established a joint working group on VATPs (the working group) last year to enhance collaboration in monitoring and investigating illegal activities related to VATPs, of the total number of cases investigated with the working group's co-ordination and collaboration efforts so far, as well as the details and progress of such cases;

(4) as the authorities indicated in their reply letter to the Panel on Financial Affairs of this Council on December 1 last year that they were working with the relevant government departments and regulators on formulating a regulatory framework for the operation of over-the-counter trading of virtual assets for public consultation, with a view to implementing the regulation of such trading through legislative amendments, whether the authorities have drawn up a relevant implementation timetable; if so, of the details; if not, the expected time for announcing such timetable;

(5) whether the authorities will bring under regulation all businesses involving virtual currencies (including the conversion between fiat currencies, stablecoins and virtual currencies) to combat at source the operation and promotional activities of unlicensed virtual asset trading service institutions; and

(6) how the Government will improve the steering and monitoring of the

regulatory regime for virtual assets at the policy level (including the steering of the work of SFC), so as to more comprehensively protect the rights and interests of investors while developing virtual assets?

Reply:

President,

The Government issued the Policy Statement on Development of Virtual Assets (VA) in Hong Kong in October 2022, setting out the commitment to enhancing the VA regulatory framework under the "same activity, same risks, same regulation" principle. In this regard, the Government has amended the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) to introduce a licensing regime for VA service providers, ensuring that VA trading platforms (VATPs) comply with relevant international requirements on anti-money laundering and counter-terrorist financing (AML/CTF) while protecting investors. The licensing regime commenced operation in June last year.

In consultation with the Police, the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA), the reply to the question raised by Hon Carmen Kan is as follows:

(1) and (2) The SFC stepped up information dissemination in September last year and published various details concerning VATPs, including the "List of Suspicious VATPs" (the List), so as to provide clear, transparent and timely information to the public. As of February 14 this year, a total of 14 VATPs were on the List.

Regarding the suspicious VATPs on the List, the SFC proactively makes public announcements through issuing press releases, social media posts, etc., to facilitate members of the public to take early precautionary actions. Depending on the circumstances of individual cases, the SFC also takes appropriate actions, including investigating whether the VATPs concerned have breached the relevant legislation, seeking the Police's assistance in blocking the websites and social media accounts involved, issuing cease-and-desist letters to relevant persons to stop their service provision on purchasing tokens suspected as fraudulent tools, issuing warning statements, conducting press briefings to alert the public, etc. Through the above measures and sustained investor education efforts, the SFC reminds the public in a timely and effective manner to prevent their falling prey to scams.

For the past three years, the numbers of VA-related criminal cases are 1 397 in 2021, 2 336 in 2022 and 3 415 in 2023. The amounts of money involved are \$824 million in 2021, \$1,704 million in 2022 and \$4,398 million in 2023. As regards the number of persons arrested and prosecuted, the Police currently only consolidates relevant figures for specific cases taking account of their individual circumstances. For example, in the case of JPEX, as of February 20, 2024, the Police has arrested 70 people with no prosecution initiated yet.

(3) The joint working group comprises representatives from the Police's Commercial Crime Bureau, Cyber Security and Technology Crime Bureau and Financial Intelligence and Investigations Bureau as well as the SFC's Enforcement Division and Intermediaries Division. It aims to (i) facilitate information sharing on suspicious activities and breaches of VATPs; (ii) implement a risk assessment mechanism on suspicious VATPs; and (iii) enhance co-ordination and collaboration in relevant investigations. Since December last year, the SFC and the Police have further implemented an information sharing mechanism under which complaints and intelligence on VATPs or suspicious VA-related activities are shared twice a week.

As of February 2 this year, the SFC and the Police have exchanged intelligence on more than 100 cases involving VATPs or VA-related activities. The SFC and the Police will decide whether to initiate investigations into complaints against individual VATPs and activities on the basis of a basket of factors, including whether there are connections to Hong Kong, whether there are breaches of relevant legislation, the number of people and amount of money involved, etc.

(4) and (5) To further enhance the regulatory framework, the Financial Services and the Treasury Bureau (FSTB) launched on February 8 this year a public consultation (up to April 12) on legislative proposals to introduce a licensing regime for providers of VA over-the-counter (OTC) trading services. The salient legislative proposals include requiring any person who conducts a business in providing services of spot trade of any VA in Hong Kong to be licensed by the Commissioner of Customs and Excise (CCE); covering all VA OTC services (including conversion) in the regulatory scope irrespective of whether the services are provided through a physical outlet and/or other platforms; providing powers for CCE to supervise the AML/CTF conduct of licensees, and enforce the statutory and regulatory requirements under the new regime; and providing transitional arrangement to facilitate the effective implementation of the regulatory regime.

Separately, the FSTB and the HKMA jointly launched a public consultation in December last year (up to February 29 this year) on the regulation of stablecoin issuers. Under the proposed regulatory regime, all fiat-referenced stablecoin (FRS) issuers that meet specified conditions (Note 1) will have to obtain a licence from the HKMA. In addition, only specified licensed entities (Note 2) will be permitted to provide services on purchasing FRS, and only FRS issued by HKMA-licensed entities will be permitted to be sold to retail investors. The proposed regulatory regime will also prohibit the advertising of unlicensed issuers' stablecoin issuance.

Subject to the consultation outcomes and progress of the preparatory work, the Government will submit bills on the above licensing regimes to the Legislative Council as soon as practicable.

(6) As mentioned above, the Government and regulators are committed to enhancing the VA regulatory framework, including the introduction of suitable licensing regimes to ensure that service providers concerned comply with the

requirements on AML/CTF and investor protection.

In fact, Hong Kong is among the first few jurisdictions to have adopted a comprehensive framework to regulate VA activities from an investor protection perspective. For the VATP licensing regime, the SFC takes into account the corporate and management structure of licence applicants, and requires them to have a sound business model and formulate detailed risk management policies as well as other VA admission and anti-market manipulation measures. To enhance investor protection, the SFC has set out detailed requirements in respect of non-professional investors' participation in VA activities. For example, the SFC requires the tokens offered to non-professional investors to be large cap VAs with high liquidity (Note 3), and platform operators to obtain the SFC's prior consent to any plan to admit VA for retail trading. In addition, the SFC has made proactive investor education efforts, disseminating information about VATPs and reminding the public of the risks of trading on unlicensed platforms.

On formulation and implementation of measures concerning VA, the FSTB maintains close communication with regulatory bodies including the SFC, ensuring that market development is taken into account and investor protection is catered for.

Notes:

1. This refers to issuers who (i) issue FRS in Hong Kong; (ii) issue Hong Kong dollar-referenced stablecoin(s); or (iii) actively market their FRS issuance to the public of Hong Kong.
2. This refers to licensed FRS issuers, authorised institutions, licensed corporations and licensed VATPs.
3. Under the SFC's Guidelines for VATP Operators, the VA should have been included in a minimum of two acceptable indices issued by at least two different index providers.