



Secretary's Blog

Letter to forerunners of the virtual asset industry:
Embracing regulation, development, tradition and innovation



Dear forerunners of the virtual asset industry,

The virtual asset (VA) industry has flourished across the globe in recent years, with a substantial increase in market capitalisation as well as a growing number of participating institutions and investors. As an international financial centre, Hong Kong has attracted a wealth of talent and a great many start-ups in the VA sector. VAs and their underlying technologies (including Blockchain) are capable of bringing numerous opportunities for financial innovation. That said,

for this emerging industry, it is important to put in place a comprehensive regulatory system to build up market confidence, and hence provide a pathway to its sustainable development. To this end, the Government and financial regulators have recently rolled out a host of measures to ensure the orderly development and operation of the VA sector and, at the same time, respond to challenges arising from investor protection or money laundering risks. These measures, which have taken into account the latest development and regulatory trends in the international market as well as our local market situation, covers three areas, namely (1) establishing a licensing regime for the VA service providers (VASPs); (2) contemplating the regulation of payment-related “stablecoins”; and (3) providing traditional financial institutions (FIs) with guidelines on offering VA-related services to clients. I am writing this letter to introduce our plan, which embraces regulation, development, tradition and innovation, to you.

One of our regulatory measures is to establish a licensing regime for VASPs in the light of the new requirement imposed by the Financial Action Task Force. Under the licensing regime, which will be implemented through amending the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO) (Cap. 615), all VA exchanges are required to apply for a licence from the Securities and Futures Commission (SFC) before providing services in Hong Kong. Both securities-type VAs and non-securities VAs (such as Bitcoin, which has the highest market capitalisation at present) are subject to the licensing regime. It is our regulatory philosophy that VA exchanges should be subject to the same requirements and obligations which currently apply to traditional FIs in such areas as anti-money laundering and counter-terrorist financing as well as investor protection (such as formulating appropriate policies and measures to guard against market manipulation) to ensure consistency in regulation. Besides, taking into consideration the fact that VA trading is a technology driven industry, requirements will be imposed to address potential risks such as system failures and cyber security.

In drawing up the details of the legislative proposal, we conducted a public consultation between November 2020 and January 2021, with the consultation conclusions released in May 2021. We also briefed the Panel on Financial Affairs of the Legislative Council (LegCo) in February 2022. Based on the views gathered from LegCo and the public consultation, we are preparing legislative amendments with the aim of introducing an amendment bill to LegCo

later this year. Those who are interested may refer to the paper¹ we submitted to LegCo, which is a good starting point for getting to understand the proposal.

In addition to the licensing regime for VASPs, we are also contemplating the need to introduce another regulatory regime for “stablecoins” as the nature of this particular type of VA makes it more likely to be used for payment purposes, and hence may pose risks different from those associated with other VAs, such as whether there is a robust mechanism for supporting its value, or the impact on real economic activities in case of disruption of its payment function. In this connection, the Hong Kong Monetary Authority (HKMA) initiated in January 2022 a consultation exercise to seek views from members of the sector and the public so as to get a preliminary idea of how payment-related “stablecoins” should be regulated. I encourage all of you, members of the VA sector, to read the HKMA’s white paper² and share with us your views on the matter.

Lastly, while we are considering the introduction of a new regulatory regime for VAs, financial regulators have been issuing guidelines and regulatory advice on VA-related matters. The latest circular, which was issued in January 2022 by the SFC and HKMA³, sets out regulatory guidelines for traditional financial intermediaries and banks to follow when they are (1) distributing VA-related products; (2) providing VA dealing services; and (3) providing VA advisory services to clients. The guidelines provides further explanation on issues that have long been the sector’s concerns. For instance, a few VA-related derivative products⁴ are traded on regulated exchanges specified by the SFC. Since such trading is governed by conventional rules and hence may be less of a concern in terms of regulation, for example on pricing transparency and potential market manipulation, it is not necessary to impose the “professional investors only” restriction on the distribution of such products as long as existing rules are observed and additional safeguards are in place. The latest circular helps FIs handle the growing number of enquiries on VAs from investors and facilitates their provision of VA-related services under a sound regulatory system and in the best interests of their clients.

Over the past few months, my colleagues and I have had opportunities to talk to quite a number of members of the VA sector, whether during the FinTech Week or on other occasions. I am pleased to learn from these discussions that the

¹ <https://www.legco.gov.hk/yr2022/english/panels/fa/papers/fa20220207cb1-32-2-e.pdf>

² <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2022/20220112e3a1.pdf>

³ <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/suitability/doc?refNo=22EC10> and <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e3.pdf>

⁴ These VA-related derivative products are authorised or approved for offering to retail investors by the respective regulator in a designated jurisdiction

VA sector in general shares our view that, to foster a suitable and transparent regulatory environment conducive to the orderly development of the sector, there is a need for Hong Kong to implement appropriate measures to regulate VA-related services. In fact, the Government and the regulators are all working on the basis of this principle.

Looking ahead, while amendments to the AMLO will provide a solid legislative framework for regulation of the VA sector, there is still much to be done having regard to the evolving landscape of the sector. In this connection, I would like to invite all of you to ride on the trend of application of technology in financial services in the post-pandemic era and, by leveraging Hong Kong's advantages as an international financial centre, and the soon-to-be-established comprehensive regulatory system, develop and expand your innovative VA businesses in this market, which embraces regulation, development, tradition and innovation.

Christopher Hui
Secretary for Financial Services and the Treasury

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