

# Charting a Regulatory Roadmap for Hong Kong's Virtual Asset Market

## Keynote Address at Hong Kong FinTech Week 2024

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Honourable guests, ladies and gentlemen, good morning. It's my pleasure to be here at FinTech Week.

I may have joined the Securities and Futures Commission (SFC) for only five months, but I have attended quite a number of regulatory events. At all these events, a recurring topic that has stood out is virtual assets. Virtual assets are at the forefront of every financial regulator's agenda, including the SFC's. The market already trading in sizeable volumes is too big to ignore. This also means a large number of investors out there need to be protected through regulation and education. At the same time, we have seen genuine momentum for innovation, and the vast potential of distributed ledger technology (DLT) is waiting to be unleashed. Today, the Hong Kong Fintech Week is a timely occasion for me to share with you the SFC's virtual asset journey and our plans ahead.

### Virtual asset market development in Hong Kong

So, what has driven the progress of the virtual asset market? Let me highlight three key factors. First, a pool of brilliant minds and talents has clearly backed the industry's rise. Second, it's the substantial economics generated in the industry. Third, the younger demographic. Research has shown the average age of individuals trading stocks is over 40, while those trading cryptos are much younger, mainly in their 20s.

Our attempt to regulate this emerging market is no easy task, as we are competing against a huge existing marketplace that is technologically advanced, borderless, and loosely-regulated. We have seen big uptake and volatility in virtual assets, and we have also seen frauds as well as corporate meltdowns.

We do see two evolving trends working in our favour. First, as much revenue is being generated and the investment community is growing in size, virtual asset practitioners are receiving increasing scrutiny from law enforcement agencies and regulators globally. Many jurisdictions have taken tougher legal actions, with some becoming rather litigious, as fines and even imprisonment in severe cases have been imposed. Many players who used to benefit in an unregulated market now start to take a step back, as they have to choose between running a legitimate, sustainable operation and being a fugitive constantly on the run.

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Note: This is the text of the speech as drafted, which may differ from the delivered version.



The second trend in our favour is the gradual convergence between traditional finance (Tradfi) and Web3. The growing participation of Tradfi in the virtual asset space brings along valuable compliance concepts in areas such as anti-money laundering (AML), conflicts of interest, client suitability, safe custody of assets, to name a few.

At the SFC, we believe the future of virtual assets lies in a regulated marketplace that balances its development with investor protection. We do not need to reinvent too many wheels in this regard, as our experience in securities regulation lays a strong foundation. The core principle underlying our virtual asset regulation is “same business, same risks, same rules”, which is the pillar for a resilient financial market.

At the same time, as I shared at a major regulatory forum recently, we need to keep ourselves on our toes as a regulator. If virtual asset liquidity still resides in unregulated venues after all our efforts, and regulated entities cannot operate a sustainable business model, then we need to reflect on why investors don’t pick our state-of-the-art regulatory framework. In short, we need to listen to the market, and balance between regulatory perfection and market development.

### **Initiatives driving growth of Hong Kong virtual asset market**

In Hong Kong, we are off to a good start. Not only are we at the global forefront in terms of virtual asset regulation, but we are also witnessing the largest year-on-year growth in virtual asset transaction volumes from 2023 to 2024. Perhaps this is one of the reasons why we have received so many enquiries from local and global players on our licensing regime for virtual asset trading platforms or VATPs. Let me jump straight into talking about our most frequently asked question: what is the current progress on licensing VATPs?

#### Swift licensing process

In short, I would say this is progressing well. Three VATPs are currently licensed, and we are processing the applications from another 14. Our key regulatory focus this year is on those applicants “deemed to be licensed” starting 1 June 2024 under the new licensing regime. There are 11 so-called “deemed” applicants with pre-existing business in Hong Kong, and we are adopting a swift approach. Instead of going through a document-based vetting process, we have conducted risk-based on-site inspections on all 11 applicants, to assess critical areas such as safe keeping of client virtual assets, cybersecurity and their processes for AML and KYC.

In only five months, we have completed all the on-site inspections and provided feedback to the applicants. During the inspection, the SFC has been able to learn about these firms’ state of compliance first-hand, and directly engage with their personnel and, more importantly, their ultimate controllers to facilitate their understanding of our expectations. The applicants and their controllers have by and large taken up our feedback, and they are willing to commit resources to rectifying issues and take a long-term view in developing their business in a regulated environment. This gives us comfort and confidence in the market’s long-term success.

We are now taking a three-pronged approach for processing our licence applications. Step one: the applicants have to agree with us on rectification actions after they receive our on-site inspection feedback. Step two: the SFC will grant licences to these applicants and at the



same time allow them to operate on a restricted scope after rectification. As things currently stand, we are on track to license a few deemed applicants by the end of this year, so that they can commence business shortly afterwards. Step three: we will join forces with licensed VATPs to strengthen their robustness through an external, third-party review. Once this review is completed, the platform can operate with the scope restriction lifted.

#### Consultative panel for virtual asset trading platforms

However, licensing is only the beginning of our work, not the end. With more platforms regulated in Hong Kong, it is necessary for us to consider a sustainable business environment as we balance our regulatory priorities. Therefore, the SFC will establish an official consultative panel in early 2025 for all licensed platforms. Each and every licensee will be represented by members of their senior management, so all their voices will be heard and considered. This will enable us to systematically and collectively prioritise developments which are backed by investor safeguards.

We trust the consultative panel will foster a sense of community, transparency and shared responsibility amongst the participants. We expect the panel's deliberation will result in a comprehensive virtual asset white paper that outlines the development roadmap for products and services, as well as potential enhancements in compliance and risk management.

#### Further regulatory building blocks for virtual assets

Next is our work to piece the rest of the regulatory regime puzzle. To establish a comprehensive framework for virtual assets, we should make reference to how trading, settlement and custody work in the securities market. The objective is to facilitate liquidity aggregation for the purpose of effective price formation and orderly risk transfer.

The SFC has been actively reaching out to the virtual asset community to understand the business models of asset managers, market makers, broker dealers and traders as well as the operation flow for efficient and AML-compliant on- and off-ramping. Our objective is to understand the type of market structure enhancements necessary to encourage more diverse trading activities. It is also important to understand how third-party custodians can better support the virtual asset community in areas such as secured safeguard of assets and on-chain transfers.

While we are trying to leverage our existing regulatory framework to the extent possible, we are also supporting the Hong Kong Government to determine further legislative framework for virtual asset trading and custody, and will conduct necessary public consultations to introduce new licensing regimes. Some of these initiatives have already been mentioned in our Chief Executive's 2024 Policy Address. Needless to say, these efforts will be highly coordinated between the Government and the relevant regulators as we need to ensure our regulatory regime is holistic and consistent to guard against potential regulatory arbitrage and to safeguard Hong Kong's status as an international finance centre.

#### Tokenisation, Project Ensemble and stablecoins

Now, from virtual assets to tokenisation of real-world assets. Following the issuance of the circulars of tokenisation last year and with the launch of Project Ensemble earlier this year, we have seen the SFC's efforts in tokenisation coming into fruition. As a core member of the



Architecture Community of Hong Kong Monetary Authority's (HKMA) Project Ensemble, the SFC co-leads the tokenisation initiatives for the asset management industry with the HKMA.

Project Ensemble is a key milestone on our tokenisation journey, which would bring about a unified standard for settling tokenised asset transactions. The participating financial institutions have proposed a vast number of innovative use cases to achieve scale and interoperability within the Hong Kong market. For example, a local bank has successfully tested the use of tokenised deposits in the Project Ensemble Sandbox to subscribe and redeem tokenised Money Market Funds for its institutional customers. I am sure you will hear more exciting news in the Fintech Week.

I am also particularly excited by the fiat-referenced stablecoin regime to be implemented by the HKMA, and we will likely see regulated stablecoins available for public usage in as early as 2025. In order to unleash the true benefits of settlement certainty and efficiency, it is equally important for us to consider how virtual assets traded on VATPs can interact with regulated stablecoins.

### Investor protection

Lastly, let me say a few words on the SFC's core mission to protect the interests of investors.

Given the borderless nature of virtual assets and their appeal to the younger generation, the potential harms to investors have taken on new forms. As such, we must upskill ourselves in technical areas such as cybersecurity, cryptography and wallet tracing solutions. Moreover, we must acknowledge the power of today's social media, as the means of engaging with the investing public have largely become digital.

To navigate these changes, we have enhanced our investor protection efforts through more visible and proactive alert systems. This is done through establishing robust monitoring and surveillance, and we have continuously stepped up collaboration with various law enforcement agencies.

A key area of investor protection is education, and the SFC has adopted a multitude of tools to educate investors on virtual assets. We have stepped up our information dissemination to ensure investors receive timely information. We maintain and update an easily accessible list of suspicious and unregulated platforms on our website to keep investors on guard and scam-savvy. To widen our reach, the SFC has launched a comprehensive publicity campaign encompassing TV drama series and commercial, bus advertisements and online promotions to enhance public awareness towards dubious platforms and investment scams.

### International collaboration

A state-of-the-art regulatory framework would not work without international collaboration. This is particularly important to prevent market players from engaging in regulatory arbitrage. To this end, the SFC will continue its close collaboration with overseas regulators, to monitor virtual asset trends and share experience and intelligence. The SFC will continue to play a leadership role in driving deliberations and alignments in the International Organization of Securities Commissions and other international contexts, as well as strengthen bilateral interactions with our peer regulators.



## Conclusion

To wrap this up, let me cite a famous quote: history doesn't repeat itself but it often rhymes. Virtual asset market today is just like the securities market a century ago: as something new develops, there are always the believers and the sceptics; the visionaries and the naysayers. With every setback, there's always progress. But one thing remains constant – during this evolution, the market always gravitates towards those that pass the test of resilience. See what we have achieved: we have developed Hong Kong from a fishing village to a world-leading financial centre, and I like our odds in doing the same for the virtual asset market.

This week at the Hong Kong Fintech Week, we have over 30,000 global attendees from over 100 economies, with a few hundred world-class speakers. We have a lot of exciting issues on hand, and we need your collective wisdom to progress and to protect. The SFC will continue to adopt a pragmatic and proactive approach in building and advancing a holistic regulatory framework, to strike a balance between market development and investor protection.

I wish the Hong Kong FinTech Week 2024 another huge success. Thank you.