

# Legal Update

## Regulatory Approach to Digital Assets in Hong Kong and Singapore

### Overview

Due to the growing popularity of digital assets, governments and regulators have had to examine their legal and regulatory frameworks to develop new laws to regulate market activities relating to this asset class, including and not limited to the management of fraud, market manipulation and anti-money laundering and counter-financing of terrorism (AML/CFT) risks presented by anonymized digital asset activities.

Unsurprisingly, digital assets were the focus of various announcements issued during Hong Kong's and Singapore's respective Fintech Week events held in early November 2022. This Legal Update provides an overview of the key developments in the evolution of the current approach to the regulation of digital assets in both jurisdictions, in particular:

- the definition of digital assets;
- evolution of the current regulatory framework in Hong Kong;
- evolution of the current regulatory framework in Singapore; and
- upcoming legislation and consultations in both jurisdictions.

### Definition of Digital Assets

There is no universal definition of digital assets. Digital assets are generally understood to refer to assets of value that exist in digital form such as cryptocurrencies and non-fungible tokens (NFTs). The definitions used in Hong Kong and Singapore are explained below.

Hong Kong's upcoming legislation to regulate digital assets (covered in this [Legal Update](#)) contains a broad definition of the term 'virtual asset (VA)'. In summary, a VA is defined as a cryptographically secured digital representation of value that:

- i. is expressed as a unit of account or a store of economic value;
- ii. either –
  - a. is used, or is intended to be used, as a medium of exchange accepted by the public, for any one or more of the following purposes: payment for goods or services; discharge of a debt; investment; or
  - b. provides rights, eligibility or access to vote on the management, administration or governance of the affairs in connection with, or to vote on any change of the terms of any arrangement applicable to, any cryptographically secured digital representation of value;

- iii. can be transferred, stored or traded electronically; and
- iv. satisfies other characteristics prescribed by the Securities and Futures Commission (SFC).

The definition of a VA is further qualified by the following:

- The following digital representations of value are *excluded* from the definition of a VA:
  - issued by a central bank, or a government or an entity authorised by a government of a jurisdiction to issue currency in that jurisdiction;
  - limited purpose digital tokens;
  - constitutes a securities and futures contract;
  - constitutes any float or stored value deposit under the *Payment Systems and Stored Value Facilities Ordinance (Cap. 584)*.
- New characteristics necessary for a digital representation of value to be a VA, or which precludes a digital representation of value from being a VA, may be prescribed by the SFC in the Gazette.
- The Secretary for Financial Services and the Treasury may prescribe any digital representation of value to be a VA, or to exclude it as a VA, by notice in the Gazette.<sup>1</sup>

In contrast, Singapore legislation uses the term 'digital payment token (DPT)' and the broader term, 'digital token (DT)'.

- A DPT is defined in the Payment Services Act 2019 (PSA 2019), section 2(1), as a digital representation of value (other than an excluded digital representation of value) that – (a) is expressed as a unit; (b) is not denominated in any currency, and is not pegged by its issuer to any currency; (c) is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; (d) can be transferred, stored or traded electronically.<sup>2</sup>
- A DT is defined in the Financial Services and Markets Act 2022, section 136(1), as a DPT or a digital representation of a capital markets product which can be transferred, stored or traded electronically, and satisfies such other characteristics as the Monetary Authority of Singapore (MAS) may prescribe.

## Evolution of the Current Regulatory Framework in Hong Kong

The regulators in Hong Kong for securities and banking activities are the SFC and the Hong Kong Monetary Authority (HKMA) respectively. Their regulatory philosophy is technology neutral, and they aim to evolve their regulatory framework around the products and usage in the market, and to meet international standards. At Hong Kong Fintech Week 2022, the [SFC's Deputy Chief Executive Officer, Ms Julia Leung](#), stressed that the SFC takes a 'same business, same risk, same rules' approach.

The new regulatory framework for VAs in the upcoming amendments to the *Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615)* (AMLO) is outlined in this [Legal Update](#). In summary, the new framework introduces a licensing regime for VA service providers and requires them to implement anti-money laundering and other risk management controls that apply to traditional financial institutions. In addition, on 31 October 2022, the SFC issued a

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<sup>1</sup> Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, section 53ZRA(4), available at <https://www.legco.gov.hk/yr2022/english/bills/b202206241.pdf>.

<sup>2</sup> Payment Services Act 2019, section 2(1), available at <https://sso.agc.gov.sg/Acts-Supp/2-2019/Published/20190220?DocDate=20190220>.

circular on VA futures exchange traded funds. A summary of this circular is covered in this [Legal Update](#).

## WHAT WERE THE DEVELOPMENTS BEFORE 2022?

Hong Kong regulators tend to adopt a risk-based approach, prioritizing regulation of products and activities which have significant impacts on investors, the financial stability of the entire market, and the status of Hong Kong as an international financial centre. VAs have received regulatory attention in Hong Kong since 2017, when the SFC first published a statement on the use of initial coin offerings to raise funds.<sup>3</sup> Since then, there have been several key milestones leading to the current regulatory framework:

- *1 November 2018*: The SFC published a circular to intermediaries on the distribution of VA funds, which introduced the opt-in regime for VA trading platforms and imposed selling restrictions of VAs strictly to professional investors (PI) (2018 SFC Circular).<sup>4</sup>
- *6 November 2019*: The SFC published a position paper on the regulation of VA trading platforms, which implemented a regulatory framework for platforms trading at least one security token.<sup>5</sup>

A major update was issued by SFC and the HKMA on 28 January 2022, in a joint circular on intermediaries' VA-related activities (Joint Circular), which supersedes the 2018 SFC Circular. The 2022 circular provides important updates in three areas on the application of existing regimes and requirements on financial institutions providing VA-related products or services.<sup>6</sup>

- *Distribution of VA-related products*: Financial institutions should comply with SFC requirements on the sale of complex products, including to ensure product suitability, provide sufficient key information, and provide clear and prominent warning statements. This is based on the SFC's view that VA-related products are complex products (except for VA-related derivative exchange-traded funds), as the risks associated with such products are not reasonably likely to be understood by retail investors.
- *Provision of VA dealing services*: Financial institutions should only provide such services to existing PI clients for which they have carried out Type 1 (dealing in securities) regulated activities, and must only partner with SFC-licensed VA trading platforms.
- *Provision of VA advisory services*: Financial institutions should only provide such services to existing PI clients for which they have carried out Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities. Financial institutions must also adhere to the terms and conditions set out in Appendix 6 of the Joint Circular, in particular, to ensure product suitability.<sup>7</sup>

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<sup>3</sup> Securities and Futures Commission, *Statement on Initial Coin Offerings* (5 September 2017), available at <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-initial-coin-offerings>.

<sup>4</sup> Securities and Futures Commission, *Circular to Intermediaries: Distribution of Virtual Asset Funds* (1 November 2018, available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/intermediaries/supervision/doc?refNo=18EC77>).

<sup>5</sup> Securities and Futures Commission, *Position Paper: Regulation of Virtual Asset Trading Platforms* (6 November 2019), available at <https://www.sfc.hk/-/media/EN/files/ER/PDF/20191106-Position-Paper-and-Appendix-1-to-Position-Paper-Eng.pdf>.

<sup>6</sup> Securities and Futures Commission and Hong Kong Monetary Authority, *Joint Circular on Intermediaries' Virtual Asset-Related Activities* (28 January 2022), available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/intermediaries/supervision/doc?refNo=22EC10>.

<sup>7</sup> Appendix 6 to the *Joint Circular on Intermediaries' Virtual Asset-Related Activities*, "Licensing or Registration Conditions and Terms and Conditions for Licensed Corporations or Registered Institutions Providing Virtual Asset Dealing Services and Virtual Asset Advisory Services", available at <https://apps.sfc.hk/edistributionWeb/api/circular/openAppendix?lang=EN&refNo=22EC10&appendix=0>.

On 28 January 2022, the HKMA also published a circular on the regulatory approaches to banks' interface with VAs and VA service providers (VASPs).<sup>8</sup> The HKMA repeated its risk-based approach to supervising VA activities in line with applicable international standards, focusing on three areas:

- *Prudential supervision*: banks are expected to conduct proper due diligence of the VAs to which they may incur financial exposures, critically evaluate their exposure to different types of risks, and implement corresponding risk-mitigation measures.
- *Anti-money laundering (AML), counter-terrorist financing (CFT) and financial crime risk*: banks should implement effective AML and CFT policies, procedures and controls, in relation to both (i) client bank accounts, including to file suspicious transaction reports to the Joint Financial Intelligence Unit; and (ii) banking relationships with VASPs, including to conduct appropriate money-laundering or terrorist financing risk assessments.
- *Investor protection*: banks should implement appropriate investor protection measures for VA-related products, as they are very likely to be considered as complex products.

From these measures, it can be seen that Hong Kong regulators have deployed existing regulatory regimes and instruments to address the regulatory gaps posed by VAs on an incremental basis as the industry has developed. This approach is also evident in the new regulatory framework for VAs which will allow the SFC to update the definition of a VA, and allow the Hong Kong government to include or exclude digital representations for value, either generally or in a particular case, as a VA, through notices in the Gazette. Finally, on 31 October 2022, the Hong Kong government issued a Policy Statement on the Development of Virtual Assets in Hong Kong, available [here](#).

## Evolution of the Current Regulatory Framework in Singapore

Similar to Hong Kong, the Monetary Authority of Singapore (MAS) first cautioned the public about the risks of investments in cryptocurrencies in 2017.<sup>9</sup> In the early years, Singapore was described by some in the market as a 'crypto paradise'. However, following stricter measures imposed in recent months on the digital assets sector, it has been lamented that the MAS has made a 'u-turn' in its policies.

Singapore's approach to digital assets is succinctly expressed in the title of a recent speech by MAS Managing Director, Mr Ravi Menon: '[Yes to Digital Asset Innovation, no to Cryptocurrency Speculation](#)'. In summary, the regulatory approach of Singapore has evolved around the concept of DPTs as part of the payment services landscape, and subsequently, DTs broader uses. Strong investor protection requirements apply to DPT services offered within Singapore. Companies based in Singapore that offer services outside of Singapore are also subject to a level of regulatory oversight by the MAS, particularly on AML/CFT requirements.

These regulatory developments began with the *Payment Services Act (No. 2 of 2019)* (PSA) which set up a new licensing framework for payment service providers, including DPT services, and introduced the legal definition for DPT (as mentioned above).<sup>10</sup> Two years later, the *Payment*

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<sup>8</sup> Hong Kong Monetary Authority, *Regulatory Approaches to Authorized Institutions' Interface with Virtual Assets and Virtual Asset Service Providers* (28 January 2022), available at <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e3.pdf>.

<sup>9</sup> Monetary Authority of Singapore, *MAS Cautions against Investments in Cryptocurrencies* (19 December 2019), available at <https://www.mas.gov.sg/news/media-releases/2017/mas-cautions-against-investments-in-cryptocurrencies>.

<sup>10</sup> Payment Services Act 2019, available at <https://sso.agc.gov.sg/Acts-Supp/2-2019/Published/20190220?DocDate=20190220>.

*Services (Amendment) Act 2021* made a number of key amendments to the PSA,<sup>11</sup> including the following:

- expanding the definition of DPT services to include the transfer of DPTs, the provision of custodial wallet services for DPTs, and the exchange of DPTs by DPT service providers without possession of money or DPTs;
- regulating the provision of DPT services through a licensing regime and requiring DPT service providers to adhere to AML and CFT regulations in Singapore; and
- empowering the MAS to impose user protection measures on DPT service providers, and measures on certain DPT service providers which are necessary or expedient in the interests of the public, the stability of the financial system in Singapore, or the monetary policy of the MAS.

Next, the *Financial Services and Markets Act 2022* expanded the scope of MAS regulatory powers over DT service providers and the statute includes the following measures:<sup>12</sup>

- regulating all DT service providers with a place of business in Singapore that provide DT services outside Singapore as a new class of financial institutions, with independent licensing and ongoing requirements to ensure adequate supervision by the MAS; and
- introducing MAS regulatory powers to conduct AML or CFT inspections on such service providers, and to render assistance to domestic authorities and foreign counterparts.

In addition, the MAS issued the following guidance to the industry.

- *A Guide to Digital Token Offerings*, last updated in May 2020, stating that the MAS may regulate any offer or issue of DPTs which constitute capital markets products under the *Securities and Futures Act 2001*.<sup>13</sup> In particular, if an offer of DPTs relates to a collective investment scheme, such offer must be accompanied by a prospectus, and must comply with the relevant investment restrictions and business conduct requirements.<sup>14</sup> Further, this guide emphasizes that all persons have obligations to report suspicious transactions under AML regulations, and must not serve individuals and entities designated under CFT regulations.
- *Guidelines on Provision of Digital Payment Token Services to the Public*, issued in January 2022. These guidelines prohibit DPT service providers from promoting their services in public areas, including putting up advertisements, and relying on third parties to promote their services to the general public. However, DPT services may be promoted through their own media platforms.<sup>15</sup>

In summary, Singapore has created a robust, standalone regulatory framework for the provision of payment services in Singapore of which DPTs form a part. Nonetheless, given the cross-border nature of digital assets, Singapore has also imposed basic regulatory requirements on DT service

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<sup>11</sup> Payment Services (Amendment) Act 2021, available at <https://sso.agc.gov.sg/Acts-Supp/1-2021/Published/20210301?DocDate=20210301>.

<sup>12</sup> Financial Services and Markets Act 2022, available at <https://sso.agc.gov.sg/Acts-Supp/18-2022/Published/20220511?DocDate=20220511>.

<sup>13</sup> Monetary Authority of Singapore, *A Guide to Digital Token Offerings* (updated 26 May 2020), available at <https://www.mas.gov.sg/-/media/MAS/Sectors/Guidance/Guide-to-Digital-Token-Offerings-26-May-2020.pdf>.

<sup>14</sup> *A Guide to Digital Token Offerings* (updated 26 May 2020), paragraphs 2.5 and 2.6, available at <https://www.mas.gov.sg/-/media/MAS/Sectors/Guidance/Guide-to-Digital-Token-Offerings-26-May-2020.pdf>.

<sup>15</sup> Monetary Authority of Singapore, *Guidelines on Provision of Digital Payment Token Services to the Public* (17 January 2022), available at <https://www.mas.gov.sg/-/media/MAS-Media-Library/regulation/guidelines/PSO/ps-g02-guidelines-on-provision-of-digital-payment-token-services-to-the-public/Guidelines-on-Provision-of-Digital-Payment-Token-Services-to-the-Public-PS-G02.pdf>.

providers operating in Singapore that provide services entirely outside of Singapore, to protect Singapore's reputation as a global financial centre.

## Upcoming Legislation and Consultations

In Hong Kong, the *Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022* (the "Bill") is currently going through the legislative process. As mentioned above, it will introduce a new VASP licensing regime expected to take effect in 2023.<sup>16</sup> The SFC is currently carrying out a soft consultation on whether retail investors should be allowed to trade VA. In addition, the SFC will consult the public on the detailed requirements of the new regime after the passage of the amendment bill.

In Singapore, the MAS issued two consultation papers related to digital assets on 26 October 2022:

- [Consultation paper on proposed regulatory measures for DPT services](#); and
- [Consultation paper on proposed regulatory approach for stablecoin-related activities](#).

The DPT services consultation paper focuses on consumer access measures, business conduct measures, managing technology and cyber risks, and market integrity. On consumer access, it is worth noting that the MAS is not proposing a ban against offering cryptocurrency services to retail customers. Instead, the MAS is considering the use of targeted regulatory measures, including limiting consumer access and improving business conduct, to address the risks posed to retail customers. The MAS has proposed issuing guidelines on these topics with a six to nine month transition period as a first step, before introducing more detailed regulatory requirements and subsidiary legislation that will also receive public consultation.

The stablecoin consultation paper builds upon an [earlier MAS consultation paper on the scope of e-money and DPT dated 23 December 2019](#). In the latest consultation paper, the MAS noted that stablecoins have the potential to perform the role of a credible digital medium of exchange if it is well-regulated and backed by arrangements with a high degree of assurance of value stability. As such, the MAS plans to develop a specific and more comprehensive regime for stablecoins which are currently classified as DPTs under the PSA.

Both MAS consultation papers are open for responses until 21 December 2022.

## Conclusion

Hong Kong and Singapore have sought to balance the risks associated with digital assets with their ambitions of becoming responsible global fintech hubs. However, the two jurisdictions have taken somewhat different approaches in their regulatory architecture.

In Hong Kong, the regulators have relied on existing regulatory frameworks to regulate VASPs as a whole, primarily through AMLO (for VAs) and the Securities and Futures Ordinance (Cap. 571) (for securities and futures contracts). In contrast, Singapore created a new regulatory framework for payment services which include DPTs, and is taking steps to create a new regulatory regime for stablecoins. Singapore's regulatory regimes are therefore more closely linked to the intended purpose or use of digital assets. Some commentators argue that this approach is more flexible as it allows the regulator to introduce more targeted and comprehensive regulations that are

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<sup>16</sup> Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, available at <https://www.legco.gov.hk/yr2022/english/bills/b202206241.pdf>.

appropriate for the activity under regulation, in line with the fact that digital assets and distributed ledger technology can be used in a variety of contexts, even within a single industry.

Discussions on retail investor access to VA-related products and services in both jurisdictions have received significant attention following the recent Hong Kong and Singapore Fintech Week events. This is as it should be, given the personal impact of such regulations on investors and the importance of financial inclusion across different demographics. Instead of drawing the line at PI versus retail investors which has been the norm in the financial regulations of both jurisdictions, it may be time to consider allowing retail investor access based on an assessment of the individual's knowledge of the risks of trading digital assets. After all, the size of an individual's net worth may not be indicative of an individual's financial literacy. In an interesting development, the MAS' latest DPT consultation paper mentions this option and seeks the industry's engagement to develop a common assessment template.

Finally, while there has been a lot of hype over the recent 'pro-crypto' comments by Hong Kong authorities<sup>17</sup> and the 'anti-crypto' comments by Singapore authorities, this is ultimately still a developing area. It remains to be seen whether and to what extent the position between the two jurisdictions will diverge in this area in upcoming legislation.

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<sup>17</sup> Notably, the SFC has, over the years, issued various reminders to investors about the risks associated with digital assets. The latest reminder concerns the risks associated with non-fungible tokens issued on 6 June 2022, available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=22PR34>.

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