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Opinion | Hong Kong's Response to Virtual Asset Activity Restrictions Loosens

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As a renowned global financial hub, Hong Kong has long been a magnet for international capital and investors, thanks to its open and diverse market landscape. In December 2023, the Hong Kong Securities and Futures Commission, along with the Monetary Authority, issued a "Joint Circular on Intermediaries' Virtual Asset-Related Activities." However, the stringent policies targeting mainland residents' participation in virtual asset activities have stirred significant controversy and discontent, potentially jeopardizing Hong Kong's standing as an international financial centre.

With an anticipated increase in the issuance of virtual asset exchange licenses, new entrants are likely to struggle in the current market environment, which poses challenges for overall market growth.

The ramifications of these restrictive policies in Hong Kong are primarily evident in the following areas:

Capital Flight and Competitiveness Decline

The exclusivity and perceived unfairness of the policies may exclude substantial capital reserves and potential investors from mainland China, causing these funds to flow toward more accessible markets, such as the United States. Notably, during the 2024 presidential campaign, the U.S. former president/president-elect Trump shifted from a previously adversarial stance on cryptocurrencies to a more favourable one, advocating for reduced regulations. This pivot could significantly bolster the U.S.'s competitiveness in virtual asset trading, attracting additional international and mainland Chinese capital, thereby further diminishing Hong Kong's international financial stature.

Lost Market Opportunities

The growing significance of virtual assets in the global financial landscape is undeniable. If Hong Kong fails to promptly revise its policies to align with market dynamics, it risks losing its competitive edge in this burgeoning sector. In contrast, other financial hubs such as New York, London, and Singapore, which maintain relatively open regulatory frameworks, are likely to draw more investments and innovative firms, solidifying their positions in the global financial ecosystem. Indeed, several virtual asset platforms originally based in Hong Kong have already relocated their headquarters to Singapore.

Regulatory Challenges and Innovation Deficit

While Hong Kong's existing regulatory framework for virtual assets aims to ensure market stability and protect investors, its conventional regulatory approach appears out of touch and insufficient to keep pace with the rapid innovations and shifts within the emerging virtual asset sector. Some of the world's leading virtual asset exchanges have withdrawn their license applications in Hong Kong due to excessively stringent regulations, highlighting the region's struggle to foster innovation and adapt to market evolution.

Complex Regulatory Structure and Compliance Burden

Furthermore, Hong Kong's intricate regulatory framework exacerbates the compliance challenges and operational costs for businesses. The oversight of various virtual asset enterprises involves multiple agencies, including the Securities and Futures Commission, the Monetary Authority, and customs authorities. This lack of coordination leads to inconsistent regulatory standards, complicating compliance for enterprises.

To bolster Hong Kong's competitiveness in the virtual asset domain and uphold its status as an international financial centre, the following measures should be considered:

1. Relax Participation Restrictions for Mainland Residents

By permitting greater participation from mainland Chinese residents in Hong Kong's virtual asset market, substantial capital and technological resources can be introduced, invigorating market vitality and liquidity, thereby enhancing Hong Kong's financial influence. A recent ruling by Shanghai's Songjiang District People's Court^[1], declaring the legality of holding virtual currency, supports the idea of allowing domestic investments in Hong Kong's virtual asset-related products, such as ETFs, within a closed-loop framework.

2. Enhance the Regulatory Framework

Evaluate and refine the regulatory system to better accommodate the distinct operational models and rapid developments of the virtual asset industry. This could involve adopting more flexible and innovative regulatory approaches that alleviate unnecessary compliance burdens while maintaining robust risk management.

3. Streamline Licensing Procedures

Expedite the licensing process for virtual asset platforms by establishing a clear timeline, industry-standard requirements, and transparent application procedures, thereby attracting more international players. Implementing an electronic application system and increasing the number of competent approval personnel could facilitate this process.

4. Create a Unified Regulatory Authority

Explore the establishment of a centralized regulatory committee for virtual assets to oversee coordination among the various regulatory bodies, ensuring consistency and efficiency in regulatory standards, ultimately reducing compliance costs for businesses.

5. Enhance Collaboration with Mainland China

The Hong Kong SAR Government should collaborate closely with relevant mainland regulatory bodies to develop a coordinated virtual asset regulatory mechanism, fostering connectivity between both markets and enabling two-way capital flows.

6. Incorporate Industry Expertise

Integrate more industry expertise into the regulatory process by involving specialists in regulation and approval tasks. This ensures that the regulatory framework remains aligned with industry standards and practices. Additionally, fostering the development of new products, like Real World Assets (RWAs), could be beneficial. For instance, in line with the policy address aimed at establishing gold warehouses and related trading facilities, gold RWAs could be developed as a virtual asset.

By implementing these initiatives, Hong Kong can navigate current challenges and sustain its competitiveness in the global virtual asset market. A collaborative effort between the government and the industry is essential to affirming Hong Kong's leadership in the international financial sphere, fostering sustainable growth in the virtual asset sector, enhancing its market appeal, and serving as a pivotal gateway for the country's integration into global virtual asset developments.

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[1] Shanghai's Songjiang District People's Court : 上海市松江区人民法院 : (2023) 沪0117民初4241号

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