

BY EMAIL

**Securities and Futures Commission**

54/F, One Island East  
18 Westlands Road, Quarry Bay  
Hong Kong

27 March 2023

Dear Sir/ Madam

**Re: Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators licensed by the Securities and Futures Commission (the “Consultation Paper”)**

Hong Kong Digital Asset Ex Limited (“HKbitEX” or the “Company”) welcomes the opportunity to comment on the Consultation Paper.

As an overarching comment, the Company is excited to see that retail investors are proposed to be included in a regulated VA trading space as in traditional finance under the “same business, same risk, same rules” principle. We are also pleased to see that certain requirements in the prevailing VATP Terms and Conditions are proposed to be removed or modified in the new VATP Guidelines that will apply to all VATPs, whether licensed under the SFO or the AMLO going forward.

We set out below our response to the consultation questions in the order as they appear in the Consultation Paper.

- 1. Do you agree that licensed platform operators should be allowed to provide their services to retail investors, subject to the robust investor protection measures proposed? Please explain your views.**

The Company welcomes the proposal to allow retail investors to access services provided by VATPs. With all the proposed robust investor protection measures in place, we consider that a broader range of products than proposed should be allowed to be provided to retail investors.

- 2. Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria?**

We recap our response to the soft consultation that we are concerned that the 10 plus eligible large-cap VAs would not satisfy retail appetite. To increase investor choices, we urge the SFC to further open up the product range accessible by retail investors and benchmark other recognised jurisdictions like USA, UK, Japan and Singapore in this regard.

With respect to the proposed criteria, the Company would like to provide our comments in the following areas.

- 2.1 S.43 states that eligible large-cap VAs refer to VAs which are included in at least two “acceptable indices” issued by at least two independent index providers. S.45 further states that “among the two indices, licensed platform operators should ensure that at least one of them is issued by an index provider which has experience in publishing indices for the traditional non-VA financial market. An example of such an index provider is one which has issued an index tracked by an SFC-authorised index fund.”

The Company suggests the SFC to adopt a criteria-based cum list-based definition of acceptable indices; i.e. an inexhaustive list of indices that would be considered by the SFC to be “acceptable indices” to be included in the definition.

Considering that the SFC proposes, in S.50, to allow non-categorised virtual assets to be made available for retail trading on a case-by-case basis upon the proposal of a licensed VATP, we assume that a list of such non-categorised virtual assets accessible to retail investors will be published by the SFC in the interests of transparency (please see our further comments in 2.4 below). In a similar vein, adding a list-based component in the definition of “acceptable indices” would increase transparency and certainty for VATPs.

- 2.2 S.48(b) states that “the licensed platform operator is expected to conduct a smart contract audit for VAs based on blockchains with a smart contract layer unless the platform operator demonstrates that it would be reasonable to rely on a smart contract audit conducted by an independent auditor.”

While the Company understands that the VATP holds the ultimate obligation to perform due diligence on the VA to be admitted for trading, we believe the smart contract audit should better be conducted by an independent auditor. We seek the SFC’s clarification on whether the VATP could rely on the smart contract audit on an VA conducted by an independent auditor engaged by the developer of the VA.

Where the VATP needs to conduct a smart contract audit in the absence of a reliable audit report available from the developer, we submit that the VATP should be allowed to outsource the audit. Similar to any service provider selected by a VATP, it is the VATP’s responsibility for selecting a suitably qualified independent professional for the task based on sound criteria. We welcome the SFC’s guidance on any specific selection criteria.

- 2.3 S.48(c) states that “except for VAs only made available to professional investors, the licensed platform operator should obtain and submit to the SFC written legal advice in the form of a legal opinion or memorandum confirming that the VA [made available for trading by retail clients] does not fall within the definition of ‘securities’ under the SFO.”

Since the Company will follow the proposed general and specific token admission criteria for VAs made available for trading by retail clients, we do not appreciate why a written legal advice on whether the VA is classified as a non-security token or a security token is essential. This is especially so when the SFC acknowledges in s.90 that “a VA’s classification may change from a non-security token to a security token (or vice versa)” and “VATPs should apply for approvals under both the existing SFO regime and the AMLO VASP regime and become dually licensed and approved”. We see avoidable third-party costs that will be transferred to investors if incurred.

- 2.4 S.50 states that “if a licensed platform operator would like to make available for retail trading VAs which fulfil the general token admission criteria but fall outside the specific token admission criteria, it should submit a proposal to the SFC for discussion. Upon a review of the proposal, the SFC may decide whether to allow the trading of such non-categorised VAs on a case-by-case basis.”

We would like to follow up on our comment made to the soft consultation, and request the SFC to publish clear and detailed criteria for approving or rejecting any VA proposed by a VATP. And, regarding a VA approved by the SFC for retail access upon the application from one VATP, do other platform operators need to apply for the SFC’s approval again in order to offer the same VA for trading by their retail customers?

**3. What other requirements do you think should be implemented from an investor protection perspective if the SFC is minded to allow retail access to licensed VA trading platforms?**

We note that stablecoins are removed in the Consultation Paper from the token admission criteria for retail access.

Stablecoin is an important component of a balanced portfolio in VA and it stands to be the only risk-on/off tool before we have more crypto-friendly banks in Hong Kong and other comparable jurisdictions. On the other hand, because of its nature (i.e. its value being pegged to USD or other assets), stablecoin is not expected to be included in the “acceptable indices” that target to measure performance.

In this regard, the Company would like to confirm if there are particular admission criteria for stablecoins to be made available for retail trading; or if the application shall follow s.50 as mentioned above.

- 4. Do you have any comments on the proposal to allow a combination of third-party insurance and funds set aside by the licensed platform operator or a corporation within its same group of companies? Do you propose other options?**
- 5. Do you have any suggestions as to how funds should be set aside by the licensed platform operators (for instance, under house account of the licensed platform operator or under an escrow arrangement)? Please explain in detail the proposed arrangement and how it may provide the same level of comfort as third-party insurance.**

**6. Do you have any suggestions for technical solutions which could effectively mitigate risks associated with the custody of client virtual assets, particularly in hot storage?**

The Company is pleased to see that our comments to the soft consultation are adopted. In terms of how funds should be set aside by the VATP, we believe any such proposal should be individually reviewed as the financial status of a VATP differs from another. Different requirements for different types of VA should also be considered since their inherent risk of getting hacked, stolen and recovered is different (e.g. security tokens can be remotely burnt and reissued if a hack really occurred – this is enabled by ERC1400 standards).

As a general principle, however, the Company suggests that liquid assets, e.g. cash, deposits, treasury bills and certificates of deposit (as in the case of for the VATP to maintain liquid assets to support 12 months' operating expenses); and house VAs should also be allowed to be included at appropriate haircut value in the "funds" or perhaps more precisely the "reserve pool" to be set aside to supplement the insurance secured.

**7. If licensed platform operators could provide trading services in VA derivatives, what type of business model would you propose to adopt? What type of VA derivatives would you propose to offer for trading? What types of investors would be targeted?**

To echo our response to the soft consultation, we look forward to further guidance that may involve a new licensing regime on VA derivatives in the future from the SFC, and tailored licensing conditions for such trading services in the interim period. The Company would submit our business and product proposals to the Commission in a separate cover for discussion.

**8. Do you have any comments on how to enhance the other requirements in the VATP Terms and Conditions when they are incorporated into the VATP Guidelines?**

Paragraph 7.24(b) of the proposed VATP Guidelines restricts that "a Platform Operator should not make any arrangements with its clients on using the client VAs held by the Platform Operator or its Associated Entity for the purpose of generating returns for the clients or any other parties." Nevertheless, similar staking service (that may or may not fall under a "collective investment scheme") is now being provided by different so-called "platforms" that may be running on a TSCP license, an SVF license or simply without any license.

The same situation is also seen in the offering of VA structured products (which are not covered as "securities" under the SFO). These products are now offered by dozens of unregulated companies in Hong Kong (or overseas) and investors in these unregulated products are exposed nakedly to issuer risk.

Under the "same business, same risks, same rules" principle for level playing field, the Company recommends the necessary requirements be set out for a licensed VATP to legitimately offer staking service and structured products to investors in Hong Kong.

**9. Do you have any comments on the requirements for virtual asset transfers or any other requirements in Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs? Please explain your views.**

With respect to the draft Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs, the Company would like to seek SFC's clarification and elaboration on the following matters.

- 9.1 Paragraph 12.3.2 requires an SFC-licensed VASP to carry out CDD measures in relation to a customer before carrying out for the customer an occasional transaction that is not a wire transfer or VA transfer but involving an amount equal to or above \$8,000; whereas footnote 107 states that "occasional transactions" do not apply to, among others, SFC-licensed VASP.

Paragraph 12.3.2 seems to contradict footnote 107 with respect to the specified type of transaction (whatever it may be) involving an amount less than \$8,000. In any event, the exemption from carrying out CDD measures for any specified type of transaction does not seem to sit well with the requirements in the proposed VASP Guidelines for the platform operator to enter into a client agreement with the client's identity verified before services are provided to the client.

- 9.2 The SFC has previously prepared a guidance setting out its expected standards for compliance with the Travel Rule, adopting a "staged" approach in enforcing Travel Rule compliance. Under the guidance, an SFC-licensed platform was permitted to adopt certain interim compliance measures subject to prescribed conditions.

According to the latest FATF's report: Targeted Update on Implementation of FATF's Standards on VAs and VASPs June 2022, only 29 of the 98 surveyed jurisdictions have passed relevant Travel Rule laws. While there are now technological solutions available to facilitate Travel Rule compliance in practice, but interoperability between solutions and across jurisdictions for facilitating full Travel Rule compliance is not yet at an advanced stage.

We would appreciate the SFC taking a pragmatic and staged approach to the enforcement of the Travel Rule requirements in the AML Guideline for LCs and SFC-licensed VASPs, in pace with the progress of implementation in other jurisdictions.

**10. Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.**

We do not have any comments on the proposed guidelines.

We are grateful for the opportunity to share our feedback on the Consultation Paper. We remain at your disposal for any questions you might have in relation to the above comments.

Yours faithfully,

**Hong Kong Digital Asset Ex Ltd**