31 March 2023

Securities and Futures Commission
54/F, One Island East,
18 Westlands Road,
Quarry Bay Hong Kong

By email: VATP-consultation@sfc.hk

To the Securities and Futures Commission

Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators licensed by the Securities and Futures Commission

On behalf of its members, the Asia Securities Industry & Financial Markets Association ("**ASIFMA**", "**we**", "**our**" or "**us**") are pleased to submit to the Securities and Futures Commission ("**SFC**") our response in relation to the questions raised in the Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission dated 20 February 2023 ("**Consultation Paper**"), as well as our additional comments.

1 Introduction

ASIFMA is an independent, regional trade association with more than 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Through the GFMA alliance with SIFMA in the US and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

We have consulted and our members have taken into consideration the Consultation Paper as well as the changes to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) ("**AMLO**")[1] in this submission.

Assisted by King & Wood Mallesons, this letter sets out the consolidated views of ASIFMA based on the responses received from our members.

We have not sought to respond to every consultation question raised by the SFC. Rather, we focus on the key areas that are of most relevance to our members and ASIFMA's mandate and focus. In this respect, while ASIFMA has historically focused on traditional capital markets, we recognise that capital markets are fast becoming digitalised to include innovative products such as digital bonds, and that virtual assets ("**VA**") are rapidly becoming part of the fabric of the financial services sector – whether directly or as reference assets underlying products such as futures contracts. Moreover, ASIFMA sees the growing and significant role that VAs have in shaping payments and transactions globally and the ASIFMA Fintech Working Group has been actively engaging on this topic for several years.

We would be pleased to engage in further discussions with the SFC in relation to the Consultation Paper and to provide further industry input where necessary.

Unless otherwise defined, terms used in our response have the meaning and construction given to them in the Consultation Paper.

[1] Including the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 gazetted on 24 June 2022 available at https://www.gld.gov.hk/egazette/pdf/20222625/es32022262516.pdf and the Amendments to be moved by the Secretary for Financial Services and the Treasury in respect of the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 available at https://www.legco.gov.hk/yr2022/english/counmtg/papers/cm20221207cb3-851-1-e.pdf.

2 Executive summary

In summary, we support and welcome the detailed guidance and regulatory framework for licensed VA trading platform operators ("**Licensed Platform Operators**") to protect investors and the integrity of the VA market. That said, some proposed regulatory requirements set out in the Consultation Paper are impractical and may create unnecessary red tape without effectively mitigating specific or identifiable risks. These proposed regulatory requirements may not be conducive to sustainably growing the VA market.

At a high level, our key comments are as follows:

(a) **"Same business, same risks, same rules" principle** - We support the SFC's adoption of this principle and the technology neutral approach in regulating the Licensed Platform Operators. In particular, we commend the SFC for recognising the similar market, credit, liquidity, counterparty and other risks involved in both VAs and traditional financial products, and applying the same level of legal and regulatory requirements currently applicable to licensed corporations. This will ensure a level playing field.

We suggest the SFC consider using the term "same activity, same risk, same regulation" to align with other jurisdictions.

(b) **Investor protection** – While we appreciate the SFC recognising and identifying the additional risks involved in the operation of a VA trading platform by a Licensed Platform Operator, some requirements appear to be inappropriate and disproportionately onerous. Investor protection should be, where appropriate, comparable to existing requirements which apply to non-VA securities platforms. We suggest some exemptions and alternatives we consider may be implemented without compromising retail investor protection.

(c) **Clear to Licensed Platform Operators, other market participants and the general public** – We request clarity on certain points to ensure effective implementation of the regime and to enable Licensed Platform Operators and other market participants to comply with the relevant requirements. We also urge the SFC to take a more active role in educating the public on VAs.

(d) **Risk-based and proportionate** – To ensure the effectiveness of the VASP regime and the sustainability of the Hong Kong VA market, regulatory requirements including token admission criteria should be proportionate and designed to address specific risks identified.

(e) **Support from the banking industry / HKMA** – Existing VA trading platforms face significant challenges when it comes to banking relationships. To ensure market stability, Licensed Platform Operators must be able to access adequate and proper banking services. If banks are subject to stringent requirements and are too constrained in their ability to offer services to Licensed Platform Operators or other VA intermediaries, this may result in higher concentration risks in the market, and may lead to market instability at the scale we observed in the past few weeks. We understand from press reports that the SFC is already working with the HKMA on initiatives to enable appropriate banking support for Licensed Platform Operators. It would be especially beneficial for the HKMA and the SFC (if deemed appropriate) to expressly confirm their support for banking Licensed Platform Operators and educating the banking industry on the exceptionally high degree of regulation in Hong Kong.

(f) **Global coordination** - Continued global coordination and collaboration to develop and implement standards are essential to avoid a fractured regulatory framework on VAs. Continued partnership between industry, international standards setters and policymakers is key to establishing a practical regulatory framework and preventing opportunities for regulatory arbitrage.

(g) **Agile regulation** - It is critical that policymakers agree on a principles-based approach to regulation that fosters innovation while requiring a consistent standard of care around public policy objectives in support of financial stability and consumer protection.

The Appendix sets out our detailed comments.

3 Next steps

We would be pleased to engage in further discussions with the SFC in relation to our comments and provide further industry input where necessary. If you have any questions, please do not hesitate to contact me at .

Yours faithfully,

Appendix – Detailed comments

This Appendix contains our responses to the specific questions raised in the Consultation Paper.

Q1 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.

We welcome the SFC's proposal to allow Licensed Platform Operators to provide services to retail investors. We understand that denying retail access could result in a negative impact on investors and could potentially push retail investors to trade on unregulated VA trading platforms overseas, thus doing greater harm.

However, we suggest this regime should always remain risk-based and note a few comments for your attention.

Alignment of the proposed onboarding requirements with those under the existing SFO regime

Under the "same business, same risks, same rules" principle, the proposed requirements should align with those under the existing SFO regime. However, when compared with the existing requirements, we note that the scope of some of the proposed client onboarding requirements have been expanded, effectively leading to a scope creep of regulations.

In particular, the following proposed requirements are new requirements under the draft Guidelines for Virtual Asset Trading Platform Operators as set out in Appendix A to the Consultation Paper ("**VATP Guideline**"), which are not required under the existing VATP Terms and Conditions or the Code of Conduct for Persons Licensed by or Registered with the SFC ("**SFC Code of Conduct**") (as applicable):

(a) the requirement to assess a client's risk tolerance level and risk profile (paragraph 9.6);

(b) the requirement to assess whether it is suitable for the client to participate in the trading of virtual assets (paragraph 9.6);

(c) the requirement to disclose the methodology for categorising clients and explain the risk profiles to the client (paragraph 9.6); and

(d) the requirement to set a VA exposure limit (paragraph 9.7).

These new requirements (which we appreciate do not apply to institutional and qualified corporate professional investors) appear to be inconsistent with the "same rules" principle. Therefore, we recommend the SFC to realign such requirements accordingly.

Requirements under the Joint Circular

We appreciate the SFC's proposal to introduce a number of the retail investor protection measures, particularly those in line with the SFC-HKMA Joint circular on intermediaries' VA-related activities dated 28 January 2022 ("**Joint Circular**"). These include the VA-knowledge test requirement and suitability obligations. That being said, given that the Licensed Platform Operators may not be existing licensed corporations, they may not be familiar with the regulatory expectations on how to comply. We recommend the SFC provide detailed guidance on the following:

(a) **VA-knowledge test** – In addition to the general guidance provided under paragraph 9.4 of the VATP Guideline, we recommend the SFC consider working with relevant industry bodies to develop a standard test for the purpose of assessing retail clients' knowledge in VAs. Alternatively, the SFC may wish to establish its minimum standards for what needs to be

included in the assessment before individual entities create their own test or relevant industry bodies start developing a standardised test to assess the knowledge of investors in VAs – this will assist to guide discussions. This can ensure consistent retail investor assessment practices are adopted across the market.

We also request the SFC provide more guidance around how assessments can be retaken if failed, and what the rules and procedures are in such case.

On a related topic, we thank the work of the SFC and the Investor and Financial Education Council ("**IFEC**") in educating and providing guidance and information to the public about VAs and VA-related activities.[2] We urge the SFC and the IFEC to continue taking an active role in educating the public. This is particularly important for the purpose of financial equality and inclusion, since satisfying the VA-knowledge test is a criterion for retail investors to access VA. In addition to the SFC, other industry players including licensed corporations and registered institutions, may also contribute to educating the public. The education programme can cover the following:

(i) Informing the public of the strict obligations that Licensed Platform Operators must comply with (eg provide accurate information, inform customers of potential risks, conduct thorough due diligence etc).

(ii) The advantage of storing VAs in a person's own cold wallet. The SFC can also encourage retail investors to take out specie insurance to protect their hardware cold wallet.

(b) **Suitability obligations** – In addition to paragraphs 9.17 to 9.23 of the draft VATP Guideline, the SFC may consider providing concrete guidance on:

(A) how to risk profile a VA and a retail client; and

(B) how to confirm suitability of a VA for a particular client using the two sets of risk profiles.

We recommend the SFC provide illustrative examples to enable the Licensed Platform Operators to understand and meet with the regulatory expectations.

"De minimis" exemptions

Whilst we support the adoption of the "same business, same risks, same rules" principle, when considering the nature of VA as an "investment", we encourage the SFC to give due consideration on the differentiating factors between VA and other traditional securities.

Unlike most traditional securities of which the main purpose is for investment, VA encompasses a variety of use cases. Many retail investors purchase VAs not for investment, but other practical uses, such as paying gas fees to mint NFTs, conducting research or gaining access to other functionalities available on platforms.

We recommend the SFC consider providing appropriate exemptions to the VA knowledge test requirement and the suitability obligations in respect of retail investors who hold less than a certain appropriate value and/or percentage of assets with the Licensed Platform Operator. For example, this exemption may apply to circumstances where a retail investor is purchasing VAs not for investment, but for other practical uses. Confirmation of this can be by way of self-attestation to confirm that the VAs are purchased for non-speculative reasons. Relevant thresholds can then apply to such retail investors as appropriate in each case. We think this can better balance the

[2] See https://www.ifec.org.hk/web/en/financial-products/fintech/ico-bitcoin/index.page.

development of the market and retail investor protection. For this exemption to be properly relied on, we highlight the importance of clearly defining the scope of exemptions.

Alignment with international regime

Given that a lot of VAs are very interconnected and globalised, it is valuable to align with international practices and the regulations in other jurisdictions to the extent appropriate[3] to minimise the risk of regulatory arbitrage – noting the ability of investors to access other platforms very easily. We emphasise the importance for regulators to consider what other investor protection measures are adopted in other markets on an ongoing basis, and to ensure they remain agile as technologies and the use of VAs evolve. This can ensure the Hong Kong regime remains practicable and compatible with the international market.

Q2 Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria?

Specific token admission criteria

To enable our members to fully understand and assess the impact of the specific token admission criteria, we would be grateful if the SFC can provide more clarity by taking the following steps:

(a) We recommend the SFC provide lists (or at least non-exhaustive lists) of the following for the purpose of paragraph 7.6 of the draft VATP Guideline:

(i) "acceptable indices"; and

(ii) "index providers which has experience in publishing indices for the conventional securities market".

When preparing the lists for (i) and (ii), we recommend the SFC consider the data sources and/or underlying pricing data providers used are reputable.

We respectfully submit the quality of the data source may be more important than whether an index provider "has experience in publishing indices for the conventional securities market". The data quality currently in the VA ecosystem can range widely depending on the sources, and they can potentially render very different results.

If the SFC does not intend to provide exhaustive lists for (i) and (ii), we respectfully recommend the SFC provide a list of acceptable VA pricing data sources, or a list of criteria for determining whether a VA pricing data source is acceptable.

The SFC's regulatory expectations will impact the number of "acceptable indices", and in turn, impact the actual number of "eligible large-cap virtual assets". This will have a significant impact on the operations and business model of a Licensed Platform Operator.

(b) Regarding the requirements under paragraph 7.4 of the draft VATP Guideline, we recommend the SFC provide a pro-forma or a sample monthly report, so that the Licensed Platform Operators will understand what needs to be covered in the monthly report. Please clarify whether such monthly reports (as well as other reports mentioned in the Consultation Paper including the draft VATP Guideline) will need to be disclosed or submitted to the SFC, and if so, how often this will be required. Based on the existing text, we understand no such consequential or subsequent submission or disclosure of such monthly reports are required.

[3] Including the IOSCO's Crypto-Asset Roadmap for 2022-2023 and the Financial Stability Board's statement on the international regulation and supervision of crypto-asset activities referred to by the SFC at footnotes 3 to 5 of the Consultation Paper.

(c) VA is broadly defined in the VATP Guidelines.

We recommend more clarification on what "VA" means in the AMLO and VATP Guidelines. Specifically, we recommend the SFC consider the following:

(i) Clarify whether stablecoins which are not asset-backed would be in scope of the regime and subject to the token admission criteria.

(ii) Provide specific exemptions available to security tokens, deposit tokens, financial market infrastructure tokens and settlement tokens, having regard to their unique nature and the purposes they serve in the broader financial system.

(d) We recommend the SFC sharing a list of examples of VAs which clearly do not meet the specific token admission criteria. This would assist the overall assessment process by Licensed Platform Operators.

More generally, we urge the SFC to consider the appropriateness of the specific token admission criteria having regard to the following points:

(i) The underlying characteristics and nature of a VA are more important than (or at least as important as) whether it is included in an index. Whilst an index has to fulfil the criteria set out in paragraph 7.6 of the draft VATP Guideline to become an acceptable index, we are concerned that the inclusion of a VA in an index does not in itself mitigate any key risks.

(ii) The specific token admission criteria may result in the unintended consequences that some indices may be specifically created for the disguised purpose of supporting trading of certain VAs.

Based on the above, we respectfully submit that the specific token admission criteria may not provide the desired outcome of enhanced investor protection. By way of example, and having regard to the market conditions at the material time, it is likely that the specific token admission criteria would not necessarily have protected the market from some of the most recent blow-ups.

We also anticipate that Note 3 under paragraph 7.6 of the draft VATP Guideline may result in a high number of applications to the SFC. There is also a risk that the retail investors may perceive the decision to admit any such VA on an exchange operated by a Licensed Platform Operator as endorsement by the SFC, which we believe may not be the intention here. Rather, we would suggest that Licensed Platform Operators select the assets they consider appropriate, be ready to justify that decision, but also have the index approach available as a "deemed sufficient" diligence test.

General token admission criteria

The general token admission criteria set out in paragraph 7.5 of the draft VATP Guideline span across most types of risks typically involved in any VA.

While we acknowledge the need to impose the general token admission criteria and the related due diligence requirements on the Licensed Platform Operators, these requirements for the Licensed Platform Operators to perform due diligence on such a scale and to monitor each VA on an ongoing basis place the Licensed Platform Operators in a de facto regulatory role for the admitted VAs, which we believe may not be the intention here.

The costs and resources involved in meeting these requirements will also affect the appeal of the whole VASP licensing regime in Hong Kong.

In particular, the following general token admission criteria may be too onerous for market players and disproportionate to the associated risks.

(a) Paragraph 7.5 of the draft VATP Guideline states that:

> *"The Platform Operator should perform all reasonable due diligence on all virtual assets before including them for trading (irrespective of whether they are made available to retail clients or not), and ensure that they* ***continue to satisfy the criteria at all times****."* [our emphasis]

Subject to the number of VAs admitted by a Licensed Platform Operator and having regard to the rapid development in the area, this requirement is unlikely to be realistically achievable. Changes in the functionality of a VA are not always publicly announced.

We suggest replacing the obligation to ensure all VAs "*continue to satisfy the criteria at all times"* with an obligation to review and check each admitted VA at an appropriate interval and upon any public announcement of any significant change to the tokenomics or functionalities of a VA, or any material adverse news involving that VA.

(b) Paragraph 7.5 of the draft VATP Guideline contains a long list of factors to be considered and involves a number of factual matters. For example, under paragraph 7.5(e) a Licensed Platform Operator is required to consider "*the marketing materials for a virtual asset issued by the issuer, which should be accurate and not misleading*" in order to fulfil its due diligence obligation with respect to each VA.

We submit that a Licensed Platform Operator may not be in a position to confirm the accuracy of the content of the marketing materials, and may have to solely rely on the issuer. In some cases, that may not be available or be significantly outdated. We suggest that the SFC expressly allow the Licensed Platform Operators to rely on written confirmations provided by an issuer to satisfy its obligation to *"perform all reasonable due diligence"* particularly in relation to factual matters, and that the guidance also takes into account the absence or irrelevance of certain marketing materials.

To enable the Licensed Platform Operators to satisfy their due diligence obligations, we recommend the SFC provide further details and guidance. For example, paragraph 7.5(a) requires a Licensed Platform Operator to consider "*the background of the management or development team of a virtual asset*". We suggest the SFC clarify the intention of this general token admission criteria, eg to prevent financial crime or to assess the technical knowledge, expertise and capability of the team to operate the protocol or to develop or deliver what is promised in the underlying project.

(c) We recommend the SFC consider adding conflicts of interest consideration as one of the general token admission criteria, ie paragraph 7.5 of the draft VATP Guideline. When determining whether a VA is appropriate to be listed, a Licensed Platform Operator should consider:

(i) whether it, or any of its senior management or its group companies ("**Affiliates**") hold a material amount of that VA; and

(ii) whether it, or any of its senior management or its Affiliates is closely associated with the VA's issuer, management or development team.

The Licensed Platform Operator and its token admission and review committee should consider these points having regard to the requirements under Part XIII of the draft VATP Guideline.

(d) We request the SFC confirm how it defines adequate levels of "liquidity".

Smart contract audit

Whilst we generally agree with the smart contract audit requirement, the actual application of the requirement may be difficult and problematic subject to the nature and characteristic of a VA. The SFC may consider providing more guidance on:

(a) the situation where the VA is on a private chain;

(b) what audit criteria should be used and what standard should be adopted; and

(c) how to select an appropriate independent auditor. To this end, we suggest the SFC to provide a non-exhaustive list of acceptable independent auditors or some objective criteria in the selection of a smart contract auditor.

We would like to add that where a smart contract-based VA is admitted by a Licensed Platform Operator, it may result in "audited legitimacy" such that the VA is perceived by the investors as having been audited or verified by a trusted "auditor", which we believe may not be the intention here.

Token admission and review committee

Unlike traditional listed securities which are traded on one to two exchanges, a VA may be traded on numerous exchanges around the world. We refer to the note under paragraph 7.10 of the draft VATP Guideline which states that:

> *"Where such factors* [eg whether there are any material adverse news or underlying liquidity issues for the VA] *would unlikely be resolved in the near future, the Platform Operator should consider whether the trading of the virtual asset should be* ***halted*** *or whether retail clients should be restricted to the selling of their positions only."* [our emphasis]

Paragraph 7.1 also refers to the responsibilities of the token admission review committee to *"**halt**, suspend and withdraw a virtual asset for clients to trade based on the criteria"* . We emphasise that any halting or suspension may potentially cause material prejudice to retail investors. For instance, if a VA is only suspended for trading in Hong Kong, while investors using exchanges in other jurisdictions are allowed to exit their position, this may harm Hong Kong investors and pose a risk to the Hong Kong market. We recommend the SFC to:

(a) make clear to all Licensed Platform Operators that a decision to halt, suspend and withdraw a listed VA from a Platform should be a last resort option;

(b) require the Licensed Platform Operators to make available to its clients the specific criteria for and the procedures involved in halting, suspending and withdrawing VAs, as well as the options available to clients;

(c) require the Licensed Platform Operators to obtain its clients' express acknowledgement that the Licensed Platform Operators have the right to halt, suspend and withdraw a listed VA. Where it is reasonably practicable, the Licensed Platform Operators should inform the clients of the reason(s) for halting, suspending and withdrawing a listed VA before doing so; and

(d) require the Licensed Platform Operators to publicise to clients before halting, suspending and/or withdrawing VAs, in advance to the extent practicable.

Q3 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 suggest introducing the following retail investor protection measures at the initial stage. The effectiveness of these measures can be reviewed and amended in the future.

(a) In addition to the standardised risk disclosure required under paragraph 9.26 of the draft VATP Guideline, a personalised risk warning on, for example, the maximum amount that a particular client should invest in VA, based on the retail clients' financial situation, investment experience and investment objectives obtained in the KYC process. We also suggest that other risk disclosures are provided, including in relation to the risks associated with over-leveraging, not diversifying a portfolio, volatility etc.

(b) Principles-based limits on Licensed Platform Operators providing incentives or monetary benefits to invest in VAs, commensurate with existing requirements for traditional asset classes.

(c) Providing specific guidelines on the quality and standards required for proper disclosure to customers. For example, we recommend that Licensed Platform Operators be required to provide detailed disclosure of IT-related risks, share their operational resilience frameworks with customers, list out their appointed service providers and highlight any associated transfer of risk from one entity to another. Furthermore, we propose that the SFC encourage the Licensed Platform Operators to highlight security risks associated with storing VAs in hot wallets versus cold wallets and encourage them to move their VAs into their own cold wallet if they do not intend to make any transactions in the foreseeable future.

(d) Requiring Licensed Platform Operators to offer their services on a continuous basis, given that VA markets are also operating on a 24/7 basis.

(e) Considering whether cooling-off provisions may be valuable to introduce for certain categories of products and services offered over time. However, in line with our overarching comments, any such initiative should be consistent with the approach taken by the SFC to cooling off generally for other types of products and services, and also take into account systemic risk considerations specific to the VA sector (including the ease with which clients can simply go to unregulated channels where onboarding or trading is too slow).

Q4 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?

We understand that custody risks are inherently difficult to manage due to the lack of limited of availability of accessible insurance for the VA sector.

We refer to the proposed insurance / compensation arrangement described in paragraphs 10.22 to 10.26. This is an area where there are some divergent views in our membership. Our views are set out below:

(a) While we appreciate the option provided by the SFC to use third party insurance or setting aside own funds on trust, we note that paragraph 10.22 of the draft VATP Guideline requires an appropriate level of coverage for risks associated with the custody of client VAs, which (when read with paragraphs 10.23 and 10.24) appears to require that a total loss scenario be contemplated – that is, a coverage is needed in respect of the total value of client VA under custody from time to time. We fully support proper investor protection, but from a practical perspective, we understand this approach is still likely to be prohibitively expensive for a lot of existing VA trading platforms and certain insurance companies will simply not insure certain risks. Cost is also naturally a competitive factor that has a bearing on the ability of Licensed Platform Operators to maintain clients within well-regulated entities

from a systemic risk perspective. The majority of our members contributing to this response therefore recommend an approach that requires a proper review of risks and risk mitigants to determine the appropriate level of coverage, while providing sufficient flexibility to reflect the business involved, the internal controls in place and other loss protection mechanisms that are available from time to time. Please also refer to our comment to provide proper risk disclosures in Question 3(c), our comments on a potential transaction levy in Question 5 and our feedback on investor protection mechanisms generally.

On behalf of the majority of the contributing members, we respectfully submit that a more reasonable approach may consist of the following:

(i) Full coverage of the total value of client VAs under custody can be a starting point.

(ii) The SFC can set out a list of acceptable technical protection measures around client VA custody, such as adoption of particular technology to safeguard client VAs, or other systems and controls.

The SFC can review and update the list on a regular basis to include the latest "best practices" and VA custody-related technology.

(iii) Upon adoption of any acceptable technical protection measure, the SFC can lower the requisite coverage amount or percentage for the purpose of the insurance / compensation arrangement for the relevant Licensed Platform Operator.

We believe this will encourage the Licensed Platform Operators to adopt the latest "best practices" and VA custody protection technology available in the market.

The opposite opinion in our membership is that premiums for insurance policies covering the risks associated with client virtual assets are at high levels, this comes as no surprise, given the high volatility and additional risks of the VA sector and it should not compromise investor protection. Given that market integrity and investor protection is SFC's priority vis-à-vis the proposed VATP regulatory framework, part of our membership agree with the introduction of a requirement for full coverage via third-party insurance and other funds, but also believe that this is the bare minimum to ensure investor protection. Hence, they strongly recommend that the SFC considers additional measures that would offer protection to VA investors against additional risks.

(b) It is also important that the SFC provides further clarity on:

(i) the types of assets that are allowed for the purpose of paragraph 10.22(b) of the draft VATP Guideline. In a number of recent collapses, certain VAs were illiquid with unrealistic valuations, or subject to wrong-way risk. The SFC should consider only allowing fiat currency or other high quality and liquid assets (which may include appropriate VAs and stablecoins) for the purpose of paragraph 10.22(b); and

(ii) the insurance requirements in respect of client VAs held in a hybrid wallet (also known as "warm" wallet).

Q5 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?

The SFC may consider drawing from the existing stored value facility ("**SVF**") regime, which permits a degree of flexibility around the measures to protect the SVF float and deposit, with useful principles-based guidance.

We also suggest the following alternatives:

(a) A framework similar to the existing deposit protection scheme, such that the Licensed Platform Operators will pay contribution to the SFC (or an entity set up by the SFC), and investors who suffer losses as a result of a default of a Licensed Platform Operator can file a claim to the SFC (or a relevant entity).

(b) A transaction levy to build up a compensation fund for the industry as a next stage.

Where a client purchases their own personal insurance to cover their VAs stored on the exchange, the transaction levy can be reduced or waived.

In any case where a bank is likely required, we also suggest that the SFC liaise with the HKMA to ensure banks have sufficient guidance (and therefore confidence and willingness) to onboard Licensed Platform Operators and provide the necessary services to effect compensation arrangements. A broad base of banking service providers is important from a systemic and financial stability perspective. Please also see our response to Q11.

Furthermore, we want to stress that using house accounts does not provide the same levels of safety as compared to other options such as escrow or trust accounts as it often leads to co-mingling of assets. To this end, it is critical that the SFC introduces safeguards which would ensure that funds under house account would be equally safe with those under a trust or escrow account. We welcome the SFC's proposal that funds used for insurance purposes need to be segregated from other assets. In addition, we would encourage additional safeguards to ensure that using house accounts does not compromise retail investor protection. For example, the SFC may consider requiring a standardised acknowledgement letter to be adopted when opening any account to hold assets on trust, similar to the requirement on intermediaries for opening an account for holding client assets with an authorised institution.

Moreover, we take note that under the VATP Guideline (paragraph 4.8), the SFC requires that Licensed Platform Operators perform a daily reconciliation of all customers' assets. We welcome such a proposal and also suggest that licensed Platform Operators perform the reconciliation using independent evidence such as online bank/custodian account statements

Q6 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?

General comments

Technology in this space is constantly evolving and fast moving. We recommend that any regulatory requirements should focus on the technology-specific principles rather than the specific technical solutions.

Working with industry participants

The SFC may consider having continuous and dynamic regulatory conversation with Licensed Platform Operators to remain up to date and be aware of the latest best practices (such as ASIFMA Best Practices For Digital Asset Exchanges[4] and Global Digital Finance's guidance on Crypto Asset Safekeeping and Custody[5]) and VA custody-related technology available in the market. This would enable effective evaluation of the available technology and solutions available in the market.

[4] Available at https://www.asifma.org/research/asifma-best-practices-for-digital-exchanges/

[5] Available at https://www.gdf.io/wp-content/uploads/2019/02/GDF-Crypto-Asset-Safekeeping_20-April-2019-2-cust-providers-additions-1-2.pdf.

The SFC may consider working with relevant industry associations to issue guidance on these best practice approaches and technology and keep all Licensed Platform Operators and the public informed of these latest developments. To encourage Licensed Platform Operators to adopt the latest best practices and technology, we refer to our recommendations under question 4.

Collaboration at the International Organization of Securities Commissions ("IOSCO") level and with other international standard setters

We respectfully submit that there is a real need for international collaboration and agreement on standards in the VA sector across jurisdictions. International association such as IOSCO is best placed to achieve alignment and harmonised rules. The IOSCO-level collaboration should be underscored to assist best practice transfer from other markets. This is particularly important since a lot of VAs are very interconnected and globalised and investors can access other platforms in other jurisdictions very easily as mentioned in our response to question 1.

Specific comments on paragraphs 10.6(c) and (d)

We refer to paragraphs 10.6(c) and (d) of the draft VATP Guideline.

We respectfully submit that some Licensed Platform Operators and their Associated Entities may be able to provide a separate set of hot and cold wallets for each client. Where the wallets of each client are segregated from the other clients (ie client VA is not stored in an omnibus exchange wallet), there is a greater necessity for each client to transfer their VAs from their cold wallet to their hot wallet on an intra-day basis to facilitate trading. The transfer of client VAs out of cold wallets are likely to be driven and directed by the clients, and not by a Licensed Platform Operator or its Associated Entity.

We submit that the provision of segregated wallets for each client is a more secure arrangement and provides better protection to client VAs. However, the requirements under paragraphs 10.6(c) and (d) of the draft VATP Guideline would hamper the ability for these clients to trade, making it unfeasible to provide such arrangement to Hong Kong investors.

Separately, with the rapid development of off-exchange settlement solutions, the SFC could consider monitoring the use of off-platform settlement solutions by Licensed Platform Operators (eg on a disclosed basis ideally, or if necessary, having permissioned visibility to relevant wallets). This, in turn, could present an opportunity to revisit the cold storage requirements under paragraph 10.6 (c) of the draft VATP Guideline.

Relevantly and in view of the above, we respectfully request:

(a) the SFC's reconsideration of the requirements under paragraphs 10.6(c) and (d) of the draft VATP Guideline; and

(b) the SFC's clarification that investors are not prohibited to use their own private wallet or use a third party custodial services to safeguard their own VAs. We submit that the investors should not be prohibited from doing so to enable them to take appropriate risk mitigation steps to secure the storage of their private keys as investors consider appropriate.

Specific comments on paragraph 10.8(e)

We refer to paragraph 10.8(e) of the draft VATP Guideline.

We respectfully submit that this requirement will restrict the ability of the Licensed Platform Operator to apply some effective security measures in respect of safeguarding of seeds and private keys, eg multi party computation ("**MPC**") technology and key-sharding. Adopting these technologies may result in the private keys being stored in different locations (potentially in other jurisdictions), as well

as multiple backups and copies being produced and stored in different locations to secure the client VAs.

These technologies are becoming the standard for VA security. We recommend the SFC reconsider this requirement under paragraph 10.8(e). Furthermore, we flag that a strict requirement to store all key shards or multi-signature keys, etc and their backups in Hong Kong would exacerbate the risk of single point of failure.

Other specific recommendations

Periodic independent audit on system and controls in managing risks associated with client VAs custody

We recommend the SFC consider requiring the Licensed Platform Operators to conduct periodical independent audits on the system and controls for managing the risks associated with the custody of client VAs. This could provide objective assessment of the security protocols in storing client VAs.

Control measures

We also recommend the SFC consider the following measures to enhance safe custody of client VA:

(a) Relevant staff members of a Licensed Platform Operator should be required to undergo appropriate screening and training as well as supervision.

(b) The Licensed Platform Operator should designate a Security Officer who should be responsible for the safekeeping of client VA.

(c) Access rights and system privileges should be granted to staff members where it is strictly necessary to fulfil their duties.

(d) The Licensed Platform Operator should apply appropriate functional segregation and physical separation between IT functions (such as operating system function, system design and development, application maintenance programming, access control administration, data security) and other security functions against other business side employees.

(e) The Licensed Platform Operator should keep records (such as payment instructions and transactions, reconciliation records, customer complaints and investigations and valuation statements) in line with existing record keeping requirements including the Securities and Futures (Keeping of Records) Rules (Cap.571 O) .

(f) The Licensed Platform Operator should introduce an operational resilience program that will ensure business continuity in the event of cyber-attack, power outages and natural disasters. In addition, the Licensed Platform Operator should also ensure that a robust third party risk management framework is in place.

Further clarifications

We seek further clarification on the following:

(a) How a Licensed Platform Operator can demonstrate to the SFC that it and its Associated Entity has complied with the requirement described in paragraph 10.5 of the draft VATP Guideline.

(b) We submit that the Associated Entities should be able to outsource certain aspects of the custody of client assets (including client VAs) to a third party licensed custodian, eg the wallet creation process. This appears to be in line with the SFC's intention as reflected in

paragraphs 10.5 and 12.6 of the draft VATP Guideline. If our interpretation is correct, we suggest the following updates:

Paragraph 10.5 of the draft VATP Guideline:

> *"A Platform Operator should ensure that all client virtual assets are properly safeguarded and held in wallet address(es) which are established by its Associated Entity and are designated for the purpose of holding client virtual assets. The Platform Operator should ensure that client virtual assets are segregated from the assets of the Platform Operator or its Associated Entity. The Platform Operator should ensure the Associated Entity's compliance with this requirement. Nothing in these Guidelines prohibits the Associated Entity from outsourcing any of its functions to a third party service provider, provided that it has obtained the consent of the Platform Operator."*

Paragraph 12.6 of the draft VATP Guideline:

> *"Where the platform or any activities associated with the platform is provided by or outsourced to a third party service provider, a Platform Operator should perform (or procure its Associated Entity to perform) appropriate due diligence, conduct ongoing monitoring and make appropriate arrangements to ensure that the Platform Operator meets the requirements in this Part and Part XIV (Record Keeping) below. In particular, the Platform Operator or Associated Entity (as appropriate) should enter into a formal service-level agreement with the service provider which specifies the terms of services and responsibilities of the provider. This service-level agreement should be regularly reviewed and revised, where appropriate, to reflect any changes to the services provided, outsourcing arrangements or regulatory developments. Whenever possible, such agreements should provide sufficient levels of maintenance and technical assistance with quantitative details."*

(c) The term "whitelisted" in paragraph 10.10(b) of the draft VATP Guideline. For example, an investor may generate a new receiving address for the purpose of receiving a VA for security reasons. We respectfully submit that clients should not be prohibited from generating or using new addresses to receive VAs.

Further, clients may not be at home or using their usual devices when making a withdrawal request. It may not be to the client's benefit to require the Licensed Platform Operators and their Associated Entities to only process a withdrawal request made from the "whitelisted" client IP addresses.

Q7 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?

We recognise that VA derivatives are important to the development of the Hong Kong VA market and to individual ASIFMA members. In some cases, they are particularly relevant to hedging and other risk-mitigating activities. VA derivatives also reduce transactional complexity to a large degree where they do not involve any handling of VAs at all – that is, a person could trade a VA derivative without ever needing to custody VAs themselves. VA derivatives are also increasingly sophisticated, particularly with the advent of VA-specific ISDA documentation.

For these reasons, we suggest a principles-based approach that requires the industry to take responsibility for due diligence and sales-related duties, rather than an outright ban. In particular, we recommend that the SFC allows Licensed Platform Operators to provide only trading services in publicly listed VA derivatives.

We do agree with the Joint Circular that VA derivatives are "*very likely*" complex products. That being the case, we do not think VA derivatives offered by the Licensed Platform Operators are likely suitable for retail investors, although exceptions could well apply so the rules should be sufficiently flexible. We also suggest that the Type 11 licensing regime also takes a consistent principles-based approach to VA derivatives.

We further recommend the SFC consider only allowing the following to help safely expand the scope of offering:

(a) **Execution-only VA derivatives trading services** - such that Licensed Platform Operators should not conduct any solicitation of business or promotion of VA derivatives-related activities.

(b) **Equivalent standards** – namely, ensuring an alignment of rules applied by Licensed Platform Operators and existing licensees, including ensuring that any appliable SFC authorisation requirements and other disclosure, suitability and other selling requirements apply.

From the perspective of managing the risk exposure of the Licensed Platform Operators, we suggest the SFC consider to only allow the Licensed Platform Operators to conduct any VA derivatives trading on an agency or riskless principal basis, and all trades must be cash-settled in fiat currency.

Having regard to the anticipated future development of the VASP regime

The Financial Services and the Treasury Bureau ("**FSTB**") expressed in the legislative proposals to enhance anti-money laundering and counter-terrorist financing regulation in Hong Kong that flexibility is built in the licensing regime *"such that it may be **expanded to cover forms of VA activities** other than VA exchanges where the need arises in future"* [our emphasis].[6]

As the scope of the VASP regime, the Licensed Platform Operators and their VA exchanges evolve both in terms of product (eg to include bilateral OTC VA derivatives) and in terms of operational mechanics (eg not only covering multilateral VA exchange type platforms, but also automated bilateral trading platform), we respectfully submit that the SFC needs to take these anticipated future developments into account as it formulates the appropriate rules around conflicts of interest.

We strongly recommend the SFC consider a principles-based approach to regulation in respect of the VA derivatives as well as the forthcoming Type 11 regulated activity licensing regime.

Q8 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?

In order to ensure a level playing field between banks and non-bank financial institutions, the requirements on customer complaints should be closely aligned to the HKMA SPM IC-4 Complaints Handling and Redress.

Also, with regards to the proposed exceptions to the proprietary trading requirement, we propose the introduction of a requirement to disclose trading profit made from a back-to-back transaction, similar to paragraph 8.3 under the SFC Code of Conduct. Such requirement will address possible conflicts of interest between the Licensed Platform Operators and customers.

6 Paragraph 2.12 of the FSTB Public Consultation on Legislative Proposals to Enhance Anti-Money Laundering and Counter-Terrorist Financing Regulation in Hong Kong, available here: https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_amlo_e.pdf

Q9 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.

We do not have any particular comments on Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs ("**AML Guideline**").

However, as a general comment, ASIFMA and its members are proponents of an expedient and efficient transaction process.

Any uncertainty in transactions, including any delays or unnecessary protracted processes will inevitably have a negative impact on the development of Hong Kong as a global player in the VA space, and will not serve the best interests of the Hong Kong investors.

We suggest adding a VA specific element to the requirements set out under Chapter 12 of the AML Guideline to emphasise:

(a) implementation of the Travel Rule;

(b) the need to conduct address screening; and

(c) the fact that some protocols may have features which make the above more difficult, or may obfuscate the capture of the requisite information.

Specific comments on Chapter 12 of the AML Guideline

We would like to share our feedback on the following paragraphs of the AML Guideline:

(a) **Paragraph 12.3.1** - occasional transactions (VA transfers and VA conversions) of less than HKD 8,000 do not require CDD or any onboarding review, while footnote 107 indicates "occasional transactions" do not apply to FIs that are LCs or SFC licensed VASPs .

We respectfully request clarification on whether footnote 107 suggests that 'FIs that are LCs or SFC-licensed VASPs' may not allow occasional transactions or that the exemption does not apply to transactions conducted by "FIs that are LCs or SFC-licensed VASPs".

We also seek additional information about whether other requirements covered in Chapter 12, such as those covering unhosted wallets and other transaction related due diligence are applicable to "occasional transactions".

(b) **Paragraph 12.6** - Other than the cross-border component, we seek further guidance on how to differentiate between:

(i) providing VA services to an FI or VASP acting in the capacity of "correspondent institution"; as opposed to

(ii) an "intermediary institution" to a VASP.

(c) **Paragraph 12.7.3** - We seek further clarity as to when the controls mentioned under paragraph 12.7.3 should be performed and whether the expectation is to perform such post-transaction.

We also ask for further guidance on:

(i) whether pre-transaction due diligence shall be performed on a risk-based approach; and

(ii) how an FI should adopt the risk-based approach in establishing the systems and controls and the regulatory expectation.

It would be helpful if the SFC can provide examples of factors that should be considered in the risk-based approach.

We also recommend expressly including the requirements specified in paragraph 12.7.3 as one of the due diligence measures for cross-border relationships and VA transfer counterparts in paragraph 12.6.

With reference to paragraph 12.7.3(b), while Licensed Platform Operators are required to maintain *"adequate and effective systems and controls to conduct screening of virtual asset transactions and the associated wallet addresses"*, we understand the capabilities of blockchain analytics tools are still under development. We look forward to participating in the industry discussion on the setting of industry standards, such as the establishment of a centralized database for the industry, to be driven by the SFC together with industry associations.

(d) **Paragraph 12.8.3** – This paragraph seems to suggest that a VA transfer can be completed without prior screening, or when any of the required originator/ recipient information is missing.

While examples of risk mitigating measures were mentioned under footnote 123 (eg implementing controls to prevent the relevant VAs from being made available to the recipient, or putting the receiving wallet on hold), we suggest the SFC to consider including as mandatory requirement that the VA transferred should not be made available to the recipient until the missing information has been provided to the FI or otherwise made available to the FI. This can ensure consistency across the industry. This can also help ensure the Licensed Platform Operators will take the necessary steps to make available the missing information within a reasonable timeframe to the counterparties.

(e) **Paragraph 12.13** - We seek further guidance on the extent of due diligence to be performed over counterparties which are located in jurisdictions with no licensing regime to drive consistency across the industry.

In particular, we note that footnote 147 provides that an FI should "*determine on a risk-sensitive basis the amount of information to collect about the VA transfer counterparty*" and "*endeavor to identify and verify the identity of the VA transfer counterparty*". We recommend the SFC consider incorporating the content of footnote 147 into the main body of paragraph 12.13.7. We also respectfully submit that SDD should apply in respect of Licensed Platform Operators, and EDD should not apply, such that the Licensed Platform Operators would be on an equal footing with other licensed entities .

(f) **Paragraph 12.14.3** – We recommend making sub-paragraph (b) a mandatory requirement for accepting an unhosted wallet for the purpose of VA transfer, instead of merely one of the examples of the risk mitigating measures.

(g) **Paragraph 12.7** – We respectfully request additional guidelines on how to conduct ongoing monitoring in relation to VA transactions and activities to detect detection of ML/TF or other illicit activities. For example, we recommend the SFC consider issuing a list of wallet types, platforms, or ledger technology which the SFC considers to be of a high risk being linked to illicit behaviours, and the additional risk mitigation steps that an FI should adopt.

Q10 Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.

We appreciate that the draft Disciplinary Fining Guidelines set out in Appendix D to the Consultation Paper are similar to the existing SFC Disciplinary Fining Guidelines for the purpose of the Securities and Futures Ordinance (Cap. 571) ("**SFO**"). We support the overall approach of aligning principles, which can enable market participants to understand the standards and effectively adopt the relevant requirements, as well as adopting a consistent approach.

Q11 Other items

(a) Pre-funding requirements

We respectfully suggest updating paragraph 7.21 as follows:

> *"A Platform Operator should execute a trade for a client only if there are sufficient fiat currencies or virtual assets in the client's account with the Platform Operator to cover that trade except for any ~~off-platform~~ transaction to be conducted by institutional and qualified corporate professional investors which are settled intra-day."*

We submit that:

(i) institutional and qualified corporate professional investors are able to understand the associated risks and withstand those risks;

(ii) the intra-day settlement requirement is sufficient to protect the Licensed Platform Operators and the Hong Kong market against the systemic risks; and

(iii) the proposed changes do not impact the risks faced by retail investors.

Paragraph 7.21 (as currently drafted) is inconsistent with the existing practices of most institutional and corporate professional investors in and outside Hong Kong, and will cause unneeded complications to professional investors in the market. This update is essential for attracting large offshore investors to participate in the Hong Kong VA sector.

(b) Support from the banking industry and the HKMA is essential

The development of the growing and thriving Hong Kong VA sector requires the support from the banking industry in Hong Kong.

Basic banking services and sophisticated fund management services are necessary for Licensed Platform Operators in order to satisfy the requirements under paragraph 10.11 of the draft VATP Guideline, and to allow clients to on-ramp and off-ramp efficiently.

Existing VA trading platforms face significant challenges when it comes to banking relationships. Few banks are active in the VA space in Hong Kong. Many Hong Kong banks have been hesitant to work with VA trading platforms due to the HKMA's circular dated 28 January 2022 on regulatory approaches to authorised institutions' interface with VAs and VA service providers.[7] The circular states that when authorised institutions establish and maintain business relationships with VA service providers (eg opening bank accounts) and depending on the nature of the relationship, *"AIs [*authorised institutions*] may need to undertake additional customer due diligence (CDD) measures similar to those*

[7] Available at https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e3.pdf.

for offering correspondent banking or similar services to financial institutions (Fis)". These customer due diligence standards are high and costly for banks to satisfy.

Recent events highlight the importance of access to banking services by Licensed Platform Operators. We believe that it is prudent to flag this as a risk. The SFC also has a special role to play in liaising with the HKMA given the SFC's significant role in creating the new VA regime and therefore being able to communicate just how stringent it is.

We urge the SFC to work with the HKMA, and to encourage the HKMA to expressly confirm its support for banking Licensed Platform Operators in principle, plus the specific due diligence measures to be applied to Licensed Platform Operators for the purpose of opening bank accounts. The SFC could also support by publicising the exceptionally high degree of regulation to which Licensed Platform Operators are subject. We understand that initiatives such as a bank roundtable are already underway – we commend this and suggest ensuring that there is sufficient publicity on who can join and in what manner an expression of interest can be given. We also recommend the results and any action items arising from such discussions be publicised to raise awareness.

Moreover, we believe it is vital for Licensed Platform Operators to follow relevant international financial practices and standards.

(c) Dual licences and future development of the VASP licensing regime

Dual licences

The SFC expressed in paragraph 90 of the Consultation Paper that:

> *"Given that the terms and features of virtual assets may evolve over time, a virtual asset's classification may change from a non-security token to a security token (or vice versa). To avoid contravening any of the licensing regimes and ensure business continuity, VA trading platforms (together with their proposed responsible officers and licensed representatives)* ***should apply*** *for approvals under both the existing SFO regime and the AMLO VASP regime and become dually licensed and approved."* [our emphasis]

In view of the above, may we please confirm whether the SFC expects or requires all Licensed Platform Operators to obtain both the licence under the AMLO (as a VASP) and the licence under the SFO (for Types 1 and 7 regulated activities) even if the Licensed Platform Operators may not intend to make available any "securities" or "futures products" on their VA trading platforms? We assume this is **not** the case and consider that is the better position given the significant other investor protections which will apply.

Future development of the VASP licensing regime

We appreciate the level of clarity in various consultation documents and in the definitions of "Platform Operator" and "Relevant Activities" under paragraph 1.1 of the draft VATP Guideline.

To enable our members to plan their development in the Hong Kong VA market, we would greatly appreciate any additional details or information regarding the development trajectory of the VASP regime or any potential timelines for the inclusion of other types of VA services to the regulatory regime, such as brokerage.

Highly regulated offshore VA trading platforms

We recommend the SFC consider working with other comparable regulators which have a sophisticated regime to regulated VA trading platforms (or are in the process of developing

one**)**, such as the Monetary Authority of Singapore and the Financial Conduct Authority in the United Kingdom. We suggest a more streamlined authorisation and supervisory regime can be developed for the VA trading platforms which are already highly regulated, similar to the authorisation for providing automated trading services under Part III of the SFO. This can attract large and highly regulated offshore VA trading platforms to enter into the Hong Kong market, and enhance the connectivity between the Hong Kong VA trading platforms and the global VA market.

(d) FRR requirements

We generally agree with the proposed financial resources and soundness requirements. However, we recommend the SFC reconsider whether the required paid-up share capital of not less than HKD 5,000,000 is sufficient. We wish to highlight that:

(i) Type 1 and Type 7 licensed corporations are subject to the same minimum paid-up share capital requirement;

(ii) the VA sector is relatively nascent and may entail higher risks than a traditional Type 1 and Type 7 licensed corporation.

We assume that this risk assessment has been undertaken but if higher risks are assessed, we recommend higher capital and liquidity standards on Licensed Platform Operators, compared to traditional Type 1 and/or Type 7 licensed corporations.

We add that Licensed Platform Operators should be required to hold high-quality and sufficiently liquid assets to ensure business continuity. We recommend the SFC consider:

(i) providing additional guidelines on what can be counted in the liquid capital computation - in light of the recent events which show that even assets which are traditionally perceived as “high-quality” and liquid can suffer periods of illiquidity under certain market conditions; and

(ii) only counting low-risk and liquid assets in the calculation of liquid capital of a Licensed Platform Operator for the purpose of ascertaining whether the minimum liquid capital requirement has been met.

(e) Definition of professional investor

We invite the SFC to consider amending the definition of "professional investor" under the SFO to take into account Licensed Platform Operators.

While the scope of Institutional Professional Investors (see paragraphs (a) to (i) of the definition of “professional investor” under the SFO) currently includes licensed intermediaries (including licensed corporations and registered institutions) and other licensed entities under the regulatory framework in Hong Kong (eg insurance companies), “Institutional Professional Investors” does not include Licensed Platform Operators which will be licensed under the AMLO only, and subject to the licensing requirement under the AMLO VASP regime.

This amendment would align with the existing SFO regime and allow licensed intermediaries to rely on the exemption under paragraph 15.2 of the SFC Code of Conduct when dealing with Licensed Platform Operators, to be exempted from complying with certain know-your-client and suitability requirements under the SFC Code of Conduct.

(f) Product authorisation

We refer to paragraph 7.11 of the draft VATP Guideline.

We understand that, unless a statutory exemption applies, a Licensed Platform Operator is required to obtain an authorisation from the SFC for the issuance of an advertisement, invitation or document which contains an invitation to the public "to acquire, dispose of, subscribe for or underwrite" a security token pursuant to section 103 of the SFO. We would be grateful if the SFC can confirm:

(i) whether our understanding is correct;

(ii) whether there will be any exemption or more streamlined procedures for application for authorisation available to the security tokens to be made available by Licensed Platform Operators; and

(iii) in respect of offers of security tokens which do not fall within the scope of "unauthorised collective investment schemes" or "structured products", whether (and if so, why) the statutory exemption in section 103(2)(a) of the SFO appears to have been disapplied through the following text set out in paragraph 7.11(b):

> *"notwithstanding the offer is made by or on behalf of an intermediary licensed or registered for Type 1 (dealing in securities), Type 4 (advising on securities) or Type 6 (advising on corporate finance) regulated activity under the SFO".*

In this respect, if this is indeed the intent, we suggest that statutory change would be more appropriately effected though the usual Legislative Council procedures.

We would welcome the opportunity to facilitate dialogue between our members and the SFC. Please let us know if there is any specific area which require further industry input.