

Feedback Area	Feedback
<p>Question 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</p>	<p>1. Yes we agree that retail investors should be allowed to access virtual assets in a safe and regulated environment. Having an avenue through regulated means for retail investors to access virtual assets would, in the long run, would be safer for investors than not offering such an avenue. A regulated channel to access VA would discourage HK investors from gaining exposure to virtual assets through other more risky channels.</p>
<p>Question 2: Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria?</p>	<p>2. Some VATPs may wish to be licensed under both the SFO and AMLO, and definition of VA now include both security tokens and non-security tokens. The current token admission criteria may not adequately address the issuance of security tokens or other token that is linked to real world assets. The SFC may wish to include additional guidelines and considerations for VASPs licensed under the SFO to list securities tokens.</p>
<p>Question 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?</p>	<p>1. In determining whether or not a VA-related product is a complex product, the SFC may wish to clarify whether the Appendix 3 to the “Joint circular on intermediaries’ virtual asset-related activities” issued by the SFC and the HKMA on 28 January 2022 can still be referred to. If it remains valid, applying the “same business, same risks and same rules” principle, the SFC may wish to re-consider whether the complex product requirement should be applied to listed non-derivative VA-related product. In that circular, the SFC took the view that trading of VA futures exchange-traded funds is governed by conventional rules, and pricing transparency and potential market manipulation may be less of a concern. The same could be said of any</p>

listed non-derivative VA-related product. From operational perspective, it will be difficult for intermediaries to set up controls and comply with the complex product requirement for listed instruments given their time-sensitive nature.

2. Save for the authorised VA futures exchange-traded funds traded on conventional exchanges, all other VA-related products are very likely to be considered as “complex” products and thus subject to suitability requirements irrespective of whether a solicitation or recommendation is made. Moreover, the spirit of the suitability obligation has all along been set at the point-of-sale instead of the KYC or onboarding stage. While we agree additional protection measures shall be provided for retail investors apart from the existing knowledge assessment and training requirements, the SFC may wish to clarify whether the proposed risk profiling assessment and trading limit would overlap with the suitability obligations at the point-of-sale. There might be concerns about level playing field as well because according to the January 2022 SFC-HKMA joint circular, VA distributors seem not to be expected to comply with this new requirement during the onboarding of their clients except ensuring clients have sufficient net worth to assume the risks and bear the potential losses of trading VA-related products.
3. As a separate note, the SFC may wish to clarify whether there is a typo in Paragraph 9.23 of the draft “Guidelines for Virtual Asset Trading Platform Operators”, and the paragraph should read as “For non-complex products which traded on the platform, where there has been no solicitation or recommendation, a Platform

	Operator is not required to comply with paragraphs 9.21 and 9.22 above for transactions in such products executed on the platform, although it must still comply with paragraphs 9.5 to 9.7 above.”
Question 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?	3. The SFC may also wish to allow the VATPs to consider using mutual insurance structures. For example, in the form of an industry insurance fund comprised of all licensed VATP operators in HK.
Question 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.	
Question 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?	<ol style="list-style-type: none"> 1. The SFC may wish to consider imposing an absolute dollar limit to each wallet (particularly for hot wallets). In effect, this would mean large balances would need to be spread out among separate wallets, and a compromise of one wallet should not compromise other wallets. This may also be applicable to cold-wallets. 2. Regarding the requirement in on 98% of assets should be in cold storage. The SFC may want to consider how long it may take assets to be transferred out of cold wallets and whether 2% in hot wallet may be sufficient liquidity to allow all clients whom wish to transfer VA outside of the platform to do so in a timely manner. The

	<p>SFC may wish to consider lowering the percentage required to be kept in cold wallet, but including additional requirements on the use of hot wallet, for example, absolute dollar amount per hot wallet, hot wallet keys and seeds must be kept in different locations, use of multi-sig for hot wallets, etc.</p>
<p>Question 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?</p>	<ol style="list-style-type: none"> 3. The SFC may wish to consider the use case of derivatives and its role in facilitating liquidity services by third party market maker. As the platforms themselves are restricted to provide market making services, the role of third party as market makers will be important. Market Makers usually uses derivatives as risk management tools in market making activities, if derivatives are not available on platform, they may need to hedge elsewhere, introducing potential additional counterparty requirements and capital requirements, which may make market making less appealing for third party market makers if derivatives are not available on platform. 4. The SFC may wish to initially consider allowing the offering of traditional futures contract on coins accepted by the TARC. The proposed business model should be: <ol style="list-style-type: none"> 1. Only to professional and institution investors, except when the derivatives is used purely for hedging purposes for VA positions held at the same VATP. (for example, if a retail investor hold 1 btc, they would then be allowed to have a short future for up to 1 btc). The hedged position would then effectively be locked and should not be tradable/transferable by the retail client until the derivative position is closed.

	<ol style="list-style-type: none"> 2. For professional and institutional investors, the initial and maintenance margins should be sufficiently high and set vis-à-vis to the volatility and risk of each underlying VA. 3. Additional training and knowledge test should be required to allow retail investors to use derivatives as hedging instruments. 5. Overtime, the SFC may wish to consider allowing VATPs to offer other form of derivatives as the market develops (e.g. options, perpetual futures, etc).
Question 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?	
Question 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	<p><u>Suggest to further elaborate the product/service/transactions risks for Institutional Risk Assessment</u></p> <p>With regard to 12.2 RBA – Institutional risk assessment and customer risk assessment in the Guideline, Guideline described the risk factors to be considered in IRA, including:</p> <ol style="list-style-type: none"> 1. Market Capitalization, value, volatility, trading volume or liquidity; 2. Anonymity-enhanced virtual asset 3. Open / close-looped blockchain 4. Reputation / controls of the issuer 5. Proportion of virtual asset transactions conducted for <p>While the above risk factors have a good coverage on assessing the risks associated with listing and trading of tokens, exchange platforms in the market are offering a wider range of products/services on top of crypto trading. On that note, we encourage the SFC to provide</p>

additional factors to be considered on the product/service/transaction risks, such as:

6. staking and yield farming (i.e. allow customer to earn "interest" on their crypto);
7. payment (some exchanges like Binance, Crypto.com have issued their own credit card to allow customers to pay with crypto);
8. NFT marketplace (online platform to mint, buy and sell NFT); and
9. P2P trading platform (e.g. allow customers to convert crypto and fiat among themselves)

The abovementioned products/services may be exploited by money launderers, in particular, for the layering and integration stages of money laundering, where wealth may appear to be generated from legitimate activities (mentioned above) using illicit funds (e.g. APY of staking is a lot higher than earning interest from traditional financial products). It is therefore important to ensure all products and services, on top of coin-listing & trading, are being considered in order to holistically consider the ML/TF risks of an exchange.

Although we acknowledge that the mentioned services may not fall within the scope of the present VASP regulations, the fast evolution of the unregulated cryptocurrency market in recent years, and Hong Kong's desire to become a future "Web 3 Hub," may prompt exchanges to offer these services on their platforms. Therefore, it would be prudent for the SFC to recognize the potential risks associated with exchanges providing these services and set out in the guideline.

Suggest to enhance description on IP addresses,

Geo-location detection related measures

Noted that SFC have mentioned in multiple sections within the Guideline to require customer to implement additional measure to monitor IP addresses, geo-location data of the customer (e.g. 12.4.1 and footnote 121, 12.16.2(c)(iv)).

We agree with such controls and we would further encourage the SFC to also mandate controls to detect and prevent the use of any tools that allow customers to disguise their actual IP addresses / geolocations (e.g. VPN) to access the exchange platform, as this is a common and easily accessible tool to circumvent geolocation controls.

As an example, an exchange in the US was fined by the regulator over lapses in AML/CFT controls in January 2023, one of the observation was that the exchange allowed its users to access it's the exchange platform while using VPNs or TOR, whereby such loophole could have been exploited for customers to access the platform from high risk/sanctioned jurisdictions.

Suggest to provide further guidance in relation clearing transaction screening alerts in relation to VA transactions

Noted that section 12.7.3 of the Guideline requires FI to establish controls to screen virtual asset transactions and wallet addresses to identify source and destination of virtual assets and whether the transactions are associated with suspicious sources.

We agree with the proposed control and would encourage SFC to provide further guidance as to how VASPs determine whether transaction screening alerts are suspicious, especially in situations where the alerted suspicion (e.g. a sanctioned wallet address or a mixer) were multiple hops away (refer to a below) OR when there was a service wallet (e.g. a DEX) in between the hops before the payment landed on the exchange (refer to b below).

a) When the alerted transaction (e.g. darknet marketplace or a sanctioned wallet address) is multiple transactions (e.g. 10 hops) away from the exchange, it is often hard for the exchange to determine if the transaction is of high ML/TF risk.

b) When there are service wallet (e.g. an exchange) between the alerted transaction and the exchange, it is

	<p>also hard for the VASP to determine if there the transactions is of high risk, given that there can be millions of transactions going through an exchange on a daily basis.</p> <p>Understand that these could be limitations faced by the industry, would therefore encourage SFC to provide further guidance on additional risk factors to be considered when clearing these alerts. For example, setting out risk factors to be considered in clearing the alerts (e.g. number of “hops”, percentage of risk exposure).</p>
<p>Question 10: Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.</p>	