

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

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

Via e-mail: VATP-consultation@sfc.hk

31 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

On behalf of the Financial Markets Committee of the British Chamber of Commerce in Hong Kong, we would like to respond to the February 2023 Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission ("The Paper").

Our responses to the Consultation Paper are set out in accordance to Questions listed in the Paper in below.

• **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.

We agree. Virtual assets have become increasingly popular as an investment option, and retail investors may benefit from having access to licensed platforms that provide a secure and regulated environment for trading and investing in virtual assets.

On the other hand, virtual assets are still a relatively new and complex asset class that carries significant risks, including price volatility, lack of transparency, and potential for fraud and market manipulation. Thus, it is important to have sufficiently robust investor protection measures.

We generally agree with the range of robust investor protection measures set out in paragraphs 28 to 52 of the Consultation.

However, given that an applicant may not be an existing licensed corporation, or is from another jurisdiction with a lighter regulatory regime, they may not be familiar with the Commission's regulatory expectations, in particular, the satisfactory implementation of the onboarding requirements as set out in the Consultation. We encourage the Commission to consider providing more detailed guidance on the following:

a) VA-knowledge assessment

We do note that the Commission has provided some criteria in paragraph 9.4 of the draft Guidelines as set out in Appendix A to the Consultation Paper ("VATP Guidelines"). We suggest that the Commission should provide guidance on design and contents of the VA knowledge assessment, to facilitate the development of standards and consistency across the industry. For example, what training or courses would be considered acceptable, should previous work experience in virtual assets have been in specific areas such as sales or trading, etc.

b) Suitability obligations

As an addition to the current FAQs on suitability, we suggest that the Commission issue FAQs on suitability specific to virtual assets as soon as possible.

• **Question 2 –**

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

Token Admission and Review Committee

We agree that a token admission and review committee will provide a degree of corporate governance and oversight. In relation to paragraph 7.1 (b) of the draft VATP Guidelines, as the committee will be responsible for making the final decision as to whether to admit, halt, suspend and withdraw a virtual asset for clients, we would like to highlight that any halting or suspension may prejudice the interests of investors in Hong Kong.

Given the potential adverse impact, we would suggest the Commission expand on its guidance in paragraph 7.2 of the draft VATP Guidelines and specifically require each licensed VA trading platform:

- to disclose any specific events that will trigger a halt, suspension or withdrawal to its clients;
- to disclose its practices and procedures that will apply in the event of a halt, suspension or withdrawal to its clients;
- to explain the options available to clients in such circumstances; and
- to have dedicated personnel to deal with clients' inquiries in the event of a halt, suspension or withdrawal.

General token admission criteria

The extent of initial and ongoing due diligence required from general token admission criteria would be costly to maintain and would put the trading platforms in a de facto regulatory role for the admitted VAs, which we believe is not the intention here.

For example, Paragraph 7.5 of the draft VATP Guidelines suggests that the licensed VA trading platforms would be required to ensure their admitted VAs continue to satisfy the criteria "at all times". This is unlikely to be realistically achievable, unless the number of admitted VAs is very limited. Having only a small number of admitted VAs may inhibit the growth of the market. On the other hand, we recognise that uncontrolled admission of numerous VAs may affect the quality of the market, so there should be appropriate ongoing due diligence.

We suggest replacing the obligation to ensure all VAs "continue to satisfy the criteria at all times" with an more flexible obligation to review each admitted VA at specific intervals, for example, annually, and upon certain trigger events such as significant changes to the functionalities of a VA, or any material adverse news involving that VA.

Specific token admission criteria

It may be that the qualifying mechanism of eligible large-cap virtual assets might not be necessarily providing the desired outcome of enhanced investor protection, as:

- the underlying characteristics and nature of a VA are more important than whether it is included in an index. The inclusion of a VA in an index does not mitigate all key risks.
- it may result in unintended consequences in that some indices may be specifically created to supporting trading of certain VAs.

The case-by-case exception approval process under Note 3 of paragraph 7.6 of the draft VATP Guidelines does build some flexibility, however to manage the market's expectations and to encourage a transparent and level playing field, we suggest that the Commission provide clear guidance as to the factors it will take into account in its decision-making.

If the Commission adopts this qualifying mechanism, we suggest that there is a timeline for review when the market is more mature.

• **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?

We suggest the following:

- Restrictions on the provision of incentives and monetary benefits should be imposed.
- Licensed VA trading platforms should also provide investors with educational resources and training to help them understand the risks and benefits of investing in VAs, as well as how to use the platform safely and effectively.

• **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?

Combining third-party insurance and funds set aside by the licensed virtual asset platform operator or a corporation within its same group of companies can provide additional protection for investors.

However, under the draft VATP Guidelines, it appears that a full coverage is needed in respect of the total value of client VA under custody at all times, which may be prohibitively expensive in the long term. We suggest a more mixed approach might be taken:

- Full coverage on the total value of client VA under custody at the beginning.
- The Commission can work with the industry to find robust technical protection measures for client VA custody and thereafter adjust the coverage required.

- **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.

We think that the use of house accounts does not provide the same levels of safety as compared to the other options of escrow or trust accounts (to be held at authorized financial institutions).

We also suggest additional investor protection measures:

- A framework similar to the existing deposit protection scheme, such that the licensed platform operators will pay contributions to the Commission (or an entity set up by the Commission), and investors who suffer losses as a result of a default of a licensed VA trading platform can file a claim; and
- a transaction levy to build up a compensation fund for the industry.

- **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?

We think that VA derivatives are unlikely to be suitable for retail investors unless they have gone through the suitability assessment.

- **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.

We would ask the Commission to provide additional practical guidance 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 that the Commission could consider issuing a list of wallet types, platforms, or ledger technology which the Commission considers to be at high risk of being linked to illicit behaviour, and the additional risk mitigation steps that can be adopted.

Yours sincerely,

The British Chamber of Commerce in Hong Kong