

**THE HONG KONG  
LICENSED VIRTUAL ASSET ASSOCIATION**  
香港數字資產持牌協會

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

**BY EMAIL:**  
VATP-consultation@sfc.hk

Date: 31 March 2023

Dear Sirs,

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

We write to the Securities and Futures Commission (the “**SFC**”) in response to the Consultation Paper to provide our feedback on key issues raised by the SFC in relation to the proposed regulatory requirements for licensed virtual asset trading platform operations (“**VATPs**”) under the new licensing regime to commence on 1 June 2023.

The Hong Kong Licensed Virtual Asset Association (the “**Association**”) is a newly established association formed by leaders of the Hong Kong virtual asset industry which have obtained a licence from the SFC. A list of initial core founding members and honorary members of the Association is attached in Appendix A hereto. The Association aims to act as a forum for coordination among the key players of the Hong Kong licensed virtual asset industry and to drive policies that promote the development of a vibrant, well-regulated market environment for virtual asset-related activities in Hong Kong.

We would therefore like to take the present opportunity to submit our views on the SFC’s proposed regulatory requirements for licensed VATPs as part of the Association’s initial launch.

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**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. (Question 1)**

We welcome the SFC's proposal to allow licensed virtual asset trading platform operators ("VATPs") to offer their services to retail investors, as prohibiting retail access would only leave retail investors, many of whom are already participating in the virtual asset market, to trade on unregulated overseas cryptocurrency exchanges which offer little to no investor protection.

However, we are of the view that the SFC should clarify the interaction and linkage between the proposed requirements of virtual asset knowledge test, suitability assessment and trading limit, as these requirements are intended to address the same issue of ensuring the exposure of retail investors to risks relating to trading of virtual assets does not exceed their ability to bear such risks. Whilst the SFC proposes that a licensed VATP should be required to assess the client's knowledge and experience in virtual asset trading (and provide training before providing any services if the client does not possess the requisite knowledge) and to assess the client's risk tolerance level and risk profile to determine whether it is suitable for the client to participate in the trading of virtual assets, we would like to point out that the suitability and virtual asset knowledge assessment requirements must be put into the context of the requirement to set a trading limit for each retail investor. If an appropriate trading limit is imposed by the VATP on the client, having regard to the personal and financial circumstances of the client known to the VATP, then the relative lack of knowledge and/or modest financial means of a client should not be treated as a bar or significant hurdle against that client's participation in the trading of virtual assets. We are therefore of the view that the SFC should allow more flexibility for VATPs to determine in their reasonable judgement what combination and extent of the above measures should be adopted to provide a sufficient level of protection to investors, subject to the SFC's review and approval of their internal policies and controls in relation to client due diligence, risk profiling, onboarding and other relevant procedures. We would welcome further guidance from the SFC on its expectations regarding the practical implementation of the above investor protection requirements.

Additionally, we would like to seek the SFC's views on the onboarding requirements in the case where the client does not deal with the VATP directly but through an intermediary licensed for Type 1 (dealing in securities) regulated activity, which may partner with a SFC-licensed VATP to provide virtual asset dealing services by either acting as introducing agent to refer its existing professional investor clients to the VATP or by opening an omnibus account with the VATP for its professional investor clients pursuant to the "Joint circular on intermediaries' virtual asset-related activities" (the "**Joint Circular**") published by the SFC and the Hong Kong Monetary Authority (the "**HKMA**") on 28 January 2022:

1. Firstly, as a preliminary question, we would like to seek the SFC's clarification on whether Type 1 intermediaries would be permitted to provide virtual asset dealing services to retail clients upon the commencement of the new licensing regime for virtual asset service providers (the "**VASP Licensing Regime**") under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the Laws of Hong Kong) (the "**AMLO**") on 1 June 2023, given the SFC's proposal to allow retail investors to trade on VATPs as set out in the Consultation Paper.
2. Secondly, if Type 1 licensed intermediaries are allowed to provide virtual asset dealing services to retail investors through partnering with a licensed VATP, then we would suggest that the SFC should consider to what extent a licensed VATP should be permitted to rely on the onboarding measures carried out by the Type 1 licensed intermediary, given that licensed corporations are subject to similar knowledge test and suitability obligations under the Joint Circular and the Code of Conduct for Persons Licensed by or Registered with the SFC (the "**Code of Conduct**"), at least in respect of virtual asset-related products which are regarded as derivatives or other complex products.

To facilitate the smooth cooperation between licensed VATPs and Type 1 licensed intermediaries, we are of the view that the onboarding and investor protection requirements applicable to both licensed VATPs and Type 1 licensed intermediaries should be synced and that a licensed VATP should be permitted to rely on the investor protection measures already carried out by the Type 1 licensed intermediary where it deals with retail investors through a Type 1 licensed intermediary.

Further, it is submitted that the treatment of different investors based on whether they are professional investors or retail investors may not necessarily be the most suitable or appropriate for the purposes of investor protection, as currently virtual assets, cryptocurrencies and other virtual assets are not included in the calculation of a client's portfolio or net worth for the purpose of the definition of "professional investors". With the increasing digitisation of the economy and shift from traditional forms of assets to digital assets, there has emerged a class of investors who have a significant portion of their assets in the form of virtual assets. These investors may in fact have substantial wealth and therefore not less capable of withstanding the risks of investing in virtual assets than investors whose wealth consist wholly or predominantly of cash, traditional financial instruments, real property and other traditional forms of assets, despite not qualifying as professional investors due to the existing rules for calculating an investor's net worth under the Securities and Futures (Professional Investor) Rules (Cap. 571N) (the "**Professional Investor Rules**"). Indeed, such investors may even possess better knowledge and experience in virtual assets. Therefore, whilst amending the Professional Investor Rules may take time, we suggest that the SFC should consider permitting licensed VATPs to take into account a client's wealth in virtual assets in assessing whether the client is suitable to participate in virtual asset trading and the

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appropriate trading limits to be established for that client. In the longer term, it is also hoped that the SFC and other financial regulators will consider revising the rules for calculation of an investor's portfolio and net worth by amending the relevant provisions in the Professional Investor Rules.

**Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria? (Question 2)**

Whilst we largely agree with the general token admission criteria set out in the Consultation Paper and the VATP Guidelines, we are of the view that the proposed specific token admission criteria applicable to virtual assets to be admitted for trading by retail investors are overly restrictive. Whilst the SFC has yet to clarify the precise details and its expectations regarding the proposed “eligible large-cap virtual asset” requirement (for example, whether there will be any restriction on the number of constituent tokens in the index), it can be anticipated that this requirement would limit the access of retail investors to only a very limited suite of mainstream tokens. This is all the more so in view of the SFC's proposal to permit retail investors to trade non-security tokens only, given that the “non-security” characterisation of many virtual assets, including certain popular ones (eg. Ripple), is currently being challenged or is at best highly uncertain. Therefore, the “eligible large-cap virtual asset” requirement and the non-security requirement together could potentially leave retail investors with only Bitcoin and perhaps a few other tokens as their only choices. Additionally, the issue is not only a *quantitative* one of how many tokens would be available to retail investors but also a *qualitative* one, as restricting retail investors to those tokens with the largest market capitalisations would preclude them from investing in smaller tokens issued by start-ups and other innovative enterprises, which would undermine Hong Kong's stated goals of being “open and inclusive” towards the global community of innovative virtual asset businesses and developing a “vibrant sector and ecosystem” for virtual assets in Hong Kong.<sup>1</sup>

Therefore, similarly to our response to Question 1 above, we would suggest that these specific token admission criteria and restrictions for retail investors could be relaxed or adjusted if appropriate limits are put in place by the VATP on its retail clients. For example, a VATP could impose concentration limits on a retail client for trades in virtual assets which do not meet either or both of the “eligible large-cap virtual asset” and the non-security requirement, which could effectively mitigate the heightened risks to the client of trading in such virtual assets. Thus, the SFC may consider allowing licensed VATPs the option to permit its retail investor clients to trade virtual assets which do not meet either or both of the aforementioned proposed requirements provided that adequate measures (including proper token due diligence as per the general admission criteria and appropriate trading limits) are

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<sup>1</sup> See paragraphs 1 and 2 of the “Policy Statement on Development of Virtual Assets in Hong Kong” issued by the Financial Services and the Treasury Bureau (the “FSTB”) on 31 October 2022.

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implemented by the VATP to effectively limit its retail clients' risk exposure in proportion to their assess risk tolerance levels. Further, should the SFC be minded to impose the "eligible large-cap virtual asset" requirement, it is suggested that the SFC should clarify whether it would accept, for example, an index that tracks the top 100 tokens by market capitalisation as an "acceptable index", as the current example of an index tracking the performance of the 10 largest tokens being provided by the SFC in the Consultation Paper may appear to suggest an index with a larger constituent base may not be accepted by the SFC. In these ways, options available to retail investors can be broadened to include relatively smaller tokens issued by newly launched innovative projects offering real utilities, including home-grown fintech businesses in Hong Kong, without subjecting retail investors to disproportionate risk levels.

**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? (Question 3)**

As mentioned above, we believe the investor protection requirements being proposed by the SFC are already very comprehensive and stringent, and perhaps more so than is necessary. Therefore, rather than proposing further requirements and restrictions, we would suggest that the SFC consider and clarify whether and how licensed VATPs could be allowed to more flexibly adapt and tailor their investor protection measures (consisting of virtual asset knowledge test, suitability assessment, trading limits, token admission criteria, product due diligence and information and risk disclosures, in varying forms and to different extents) in a holistic manner to enable greater and more meaningful retail access whilst maintaining a sufficient level of investor protection. We would also suggest that the SFC consider the possibility of allowing VATPs which impose a specified trading limit for retail investors (eg. 10% of the client's proven net worth) to conduct simplified virtual asset knowledge assessment and/or suitability test on retail clients and to permit retail clients to trade virtual assets which may not satisfy both the "eligible large-cap virtual asset" and non-security token requirements.

**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? (Question 4)**

We welcome the SFC's proposed move to allow VATPs to adopt a combination of third-party insurance and funds of the VATP itself and/or its affiliated group companies in its risk compensation arrangement, as exorbitant premiums charged by the few insurance companies willing to offer insurance policies covering virtual assets held in hot storage are a huge burden on the finances of licensed VATPs, making it even harder for VATPs to sustain their operations, much less make a profit. However, we await further guidance from the SFC

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as to its expectations as to the respective proportions of third-party insurance and funds set aside by the VATP and/or its affiliated group companies (eg. 50:50, 80:20 or potentially 100% funds of the VATP and/or its affiliated group companies only) within a risk compensation arrangement and whether different standards would apply to client virtual assets held in hot wallets and in cold wallets.

Notwithstanding the foregoing, given that VATPs are already required to maintain sufficiently liquid assets equivalent to not less than 12 months of its operating expenses, which could easily run to some HK\$30 million to HK\$50 million or even more due to the high costs of well-qualified personnel as well as regular technological audit, cybersecurity assessments and professional services, VATPs may have difficulty setting aside additional funds for risk compensation purposes. Therefore, it is hoped that the SFC will consider whether it may be possible to adjust the coverage percentages, particularly in respect of client virtual assets held in cold storage in view of the relatively lower risks involved.

**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 5)**

We are of the view that different options should be allowed to VATPs, so long as the funds are set aside on trust and designated for the purpose of the VATP's risk compensation arrangement. In particular, VATPs should be allowed to place the funds in a fixed deposit bank account (from which it cannot withdraw funds for a specified period of time) without necessarily depositing those funds with a third-party escrow agent or custodian, which would incur additional fees and expenses and diminish the benefit of allowing a combination of third-party insurance and the VATP and/or its affiliated group companies' own funds in the first place.

Alternatively, the SFC could consider simply increasing the financial resources requirements (including the minimum share capital and liquid asset requirements) as a means to ensure there are sufficient funds for risk compensation purposes, whilst adjusting the required insurance coverage to appropriate levels which are reasonably affordable by VATPs. For example, the liquid asset requirement could be raised from the current 12 months to 18 months of operational expenses calculated on a rolling basis and to be maintained by the VATP at all times, whereas the required insurance coverage for client virtual assets held in hot and cold storage could be lowered to a corresponding extent. This would be a simple, cost-effective way to achieve the aims of affording adequate protection to investors in the event of loss to client virtual assets held by the VATP (through its wholly-owned subsidiary

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acting as custodian) and other contingencies and, at the same time, alleviating the financial burden and practical difficulties faced by VATPs in maintaining third-party insurance.

**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? (Question 7)**

We would propose to offer at the initial stage virtual asset derivatives with relatively familiar product structures similar to futures and options in the traditional financial market. In this connection, we would also like to seek the SFC's preliminary views on whether it would be prepared to permit the trading of virtual asset derivatives and futures products similar to Bitcoin futures and Bitcoin options, which have been in existence in the market for several year since 2017. Given the SFC's recognition of the important role played by virtual asset derivatives in the interface between traditional finance and the virtual asset space and their value in enabling institutional investors to hedge risks more effectively, we are of the view that the SFC should consider allowing at least professional investors to trade virtual asset derivatives on licensed VATPs initially and gradually opening up retail access to improve the competitiveness of locally licensed VATPs vis-à-vis overseas cryptoexchanges and encourage more virtual asset businesses to come to Hong Kong.

**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. (Question 9)**

Whilst we agree that appropriate amendments should be made to the existing AML/CTF requirements to address virtual asset transactions, we are of the view that the immediate implementation of the "travel rule" in relation to virtual asset transfers (as provided by Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs) (the "Travel Rule") with effect from 1 June 2023 would be impracticable. As there are currently no commonly accepted standards and systems for the collection, handling, disclosure, retention and record-keeping of originator and recipient information as provided by Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs, it will take time for licensed VATPs and other licensed corporations ("LCs") to prepare and develop adequate systems and procedures to comply with the new AML/CTF requirements in respect of virtual asset transfers.

Additionally, given that in many cases the ordering institution, the beneficiary institution and/or the intermediary institution will be located outside Hong Kong and that to date the Travel Rule has yet to be implemented or to take effect in a number of jurisdictions (including the United Kingdom, Australia, South Africa and parts of the European Union), requiring licensed VATPs and LCs in Hong Kong to comply with the Travel Rule with effect from 1 June 2023 would put

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them in a situation where it would be impossible for them to process and execute virtual asset transactions involving a number of their existing partner institutions and other counterparties overseas. Further, if the licensed VATP or LC being the ordering institution in Hong Kong submitted the originator and recipient information to the intermediary institution or beneficiary institution located in a jurisdiction which has not implemented or enforced the Travel Rule, it is uncertain how such information would be handled by the overseas intermediary institution or beneficiary institution, thus posing risks to the security and privacy of client data.

In view of the above concerns, we would recommend that the implementation of the Travel Rule in Hong Kong be postponed by a period of 12 to 18 months to enable licensed VATPs and other LCs to develop the necessary systems and procedures and to coordinate viable arrangements with overseas institutions.

### **Conclusion**

We shall be most grateful if the SFC will take into account our submissions above in finalising the regulatory requirements for VATPs under the new licensing regime. Going forward, we shall aim to be an active presence in the advocacy for regulatory changes and new policies that will support the sustainable development of the Hong Kong virtual asset industry in a compliant manner and promote Hong Kong's status as an international financial centre and fintech hub.

Should you have any enquiries or wish to discuss with us any of the issues above, please do not hesitate to contact

Yours Faithfully,



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APPENDIX A

CORE FOUNDING MEMBERS AND HONORARY MEMBERS

**Core Founding Members**

Venture Smart Asia Limited



HashKey Digital Asset Group Limited



Victory Securities Company Limited



Axion Global Asset Management Limited



MaiCapital Limited



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**Secretary General**

Henry Yu & Associates



**Honorary Members**

Hong Kong Virtual Asset Exchange  
Limited

GSR



**Other organisations**

Cyberport

Hong Kong Blockchain Association



Deloitte

