SUBMISSION VIA WEBFORM TO: vacustody-consult@fstb.gov.hk

To whom it may concern,

Re: Public Consultation on Legislative Proposal to Regulate Virtual Asset Custodian Services

About Global Digital Finance (GDF) & Web3 Harbour (W3H)

GDF is an open innovation community that works towards improving market standards and regulation for digital finance through engagement with industry, policymakers and regulators. W3H is a Hong Kong-based, member-led community of Web3 builders, users, investors and industry leaders committed long-term to promoting a pro-innovation, pro-collaboration and inclusive environment for the development of the decentralized internet and virtual asset economy.

GDF and W3H collaborate on areas of mutual interest and alignment across the two organisations' policy, regulatory and technical activities and the input to this response has been curated through a series of member discussions and industry engagement. Both organisations are grateful to all members who have taken part.

GDF and W3H remain at your disposal for any further questions or clarifications you may have and we would welcome a meeting with you to further discuss these matters in more detail with our members.

Yours faithfully,

Elise Soucie Watts – Executive Director – GDF
Jeffrey Tchui – Executive Director – W3H

Response to the Consultation: Executive Summary

Dear The Financial Services and Treasury Bureau and Securities and Futures Commission,

Global Digital Finance (GDF) and Web3 Harbour (W3H), (together, the "associations") welcome the opportunity to respond to the consultation on the proposed legislative framework for the regulation of Virtual Asset (VA) custody services. We strongly support the Hong Kong authorities' continued efforts to develop a robust, internationally aligned and innovation-enabling regulatory environment for digital assets.

We recognise that this Consultation forms part of the broader policy trajectory set out in the Securities and Future Commission's (SFC) A-S-P-I-Re roadmap (Access, Safeguards, Products, Infrastructure, Relationships). Its emphasis on product diversification, cross-border connectivity and proportionate safeguards aligns closely with our recommendations. The associations support the timely implementation of these initiatives, which will strengthen Hong Kong's position as a globally connected hub for digital assets and Web3 innovation.

The associations recognise the importance of custody as a foundational element of safe and trusted VA markets and agree with the need for a clear, proportionate and technology-neutral regime. Our response highlights areas where greater clarity and refinement would support regulatory effectiveness, avoid duplicative obligations and preserve Hong Kong's competitiveness as a leading global hub.

Key points raised include:

- **Scope and definition**: While we are supportive of the proposed definition of VA custodian services, we recommend refinements to ensure technology neutrality, avoid capturing non-controlling non-custodial functions (e.g. self-custody, transitory holdings, or technical third-party providers) and provide clear delineation from other licensing regimes such as VATP or SVF regulation.
- **Entity vs. individual licensing**: We recommend an entity-focused approach to licensing, consistent with international best practice, with only limited oversight for senior responsible officers. Broad individual licensing of operational staff would be disproportionate and inconsistent with global norms.
- **Reliance on third parties:** We are highly supportive of regulatory clarity in the reliance on third parties, both licensed third-party custodians and third-party technology providers, subject to outsourcing requirements and existing security standards.
- **Exemptions and proportionality**: We support exemptions for custody ancillary to other regulated activities and recommend explicit recognition of transitory custody, intra-group arrangements and self-custody. Exemptions should be designed to avoid excessive concentration risk by recognising equivalent overseas custodians.
- **Cross-border interoperability**: The regime should enable recognition of custodians licensed in jurisdictions with comparable standards (e.g. MAS, VARA, MiCA) to avoid market fragmentation, foster equivalence and strengthen Hong Kong's global positioning.
- **Financial and prudential requirements**: We support alignment with principles applied to Type 13 regulated activity but emphasise the need for proportionality, calibration to VA-specific risks and avoidance of duplication for existing licensees.
- **Operational resilience and governance**: We encourage a principles-based and technology-neutral approach to requirements on segregation of assets, key

management technologies such as Hardware Security Module (HSM) and Multi-party Computation (MPC), hot/cold wallet ratios, reconciliation, and cybersecurity, with proportional tailoring to business models and risk profiles.

- **Transitional arrangements**: We strongly recommend the introduction of a structured transitional period of at least 12–18 months, to prevent market disruption and support orderly licensing, recognising existing operators and international custodial infrastructure.
- **Supervisory and enforcement powers**: We support granting appropriate powers to the SFC and HKMA, along with proportionate sanctions and the establishment of an independent review tribunal to ensure fairness and transparency.

Taken together, our recommendations are designed to help shape a custody framework that protects investors, provides legal clarity and enhances market confidence, while maintaining flexibility for innovation and global interoperability. The associations stand ready to continue engaging with regulators to ensure the successful implementation of this important initiative.

Response to the Consultation Questions

Q1 Do you have any comments on the proposed definition and scope (e.g. too narrow or too wide) of VA custodian services to be regulated?

The associations are broadly supportive of the proposed definition and scope of VA custodian services, noting the benefits of regulatory clarity and the proportionality of proposed exemptions where custody is wholly incidental to other regulated VA services. However, we believe the definition would benefit from greater precision and futureproofing to ensure it remains technology-neutral and avoids unintended regulatory overlap.

In particular, we highlight the following considerations:

- *Technology neutrality and breadth of scope*: The inclusion of "instruments enabling transfer" (such as private keys) within the definition is welcomed, as it clarifies what constitutes VA custody. However, care should be taken to ensure the definition does not unintentionally capture authentication credentials or access controls more broadly, which may not involve true custodial functions.

- *Virtual assets versus digital assets:* The definition should also anticipate the potential future expansion of tokenised real-world assets (RWAs), beyond the current focus on cryptoassets.

- *Introducing the concept of control:* As "safekeeping" is not currently defined in the Securities and Futures Ordinance (Cap. 571) (SFO) or the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO) or in any other legislation in Hong Kong, we believe additional language can introduce helpful clarity to the meaning of "safekeeping..an instrument enabling a transfer" such that only entities that engage in the **safekeeping and control** of clients assets are deemed custodians. This will be an extremely relevant clarification if relying on technologies such as MPC where a single private key (instrument) is never generated, yet participating financial institutions and third-party technology providers (TPPs) have a clear delineation of responsibilities in their ability or inability to exert control.

- *Regulatory overlap and clarity*: Additional guidance is required to delineate the boundary between VA custodian services and other licensing regimes. For example:
    - Whether assisting clients in receiving/transferring VAs from/to third-party wallets would be treated as custody, VA dealing or another regulated activity.
    - Whether such activities could overlap with the Stored Value Facility (SVF) regime under the Payment Systems and Stored Value Facility Ordinance.
    - Whether VA custodians would also be required to obtain a TCSP licence, given that custodial arrangements typically involve holding assets on trust.

- *Proportional exemptions for transitory custody*: Certain market participants, such as payment service providers (PSPs) and infrastructure providers without unilateral control over client asset and incidental custody ancillary to another licensed VA activity, may temporarily hold VAs (including stablecoins) while facilitating payments, remittances or transfers. Such holdings are incidental and comparable to the treatment of fiat funds in traditional payment services, which do not trigger custody licensing requirements. We recommend that the framework explicitly provide exemptions for entities holding VAs on a purely transitory basis (e.g. five business days or less), where the purpose is limited to facilitating payment or settlement.

- *Group and third-party arrangements*: Further clarity is needed on whether entities that do not directly safekeep private keys but arrange for a third party (including an affiliated group entity) to provide custody would themselves require licensing. We encourage the regulators to consider proportional treatment of intra-group custody arrangements, subject to appropriate governance and safeguards.

- *Cross-border:* The regime should avoid capturing arrangements where Hong Kong clients independently approach offshore custodians without prior marketing in Hong Kong, consistent with existing Securities and Futures Ordinance practice.

- *Self-custody exclusion:* Explicitly clarify that arrangements where clients retain full control over their private keys and no third party can initiate or approve transactions are out of scope.

Overall, the associations support the proposed approach but encourage refinements to ensure clarity, proportionality and alignment with established regulatory principles. This will help avoid regulatory duplication, support innovation and ensure that the regime captures genuine custodial risks without overreach.

Q2 For entities which do not safekeep private keys but arrange a third party to custody the client VAs or otherwise safekeep the private keys (such as a private fund trustee of a VA fund that delegates the safekeeping of private keys to a sub-custodian), should they be required to obtain a VA custodian service provider licence? Please explain your comments.

The associations do not believe that entities which arrange for a third party to provide VA custody, but do not themselves safekeep private keys or hold control over client wallets, should be required to obtain a VA custodian service provider licence. Such entities are not, in substance, providing custody, even where they may retain contractual responsibility for oversight of the custodian.

We recommend the following refinements and clarifications:

- *Proportional treatment of outsourcing*: Provided the third-party custodian or sub-custodian is itself appropriately licensed and the arrangement is clearly disclosed to and consented by the client, the delegating entity should not be separately licensed. Instead, its obligations should focus on conducting vendor due diligence, maintaining appropriate contractual oversight and ensuring safeguarding responsibilities are met.

- *Onshore/offshore considerations*: Further clarity is required on the treatment of sub-custodians located outside Hong Kong. The SFC could consider mutual recognition or equivalence where the sub-custodian is licensed in a jurisdiction with a comparable regime (e.g. MAS in Singapore, VARA in Dubai). This would avoid unnecessary duplication and foster international interoperability.

  To support consistency and reduce duplicative licensing, we recommend that the SFC maintain and periodically update an official list of recognised jurisdictions whose VA custodians meet equivalent regulatory standards. Transparent assessment criteria and regular review of this list would streamline cross-border sub-custody arrangements and provide industry participants with greater operational certainty.

- *Ancillary custody by VATPs and other service providers*: We support the SFC's proposal to exempt entities performing custody functions on an ancillary basis to their main regulated activity (e.g. VATPs facilitating exchange or settlement). This is consistent with international practice such as:
  - In Singapore, DPT service providers may perform custody under the same licence without requiring a standalone authorisation.
  - Under the EU's MiCA framework, CASPs may provide custody alongside other services under a single licence.

- *Clarity in the reliance on technology infrastructure companies:* A clear distinction should be made between outsourcing the regulated custodial activity to third-party custodians and outsourcing the security of the custody operations to TPPs. In the latter, the common international regulatory practice is that when TPPs are relied upon by regulated virtual assets custodians, these TPPs are not regulated as custodians if they cannot unilaterally control the transfer of client assets and if access to client assets can be retrieved without support from the TPP.

- *Reliance on Multi-Party Computation:* As this consultation specifically invites views on MPC, we put forward three observations:
  - Firstly, the combined outcome of the new VA Dealing regime and the VA Custody regimes will require a significant portion of Hong Kong market participants to potentially outsource their custodial responsibilities. Permitting reliance on MPC is among the least disruptive and most scalable policy choices available.
  - Secondly, the custodial responsibility between a VA custodian and TPP can be clearly delineated around the concepts of control and access to back-up private key recovery, as explained above.
  - Thirdly, the reliance on MPC can be safeguarded, from a security perspective, based on these recognized international best practices; be the MPC solutions developed in-house or provided by a TPP.

- Availability of a solid security framework, including at least SOC2 audits and industry standards such as ISO-27001.
- Reliance on industry-specific certifications such as CryptoCurrency Security Standards (CCSS).
- Presence of a robust Secure Software Development Lifecycle (S-SDLC) policy, including peer reviews, approvals, risk management.
- Presence of multiple and various methods of technical validation and testing, including but not limited to penetration testing, code reviews, red teaming, bug bounty programs, and security assessments by both internal and external parties.

In the case of TPPs, these should grant the customer rights to perform independent validations, including audits, code reviews, and testing.

- *Defining custody vs. non-custodial services*: To provide clarity, the SFC could issue guidance on the circumstances in which an activity constitutes regulated custody. Indicators might include:
  - Whether the provider has unilateral control over private keys;
  - Whether the provider can access client wallets without client intervention;
  - Whether the client can independently recover their assets if the provider ceases to operate;
  - Whether the provider markets itself as offering "custody" or recovery services.

- *Self-custody out of scope*: We recommend the SFC explicitly recognise that self-custody, where clients retain exclusive control over their private keys, falls outside the scope of the licensing regime. This would ensure a technology-neutral and proportionate framework and avoid inadvertently capturing non-custodial business models.

Overall, the associations believe that requiring licences for entities that only arrange, but do not themselves perform, custody would create unnecessary regulatory burdens without addressing genuine custodial risks. A framework based on proportionality, interoperability and international alignment will support both investor protection and market development.

Q3 Are there any entities which should be licensed or registered for providing VA custodian services but are not caught by the proposed definition? Please explain your comments.

The associations believe the proposed definition provides an appropriate starting point but emphasise the need for greater clarity from the SFC on the precise scope of activities that constitute VA custodian services. A clearly defined set of criteria would help ensure that:

- *Entities effectively providing custody are captured*: Firms that in substance control client assets, whether through unilateral or joint access to private keys, the ability to authorise or block transactions or by holding themselves out as providing custody, should fall within the licensing perimeter, even where custody is provided through contractual delegation to a third party. This would prevent regulatory arbitrage and ensure consistent investor protections.

- *Entities not providing custody are excluded*: Conversely, entities that do not themselves hold or control client assets, for example, those that only facilitate technical integrations, arrange sub-custody or support self-custody, should not be captured. Capturing such activities would create unnecessary burdens while not addressing genuine custodial risks.

We note that international practice often applies a substance-over-form approach to defining custody:

- In Singapore, DPT service providers require licensing where they hold customer assets; service providers that do not take possession or control are not treated as custodians.
- Under the EU's MiCA regime, CASPs are licensed for custody only where they hold or have access to client assets, rather than for arranging functions.

Accordingly, we recommend the SFC issue guidance or illustrative case studies clarifying when an activity crosses the threshold into regulated custody. Such guidance could build on the factors outlined in our response to Q2, including (i) control over private keys, (ii) independent asset recovery by clients and (iii) representations made in marketing materials. This distinction between operational custody control and purely technical roles is essential to avoid over-capture.

Overall, the associations believe that any entities that in practice hold or control client VAs should be licensed, while those that only provide ancillary or facilitative functions should not be. This approach would ensure the regime is risk-based, future-proof and internationally consistent.

Q4 For an entity ("Entity A") within a corporate group that safekeeps private keys whereby personnel from different group entities ("Group Entities") may also be involved in safekeeping the private key and/or signing a VA transaction:

(i) Should the Group Entities be required or not be required to obtain VA custodian service provider licences? Please explain your comments.

The associations believe that licensing requirements should be determined by the substance of the function performed, rather than the corporate structure in which it sits. In practice, this means:

- *Group entities exercising custody functions should be licensed:* Where a group entity (or its personnel) has control over private keys, whether by holding access credentials, being able to authorise or block transactions or otherwise exercising functional custody, it should be considered as providing VA custodian services and be subject to licensing requirements.

- *Supporting entities should not be captured:* Conversely, where a group entity provides only supporting infrastructure or administrative services, without any ability to access client assets or approve transactions, it should not be required to obtain a licence. Capturing such functions would impose unnecessary regulatory burdens without addressing genuine custodial risks.
- *Disclosure and supervisory transparency:* To ensure clarity and effective oversight, applicants should be required to disclose in their licence applications how custody

functions are allocated within their group, including which entities and personnel are involved. This will avoid ambiguity, support proportional supervision and ensure the regulator has clear visibility of intra-group custody arrangements.

This approach reflects a risk-based and function-driven framework, aligning with international regulatory practice and ensures that licensing obligations apply where actual custodial risks arise, rather than simply by virtue of group structure.

(ii) If the answer to (i) is yes, please provide your comments on the types of personnel within the Group Entities which should obtain an individual licence ("Relevant Personnel"). What steps of the transactions should trigger this licensing requirement?

The associations note that the concept of "Relevant Personnel" and the introduction of an individual licensing framework for custody services is not defined in the Consultation or under existing Hong Kong legislation. We therefore encourage the SFC to provide further clarity before introducing such a framework.

We emphasise that:

- *Entity-level licensing should remain primary*: In line with international practice, licensing should apply to legal entities rather than individuals, as personnel typically act in their professional capacity on behalf of the entity. Individual licensing for custody services would be unusual and could create operational complexity without materially improving investor protection. Most regulatory regimes instead provide entity-level approvals, with oversight of responsible officers or key function holders.

- *If an individual licensing framework is pursued*: The SFC should carefully define scope, responsibilities and liability. Licensing should be limited to individuals with significant responsibilities in safeguarding client assets, comparable to designated roles such as Money Laundering Reporting Officers. Clarity would also be required on the portability of licences when individuals move between firms and how accountability would be apportioned between the entity and the individual.

- *Potential scope of Relevant Personnel*: Should the SFC proceed, licensing obligations should be proportionate and limited to individuals directly involved in material custody functions, including:
    - Private key generation and lifecycle management;
    - Transaction authorisation or execution (where individuals can unilaterally or jointly approve/sign client transactions);
    - Technical or operational access to client wallets;
    - Transaction monitoring, freezing or recovery capabilities; and
    - Custody-specific risk management or control functions directly tied to asset safeguarding.

We strongly encourage the SFC to weigh these considerations carefully. Introducing an individual licensing regime would be a significant departure from existing practice and could impose substantial administrative burdens. Any such obligations should therefore be narrowly targeted, risk-based and proportionate to the role individuals play in the actual safeguarding of client assets.

(iii) If the answer to (i) is no, please provide your comments on whether the Relevant Personnel of the Group Entities should be required to be accredited to Entity A (assuming Entity A will obtain a VA custodian service provider licence) and also obtain an individual licence. Please explain your comments.

The associations emphasise that any licensing framework should remain entity-focused, with regulatory accountability placed on the licensed VA custodian service provider. While we recognise the importance of transparency where group entities participate in custody arrangements, we do not believe a broad, standalone individual licensing regime would be proportionate or consistent with international practice.

Our recommendations are as follows:

- *Entity-level responsibility as the baseline*: Consistent with the SFO framework, accountability should rest with the licensed custodian entity, which should disclose in its licence application the group entities and personnel involved in custody functions. Where a group entity exercises substantive control (e.g. by holding private keys, jointly approving transactions or managing reserve assets), that entity should itself be licensed.

- *Accreditation of personnel as a pragmatic option:* If group entities are not separately licensed, a practical approach would be to permit personnel from those entities to be accredited to the licensed custodian (Entity A). This would ensure supervisory visibility without fragmenting responsibility across multiple licences. Legal responsibility and liability, however, should remain squarely with the licensed entity.

- *Caution on individual licensing*: Introducing an individual licensing regime for custody staff would be a significant departure from current Hong Kong practice. Most regulatory regimes adopt an entity-level model, with approval of senior individuals acting as Responsible Officers or key function holders (e.g. under MiCA in the EU, MAS in Singapore). We would therefore not support a broad individual licensing requirement. If pursued, it should be limited to senior management with material accountability for custody operations (e.g. Directors, CTO, Compliance Officer), rather than extending to operational staff.

- *Risk-based triggers*: Any accreditation or approval regime should be linked to substantive control functions, such as:
    - Private key generation, storage or management;
    - Unilateral or joint authorisation of transactions;
    - Control over wallets or ability to freeze/recover assets;
    - Oversight of custody-specific risk management.

Overall, the associations recommend that entity-level licensing, supplemented by disclosure of group custody arrangements and approval of Responsible Officers, is sufficient to safeguard investors. Accreditation of group personnel to the licensed custodian could provide a proportionate fallback mechanism, but we do not support the introduction of a broad individual licensing framework.

Q5 What are your comments on the proposed exemptions? Would there be other exemptions that are necessary?

The associations are supportive of the proposed exemptions, in particular the exemption for custody functions that are wholly incidental to the principal business of providing a licensed VA service. Such exemptions are consistent with international practice and reflect a proportionate, risk-sensitive approach aligned with the principle of "same activity, same risk, same regulation."

At the same time, we encourage refinements in four key areas:

1. *Avoiding excessive concentration risk*: The proposal to require client VAs to be held exclusively with licensed or registered custodians in Hong Kong, while well-intentioned, may create operational bottlenecks and systemic vulnerabilities in the early stages of the regime, when the number of licensed custodians may be limited. Excessive concentration among a small pool of providers could undermine resilience and limit service quality. We therefore recommend that licensees be permitted to appoint overseas custodians regulated under equivalent regimes (e.g. MAS in Singapore, VARA in Dubai, MiCA in the EU), provided:
    - The custodian meets equivalent prudential, operational and risk management standards; and
    - The Hong Kong licensee remains contractually responsible to clients for safekeeping of assets.

2. *Technical safeguards exemption*: We recommend extending incidental exemptions to entities that, by design, have no ability to transfer VAs on behalf of clients, but may have technical safeguards (e.g. ability to freeze or restrict transfers). As these entities do not exercise true custody, licensing would not be proportionate.

3. *Recognition of existing regulated entities*: Entities already subject to stringent oversight by the HKMA or SFC and which are required to conduct comprehensive third-party/vendor risk assessments, should not be required to obtain an additional VA custodian licence solely by virtue of appointing another licensed VA custodian. This would reduce duplication while maintaining robust oversight.

4. *Self-custody out of scope*: We recommend the SFC explicitly recognise that self-custody, where clients retain exclusive control over their private keys, falls outside the scope of the licensing regime. This would ensure a technology-neutral and proportionate framework and avoid inadvertently capturing non-custodial business models.

Finally, we encourage the SFC and FSTB to adopt a market-level perspective, considering the interconnectedness of providers and the potential risk of single points of failure. Exemptions should support both investor protection and the long-term competitiveness of Hong Kong's VA market, ensuring that clients have access to safe and efficient custody solutions both locally and internationally.

We also recommend clarifying an "in-transit" exemption to cover business-to-business arrangements between licensed VA dealers/brokers and technology or liquidity partners. In these cases, wallet infrastructure may be used to facilitate execution and settlement, but there is no ongoing safekeeping function by the infrastructure provider.

The exemption should therefore be defined not only on a time basis (short duration holdings) but also on a functional basis (activities limited to execution and settlement flows without discretionary control).

Q6 Do you have any comments on the proposed scope of allowed activities?

The associations are supportive of the proposed scope of allowed activities as outlined in the Consultation. We agree that the key determinant of whether custody services are being provided should be based on whether an entity has control over private keys or client wallets, consistent with the substance-over-form approach recommended in our responses to Questions 1 and 4.

To support clarity and consistency in implementation, we encourage the SFC to issue further guidance or illustrative examples to help market participants determine when control is deemed to exist. Such guidance would reduce the risk of interpretative uncertainty, support proportionate compliance and help ensure a level playing field across the industry.

We also recommend that the scope of allowed activities explicitly include value-added services such as staking and collateral management, subject to appropriate safeguards. These should include client consent, segregation of assets and risk controls (e.g. slashing mitigation mechanisms). Providing clarity on these services would reduce ambiguity in licensing scope and enable institutional product innovation under appropriate regulatory oversight.

Q7 Do you have any comments on the types of VAs that a VA custodian service provider should not provide custodian services for?

The associations support the SFC's proposal not to impose restrictions on the types of virtual assets that may be held in custody. This is consistent with the approach under Hong Kong's existing securities frameworks, where custodians are not typically limited by asset class. We believe the same principle should apply to VA custodians.

Instead, regulatory focus should be placed on:

- *Competence and safeguards of the custodian*: Custodians should be required to demonstrate appropriate governance, operational resilience and risk management capabilities before offering custody of a given token.

- *AML/CFT due diligence*: Custodians should conduct robust assessments of the tokens they safekeep to ensure that money laundering and terrorist financing risks are appropriately managed, consistent with FATF standards including Travel Rule compliance.

  We further recommend that any prohibitions be framed on a principle-based basis, limited to assets that are illegal, sanctioned or present unmanageable AML/CFT risks. This approach would provide legal clarity while ensuring the framework remains innovation-friendly and adaptable, rather than relying on prescriptive or static lists of restricted assets.

- *Technical capacity*: Custodians should only take into custody assets for which their infrastructure is capable of securely supporting custody (e.g. private key management, wallet compatibility and recovery mechanisms).

This approach ensures that investor protection and financial integrity objectives are met without creating arbitrary exclusions that could stifle innovation or limit investor choice.

Q8 Do you have any comments on the scope of individual licence and engagement as relevant individuals for providing VA custodian service?

The associations do not support the introduction of a broad individual licensing regime for personnel engaged in VA custodian services. In our view, accountability should rest primarily with the licensed entity, with individual oversight applied only to senior personnel holding significant responsibility for the custody function.

We therefore recommend:

- *Adopting a Responsible Officer / MIC-style framework*: Rather than requiring all relevant individuals to obtain an individual licence, the SFC could apply an approval regime similar to the Responsible Officer (RO) requirements under the Securities and Futures Ordinance (SFO) or the Manager-In-Charge (MIC) framework. This would ensure that individuals with ultimate responsibility for the custody function are subject to regulatory scrutiny and approval, while avoiding unnecessary administrative burdens on operational staff.

- *Role-specific accountability*: Under such a framework, individuals should be approved in connection with a specific role at a licensed entity, rather than being granted a portable licence. This ensures accountability is aligned to the entity's governance structure and reflects the fact that custody staff act on behalf of the entity, not independently.

This approach would be consistent with Hong Kong's existing regulatory practice, internationally proportionate and sufficient to safeguard investor protection without imposing undue complexity or cost.

Q9 Should individuals with authority to approve or sign VA transactions be required to obtain a licence or be engaged as relevant individuals? If yes, what steps of the transactions should trigger this requirement?

The associations do not believe that individuals who approve or sign VA transactions should be required to obtain a separate licence. As set out in our responses to Questions 4(ii) and 8, such individuals typically act in their professional capacity as employees of a licensed entity, rather than on their own behalf. Licensing should therefore remain at the entity level, with regulatory approval applied only to senior personnel who hold ultimate responsibility for the custody function (e.g. Responsible Officers under the SFO or equivalent MIC-style roles).

If a licensing or approval mechanism is introduced, we recommend that:

- *Scope is limited to critical custody functions*: Approval requirements should only apply to individuals with meaningful control over the safeguarding of client assets, such as:
    - Private key generation and lifecycle management;
    - Transaction authorisation or execution (where the individual can unilaterally or jointly approve/sign transactions); and
    - Technical or operational access to client wallets.

- *Structured as role-specific approval within the entity*: Any such requirements should be linked to the individual's role within the licensed entity, rather than establishing a portable individual licence. This approach is more consistent with existing Hong Kong regulatory frameworks and international practice.

- *Clear boundaries are necessary*: It should be made explicit that routine personnel, such as marketing staff or technical employees who provide maintenance or safeguards but have no ability to access or authorise client transactions, are not captured by these requirements. Without such clarity, there is a risk of overreach and unnecessary administrative burden.

Overall, the associations recommend that the regulatory framework focus on entity-level accountability, supplemented by proportionate oversight of key function holders, rather than requiring all transaction-approving personnel to be individually licensed.

Q10 Do you think that licensed VA custodian service providers should be subject to the similar financial requirements as licensed corporations carrying on Type 13 regulated activity of providing depositary services for a relevant CIS? Do you think additional resources calibrated with scale of business or operations are required?

The associations broadly support applying prudential and financial requirements to VA custodian service providers that are consistent with the principles underpinning Type 13 regulated activity, given the comparable nature and risk profile of safeguarding client assets. Robust financial standards are important to ensuring trust, resilience and investor protection.

However, we caution against a rigid one-size-fits-all approach and recommend the following refinements:

- *Proportionality and risk-based calibration*: Requirements should reflect the scale, complexity and risk profile of the custodian's business. Smaller or specialised custodians should not face the same capital and liquidity requirements as large, systemically important entities. Additional safeguards should also reflect VA-specific risks such as cybersecurity and technology infrastructure, which may not be fully captured in the Type 13 framework.

- *Avoiding duplication for existing VATPs*: For licensed VATPs that are required to obtain a custody licence, prudential requirements should build on existing obligations rather than apply from scratch. An uplift approach, recognising excess capital or prudential resources already allocated under an existing licence, would reduce unnecessary duplication while maintaining investor protections.

- *Competitiveness and international alignment*: Overly onerous financial requirements may make Hong Kong less attractive as a hub for VA custody, particularly given that many existing custodians operate under the more proportionate TCSP framework today. We note also that associated entities under the Securities and Futures Ordinance (SFO) may hold client assets without being subject to equivalent prudential obligations, raising the risk of inconsistency with the "same activity, same risk, same regulation" principle.

Overall, we recommend that financial requirements for VA custodians be designed to ensure robustness while remaining proportionate, risk-based and internationally competitive. A calibrated approach, recognising existing obligations, avoiding duplication and tailoring prudential standards to VA-specific risks, will provide a balanced framework that supports both investor protection and Hong Kong's role as a leading FinTech and digital assets hub.

Q11 Should other regulatory requirements be added to mitigate the risks of VA custodian services?

The associations support a risk-based approach to regulatory requirements for VA custodians, with emphasis on governance, operational resilience and due diligence rather than prescriptive technology mandates. This approach would ensure that client assets are safeguarded while allowing providers the flexibility to adopt solutions tailored to their business models and risk profiles.

In addition to the measures outlined in Section 2.39 of the Consultation, we recommend that the framework address the following areas:

- *Proportionality:* We recommend that certain detailed standards from the August 2025 SFC circular be calibrated for proportionality. Requirements such as real-time reconciliation, 24/7 security operations and extensive third-party vendor monitoring may be disproportionate for professional-only custodians or smaller operators. A phased or risk-tiered approach would ensure high standards without creating unnecessary barriers to entry.

- *Access controls and segregation of duties*: Regulatory expectations should include multi-signature or multi-party approval mechanisms, with clear separation between private key generation and transaction execution functions to mitigate insider risk.

- *Hot and cold wallet storage*: While we support requirements to maintain appropriate cold/hot wallet ratios, we recommend that the onus be placed on licensees to justify their storage policies to the SFC, rather than prescribing fixed thresholds (e.g. the 98/2 ratio applied to Platform Operators). This would allow for proportionate tailoring across different business models.

- *Asset segregation*: Regulations should require that client assets be held in trust, segregated from the custodian's own assets and clearly identified as client property. This would provide legal certainty and protect clients in the event of insolvency or third-party creditor claims.

- *Private key management and reconciliation*: The SFC could issue guidance on good practices for private key lifecycle management, including secure generation, backup, storage and regular reconciliation. Establishing expected standards would help strengthen resilience and reduce operational risk.

In addition, we recommend that the SFC reference established international standards for operational resilience, such as ISO 27001 and NIST cybersecurity frameworks, alongside clear expectations for penetration testing frequency, private key lifecycle controls and proportionate insurance coverage. Establishing such baseline standards would provide clarity and consistency for both firms and regulators, while ensuring flexibility to accommodate different business models.

Overall, the associations recommend a regulatory framework that focuses on principles of sound governance and risk management, supported by targeted guidance from the SFC. This would safeguard client assets without constraining innovation or imposing unnecessary operational burdens.

Q12 What are your comments on the proposed transitional arrangement for the licensing regime for VA custodian service providers?

The associations support the proposal to grant open-ended licences or registrations, which is preferable to a fixed renewal cycle. However, we are concerned that the absence of any transitional period could create unnecessary disruption for both industry and regulators.

- *Need for a transitional period*: Without a defined transition, otherwise compliant firms may be forced to cease operations temporarily while awaiting licence approval, particularly if the SFC faces a high volume of applications at the same time. This could create market instability and undermine client confidence. We therefore recommend that the SFC revisit its earlier OTC Consultation proposal to allow for a minimum twelve-month transitional period, conditional on firms submitting licence applications within the first three months. This would enable continuity of services while ensuring timely engagement with the regulator.

  We also encourage the SFC to consider whether a longer transitional period of up to eighteen months, with phased milestones, may better support market stability. Allowing firms to continue operating while applications are under review, subject to appropriate interim safeguards, would help ensure operational continuity and investor protection during the transition. This would give legitimate operators time to align their governance and capital arrangements with the new framework, while avoiding market disruption.

- *Pre-existing business recognition*: Clear criteria should be developed to distinguish legitimate pre-existing operators from shell companies seeking to exploit the

transitional regime. This would ensure that the regime rewards good-faith operators while maintaining safeguards against regulatory arbitrage.

- *Cross-border sub-custody arrangements*: Transitional rules should also recognise the reality of cross-border custody and outsourcing arrangements, including to group entities. Many providers rely on international custodial infrastructure and transitional measures should avoid creating artificial barriers that could disrupt existing operations.

We recognise the SFC and FSTB's concern that a deeming arrangement could allow unqualified firms to operate for an extended period if their licence applications are ultimately rejected. However, this risk can be mitigated through strict timelines for submission, clear disclosure requirements and enhanced supervisory monitoring during the transitional phase.

Overall, the associations strongly encourage the adoption of a commercially practical, structured transitional period. This would support regulatory objectives while ensuring continuity, market stability and operational resilience during implementation of the new regime.

Q13 Based on the "user-pays" principle, do you have any comments on requiring higher licensing application fees and annual fees for a VA custodian service provider licensed by or registered with the SFC (such as requiring fees in the same amounts as those for Type 3 regulated activity under the SFO or other higher amounts)?

The associations support aligning licensing and annual fees for VA custodians with existing models under the Securities and Futures Ordinance (SFO), such as the current fee structure for Type 3 regulated activity. We do not believe the technical components of VA custody justify significantly higher fees than those applied to equivalent securities-related services.

We highlight the following considerations:

- *Proportionality*: Excessive fees may create barriers to entry, discouraging reputable operators from entering the Hong Kong market and potentially undermining the competitiveness of the regime. Fees should therefore be proportionate and benchmarked to equivalent financial services activities.

- *Assessment standards and efficiency*: At present, there are limited established industry guidelines or best practices for digital asset custody assessments. Combined with the tripartite arrangement (involving licensees, external assessors and the SFC), this creates cost and operational inefficiencies. Higher fees in this context risk compounding inefficiencies without corresponding regulatory benefit.

- *Regulatory client model*: The current framework effectively positions the SFC as a "non-paying client" of assessment providers, which may distort incentives and reduce efficiency. Fee structures should be designed to ensure transparency, efficiency and alignment of interests between regulators, assessors and licensees.

Overall, we recommend that fees for VA custodians be aligned with existing SFO models and remain proportionate. Rather than imposing higher charges, the SFC could focus on improving assessment standards and streamlining supervisory processes to achieve efficiency and consistency in oversight.

Q14 Do you agree that, for the purpose of protecting the investing public, persons not licensed by or registered with the SFC should not be allowed to actively market VA custodian services to the public of Hong Kong?

The associations are broadly supportive of the proposal, as it would help safeguard investors by ensuring that only regulated entities may actively market VA custodian services to the Hong Kong public.

However, we believe further clarity is required on the scope of "actively marketing." In particular, we recommend that the SFC confirm whether it intends to apply the same interpretation as under the Securities and Futures Ordinance (SFO) and existing SFC guidance. Clear parameters would help ensure that entities do not inadvertently breach requirements, particularly in relation to cross-border activities, group-level marketing or the passive availability of online materials.

In addition, we recommend that the framework explicitly preserve reverse solicitation for professional and institutional clients, supported by appropriate record-keeping requirements. This would maintain Hong Kong's international connectivity and market competitiveness without undermining onshore investor protections.

Q15 Do you agree that the SFC and the HKMA should be provided with the proposed powers?

The associations are supportive of the proposal to provide the SFC and the HKMA with the necessary supervisory and enforcement powers to effectively implement and oversee the VA custodian licensing regime. Robust supervisory authority is essential to safeguarding client assets, maintaining market integrity and ensuring investor confidence.

We encourage the regulators to apply these powers in a proportionate and risk-based manner, with clear guidance on expectations, to provide industry participants with certainty while allowing flexibility for innovation.

Q16 Do you agree with the proposed sanctions, which are comparable to those under the existing regulatory regimes for VATPs?

The associations support the proposed sanctions framework, noting that it is broadly consistent with the enforcement provisions already applied under the VATP regime. Maintaining alignment across regulatory frameworks will promote clarity, consistency and fairness, while ensuring that regulators have effective tools to address misconduct and safeguard investors.

Q17 Do you agree that a review tribunal mechanism should be put in place to handle appeals against the decisions to be made by the SFC or the HKMA in implementing the licensing regime?

The associations support the establishment of a fair and transparent review tribunal mechanism. Providing an efficient clear, independent avenue for appeal is an important safeguard for procedural fairness and will enhance confidence in the regulatory regime.

Such a mechanism will help ensure transparency, accountability and consistency in decision-making, while giving market participants appropriate recourse in cases of disagreement.