



EMAIL SUBMISSION TO: [vadealing-consult@fstb.gov.hk](mailto:vadealing-consult@fstb.gov.hk)

To whom it may concern,

**Re: Public Consultation on Legislative Proposal to Regulate Virtual Asset Advisory Service Providers and Virtual Asset Management Service Providers**

**About Web3 Harbour (W3H) and Global Digital Finance (GDF)**

W3H is a Hong Kong-based, member-led community of Web3 builders, users, investors and industry leaders committed to promoting a pro-innovation, pro-collaboration and inclusive environment for the development of the decentralised internet and virtual asset economy. 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 and GDF 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 industry engagement and discussions with member firms. Both W3H and GDF are grateful to all members who have taken part.

As always, W3H and GDF remain at your disposal for any further questions or clarifications you may have. Given the importance of these proposals - inclusive of the recently released consultation conclusions on the proposals to regulate dealing in virtual assets - we would very much appreciate the opportunity to meet with you at your earliest convenience to discuss liquidity sourcing, potential market limitations, and related matters in greater detail with our members.

Yours faithfully,

Jeffrey Tchui - Executive Director - W3H

Elise Soucie Watts - Executive Director - GDF

## Response to the Consultation: Executive Summary

W3H and GDF convened their joint APAC Policy and Regulatory Working Group to analyse the **Consultation Paper on the Legislative Proposal to Regulate Virtual Asset Advisory Service Providers and Virtual Asset Management Service Providers**.

Please note that, as this response was developed in collaboration with W3H and GDF members, as well as community partners, portions of our response may be similar or verbatim to responses that the SFC may receive from individual firms. However, noting as well that this response reflects a consensus-based submission across a diverse membership.

We appreciate the opportunity to engage on the proposals, and our response to the consultation aims to support the SFC and FSTB in further developing an overarching framework for virtual assets.

In collaboration with our members, we have aimed to provide feedback and suggested key themes that would be beneficial for consideration as the SFC continues to build out its proposals. We also aimed to consider requirements in other jurisdictions that impact our members.

## Response to the Consultation Questions

### *Q1 Do you agree with the proposed definition and scope of VA advisory services?*

Members broadly support the proposed definition and scope of Virtual Asset (“VA”) advisory services and, in particular, the decision to model the regime closely on Type 4 (advising on securities) regulated activity under the Securities and Futures Ordinance (“SFO”).<sup>1</sup>

We agree that defining VA advisory services by reference to the function performed. This approach is consistent with IOSCO’s recommendations on crypto-asset regulation, which emphasise that regulatory obligations should be determined by the *economic function of the activity and the risks it poses*, rather than by the technological form or asset classification.<sup>2</sup>

IOSCO has specifically identified that advisory activities relating to crypto-assets raise investor protection concerns analogous to those observed in traditional securities markets, including:

- mis-selling and inappropriate recommendations,
- information asymmetry and complexity risk,
- conflicts of interest, and

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<sup>1</sup> **Securities and Futures Ordinance (Cap. 571)**, Schedule 5, Part 2 - *Type 4 regulated activity: Advising on securities*.

<sup>2</sup> **IOSCO**, *Policy Recommendations for Crypto and Digital Asset Markets (2023)*, particularly the recommendations on activity-based regulation and intermediary conduct.

- failures in suitability and client assessment.<sup>3</sup>

Members therefore consider it appropriate that VA advisory services be subject to licensing, conduct, and suitability requirements comparable to those applicable to traditional investment advisory activities under the SFO.

Members further note that the proposed scope is aligned with the Bank for International Settlements' (BIS) articulation of functional regulation in the crypto-asset context, which calls on authorities to regulate activities that replicate the economic substance of traditional financial services - such as investment advice - regardless of whether those services are delivered using distributed ledger technology or novel business models.<sup>4</sup> The BIS has consistently stressed that regulatory frameworks should focus on *what activity is being performed and what risks are created, rather than how the service is technologically implemented.*<sup>5</sup>

By anchoring the VA advisory regime to the existing Type 4 advisory framework under the SFO, including its concepts of advice, incidental exemptions, and conduct standards as set out in Schedule 5 to the SFO, the proposal:

- reinforces the principle of “same activity, same risks, same regulation”;
- reduces the potential for regulatory arbitrage between traditional and virtual-asset advisory services; and provides legal and supervisory clarity for professional advisory firms operating in or from Hong Kong.

Members therefore support the proposed definition and scope of VA advisory services as a sound and internationally consistent application of activity-based and functionally equivalent regulation, while preserving appropriate flexibility for innovation within a robust investor-protection framework.

## *Q2 Are there any other exemptions which may be appropriate?*

Members generally support the exemptions proposed in the consultation paper. These exemptions are consistent with long-standing approaches under Hong Kong's securities regulatory framework and reflect international best practices regarding the appropriate delineation of the regulatory perimeter.

From an international standards perspective, IOSCO has consistently emphasised that regulatory regimes for crypto-asset intermediaries should adopt an activity-based and proportionate approach, ensuring that licensing obligations apply where investor-facing risks arise, while excluding activities that are ancillary, incidental, or informational in nature.<sup>6</sup> In particular, IOSCO has recognised that not all forms of information

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<sup>3</sup> IOSCO, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms* (2020) and subsequent updates, sections on investor protection and intermediary behaviour.

<sup>4</sup> Bank for International Settlements, *Cryptoassets and Decentralised Finance: Functions and Financial Stability Implications* (BIS Quarterly Review / Annual Economic Report).

<sup>5</sup> BIS, *Annual Economic Report 2023*, chapter on cryptoassets - discussion on functional equivalence and “same risk, same regulation.

<sup>6</sup> IOSCO, *Policy Recommendations for Crypto and Digital Asset Markets* (2023), recommendations on regulatory perimeter, proportionality, and activity-based supervision.

dissemination or professional services constitute regulated investment advice, provided that such activities do not involve personalised recommendations or inducement to transact.<sup>7</sup>

Members note that the proposed exemptions closely mirror those available under the Type 4 (advising on securities) regime of the Securities and Futures Ordinance (“SFO”), including:

- the incidental exemption, where advisory conduct is wholly incidental to another regulated activity for which the person is already licensed;
- exemptions for advice given to group companies; and
- exclusions for advice given through bona fide publications of general circulation.<sup>8</sup>

These concepts are well-understood by market participants and supervisors in Hong Kong and have been applied consistently across traditional securities markets.

Members further note that similar perimeter distinctions exist in Hong Kong case law and regulatory practice, which draw a clear line between:

- personalised or transactional investment advice (which is regulated), and
- general market commentary, research, education, or professional opinion provided without an intent to induce a specific investment decision (which is not).<sup>9</sup>

In this context, members do not propose materially expanding the scope of exemptions beyond those already identified. However, members would welcome additional regulatory guidance or illustrative examples, particularly in relation to:

- factual or educational research on virtual assets that does not contain recommendations;
- technology providers offering analytics, dashboards, or tooling without interpretive or advisory overlays; and
- hybrid business models where advisory elements are clearly ancillary and non-determinative.

Such guidance would enhance legal certainty, support compliance, and remain fully aligned with IOSCO principles and existing Hong Kong securities law precedent, without diluting investor protection or undermining the integrity of the proposed licensing regime.

### *Q3 Do you have any comments on the regulatory requirements to be imposed on VA advisory service providers?*

Members’ key concern is to ensure that there is a level playing field.

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<sup>7</sup> IOSCO, *Report on the Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms* (2020), sections addressing advisory activities, information asymmetry, and investor inducement.

<sup>8</sup> **Securities and Futures Ordinance (Cap. 571)**, Schedule 5, Part 2 - Type 4 regulated activities; see also SFC guidance on incidental exemptions and exclusions for group advice and publications.

<sup>9</sup> **SFC**, *Guidelines on Online Distribution and Advisory Platforms* and related licensing FAQs, which distinguish regulated advice from general information and educational content; see also established Hong Kong regulatory practice under Parts IV and V of the SFO.



Members support the proposal to align the regulatory requirements applicable to VA advisory service providers with those imposed on Type 4 (advising on securities) licensed corporations under the Securities and Futures Ordinance (“SFO”).

From an international standards perspective, members note that IOSCO has consistently emphasised that intermediaries providing advisory services, regardless of whether the underlying asset is a security or a crypto-asset, should be subject to robust conduct, suitability, and conflict-of-interest requirements.<sup>10</sup> IOSCO has specifically highlighted the heightened investor protection risks associated with complex and volatile crypto-assets, reinforcing the need for strong client assessment, disclosure, and governance controls at the advisory layer.<sup>11</sup>

Members therefore support the application of requirements relating to:

- assessment of clients’ knowledge and experience with virtual assets;
- suitability and risk profiling, including the appropriateness of VA exposure;
- disclosure of risks, fees, and conflicts of interest; and
- record-keeping, auditability, and supervisory reporting.

These requirements closely parallel long-standing obligations imposed on Type 4 intermediaries under the SFO, including those articulated in the Code of Conduct for Persons Licensed by or Registered with the SFC, as well as the Joint Circular on Intermediaries Virtual Asset-Related Activities.<sup>12</sup> Members consider this continuity important for regulatory clarity, supervisory efficiency, and market discipline.

Members further note that the proposal to subject VA advisory service providers to AML/CFT obligations under Schedule 2 to the AMLO is consistent with both international standards and domestic precedent. FATF and IOSCO have jointly underscored that advisory and intermediary functions play a critical role in the prevention of illicit finance and should therefore be subject to customer due diligence and record-keeping requirements proportionate to their risk profile.<sup>13</sup>

At the same time, members encourage the SFC to continue applying a risk-based and proportionate supervisory approach, consistent with BIS guidance on financial regulation of crypto-asset activities.<sup>14</sup> In particular, members note that advisory firms that:

- do not hold client assets,
- do not execute transactions, and

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<sup>10</sup> **IOSCO**, *Policy Recommendations for Crypto and Digital Asset Markets* (2023), recommendations on intermediary conduct, suitability, and conflicts of interest.

<sup>11</sup> **IOSCO**, *Investor Protection in Crypto-Asset Markets* (2022), discussion of complexity, volatility, and information asymmetry risks in crypto-asset advice.

<sup>12</sup> **SFC**, *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*; and Joint Circular on Intermediaries’ Virtual Asset-Related Activities (22 December 2023, as amended).

<sup>13</sup> **FATF**, *Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (updated 2023), sections on intermediary and advisory functions.

<sup>14</sup> **Bank for International Settlements**, *Annual Economic Report 2023*, chapters on crypto-assets and the application of proportional, risk-based supervision.

- operate purely on a non-discretionary basis

may present a different risk profile from custodial or dealing intermediaries, and supervisory calibration should continue to reflect such distinctions without weakening core investor-protection outcomes.

Overall, members consider the proposed regulatory requirements to be appropriate, internationally consistent, and well-aligned with Hong Kong’s existing securities regulatory framework. The approach supports investor protection, institutional confidence, and the sustainable development of VA advisory services within a well-understood and credible regulatory environment.

#### *Q4 Do you agree with the proposed definition and scope of VA management services?*

Members support the proposal not to introduce a de minimis threshold (for example, based on the proportion of virtual assets in a portfolio). This mirrors the treatment of asset management under the SFO, which does not provide exemptions based on asset allocation, portfolio size, or investment proportion. From a Hong Kong regulatory perspective, the existence of discretionary authority over client assets, rather than the percentage of any particular asset class, is the determinative factor in assessing whether asset management regulation should apply.<sup>15</sup> In this light, members recommend that the SFC rationalise requirements across existing Type 9 licensed corporations managing VAs. Currently, those with less than 10% VA exposure are regulated solely under the SFO Type 9 framework, while those exceeding 10% must comply with additional VA fund manager terms and conditions. With no de minimis threshold under the proposed AMLO regime, harmonising treatment across these groups and newly licensed VA managers would reduce fragmentation and promote a level playing field for comparable risks.

Members further note that this approach is consistent with current SFC supervisory practice, including the expectations articulated in the Code of Conduct for Persons Licensed by or Registered with the SFC and the Joint Circular on Intermediaries’ Virtual Asset-Related Activities, which already subject licensed asset managers managing VA portfolios to enhanced governance, risk management, disclosure, and suitability requirements.<sup>16</sup> Aligning the statutory licensing perimeter with these existing supervisory expectations improves regulatory coherence and reduces interpretive uncertainty for market participants.

From an international perspective, members observe that this approach is consistent with IOSCO’s guidance on crypto-asset intermediaries, which recognises that discretionary portfolio management involving crypto-assets presents risks comparable to traditional asset management, including conflicts of interest, valuation uncertainty, liquidity risk, and operational resilience challenges. IOSCO has therefore emphasised that such activities should be regulated within established asset-management frameworks rather than through bespoke or parallel regimes.<sup>17</sup>

Members also note that the proposal reflects the Bank for International Settlements’ (“BIS”) principle of functional regulation, which calls for crypto-asset activities that replicate the economic substance of

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<sup>15</sup> **Securities and Futures Ordinance (Cap. 571)**, Schedule 5 - absence of asset-allocation-based thresholds for Type 9 licensing; see also SFC licensing FAQs on asset management.

<sup>16</sup> **SFC**, *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*; *\*Joint Circular on Intermediaries’ Virtual Asset-Related Activities* (22 December 2023, as amended).

<sup>17</sup> **IOSCO**, *Policy Recommendations for Crypto and Digital Asset Markets (2023)*, sections addressing portfolio management, conflicts of interest, and investor protection.

traditional financial services, such as asset management, to be regulated on a technology-neutral basis.<sup>18</sup> In this respect, discretionary VA management raises prudential and conduct risks similar to those addressed by Type 9 regulation and should therefore be subject to equivalent oversight.<sup>19</sup>

Members therefore support the proposed definition and scope of VA management services as a legally coherent, supervisory-aligned, and internationally consistent extension of Hong Kong’s asset-management regime.

### *Q5 Are there any other exemptions which may be appropriate?*

Members generally support the exemptions proposed in respect of Virtual Asset (“VA”) management services and consider them to be appropriately calibrated by reference to existing exemptions applicable to Type 9 (asset management) regulated activity under the Securities and Futures Ordinance (“SFO”).<sup>20</sup> These exemptions closely mirror those available under Schedule 5 to the SFO for Type 9 regulated activity under the Securities and Futures Ordinance (“SFO”). These exemptions closely mirror those available under Schedule 5 to the SFO and reflect long-established perimeter concepts that have been applied consistently by the SFC in traditional securities and fund management contexts.<sup>21</sup>

Members consider it appropriate that the VA management regime adopts these same exemption constructs, as doing so promotes continuity, legal certainty, and regulatory coherence for market participants transitioning existing business models to incorporate virtual assets. Aligning the VA regime with established Type 9 concepts also reduces the risk of unintended perimeter expansion and supports a technology-neutral approach to regulation.

From a broader policy perspective, members note that international standard-setting bodies, including the Bank for International Settlements (“BIS”), have emphasised that crypto-asset activities which replicate traditional financial functions, such as discretionary portfolio management, should be regulated on a functionally equivalent and technology-neutral basis. This reinforces the importance of grounding exemptions in the nature of the regulated activity rather than solely in asset classification or portfolio composition.

In light of the above, members do not at this stage identify a clear need for additional or alternative exemption categories beyond those outlined in the consultation. However, members would welcome additional SFC guidance or illustrative examples to clarify the application of existing exemptions in the VA context, particularly in relation to:

- private fund and venture capital structures;
- transitional scenarios involving newly issued or illiquid tokens; and

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<sup>18</sup> **Bank for International Settlements**, *Cryptoassets and Decentralised Finance: Functions and Financial Stability Implications* (BIS Quarterly Review / Annual Economic Report).

<sup>19</sup> **BIS**, *Annual Economic Report 2023*, discussion on functional equivalence and prudential treatment of crypto-asset activities.

<sup>20</sup> **Securities and Futures Ordinance (Cap. 571)**, Schedule 5, Part 2 - *Type 9 regulated activity: Asset management*.

<sup>21</sup> **SFC**, Licensing Handbook; SFC licensing FAQs and established supervisory practice concerning exemptions applicable to Type 9 regulated activity.



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- hybrid business models where VA management activities are clearly ancillary and non-determinative.

Such guidance would enhance compliance certainty while remaining fully aligned with the SFO, SFC supervisory practice, and internationally recognised regulatory principles, without constraining market development or access to global opportunities.

#### *Q6 Do you have any comments on the requirements relating to VA management?*

Members broadly support the proposed regulatory requirements applicable to Virtual Asset (“VA”) management service providers and agree that these requirements should closely align with those imposed on Type 9 (asset management) licensed corporations under the Securities and Futures Ordinance (“SFO”).<sup>22</sup>

Members agree that equivalent standards are justified given the fiduciary responsibilities inherent in discretionary portfolio management, regardless of whether the underlying assets are virtual or traditional.

Members further support the proposal to apply AML/CFT requirements under Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”) to VA management service providers. This is consistent with existing requirements applicable to SFC-licensed asset managers and reflects the role of asset managers as important gatekeepers within the financial system.<sup>23</sup> Members note that this approach aligns with FATF guidance, which emphasises that intermediaries exercising control over client assets should be subject to robust customer due diligence, record-keeping, and ongoing monitoring obligations.<sup>24</sup>

With respect to financial resources requirements, members support aligning capital and liquid capital thresholds with those applicable to Type 9 regulated activity under the SFO. This promotes regulatory parity and avoids creating incentives for regulatory arbitrage between VA and non-VA asset management activities. At the same time, members also encourage the SFC to continue applying its established risk-based supervisory discretion, including calibrating requirements by reference to whether a VA manager:

- holds client assets directly;
- appoints third-party custodians; or
- operates purely on a non-custodial basis.

Members note that such supervisory calibration is consistent with SFC licensing practice and does not detract from baseline prudential standards.

More broadly, members note that, as Hong Kong continues to position itself as a leading international financial centre for virtual assets, regulatory requirements should facilitate appropriate access to global liquidity and overseas markets, subject to robust governance, risk management, and supervisory safeguards. Members observe that the SFC already operates a rigorous approval and oversight framework for permitting

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<sup>22</sup> **Securities and Futures Ordinance (Cap. 571)**, Schedule 5, Part 2 — Type 9 regulated activity: Asset management.

<sup>23</sup> **Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615)**, Schedule 2 - customer due diligence and record-keeping requirements.

<sup>24</sup> **FATF**, *Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (updated 2023), sections addressing asset managers and intermediary controls.

Hong Kong-regulated entities to access overseas trading venues, including through detailed standards and ongoing supervisory expectations.

In this context, members consider that, rather than relying on restrictions as the primary mechanism for managing risk, it may be appropriate for the SFC to continue exploring risk-based pathways that enable SFC-licensed intermediaries, including asset managers and broker-dealers, to access overseas virtual asset trading platforms where equivalent regulatory outcomes, operational resilience, and investor protection standards can be demonstrated. Such an approach would support Hong Kong’s global connectivity and competitiveness while preserving strong supervisory oversight.

Members emphasise that facilitating access to overseas virtual asset trading platforms should not dilute the importance of robust regulatory standards or appropriate licensing. The SFC’s licensing framework plays a critical role in promoting high standards of governance, investor protection, and market integrity, and remains a key signal of regulatory credibility for firms seeking to serve Hong Kong clients.

Any risk-based pathways for accessing overseas venues should therefore be grounded in clear eligibility criteria, supervisory oversight, and demonstrable equivalence of regulatory outcomes, so as to help ensure that platforms seeking to operate in or actively target the Hong Kong market meet the SFC’s licensing expectations and the high standards applied to licensed firms.

From an international perspective, members observe that IOSCO has emphasised that crypto-asset portfolio management activities raise risks comparable to traditional asset management, including valuation uncertainty, liquidity constraints, custody risk, and operational resilience challenges. IOSCO has therefore supported regulating such activities within existing asset-management frameworks rather than through bespoke regimes.<sup>25</sup>

Members also note that the proposed requirements are consistent with the Bank for International Settlements’ (“BIS”) guidance on functional regulation, which underscores that discretionary management of client assets, regardless of whether those assets are digital or traditional, engages similar prudential and conduct risks and should therefore be subject to equivalent regulatory standards.<sup>26</sup>

Overall, members consider the proposed regulatory requirements for VA management service providers to be appropriate, proportionate, and well-aligned with both Hong Kong’s existing asset management regime and internationally recognised standards. Members support the SFC’s continued engagement with industry during implementation, particularly in relation to custody models, operational risk controls, and supervisory expectations, to ensure a smooth transition and high standards of compliance from commencement.

***Q7 Should VA management service providers be required to hold VAs of the private funds they manage via SFC-regulated VA custodians?***

Members recognise the regulatory rationale underpinning the proposal to require Virtual Asset (“VA”) management service providers to safekeep virtual assets of the private funds they manage via SFC-regulated

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<sup>25</sup> **IOSCO**, *Policy Recommendations for Crypto and Digital Asset Markets* (2023), sections on portfolio management, custody, valuation, and investor protection.

<sup>26</sup> **Bank for International Settlements**, *Annual Economic Report 2023*; *Cryptoassets and Decentralised Finance: Functions and Financial Stability Implications*, discussion on functional equivalence and prudential oversight.

VA custodian service providers, particularly in relation to asset segregation, investor protection, and supervisory oversight.

From a Hong Kong regulatory perspective, members note that custody arrangements are a core component of the SFC's asset-management supervisory framework, including under the Fund Manager Code of Conduct ("FMCC"), which requires licensed asset managers to ensure that client assets are properly safeguarded, segregated, and subject to appropriate oversight, whether custody is performed directly or delegated to third-party custodians.<sup>27</sup> These principles are well-established in traditional securities and fund management contexts and are equally relevant in the VA environment.

Members further note that requiring the use of SFC-regulated VA custodians strengthens compliance with the Anti-Money Laundering and Counter-Terrorist Financing Ordinance ("AMLO"), particularly the customer due diligence, record-keeping, and ongoing monitoring obligations set out in Schedule 2 to the AMLO.<sup>28</sup> Custody arrangements that fall within the SFC's regulatory perimeter enhance the authorities' ability to supervise asset flows, monitor suspicious transactions, and ensure effective implementation of AML/CFT controls across the VA value chain.

At the same time, members highlight practical considerations faced by VA managers, particularly private equity, venture capital, and early-stage fund strategies, where:

- newly issued or illiquid tokens may not yet be supported by SFC-regulated custodians;
- interim self-custody or alternative custody solutions may be operationally necessary;
- newly created blockchains may not yet be supported by regulated custodians, calling for direct custody capabilities to some threshold
- intraday safekeeping in both direct custody and hot wallets might be operationally necessary to a threshold higher than currently stipulated in relevant Guidelines
- technology neutrality, including in the choice of key management technologies like MPC, is important in giving access to cost effective and scalable custody architecture. This, including appropriate risk management, could be reflected into the industry-wide Guidelines

In this regard, members welcome the SFC's indication that it is considering limited and conditional flexibility, including the possibility of allowing self-custody up to a defined threshold or on a transitional basis, subject to appropriate safeguards. Members consider such an approach to be consistent with existing SFC practice, which allows for risk-based calibration of custody requirements under the FMCC where asset characteristics or market infrastructure warrant tailored treatment.

Members also emphasise the need for a level playing field and equivalent protections across custody arrangements. The insurance market's ability to provide meaningful coverage for VA-related risks rely heavily on the detailed security controls, private key management, and operational resilience demonstrated by SFC-regulated custodians and exchanges. Therefore, should the SFC allow limited use of non-regulated or offshore custodians (as referenced in the consultation paper for certain operational scenarios), members strongly recommend that these alternative custodians be required to meet and maintain equivalent standards of security, insurance, and operational resilience, so that key outcomes of investor protection and

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<sup>27</sup> SFC, *Fund Manager Code of Conduct*, in particular provisions relating to safekeeping of client assets, delegation of custody, and oversight of custodians.

<sup>28</sup> **Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615)**, Schedule 2 - customer due diligence, record-keeping, and ongoing monitoring obligations.

supervisory outcomes are not weakened. This balanced approach safeguards investor interests while ensuring that SFC-regulated custodians are not disadvantaged in the market.

Relying on individual VA managers to conduct their own due diligence on, and then appoint, any custodian as they see fit, may not offer sufficient investor protection and does not leverage on the extensive efforts that the SFC and the industry would already have expended in licensing and supervising SFC-licensed VA custodians to ensure safe custody of client assets. Any exception to this general rule should be narrowly crafted, with particular focus on risk management and investor compensation.

Requiring VA managers, like VA dealers, to custody only with SFC-licensed VA custodians would promote consistent standards of custody, security, and investor protection across domestic and overseas custodial arrangements.

From an international perspective, members note that IOSCO has identified custody as a critical risk area in crypto-asset portfolio management, particularly in relation to asset segregation, operational resilience, conflicts of interest, and insolvency risk. IOSCO has emphasised that regulators should ensure that crypto-asset custodians are subject to robust oversight and that asset managers retain responsibility for proper due diligence and ongoing monitoring of custodial arrangements.<sup>29</sup> IOSCO has also recognised that, in limited circumstances, proportional flexibility may be required where custody infrastructure is still developing, provided that investor protection is not compromised.<sup>30</sup>

Members further observe that the Bank for International Settlements (“BIS”) has similarly highlighted custody risk as a key transmission channel for financial stability and investor harm in crypto-asset markets, reinforcing the importance of bringing custodial functions within a regulated and supervised perimeter wherever possible.<sup>31</sup>

Accordingly, members support the SFC’s proposed direction of travel, namely:

- establishing SFC-regulated VA custodians as the default custody standard for VA management service providers; and
- permitting carefully scoped, risk-based exceptions where operational realities justify temporary or limited flexibility, provided that any permitted alternative arrangements maintain equivalent standards of security, insurance, and investor protection to avoid undermining the level playing field for SFC-regulated custodians.

Members consider this approach to be consistent with the SFO, the FMCC, the AMLO, and internationally recognised standards, while supporting the orderly and responsible development of Hong Kong’s VA fund management ecosystem.

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<sup>29</sup> **IOSCO**, *Policy Recommendations for Crypto and Digital Asset Markets* (2023), sections addressing custody, asset segregation, and responsibilities of portfolio managers.

<sup>30</sup> **IOSCO**, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms* (2020) and subsequent IOSCO work discussing proportionality and transitional custody considerations.

<sup>31</sup> **Bank for International Settlements**, *Annual Economic Report 2023; Cryptoassets and Decentralised Finance: Functions and Financial Stability Implications*, discussion on custody risk and regulatory perimeter integrity.



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*Q8 Do you have any comments on the licensing or registration application fee and annual fee for a licensee or registrant providing VA advisory services or VA management services?*

Members recognise the importance of appropriate licensing and annual fees in supporting effective supervision, resourcing, and ongoing regulatory oversight of Virtual Asset (“VA”) advisory and management service providers.

Members note that aligning the fee structure for VA advisory and VA management services with those applicable to comparable regulated activities under the Securities and Futures Ordinance (“SFO”) promotes consistency, transparency, and predictability for market participants. Such alignment also supports regulatory coherence as firms transition or expand existing licensed activities to include virtual assets.

At the same time, members encourage the SFC to continue applying a proportionate and risk-based approach to fee calibration, taking into account the nature, scale, and complexity of a firm’s activities. In particular, predictable and clearly articulated fee structures will be important in supporting orderly market entry, business planning, and sustained compliance, especially for firms operating across multiple regulated activities.

Members would welcome further clarity, where appropriate, on the application of fees in transitional scenarios, including for firms seeking to uplift existing licences or expand the scope of regulated activities to include VA advisory or VA management services.

*Q9 Do you have any other comments on the VA advisory and VA management service providers licensing regimes?*

Members consider that further clarity on transitional and licensing pathway arrangements would greatly assist market participants in preparing for the implementation of the proposed regimes, support orderly market development, and minimise unnecessary disruption to existing operations.

In particular, members seek additional guidance on the treatment of licensed corporations that have already obtained supervisory “uplifts” to their Type 1, Type 4, or Type 9 regulated activities to encompass virtual asset-related conduct under the current framework, as well as those currently in the application process for such uplifts. Specifically:

- whether these corporations will be required to submit fresh applications for the new dedicated VA advisory or VA management licences, and if so, whether they would need to suspend relevant VA activities pending approval;
- whether existing uplifts will be recognised on a continuing basis without immediate re-application;
- whether transitional exemptions, grandfathering provisions, or extended compliance timelines will be provided; or



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- whether existing uplifts could be converted de facto to the new licences upon satisfaction of any additional conditions and payment of applicable fees.

Members would also welcome clarification on the licensing process and any available exemptions or streamlined procedures for entities primarily intending to provide VA advisory or VA management services when they concurrently apply for traditional securities-related regulated activities under Types 1, 4, or 9 of the Securities and Futures Ordinance.

To enhance legal and operational certainty for all stakeholders, members recommend that the SFC publish guidance following the conclusion of the consultation, including illustrative decision flowcharts that outline the available licensing pathways, transitional arrangements, and interaction between the existing uplift framework and the new VA-specific licensing regimes.