

Dear Securities and Futures Commission,

This submission is contributed by of TKX Capital and of Mura Consultancy, for the purpose of providing comment on the Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform ("**Consultation Paper**") dated 20 February 2023.

Background

Purpose of the Comments

 both have widespread networks in both traditional finance sectors and native virtual asset industry. They have spoken to and discussed with various interested parties in the Consultation Paper and the virtual asset trading platform. The comments herein consist of the opinions of given their extensive experience in the virtual asset industry and reflect some of the voice from other parties who are from the traditional finance sectors and native virtual asset industry and interested in this Consultation Paper and virtual asset trading platform in Hong Kong.

Comments

Question 1:

Do you agree that licensed platform operators should be allowed to provide their services to retail investors, subject to the robust investor protection measures proposed? Please explain your views.

Comment 1:

We do agree that the licensed platform operators should be allowed to provide service to retail investors. The main reason is that there are many overseas unregulated platform operators which are easily accessible by retail investors from Hong Kong. These unregulated operators may not be able to provide sufficient investor protection to retail investors and retail investors may face risks associated with mismanagement of platform operators, market manipulation, cybersecurity, etc.

A robust investor protection is recommended and yet protection measures must be balanced with a certain extent of freedom of choice of tokens/products to be invested, otherwise retail investors will still go to overseas unregulated platforms and the licensed platform in Hong Kong SAR may lose its functions and significance. Allowing retail investors to participate in virtual asset investment is also an opportunity to educate retail investors and the general public of Hong Kong about virtual assets, be it the underlying technology, the web 3.0 ecosystem and the risks associated with them. As the Financial Secretary announced that Hong Kong SAR shall be a Web 3 hub in the foreseeable future, having retail investor education and participation will be also important element leading to the direction.

Anyway, education of crypto is a must for all investors especially retail investors. Investors should know the assets' characteristic including risks, technology and rewards. We should have some kind of education tools for investors to understand virtual assets.

Question 2:

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

Comment 2:

The proposed general token admission criteria is fair and reasonable. In particular, the due diligence of the background of the token project team, the regulatory status, the market risks are of the cardinal importance to be listed on the licensed operator. In any event there are several observations which may also be considered for the listing criteria of a token. First, SFC has adopted the right approach to allow the platform operators to have the ultimate responsibility to perform due diligence on token listing. However, such assessment process may be costly, time consuming and labour intensive.

We believe that it would be great if a streamline mechanism could be imposed for licensed platform operators. For example, if a platform has passed due diligence on a token, the other platform may not be necessary to through the same process to list the tokens. Another suggestion would be utilizing a third party's assessment to conduct such due diligence in order to be fair and avoid conflict of interests between the token issuer and the platform operator. Aside from token admission / listing criteria, it is equally important to have a delisting mechanism in place to ensure that the tokens listed on the platform operator have an ongoing obligation that fits the criteria. In order to impose such mechanism an independent assessment from a third party may be required to conduct assessment fairly and independently.

As to specific token admission criteria, after discussing with various stakeholders and investors in the industry, it is generally understood that the requirements to be included in two "acceptable indices" issued by two independent index providers are (a) slightly confusing; and (b) not practical to be an indicator for token listing. "Confusion" is mainly from the definition of "acceptable indices" and "independent index providers". From a platform operator perspective, the thinking process or practical mechanism of listing tokens will be first to choose a token and thereafter consider

whether the token could fit the listing criteria. When these platform operators choose a token, they would not take virtual assets index funds as an consideration. Rather, they will look at the liquidity of the token and other elements of the token directly. Another problematic scenario may arise when the index fund replaces or removes a token from the fund's constituent. It would be easy for the fund to replace a constituent, but it would be difficult for a platform operator to delist tokens, and it takes time.

Given the difficulties above, it will be advisable to have a similar mechanism for general token admission and specific token admission, but to impose a more stringent criteria for specific token admission, such as higher trading volume, longer track record, etc.

Question 3:

What other requirements do you think should be implemented from an investor protection

perspective if the SFC is minded to allow retail access to licensed VA trading platforms?

Comment 3:

There are several items could be implemented for investor protections:

- a) Deal execution notification through SMS or email etc.
- b) Multi-factor login to investment account such as combination of cell phone, email, and google authenticator.
- c) Monthly reporting requirement for customers deposit in fiat and virtual assets.
- d) Regular random check by regulators on platform's wallet addresses which hold client's virtual assets.

- e) Limitation on deposit frequency by retail investors. For example, if a retail investor made a deposit of USDC 100,000, he/she cannot make another deposit over USDC 100,000 within the next 24 hours.
- f) Providing a hedging mechanism for retail investors, such as futures contracts with small leverage, such that retail investors could also use strategies to hedge against their investment in virtual assets.
- g) Mandatory require platform operators to put a portion of their transaction fees into a self insurance fund (or in a form of levy) to cover retail investors loss in case of platform operators' winding up or being hacked.
- h) Training sessions for retail investors could be provided by third parties (not suggested to be conducted by platform operators due to conflict of interest) to educate retail investors about the risks associated with virtual assets. Those retail investors who have received training may be allowed to trade virtual asset derivatives.

Question 4: Do you have any comments on the proposal to allow a combination of third-party insurance and funds set aside by the licensed platform operator or a corporation within its same group of companies? Do you propose other options?

Comments 4:

Allowing a combination of third-party insurance and funds set aside by the licensed platform operator or a corporation within its same group of companies is welcomed. As for the mechanism, it is suggested that an allocation of transaction fees collected by platform operators shall be put into an investor protection fund for insurance.

Question 5: Do you have any suggestions as to how funds should be set aside by the licensed platform operators (for instance, under house account of the

licensed platform operator or under an escrow arrangement)? Please explain in detail the proposed arrangement and how it may provide the same level of comfort as third-party insurance.

Comments 5:

N/A

Question 6: Do you have any suggestions for technical solutions which could effectively mitigate risks associated with the custody of client virtual assets, particularly in hot storage?

Comments 6:

Risks associated with custody of client virtual assets could mainly be divided into 3 categories: (1) mismanagement of client assets; (2) hacking; (3) counterparty risks.

As to mismanagement of client assets is a moral/ethical issue. On one side, it is suggested to impose a more stringent accounting reporting or disclosure system. For example, to report platform account vs. client's account on a more regular basis, or to develop an online reporting system such that platform operators will need to report and disclose their own account verse client's account information on a timely basis. This is a similar approach of some European countries that regulate their licensed gambling operators. In a few very advanced regulators, they have developed a real time system which connect with the accounting book of operators, where regulators could monitor directly and to random check on particular point of time of the operators account and client's account, and to ensure no client's money is misappropriated at all time. Another stringent regulation example is from Japan regulator FSA. Japan FSA is conducting thorough audit on virtual assets platform operators on a yearly basis, and these audit include accounting audit, IT audit, system audit, etc., and have made thorough requisition on the choice of counterparties and choice of vendors. These

audit may take 2-3 months to complete in some cases. Such audit exercise may have deterrent effect on IT system and counterparty risks as well, so as to mitigate the risks.

Question 7: If licensed platform operators could provide trading services in VA derivatives, what type of business model would you propose to adopt? What type of VA derivatives would you propose to offer for trading? What types of investors would be targeted?

Comments 7:

VA derivatives are suggested to be allowed on platform operators. Depends on the leverage level, it should also be allowed to be allowed to retail investors such that retail investors could also hedge their investment. Derivatives such as future, options and perpetuals contracts are suggested. At the beginning, professional investors would be targeted.

Question 8: Do you have any comments on how to enhance the other requirements in the VATP Terms and Conditions when they are incorporated into the VATP Guidelines?

Comments 8:

There are two comments:

(1) As "Travel Rules" recommended by FATF is likely to be implemented, it is suggested that we could adopt the market practice in Korea. In Korea, there are self regulated organizations that align various virtual asset platforms as their members and to share their users KYC information with each other in case their users transfer virtual

assets between the members. These organizations could easily help platform operators to comply with the “travel rules”.

(2) The Responsible Officers are required to have virtual assets experience and at the same time to have CPT requirement. It is suggested that more CPT with virtual assets training should be conducted such that the ROs would have updated information with the virtual assets industry around the globe as well as updated regulations in Hong Kong or elsewhere.

Best Regards,