



Securities and Futures Commission

54/F, One Island East
18 Westlands Road
Quarry Bay
Hong Kong

Date: 23 March 2023

To whom it may concern:

**Re: Seeking comments from the public and the industry on the proposals in the
“Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading
Platform Operators Licensed by the Securities and Futures Commission”
published at 20 February 2023.**

Please refer to the answers to the questions below. We hope the feedback will help in finalising the proposed regulatory requirements applicable to licensed VA trading platform operators.

Question 1:

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

We support the proposal to allow retail investors to gain limited exposure to VA. Banning retail investors from trading VA will cause Hong Kong to lose competitiveness in the global VA market. This is not in accordance with the policy statement published by the Hong Kong Government last October to support the development of VA ecosystem in Hong Kong (the “Policy Statement”).

In this regard, preventing retail investors from switching to unregulated exchanges, a regulated channel for retail investors to trade VA should be allowed. The proposed robust investor protection measures could serve as an extra-level of investor protection.

Comparing to a few years ago, VA related knowledge become more organized and accessible. Webinar and talk held by non-for-profit organizations like Hong Kong Digital Assets Society is one example. Young investor who is interested in trading VA need a platform to gain necessary trainings and experiences. Majority of the young investors in Hong Kong are retail investors. Allowing them to access VA could also open more space for innovation and entrepreneurship that can eventually facilitate the development of VA in Hong Kong.

Question 2:

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

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We support the proposal that VATP Operators should set up a token admission and review committee. This committee could provide a framework for the VATP Operators to perform relevant duties and make decisions.

We think expecting the VATP Operators to conduct in-house smart contract audit is not suitable and practicable. This could impose large operational and financial burden to the platform. Reviewing whether the smart contract layer is subject to any security flaws or vulnerabilities involves extended knowledge that VATP may not have sufficient in-house expertise with auditor quality. Similar to the credit rating system, brokers can rely on the 3rd party credit rating report. VATP should be allowed to rely on 3rd party audit by reputable smart contract audit service providers.

The proposed definition of "Eligible Large-Cap Virtual Assets" is built on the definition of "acceptable indices". Subject to other criteria set out in the clause 44, the foot note 20 "For instance, an index which captures the top 10 largest virtual assets may be considered an acceptable index." Indicates that "largest virtual assets" plays a key role in the definition. However, explicit and quantitative approach to measure the ranking of such "largest virtual assets" is not concluded. In this regard, we think a more direct and straight forward definition should be considered. The definition of "Eligible Large-Cap Virtual Assets" we proposed is the top 50 virtual assets in terms of market capitalization in major crypto exchanges, with semi-annually rebalancing.

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?

N.A.

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?

We agree VATP should ensure that not more than 2% of the client virtual assets are stored in hot storage, and hot storage should be fully covered by insurance policy or funds set aside. Considering an insurance policy fully covers hot storage for VA service providers is hard to obtain or over wise very costly. Most likely, many small VATPs would choose to meet the requirement by funds set aside. This already put a financial burden on the operations and competitiveness of those platforms. Given that the hot storage is fully covered, introducing some flexibility on the insurance policy for cold storage could provide more space to VATPs (and give more space to start-up platforms to grow). We suggest allowing investors to make their own decisions on the level of insurance coverage for cold storage and absorb the relevant insurance cost. The VATP

provides the infrastructure for investors to obtain insurance coverage from 3rd party insurance companies.

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.

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?

As VA trading platforms hold clients' private keys which makes the platform an attractive target for hackers. Cybersecurity measures like whitelisting, Two-Factor Authentication (2FA), and stringent password mechanism should be required for any VA movement. Introducing an extra layer of security using hardware like Yubikey security keys is encouraged.

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?

Letting Hong Kong be competitive enough to other crypto regulation-friendly jurisdictions, we should be inclusive regarding VA derivations. If VATPs are not allowed to offer trading services of VA derivatives, could make institutional crypto investors lose their interest in Hong Kong. At least, traditional and perpetual crypto futures should be offered for trading. Given this, we think VA derivatives should be accessible to all types of investors including both retail investors and professional investors.

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?

N.A.

Question 9:



Do you have any comments on the requirements for virtual asset transfers or any other requirements in Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs? Please explain your views.

N.A.

Question 10:

Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.

We think the disciplinary fining regarding VA should be the same as SFC's current guidelines.

For an on behalf of
Alphalex Capital Management (HK) Limited