Chinese Gold and Silver Exchange Society

In Response to

Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission

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22 March 2023

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.**
Answer:	Yes, we welcome the Hong Kong Securities and Futures Commission's consideration of allowing licensed platforms to offer virtual assets to retail investors. Virtual assets are an irreversible trend, and innovative applications can bring positive effects to the economy. However, as mentioned in the consultation document, the market is full of good and bad actors, and to prevent retail investors from falling into scams, we support the Hong Kong Securities and Futures Commission's promotion of regulation for virtual asset platforms, which we believe will have a profound and beneficial impact on the industry.

Question 2:	**Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria?**
Answer:	We disagree with the practice of licensed platforms using only indices as a reference when admitting tokens. Although there are well-known index providers that produce virtual asset indices, these indices are not widely recognized in the industry, and the public is unaware of their composition. Therefore, we oppose this approach. Moreover, virtual assets are based on technology, and there is a high degree of substitutability. For example, nearly 30% of a certain foreign index is in Ethereum. If there are virtual assets that are superior to Ethereum in the market, investors

	should be able to switch to better alternatives to avoid losses. If VATP only uses a single standard for admission, it may limit the choices of investors to avoid losses. Additionally, index providers are usually based overseas, and although their inclusion criteria have some objective basis, subjective factors related to regional bias cannot be ruled out, which may result in good local virtual assets losing the opportunity to circulate in the market. We suggest that in the token admission process, VATP should consider the background of the issuers. If the issuer or its parent company has a strong presence or a long-term operating record in Hong Kong, the issuer must take into account the reputation of the parent company when issuing virtual assets. Therefore, the chances of local issuers being involved in fraud should be lower than those of overseas and newly established counterparts. In summary, we oppose the use of virtual asset indices as the basis for VATP inclusion criteria. The token admission criteria should be continually diversified and optimized to avoid relying on a single standard.

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?**
Answer:	We have no additional comments, but we believe that the regulatory authority should emphasize the importance of continuous education for industry practitioners and investors. Education is the best form of protection.

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?**
Answer:	Regarding third-party insurance, we disagree for two reasons. First, as stated in the consultation paper, it is difficult to find underwriters, and the cost is likely to be expensive, which would increase the cost for licensed platforms and indirectly force investors to turn to illegal overseas platforms. Second, there is no requirement for third-party insurance for other traditional assets, so it is unreasonable to impose such a requirement on virtual assets. We support the establishment of reserve funds on platform holdings as a measure to protect retail investors. It is generally accepted in the industry that all trading platforms have inherent risks, so investors should avoid keeping virtual assets on trading platforms. We propose that investors should be encouraged to withdraw their virtual assets from trading platforms to protect their own assets.

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.**

Answer:	We support the establishment of reserve fund. However, we do not have opinion on how the reserve fund should be set aside.

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?**
Answer:	We believe that efforts should be made to mitigate and manage the risks associated with holding and storing customer virtual assets. There are several technologies available in the market that can help reduce the risks associated with storing customer virtual assets. For example, the use of multi-signature (multi-sig) wallet controls for withdrawals is a generally recognized best practice. However, licensed platform operators must appoint suitable and qualified personnel to act as wallet custodians. Due to the decentralized nature of virtual assets, licensed platforms must have sufficient redundancy in wallet holders to prevent the loss of client assets. Moreover, virtual asset custody services are available in the market, managed by professionals who meet the highest standards for private key custody. Investors may consider paying for the use of professional custody services. Additionally, there are service providers that offer reporting services for virtual asset holders, and their applications can monitor the flow of virtual assets in real-time across different blockchains. If platform operators adopt these applications, they can strengthen their ability to manage asset custody 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?**
Answer:	We support licensed platforms in providing derivative trading services, as it can provide positive functions for market liquidity and hedging, and we are pleased to see their development. However, due to the high price volatility of virtual assets, regulatory bodies should set higher standards for derivative trading services than for spot trading. a. Regarding the business model, it may be initially implemented through a designated "exchange" model. If individual licensed platforms introduce derivative products, unless managed properly, the entire industry will face significant risks. b. As for the tools, it is more ideal to start with futures contract trading because related products are more mature, and it can also avoid investors participating in unregulated foreign exchanges. Currently, foreign futures are settled based on indices, but Hong Kong can consider using spot settlement to avoid index manipulation during settlement, and funds can also be kept in Hong Kong. In addition, cross-virtual asset trading pairs can also be provided, such as ETH/BTC, which has been in demand in the market, but foreign exchanges have not been able to provide corresponding products. c. Whether retail investors are suitable for derivative trading services depends on their risk tolerance and whether they have relevant trading knowledge. We have no additional comments on this aspect.

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?
Answer:	We welcome the Securities and Futures Commission's consideration to remove the relevant regulations on "security tokens" and agree with the admission criteria outlined in section 7.5 of the "Virtual Asset Trading Platform Guidelines." However, we recommend that the token admission guidelines should be continuously optimized.

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.
Answer:	Regarding the requirements on non-custodial wallets in virtual asset transfers, we recommend using the industry-accepted "Satoshi Test" as best practice for establishing customer identity. To promote to adherence with FATF Virtual Assets Travel Rules, We do not support that platform operators transfer virtual assets to third parties outside of their customers. Platform operators should only accept virtual asset deposits from customers' registered wallets, unless the third party is also a licensed platform operator.

Question 10:	Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.
Answer:	We welcome the SFC's efforts to clearly define the Disciplinary Fining Guidelines. However, we believe that the proposed

	guideline, which is very similar to the current Anti Money Laundering and Counter Terrorist Financing Ordinance, needs to be better tailored to the ever-evolving virtual asset class. We hope that the virtual asset industry will provide constructive proposals to improve the guidelines, and we trust that the SFC will take these suggestions into consideration.

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