# Explanation of Risks Associated with Virtual Assets and Virtual Asset-related Products

*i.* *Trading in virtual assets and virtual asset-related products (VA-related Products) is highly risky and is only suitable for clients with high-risk tolerance and the financial ability to sustain losses if the trading becomes unprofitable. The risk of loss in transactions involving virtual assets or VA-related Products can be substantial. You should therefore carefully consider whether such transactions are suitable for you in light of your investment objectives, financial circumstances, your tolerance to risks and your investment experience. You should be capable of bearing a full loss of the amounts invested as a result of or in connection with trading in any virtual assets or VA-related Products and any additional loss over and above the initial amounts traded or invested that may become due and owing by you. In considering whether to trade or invest, you should inform yourself and be aware of the risks generally, and in particular should note the following general and specific risk factors which may apply to trading in any virtual assets or VA-related Products.*

*ii.* *You must consider carefully whether the risks set out below, as well as all other applicable risks, are acceptable to you prior to any trading in virtual assets or VA-related Products. You should seek professional advice regarding your particular situation before trading in virtual assets or VA-related Products.*

*iii.* *Besides this document, clients are also required to review and acknowledge the "Warning Statements on Complex Products" (where applicable) and the risk disclosure document entitled "Explanation of Risks Associated with Exchange–Traded Derivative Products" provided by KGI Asia Limited/KGI Futures (Hong Kong) Limited before being provided with any services relating to virtue assets or allowed to trade any VA-related Products.*

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## 1. Definition of "Virtual Assets" and "VA-related Products"

"Virtual assets" or "VA" refers to digital representations of value which may be in the form of digital tokens (such as utility tokens, stablecoins or security- or asset-backed tokens) or any other virtual commodities, crypto assets or other assets of essentially the same nature, irrespective of whether or not they amount to "securities" or "futures contracts" as defined under the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "SFO"), but excludes digital representations of fiat currencies issued by central banks. A popular example of a virtual asset is the cryptocurrency, Bitcoin.

VA-related Products" refers to investment products which: (a) have a principal investment objective or strategy to invest in virtual assets; (b) derive their value principally from the value and characteristics of virtual assets; or (c) track or replicate the investment results or returns which closely match or correspond to virtual assets.

## 2. General Risk Disclosures for Virtual Assets and VA-related Products

**Nature of Virtual Assets:** Virtual assets are not legal tender. They may not be backed by physical assets, and are not backed or guaranteed by the government. They may not have intrinsic value. Some of the virtual assets may not circulate freely or widely, and may not be listed on any secondary markets. Virtual assets are generally a high-risk asset class. You should exercise caution in relation to the trading of virtual assets and VA-related Products.

**Legal & Regulatory Risk:** Virtual assets are a relatively new innovation, and the markets for such assets is subject to rapid price swings, changes, and uncertainty. Changes in the regulatory or legal landscape may negatively impact the operation of a virtual asset's network or restrict the use of such assets. The actualization of any of these risks could cause a decline in the acceptance of the virtual assets and, consequently, their values.

Furthermore, the legal and regulatory treatment of virtual assets and VA-related Products may change. Regulation of virtual assets and VA-related Products is unsettled and rapidly changing. Legal and regulatory treatment varies according to the relevant jurisdictions. The effect of regulatory and legal risk is that a virtual asset or VA-related Product may decrease in value or lose all of its value due to legal or regulatory change. This may affect the value or potential profit of a transaction in virtual asset or VA-related Product.

Virtual assets may or may not be "securities" as defined in the SFO and accordingly may or may not be subject to the securities laws of Hong Kong. Investments in virtual assets and VA-related Products may not enjoy the same protection as that conferred on investments in securities under the SFO.

**Price Volatility:** Virtual asset investments have been subject to significant price volatility. The values of the virtual assets may fluctuate significantly over a short period of time. The volatile and unpredictable fluctuations in price may result in significant losses over a short period of time.

Virtual assets usually are not backed by any tangible assets. Such virtual assets would be merely speculative investments and their prices can fluctuate greatly within a short period of time. The virtual assets could be rendered worthless and investors may stand to lose all of their investments.

Any virtual asset may decrease in value or lose all of its value due to various factors including discovery of wrongful conduct, market manipulation, change to the nature or properties of the virtual asset, governmental or regulatory activity, legislative changes, suspension or cessation of support for a virtual assets or other exchanges or service providers, public opinions, or other factors outside of our control. Technical advancements, as well as broader economic and political factors, may cause the values of virtual assets to change significantly over a short period of time.

As such, an investment in a virtual asset or VA-related Product involves a substantial degree of risk. The value of a virtual asset or VA-related Product could decline significantly and without warning. Investors should be prepared to lose part of, or even their entire investment. The performance of a VA-related Product (i.e., ETFs, futures) may differ significantly from the performance of the underlying virtual asset itself. Any representation of past performance is not necessarily a guide to future performance.

**Potential Price Manipulation:** Speculation regarding the potential future appreciation in prices of virtual assets and VA-related Products may artificially inflate or deflate their trading prices. Market fraud or manipulation and other fraudulent trading practices, including the intentional dissemination of false or misleading information, can, among other things, lead to a disruption of the orderly functioning of markets, resulting in significant market volatility, causing the values of virtual assets and VA-related Products to fluctuate quickly and without warning.

**Lack of Secondary Markets:** There is a possible absence of a liquid secondary market for certain virtual assets or VA-related Products, which could, in turn, impact the prices and liquidity of virtual assets or VA-related Products with such exposure. Furthermore, there is no guarantee of an active trading market for virtual assets or VA-related Products whether listed on an exchange or not. Furthermore, secondary markets may be subject to wide bid/ask spreads, irregular trading activity, and extended trade settlement periods during times of market stress due to a lack of market makers or authorized participants.

**Unregulated Marketplace:** Currently, most trading, lending, or other dealing platforms and custodians of virtual assets are unregulated and service providers for VA-related Products, including custodians and fund administrators, may be unregulated, regulated only for anti-money laundering and counter-financing of terrorism (AML/CFT) purposes or subject to light-touch regulation. Therefore, they may not be subject to the same robust regulation as service providers in traditional financial markets and the regulators may not have jurisdiction over them. In case of disputes, seeking recourse is likely to be difficult and legal remedies may be unavailable. Any investment in virtual assets or VA-related Products is not insured or guaranteed.

Investors should be wary of the risks of trading virtual assets or VA-related Products on an unregulated platform. If the platform ceases operation, collapses, or is hacked, investors may face the possible risk of losing their entire investments held on the platform. Furthermore, due to the lack of regulation, individuals or groups may engage in fraud or market manipulation, and investors in virtual assets or VA-related Products may be more exposed to the risk of fraud, theft, and market manipulation when investing in virtual assets or VA-related Products compared to more traditional asset classes. These risks, if realized, can cause a decline in the acceptance of the virtual assets or VA-related Products, hence reducing their values.

**Counterparty Risk:** There is invariably a risk that one or more issuers, private buyers or sellers of virtual assets or VA-related Products or market participants of trading, lending or other virtual asset or VA-related Product dealing platforms may renege, default, or fail to honour their obligations or are unwilling or unable to abide by the terms of their agreements when effecting transactions. In the event that this risk materializes, investors and other market participants will likely incur financial losses or reductions in gains from their trading or open positions in such assets.

**Risk of Loss:** Investors can lose their investments in virtual assets and VA-related Products due to criminal or fraudulent activities, especially if their investments or funds are held in a "hot wallet." A hot wallet is a virtual wallet that is connected to the internet, allowing investors to store, send, and receive virtual assets. Due to their online accessibility, hot wallets are deemed to be more vulnerable to hacks and theft than cold storage methods, i.e., offline wallets.

**Hacking and Technological-related Risk:** Virtual assets and VA-related Products may be subject to expropriation and/or theft. Hackers may attempt to obtain unauthorized access to information and/or assets in different ways, including but not limited to malware attacks, smurfing, and spoofing, resulting in the loss of virtual assets and VA-related Products or the loss of an investor's ability to access or control their virtual assets and VA-related Products. There may be no remedy in such an event, and holders of virtual assets and VA-related Products are not guaranteed any remedy, refund, or compensation.

Additionally, virtual assets rely on various types of distributed ledger technology. Some of this technology is open source software that is built upon experimental technology, namely blockchain. There are various technological risks when transacting in virtual assets, including, but not limited to, the existence of technical flaws in the technology, targeting by malicious persons, majority-mining, consensus-based or other mining attacks, changes in the consensus protocol or algorithms, decreased community or miner support, rapid fluctuations in values of relevant virtual assets, the failure of hardware, software, internet connections, the risk of malicious software introduction, cyber-attack, failure of the underlying technology, blockchain, or other networks, computer viruses, communication failures, disruptions, errors, distortions or delays, and other attacks or failures. Any such cybersecurity failures or breaches, whether involving the VA trading platform or third-party service providers, could negatively affect the virtual assets' price, liquidity, and/or tradability.

**New Types of Virtual Assets:** The fast-evolving blockchain and distributed ledger technologies have the potential to radically transform the financial landscape, introducing new forms of virtual assets in the market. Such assets will likely come with their own unique set of risks.

**Complex Transaction Strategies:** Virtual asset transactions are typically created, propagated on the network, and validated before being added to the global ledger of transactions (the blockchain). Transactions are data structures that encode the transfer of value between participants in the virtual asset's network. Market participants' engagement in more complex transaction strategies for virtual assets or VA-related Products can result in increased risk, which may impact the values of the virtual assets or VA-related Products.

**Risks of assets received or held outside Hong Kong:** Virtual assets and VA-related Products received or held outside Hong Kong are subject to applicable laws (if any) of the relevant overseas jurisdictions, which may be different from the SFO and the rules made thereunder (if applicable). Consequently, such assets may not enjoy the same protection (if any) as that conferred on assets received or held in Hong Kong.

### 3. Risks Specific to Virtual Asset Futures Contracts

**Magnified Risks and Potential Losses:** The risks of the underlying virtual assets (e.g., insufficient liquidity, high price volatility, and potential market manipulation) may be magnified in trading VA futures contracts by the speculative nature of the underlying virtual assets and the leverage inherent in futures contracts. Additionally, as VA futures are margin products, losses (or gains) will also be magnified. Investors may lose more than what they initially invest.

**Pricing Difference:** The difficulty of valuing the underlying virtual assets poses significant challenges for investors in reliably valuing VA futures contracts. Hence, the virtual asset futures price should be expected to differ from the current cash price of the virtual asset, which is sometimes referred to as the "spot" price.

**Liquidity Risk:** The market for virtual asset futures contracts is still developing and may be subject to periods of illiquidity. It may be challenging or impossible to buy or sell a position at the desired price during such times. Market disruptions or volatility can also make it challenging to find a counterparty willing to transact at a reasonable price and adequate size. Illiquid markets can cause losses, which could be significant and impact the price of virtual asset futures, which could reduce the correlation between the performance of virtual asset futures and the "spot" price of a virtual asset.

**Virtual Asset Futures Risk:** The market for virtual asset futures is less developed and hence, potentially less liquid and more volatile than futures markets that are more established. While the virtual asset futures market has grown substantially over the recent years, there can be no guarantee that this growth will continue. The price for a VA futures contract is based on several factors, including the supply and demand for the VA futures contract. Market conditions and expectations, position limits, collateral requirements, and other factors can affect the supply and demand for VA futures contracts.

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