

# Joint Circular on Intermediaries' Virtual Asset-Related Activities

The Securities and Futures Commission (“SFC”) and Hong Kong Monetary Authority (“HKMA”) have recently experienced a growing inquiry by intermediaries wishing to provide investment products and dealing services related to virtual assets (“VA”) to their clients. In response to this blossoming interest, the SFC published two circulars on **22<sup>nd</sup> December 2023** informing of an update of existing policy for intermediaries who wish to engage in virtual asset-related activities.

At the onset of the regulatory framework for VA, the SFC had imposed a broad “**professional investors only**” condition on VA-related activities. However, with the increasing integration of VA into mainstream finance and the wider array of investment products now available, the SFC had approved for SFC-licensed virtual asset trading platforms (“VATPs”) to cater to retail investors. Additionally, the SFC had also authorised VA futures exchange-traded funds (“ETFs”) for **retail offering (to non-professional investors)** in Hong Kong.

**A complex product** refers to an investment product whose terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure. **VA-related products are considered complex** on the basis that they:



- a) have a principal investment objective or strategy to invest in VA;
- b) derive their value principally from the value and characteristics of VAs; or
- c) track or replicate the investment results or returns which closely match or correspond to VA.

On a general note, most complex products are therefore not allowed to be offered or recommended to retail investors in Hong Kong (i.e., non-professional investors.). The exception to this being complex products which have been approved by the SFC as would be discussed later within this publication.

This circular outlines requirements for intermediaries when providing certain services in connection with VA-related SFC-authorized VA funds. These services include **Distribution of VA, Provision of VA Dealing Services, Asset Management in respect of VAs; Provision of VA Advisory and Implementation of the SFC guidance.**

## A. Distribution of investment products with exposure to virtual assets

Despite the growing popularity of VA, the global regulatory landscape remains **uneven**. The risks associated with investment in VA as previously highlighted by the SFC still persist. For example, counterparties and service providers in the VA industry such as **custodians or index providers** may be unregulated, regulated only for anti-money laundering and counter-financing of terrorism (“**AML/CFT**”) purposes, or subject to minimal regulation. There are also potential investor protection issues ranging from **a lack of pricing transparency to potential market manipulation.**

As **retail investors** may not fully grasp these risks, VA products which have a principal investment objective or strategy in VA, derive their value primarily from virtual assets, or closely track the investment results of VA, are likely to be considered as being complex. Therefore, intermediaries distributing such VA complex products are required to **comply with SFC requirements** on the sale of complex products.

Considering the uneven global regulatory standards for VA, the SFC and HKMA have proposed enhanced investor protection measures beyond the complex product regime to mitigate risks associated with VA-related products. These measures include:

- a) **Selling Restrictions:** VA-related products classified as complex should be exclusively offered to professional investors, subject to applicable exemptions.
- b) **VA-Knowledge Test:** With the exemption of Institutional Professional Investors and exempt-Corporate Professional Investors, intermediaries must assess a client’s knowledge of investing in virtual assets or VA-related products before executing transactions on their behalf. Where a client lacks such knowledge, the intermediary may proceed only after providing adequate training on the nature and risks of VAs. Intermediaries should also ensure clients have sufficient net worth to bear the associated risks and potential losses.



Certain **VA derivative products** such as **authorized or approved VA futures contracts** are traded on regulated exchanges. Public VA futures ETFs authorized and traded on the SEHK or authorized in a designated jurisdiction for retail investors and traded on a specified exchange, are exempt from the **“professional investors only”** condition (i.e., can be sold to retail investors in Hong Kong).

With regards to **complex exchange-traded derivatives** which have not been solicited or recommended to clients, intermediaries are allowed to execute client orders without adhering to suitability requirements or minimum information and warning statements. However, intermediaries **must comply with derivative product requirements** (i.e., ensure client’s knowledge and capability to assume potential risks), and **conduct a virtual asset-knowledge test** as an additional safeguard.

While authorised VA funds are exempt from the “professional investors only” restriction, the following requirements shall apply in relation to their distribution:

- a) For **ETFs listed and traded on the SEHK**, in the absence of solicitation or recommendation, intermediaries may execute client orders on the exchange **without** complying with suitability or minimum information and warning statement requirements. Nevertheless, intermediaries must conduct a **virtual asset-knowledge test** on the clients.
- b) For **those not listed, or those listed with off-exchange trading of fund units**, intermediaries **must comply with** suitability, minimum information, and warning statement requirements and a **virtual asset-knowledge test is** required for the clients.



Intermediaries are reminded of compliance obligations and selling restrictions in Hong Kong and other relevant jurisdictions for VA-related products. Where such products are distributed through online platforms, ensure proper design and compliance controls.

Intermediaries should also observe **suitability obligations** (where applicable) as supplemented by the SFC Suitability FAQs. These include:

- a) Ensuring recommendations or solicitations align with **client interests**, considering product features, risks, and client's financial situation.
- b) Ensuring compliance with paragraphs 5.1A (Know your Clients - General) and 5.3 (Know your Clients - Derivative Products) of the **Code of Conduct**.
- c) Conducting **due diligence** on VA-related products, addressing risks, features, investors, restrictions, and regulatory status.



In line with SFC's Code of Conduct, intermediaries offering services for VA-related derivative products must ensure **clients comprehend the products' nature and risks**. Given the high-risk nature, **intermediaries must be cautious** when offering financial accommodation for VA-related product investments. **Clients must possess the financial capacity** to meet obligations arising from leveraged or margin trading, including in a worst-case scenario. In the absence of such, intermediaries should not accept instructions.

Except for institutional professional investors and exempt-corporate professional investors, intermediaries distributing VA-related products should:

- a) Provide **clear, easily comprehensible information and warning statements** to clients regarding VA-related products and underlying virtual asset investments; and
- b) Provide clients with **risk disclosure statements** (including one-off disclosures) specific to virtual assets.



## B. Provision of virtual asset dealing services (VA dealing services)

In light of concerns that overseas VATPs may lack regulatory standards comparable to the Hong Kong framework, the SFC and HKMA mandates intermediaries to engage **only SFC-licensed VATPs** when providing VA dealing services. This includes introducing clients for **direct trading** or **establishing an omnibus account with platforms**.

While VA dealing services does not necessarily qualify as "**dealing in securities**", these services may impact an intermediary's fitness and properness to conduct regulated activities. As trading activities including VAs fall under the services provided by Type 1 intermediaries, **compliance with all regulatory requirements** from the SFC and HKMA is expected, and intermediaries should limit provision of such services to Type 1 regulated activity clients.

The SFC and HKMA shall, where applicable, put in place conduct requirements for intermediaries providing VA dealing services under an **omnibus account arrangement**. These requirements, imposed as licensing or registration conditions, will align with the SFC's framework for VA trading platforms relating to the performance of the dealing function by intermediaries.

Key points from the prescribed terms and conditions include that:

**a. Before offering VA dealing services to retail clients, intermediaries must:**



- i. Assess the retail client's knowledge of virtual assets and risk tolerance level;
- ii. Set reasonable exposure limits based on the client's financial situation and circumstances;
- iii. Conduct VA dealing activities through an omnibus account with an SFC-licensed platform, and
- iv. Implement controls to restrict retail clients to trade only in VAs available for retail investors on the platform.

**b. Intermediaries facilitating virtual asset deposits or withdrawals must use segregated accounts maintained with:**



- i. Partnered SFC-licensed platforms.
- ii. AIs or their subsidiaries that meet HKMA's expected standards for virtual asset custody.

Intermediaries should also **comply with the provisions of the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism** (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers) when handling virtual asset deposits and withdrawals.

**Type 1 intermediaries** acting as introducing agents for VA dealing services **should not relay client orders to SFC-licensed platforms or hold client assets**. The SFC or HKMA shall impose these requirements as licensing or registration conditions. **Intermediaries dealing in tokenized securities** must also comply with requirements for securities dealing and comply with SFC's standards of conduct and guidance on tokenized securities.

## C. Provision of asset management services in respect of virtual assets

Intermediaries providing virtual asset portfolio management services **meeting the de minimis threshold** (i.e., intention to invest 10% or more of their gross asset value ("**GAV**") in VAs. are subject to **additional requirements** outlined in the Proforma terms and conditions for licensed corporations or registered institutions managing portfolios investing in virtual assets. These requirements, to be imposed by the SFC or HKMA will serve as **licensing or registration conditions**.

For discretionary account management services, **Type 1 intermediaries** authorized by its clients for discretionary VA dealing services as an ancillary service should invest **less than 10%** of the gross asset value of the client's portfolio in virtual assets. Intermediaries offering asset management services in tokenized securities should comply with the requirements for asset management and expected standards of conduct and guidance on tokenized securities issued by the SFC.

## D. Provision of virtual asset advisory services

Intermediaries are expected to comply with all regulatory requirements from the SFC and HKMA when providing advisory services, regardless of the nature of the VA. Additionally, these services should only be provided to clients by intermediaries who hold a license to conduct **Type 1** or **Type 4** regulated activities. The conduct requirements for VA advisory services are detailed out in the prescribed **Terms and conditions**, and intermediaries providing VA advisory services must comply with **suitability obligations**.

In recommending VAs to **retail clients**, intermediaries should ensure that the VA is:

- a) Highly liquid, available for retail trading, and should be an eligible large-cap virtual asset included in at least two indices issued by different providers.
- b) Available for trading by retail investors on SFC-licensed platforms.



Intermediaries providing advisory services in **tokenized securities** must comply with requirements for advising on securities. Additionally, they should comply with the **expected standards of conduct and guidance on tokenized securities** issued by the SFC.

## E. Implementation

Intermediaries **currently offering** VA dealing services to **non-exempt corporate professional investors and individual professional investors** should **adjust their systems and controls** to align with the updated requirements. Per the joint SFC and HKMA circular issued on 20<sup>th</sup> October 2023, a 3-month transition period (ended 20<sup>th</sup> January 2024) provided for intermediaries serving existing clients with VA dealing services to fully comply with the expected requirements.

Intermediaries **not currently involved** in VA-related activities or planning to extend VA dealing services to non-exempt corporate professional investors, individual professional investors, or retail investors should ensure compliance with regulatory requirements before introducing such services.

Intermediaries are **reminded to notify the SFC or HKMA** (if licensed or registered) **in advance** where they intend to engage in activities involving VAs or make changes, including changes in the type of clientele served.

*This publication has been prepared for general guidance on matters of interest only. The comments raised within this article do not form a legal opinion nor should they be construed as being legal advice.*



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Please feel free to contact us via [info@pcacompliance.com](mailto:info@pcacompliance.com) if you need further clarity relating to regulatory compliance obligations in Hong Kong and Singapore.