



28 January 2022

## Joint circular on intermediaries' virtual asset-related activities

1. The Securities and Futures Commission (**SFC**) and the Hong Kong Monetary Authority (**HKMA**) have received an increasing number of enquiries from intermediaries about distributing virtual asset<sup>1</sup>-related products<sup>2</sup> (**VA-related products**) to investors. Intermediaries are also interested in providing virtual asset dealing services<sup>3</sup> to their clients.
2. When the SFC formulated its regulatory approach for virtual assets in 2018, it imposed an overarching “professional investors<sup>4</sup> only” restriction on various types of activity, including the distribution of virtual asset funds (**VA funds**). Since then, the virtual asset landscape has evolved rapidly and begun to expand into mainstream finance. A broader range and larger number of investment products are now available which provide investors, whether retail or professional, with exposure to virtual assets.
3. The SFC and the HKMA have reviewed their existing policy in light of the latest market developments and enquiries from the industry. This updated guidance is provided for intermediaries which wish to engage in virtual asset-related activities (**VA-related activities**). For the avoidance of doubt, this circular will supersede the 1 November 2018 circular to intermediaries on the distribution of VA funds.

### A. Distribution of VA-related products

4. Although virtual assets are becoming more popular in some parts of the world, the global regulatory landscape remains uneven. The risks associated with investing in virtual assets identified by the SFC back in 2018 continue to apply. For instance, service providers for VA-related products, including custodians, fund administrators, virtual asset trading platforms (**VA trading platforms**) and index providers, may be unregulated, regulated only for anti-money laundering and counter-financing of terrorism (**AML/CFT**) purposes or subject to light-touch regulation (eg, for payment purposes). Thus, they may not be subject to the same robust regulation as service providers or products in traditional financial markets, posing additional counterparty risks for VA-related products. Furthermore, as the spot markets for virtual assets (ie, the underlying assets of VA-related products) are largely unregulated at present, they are more likely to present

<sup>1</sup> “Virtual assets” 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 (**SFO**), but excludes digital representations of fiat currencies issued by central banks.

<sup>2</sup> For the purpose of this circular, “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.

<sup>3</sup> Such services may involve virtual assets which do not fall under the definition of “securities” under the SFO.

<sup>4</sup> As defined in section 1 of Part 1 of Schedule 1 to the SFO.

investor protection issues, ranging from a lack of pricing transparency to potential market manipulation.

5. As these risks are not reasonably likely to be understood by a retail investor, VA-related products are very likely to be considered complex products. Intermediaries distributing VA-related products considered to be complex products (except for VA-related products considered to be complex exchange-traded derivatives as discussed in paragraph 8 below) should comply with the SFC's requirements which govern the sale of complex products<sup>5</sup>, including ensuring the suitability<sup>6</sup> of VA-related products, irrespective of whether or not there has been a solicitation or recommendation.
6. However, given the uneven global virtual asset regulatory landscape, the SFC and the HKMA consider that investor protection measures, in addition to the requirements under the complex product regime, should be imposed to cover specific risks associated with these products. For instance, a number of overseas virtual asset-related non-derivative products, such as virtual asset exchange-traded funds (**VA ETFs**) and exchange-traded products (**VA ETPs**), invest directly in virtual assets and may be subject to the aforementioned risks.
7. As such, the SFC and the HKMA are of the view that it would be necessary to impose the following additional investor protection measures on the distribution of VA-related products:
  - 7.1. **Selling restrictions** – Except for a limited suite of products discussed in paragraph 8 below, VA-related products which are considered complex products should only be offered to professional investors. For example, an overseas VA non-derivative ETF would very likely be considered a complex product and it should only be offered to professional investors.
  - 7.2. **Virtual asset-knowledge test** – Except for institutional professional investors and qualified corporate professional investors<sup>7</sup>, intermediaries should assess whether clients have knowledge of investing in virtual assets or VA-related products prior to effecting a transaction in VA-related products on their behalf<sup>8</sup>. If a client does not possess such knowledge, the intermediary may only proceed if, by doing so, it would be acting in the client's best interests and it has provided training to the client on the nature and risks of virtual assets. Intermediaries should also ensure that their clients have sufficient net worth to be able to assume the risks and bear the potential losses of trading VA-related products. Appendix 1 to this circular sets out non-exhaustive criteria for assessing whether a client can be regarded as having knowledge of virtual assets.

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<sup>5</sup> This refers to the requirements in paragraph 5.5 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) and Chapter 6 of the Guidelines on Online Distribution and Advisory Platforms.

<sup>6</sup> This would include ensuring that the aggregate amount to be invested by the client in VA-related products is reasonable, as determined by intermediaries, considering the client's net worth.

<sup>7</sup> "Institutional professional investors" is defined under paragraph 15.2 of the Code of Conduct as persons falling under paragraphs (a) to (i) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the SFO. "Qualified corporate professional investors" refers to corporate professional investors which have passed the assessment requirements under paragraph 15.3A and gone through the procedures under paragraph 15.3B of the Code of Conduct.

<sup>8</sup> A one-off knowledge assessment conducted by an intermediary prior to entering into a transaction in a VA-related product is acceptable.

8. However, a limited suite of VA-related derivative products are traded on regulated exchanges specified by the SFC<sup>9</sup> and, in the case of exchange-traded VA derivative funds, they are authorised or approved for offering to retail investors by the respective regulator in a designated jurisdiction<sup>10</sup>. For example, in the case of virtual asset futures contracts traded on a specified exchange which is a regulated futures market, trading is governed by conventional rules. Pricing transparency and potential market manipulation may be less of a concern. The same could be said of a public futures-based VA ETF authorised or approved in a designated jurisdiction for offering to retail investors by the respective regulator and traded on a specified exchange. Accordingly, the “professional investors only” restriction is not imposed for the distribution of these products. Nonetheless, as such products are considered complex exchange-traded derivatives, under the existing complex product regime, where there has been no solicitation or recommendation, intermediaries may distribute them without the need to comply with the suitability requirement, but must comply with the existing requirements for derivative products (see paragraphs 11.2 and 12 below). Intermediaries must also conduct a virtual asset-knowledge test as an additional safeguard.
9. For the avoidance of doubt, other exchange-traded VA-related derivative products, irrespective of whether or not they are traded on a specified exchange, would be considered complex products where they are not of the same type as a complex exchange-traded derivative as set out in the non-exhaustive list of examples of non-complex and complex products published on the SFC’s website<sup>11</sup>. The distribution of these exchange-traded VA-related derivative products would thus be subject to the full scope of complex product requirements and additional investor protection measures set out in paragraph 7 above. Appendix 3 provides a flowchart illustrating the factors for determining whether or not a VA-related product is a complex product.
10. In addition to the complex product requirements, the SFC and the HKMA would like to remind intermediaries to observe the selling restrictions in Hong Kong and other jurisdictions which may be applicable to a particular VA-related product. In particular, intermediaries should observe the provisions in Part IV of the SFO which prohibits the offering to the Hong Kong public of investments which have not been authorised by the SFC. Furthermore, depending on the selling restrictions specific to a particular jurisdiction<sup>12</sup>, exchange<sup>13</sup> or product, a VA-related product may or may not be offered to retail investors. Intermediaries should ensure strict adherence to all such selling restrictions. Where the VA-related products are distributed on an online platform, it must be properly designed and have appropriate access rights and controls to ensure compliance with such selling restrictions.

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<sup>9</sup> This refers to the list of specified exchanges set out in Schedule 3 to the Securities and Futures (Financial Resources) Rules (Cap. 571N).

<sup>10</sup> The list of designated jurisdictions are set out in Appendix 2 to this circular.

<sup>11</sup> The non-exhaustive list of examples of non-complex and complex products can be accessed at <https://www.sfc.hk/en/Rules-and-standards/Suitability-requirement/Non-complex-and-complex-products>. For example, VA derivative ETPs are not of the same type as the examples of complex exchange-traded derivatives on the list.

<sup>12</sup> In some jurisdictions such as mainland China, the sale of VA-related products to Mainland investors may be prohibited.

<sup>13</sup> For example, the rules of an established futures exchange governing virtual asset futures contracts traded on the exchange may prohibit the offering of such futures contracts to retail investors.

11. Intermediaries should also observe the suitability obligations (where applicable) as supplemented by the Suitability FAQs<sup>14</sup>, including:
  - 11.1. ensuring that any recommendations or solicitations made are suitable for clients in all circumstances. Intermediaries should diligently assess whether the nature and features of the VA-related product (including the effects of gearing and the risks of the underlying virtual assets) are suitable for the client and are in the best interests of the client, taking into account the client's risk tolerance, financial situation, etc;
  - 11.2. where the VA-related product is a derivative product, ensuring compliance with paragraphs 5.1A and 5.3 of the Code of Conduct; and
  - 11.3. conducting proper due diligence on the products, which would include, amongst others, understanding their risks and features (in particular the inherent high-risk nature of the underlying virtual assets), the targeted investors (including any applicable selling restrictions) and the products' regulatory status. Additional due diligence requirements for unauthorised VA funds are set out in Appendix 4 to this circular.
12. As part of its obligation under paragraph 5.3 of the Code of Conduct, an intermediary assessing whether to provide a client with services for VA-related derivative products should assure itself that the client understands the nature and risks of these products. For example, in providing trading services in virtual asset futures contracts traded on a specified exchange, an intermediary should ensure its client understands that leveraged trading increases the client's exposure to the volatility of the underlying virtual assets. This is because relatively small market movements may have a proportionately larger impact on the margin deposited and the client may lose more than the amount of the initial margin deposited. Intermediaries should also provide clients with warning statements (which can be a one-off disclosure) specific to virtual asset futures contracts, examples of which are set out in Appendix 5 to this circular.
13. Given the high-risk nature of virtual assets, intermediaries should be cautious in providing any financial accommodation for investing in VA-related products to clients. Where an intermediary provides financial accommodation to a client, it should assure itself the client has the financial capacity to meet the obligations arising from leveraged or margin trading in VA-related products, including in a worst-case scenario. In the absence of such assurance, the intermediary should not accept instructions from the client.
14. Intermediaries distributing VA-related products should provide information to clients in relation to VA-related products and the underlying virtual asset investments in a clear and easily comprehensible manner.
15. Intermediaries should also provide to clients warning statements (which can be a one-off disclosure) specific to virtual assets, examples of which are set out in Appendix 5 to this circular.

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<sup>14</sup> The Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons and the Frequently Asked Questions on Triggering of Suitability Obligations (**Suitability FAQs**).

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

16. As mentioned above, the majority of VA trading platforms in Hong Kong and overseas are unregulated or regulated only for AML/CFT purposes. The SFC and the HKMA are concerned that such platforms may not be subject to regulatory standards comparable to those under the SFC's regulatory framework for VA trading platforms<sup>15</sup>, and the protections for investors trading on these platforms may be manifestly insufficient. For instance, these platforms are not subject to any client asset protection regulations, eg, the requirements governing hot and cold wallets<sup>16</sup>, private key management and insurance. In the event of hacking or fraud, investors may suffer substantial losses without recourse. They may also have practical difficulties recovering their assets from or pursuing claims against platforms located overseas.
17. To provide adequate investor protection, the SFC and the HKMA consider it appropriate and necessary to require intermediaries to partner only with SFC-licensed VA trading platforms<sup>17</sup> (**SFC-licensed platforms**) for the provision of VA dealing services, whether by way of introducing clients to the platforms for direct trading or establishing an omnibus account with the platforms. Such services should only be provided to professional investors.
18. Although VA dealing services may involve trading in non-security virtual assets which falls outside the SFC's jurisdiction, such services may have an impact on an intermediary's fitness and properness to conduct regulated activities<sup>18</sup>. Trading activities involving virtual assets also form part of the dealing services provided by intermediaries<sup>19</sup>. Accordingly, intermediaries are expected to comply with all the regulatory requirements imposed by the SFC and the HKMA when providing VA dealing services, irrespective of whether or not the virtual assets involved are securities. Furthermore, such services should only be provided to the intermediaries' existing clients to which they provide services in Type 1 regulated activity<sup>20</sup>.
19. The expected conduct requirements for intermediaries' provision of VA dealing services under an omnibus account arrangement will be imposed by the SFC (and in consultation with the HKMA, where applicable) as licensing or registration conditions. These are set out in Appendix 6 to this circular. One licensing or registration condition will require intermediaries to comply with the prescribed terms and conditions (**Terms and conditions**). The standards set out therein align with the requirements under the SFC's

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<sup>15</sup> Hong Kong is one of the few major jurisdictions which has introduced a comprehensive framework for VA trading platforms from an investor protection perspective. The framework imposes requirements on key areas such as custody of client assets, know-your-client, AML/CFT, prevention of market manipulation, admission of virtual assets for trading, cybersecurity and risk management. For details, please refer to the SFC's [Position Paper on Regulation of VA trading platforms](#) published on 6 November 2019.

<sup>16</sup> A "hot wallet" or "hot storage" describes the practice where the private keys to virtual assets are kept in an online environment. As "hot wallet" or "hot storage" is connected to the internet, it is more susceptible to cyber attacks. In contrast, a "cold wallet" or "cold storage" describes the practice where the private keys to virtual assets are kept in an offline environment.

<sup>17</sup> VA trading platforms which are licensed pursuant to section 116 of the SFO under the 2019 regulatory framework for VA trading platforms.

<sup>18</sup> The SFC may, under section 129 of the SFO, take into account the state of affairs of any other business of the corporation.

<sup>19</sup> Currently, the SFC and the HKMA are only prepared to allow intermediaries licensed or registered for Type 1 (dealing in securities) regulated activity to provide VA dealing services.

<sup>20</sup> See footnote 19 above.

framework for VA trading platforms<sup>21</sup> to the extent that they relate to the performance of the dealing function carried out by intermediaries.

20. The SFC and the HKMA wish to highlight that under the Terms and conditions, intermediaries should only permit clients to deposit or withdraw fiat currencies from their accounts, and should not allow the deposit or withdrawal of client virtual assets, so as to minimise the risks associated with the transfer of virtual assets.
21. Where Type 1 intermediaries provide VA dealing services as an introducing agent<sup>22</sup>, they should only introduce clients which are professional investors to SFC-licensed platforms. They should not relay any orders on behalf of their clients to the platforms or hold any client assets, including fiat currencies and client virtual assets, for the introducing services. These requirements will be imposed by the SFC (and in consultation with the HKMA, where applicable) as licensing or registration conditions<sup>23</sup>.
22. With respect to virtual asset discretionary account management services<sup>24</sup>, licensed corporations providing services which meet the de minimis threshold, ie, a stated investment objective of a portfolio to invest in virtual assets or an intention to invest 10% or more of the gross asset value of a portfolio in virtual assets, are subject to additional requirements set out in the Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets (**RA9 Terms and Conditions**) published in October 2019. Going forward, registered institutions wishing to provide such services should inform the SFC and the HKMA and will be required to comply with the RA9 Terms and Conditions which will be imposed as registration conditions.
23. For discretionary account management services, the SFC and the HKMA wish to further clarify that where a Type 1 intermediary is authorised by its clients to provide VA dealing services on a discretionary basis as an ancillary service<sup>25</sup>, the intermediary should only invest less than 10% of the gross asset value of the client's portfolio in virtual assets.

### **C. Provision of virtual asset advisory services**

24. Provision of advisory services in virtual assets (**VA-advisory services**) forms part of an intermediary's advisory business and may therefore affect its fitness and properness to conduct regulated activities<sup>26</sup>. Accordingly, intermediaries are expected to comply with all the regulatory requirements imposed by the SFC and the HKMA when providing advisory services, irrespective of the nature of the virtual assets. Furthermore, such services

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<sup>21</sup> For example, all client orders should be pre-funded (ie, intermediaries should only execute a trade for a client if there are sufficient fiat currencies or virtual assets in the client's account to cover that trade) and intermediaries should not provide any financial accommodation for their clients to acquire virtual assets. Intermediaries will also be required to only permit deposits and withdrawals of fiat currencies to and from the segregated account maintained with an SFC-licensed platform.

<sup>22</sup> Under the introducing agent model, clients of intermediaries will be onboarded by SFC-licensed platforms and trade directly through the platform. Trading accounts with the platform will be designated in the names of the respective clients. Intermediaries should ensure that a written agreement is entered into with the SFC-licensed platform so as to set out the respective responsibilities of the intermediary and the SFC-licensed platform under the introducing arrangement.

<sup>23</sup> Under section 116(6) or 119(5) of the SFO (as the case may be).

<sup>24</sup> This refers to discretionary account management services provided in the form of an investment mandate or a pre-defined model investment portfolio and which receive a management or performance fee in return.

<sup>25</sup> Such activities are performed wholly incidental to an intermediary's provision of services in Type 1 regulated activity.

<sup>26</sup> Currently, the SFC and the HKMA are only prepared to allow intermediaries licensed or registered for Type 1 (dealing in securities) or Type 4 (advising on securities) regulated activities to provide VA-advisory services.

should only be provided to intermediaries' existing clients to which they provide services in Type 1 or Type 4 regulated activities<sup>27</sup>.

25. The expected conduct requirements for VA-advisory services are set out in the prescribed Terms and conditions (see Appendix 6 to this circular). In particular, intermediaries providing VA-advisory services are expected to observe the suitability obligations. They should offer such services only to professional investors and conduct a virtual asset-knowledge test before providing them.
26. Where an intermediary provides advisory services in VA-related products, it should observe the same requirements as highlighted in Part A above and at the same time, it must ensure the suitability of its recommendations.

#### **D. Implementation**

27. The SFC and the HKMA understand that intermediaries which already engage in VA-related activities may wish to revise their systems and controls to align with the updated requirements. Accordingly, there will be a six-month transition period for intermediaries when serving existing clients of its VA-related activities before the full implementation of the expected requirements in this circular. Intermediaries which do not currently engage in VA-related activities should ensure that they are able to comply with the requirements in this circular before introducing such services.
28. Intermediaries are reminded to notify the SFC (and the HKMA, where applicable) in advance if they intend to engage in VA-related activities, which include the distribution of VA-related products and the provision of VA dealing services<sup>28</sup>.
29. The SFC and the HKMA will keep in view the evolving global regulatory landscape and review their position as and when necessary.

For enquiries, please contact your case officer at the SFC or Banking Conduct Department of the HKMA (as the case may be).

**Intermediaries Division  
Securities and Futures Commission**

**Banking Conduct Department  
Hong Kong Monetary Authority**

Enclosure

End

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<sup>27</sup> See footnote 26 above.

<sup>28</sup> [Circular to intermediaries on compliance with notification requirements](#) dated 1 June 2018.