

HONG KONG SFC PUBLISHES LICENSING CONDITIONS FOR VIRTUAL ASSET FUND MANAGERS

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Legal Briefings - By **William Hallatt and Valerie Tao**

On 4 October 2019, the Securities and Futures Commission (**SFC**) published [proforma terms and conditions](#) which will apply to virtual asset fund managers that meet specified criteria.

This follows the SFC's [statement of 1 November 2018](#) regarding the regulatory framework for virtual asset fund managers, fund distributors and trading platform operators (see our [e-bulletin of 2 November 2018](#) for further details), in which the SFC indicated (among other things) that it would impose terms and conditions on certain virtual asset fund managers.

The terms and conditions will be imposed by way of licensing conditions. Going forward, they will apply to all in-scope virtual asset fund managers, subject to variations and elaborations which are relevant to certain business models and circumstances. Only professional investors can invest in in-scope funds (except collective investment schemes authorised by the SFC).

Senior management of virtual asset fund managers should ensure that appropriate standards of conduct are maintained and that proper procedures are adhered to by their fund managers.

WHO WILL THE TERMS AND CONDITIONS APPLY TO?

The terms and conditions will apply to licensed corporations which manage or plan to manage funds (or portions of funds) with:

a stated investment objective to invest in virtual assets; or

an intention to invest 10% or more of the gross asset value of the fund in virtual assets.

“Virtual assets” is defined as digital representations of value which may be in the form of digital tokens (such as digital currencies, utility tokens or security or asset-backed tokens), any other virtual commodities, crypto assets or other assets of essentially the same nature, irrespective of whether they amount to “securities” or “futures contracts” as defined under the *Securities and Futures Ordinance (SFO)*.

DO THE SAME TERMS AND CONDITIONS APPLY TO ALL VIRTUAL ASSET FUND MANAGERS MEETING THE ABOVE CRITERIA?

As noted in the “Application” section:

certain terms and conditions are only applicable to virtual asset fund managers that are responsible for the overall operation of a fund or have been delegated responsibility for that function;

Appendix 1 of the terms and conditions sets out the requirements that are not applicable to, as well as additional requirements that are applicable to, virtual asset fund managers conducting discretionary accounts management.

WHAT ARE THE CONSEQUENCES OF BREACH OF THE TERMS AND CONDITIONS?

Contravention of the terms and conditions (ie, licensing conditions) is likely to be considered as misconduct under the SFO and may call into question the person-in-breach’s fitness and properness to remain licensed or registered. This may result in disciplinary action by the SFC.

However, the SFC has indicated that a pragmatic approach will be adopted, taking into account all relevant circumstances, including the size of the virtual asset fund manager and any compensatory measures implemented by its senior management.

WHAT ASPECTS DO THE TERMS AND CONDITIONS COVER?

The key aspects covered by the terms and conditions include:

General principles – They are similar to those under the SFC’s main code of conduct, but with a focus on virtual asset funds and fund managers. General principle 8 specifically states that the senior management of a virtual asset fund manager should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the fund manager.

Organisation and management structure – This includes requirements relating to governance structure, senior management responsibilities, human and technical resources, liquid capital, segregation of duties, conflicts of interest, compliance and risk management.

Virtual asset fund management – This includes all aspects of fund management such as investing within the mandate, best execution, order allocation, participation in initial offerings, transactions with connected persons, house accounts, risk management, disclosure of leverage and liquidity management. Appendix 2 sets out risk management control techniques and procedures in further detail.

Custody of fund assets and client money – A virtual asset fund manager should ensure that any fund assets and client money entrusted to it are accounted for and adequately safeguarded. There are also requirements relating to self-custody and the appointment of independent custodians.

Operations – This includes requirements such as those relating to record keeping, audits, fund portfolio valuation and disclosure and management of side pockets.

Dealing with the fund and fund investors – Among other things, a virtual asset fund manager should provide fund investors with adequate information to enable them to make informed decisions about their investments, including information about the trading platforms and custodians used by the fund and the key risks associated with the fund’s investment in virtual assets (Appendix 3 provides examples of such risks). There are also requirements relating to confidentiality and handling of complaints.

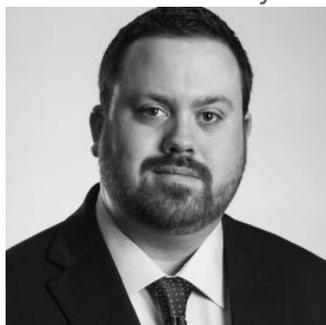
Marketing activities – Only professional investors should be permitted to invest in in-scope virtual asset funds (other than collective investment schemes authorised by the SFC). Representations and marketing materials must be accurate and not misleading.

Fees and expenses – This includes requirements relating to the disclosure and reasonableness of charges, and appropriateness of soft commissions and rebates.

Reporting to the SFC – A virtual asset fund manager should report to the SFC as soon as practicable any actual or suspected material non-compliance with the terms and conditions or any other applicable legal or regulatory requirement. It should also notify the SFC of any significant change in its business activities, at least 7 business days prior to the change. When requested by the SFC to provide information, such information should be provided promptly and in an open and cooperative manner, and should be accurate and not misleading.

KEY CONTACTS

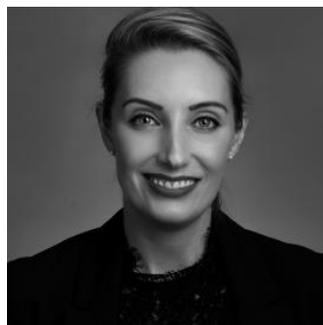
If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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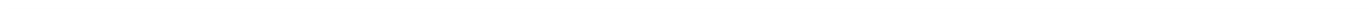
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