

Appendix 1

Non-exhaustive criteria for assessing whether a client can be regarded as having knowledge of virtual assets

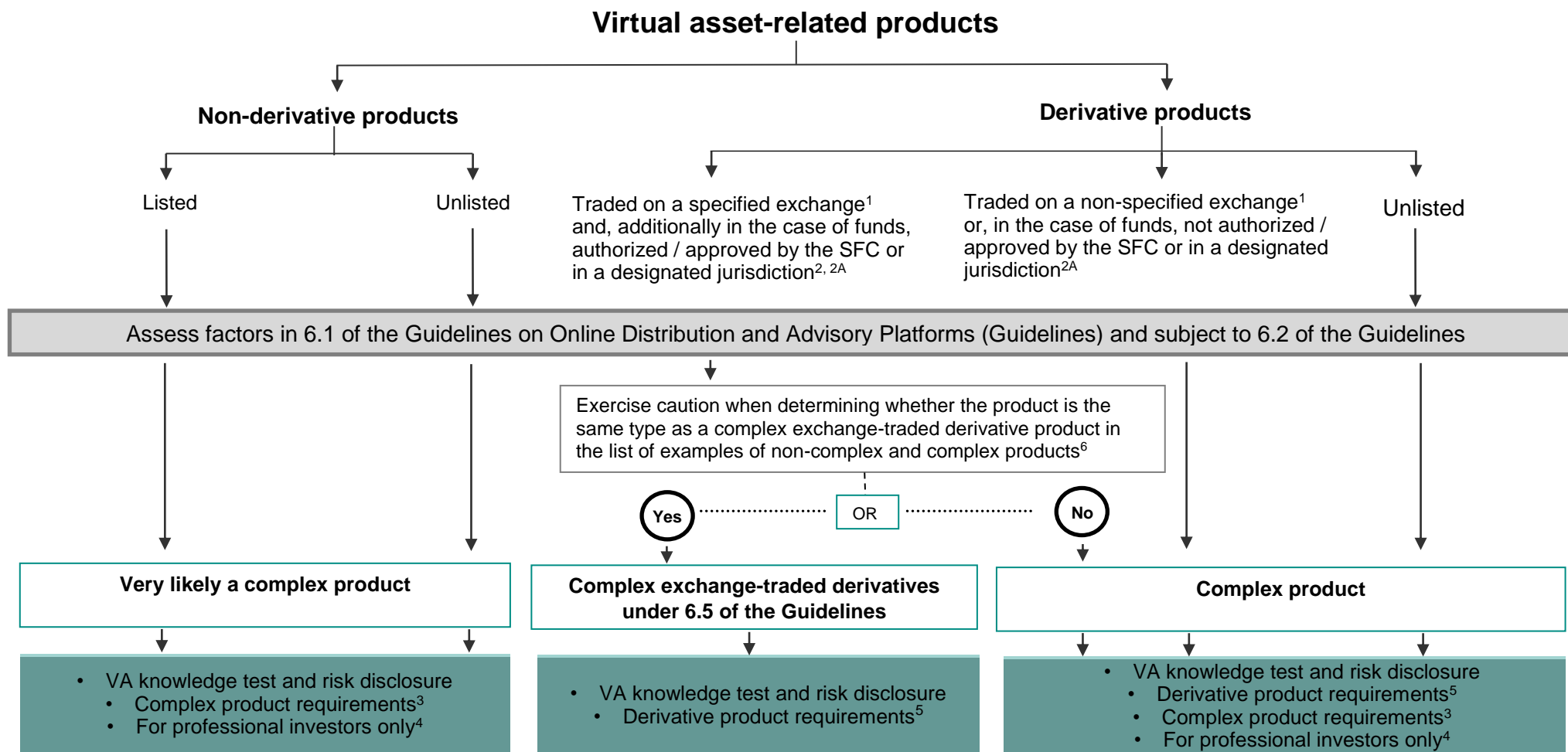
1. Whether the client has undergone training or attended courses on virtual assets or VA-related products;
2. Whether the client has current or previous work experience related to virtual assets or VA-related products; or
3. Whether the client has prior trading experience in virtual assets or VA-related products.

Appendix 2

List of designated jurisdictions for exchange-traded unauthorised VA derivative funds

- Australia
- France
- Germany
- Ireland
- Luxembourg
- Malaysia
- The Netherlands
- Switzerland
- Taiwan, China
- Thailand
- United Kingdom
- United States of America

* This flowchart is for illustration purposes only. Please refer to the Joint circular on intermediaries' virtual asset-related activities issued by the SFC and the HKMA regarding the specific requirements for determining whether or not a virtual asset-related product is a complex product.



¹ “Specified exchange” refers to the list of specified exchanges in Schedule 3 to the Securities and Futures (Financial Resources) Rules.

² This refers to exchange-traded VA derivative funds traded on specified exchanges and authorized or approved by the SFC or in a designated jurisdiction for offering to retail investors by the respective regulator.

^{2A} “Designated jurisdictions” are Australia; France; Germany; Ireland; Luxembourg; Malaysia; the Netherlands; Switzerland; Taiwan, China; Thailand; the UK and the US.

³ This includes ensuring suitability, minimum information and warning statements.

⁴ In addition to existing selling restrictions, only professional investors will be allowed to invest in the product if it is classified as complex.

⁵ This refers to paragraphs 5.1A (knowledge assessment) and 5.3 (eg, ensure sufficient net worth) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

⁶ 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>.

Product due diligence - unauthorised VA funds

Additional due diligence requirements

Intermediaries distributing VA funds which are not authorized by the SFC should conduct proper due diligence on the funds as well as their fund managers and the parties which provide trading and custodian services for the funds. This should include, but is not limited to, scrutinising the fund's constitutive documents and due diligence questionnaire and making enquiries with the fund manager to develop an in-depth understanding of the following matters where applicable:

(A) *About the fund manager*

(a) General

- Its background, relevant experience and, where applicable, the track record of its senior management, including its chief investment, operation, risk and technology officers;
- its regulatory status, for example, whether the fund manager is subject to any regulatory oversight and its robustness; and
- its compliance history, for example, whether any regulatory authorities have taken any disciplinary or regulatory actions against it.

(b) Operations

- its internal controls and systems, for example:
 - whether there is a proper segregation of key functions, such as portfolio management, risk management, valuation and custody of assets, and, if not, whether there are any adequate compensating controls to prevent abuse;
 - the persons who can transfer assets from the fund or custodians and what safeguards are in place;
 - the persons responsible for and the procedures for reconciling transactions and positions, including the frequency at which such reconciliations are performed;
 - the methodology and persons responsible for determining the pricing and assessment of the reasonableness of the determined price of each virtual asset; and
 - the measures adopted by the fund manager to mitigate the risks of money laundering and terrorist financing, especially in respect of subscriptions made by fund investors in virtual assets (where applicable).

- (c) IT system
 - its IT infrastructure (for example, its security and access management).
- (d) Risk management
 - its risk management procedures, including concentration limits, counterparty risk management procedures, stop-loss arrangements and stress testing;
 - its liquidity risk management policy;
 - its risk management policy for other risks associated with VA fund management, for example, hacking or other technology-related risks; and
 - its disaster recovery plan.

(B) About the fund

- (a) the fund's targeted investors;
- (b) the list of instruments the fund intends to trade or invest in and any limitations on the size of its virtual asset holdings issued by way of an initial coin offering (ICO Tokens), pre-ICO Tokens or other illiquid or hard-to-value instruments;
- (c) the fund's valuation policy (especially for ICO Tokens, pre-ICO Tokens or other illiquid or hard-to-value instruments);
- (d) the custody arrangement of the fund assets, including the policy for allocating assets to be kept at different host locations, such as exchanges, custodians, hot storage and cold storage;
- (e) the use of leverage and derivatives by the fund;
- (f) the fund's targeted risk and return per annum;
- (g) the fund's key risks (please refer to the "Information for clients" section in Appendix 5 to this circular);
- (h) the fund's auditors and audited financial statements, including whether the fund received a qualified audit opinion in the past, and whether the audited statements are up-to-date; and
- (i) the exchanges on which the fund are traded.

(C) About the fund's counterparties

- (a) their legal and regulatory status (ie, whether they are regulated by any authorities to, amongst other things, undertake custody business or trade in virtual assets);

- (b) their experience and track record in dealing with virtual assets;
- (c) the robustness of their IT systems (including cybersecurity risk management measures) and contingency plans; and
- (d) their financial soundness and insurance coverage, for example, to cover losses of customer assets.

Information for clients investing in VA-related products – a non-exhaustive list of risk disclosure statements

For virtual asset futures contracts, in addition to disclosing the general risks of trading in futures contracts, risk disclosure statements should also cover the risks specific to virtual asset futures contracts, such as:

- (a) the risks of the underlying virtual assets (eg, insufficient liquidity, high price volatility and potential market manipulation) may be magnified in trading virtual asset futures contracts by the speculative nature of the underlying virtual assets and the leverage inherent in futures contracts; and
- (b) the difficulty of valuing the underlying virtual assets poses significant challenges for investors in reliably valuing virtual asset futures contracts.

For all VA-related products, in addition to disclosing the risks specific to the product, the risk disclosure statements should cover, amongst other things, and where applicable:

- (a) the continuing evolution of virtual assets and how this may be affected by global regulatory developments;
- (b) legal uncertainty on whether virtual assets can be regarded as “property” under the law;
- (c) difficulties in verifying the ownership of virtual assets;
- (d) price volatility;
- (e) potential price manipulation on trading, lending or other dealing platforms;
- (f) a lack of secondary markets for certain virtual assets;
- (g) most trading, lending or other dealing platforms and custodians of virtual assets are presently unregulated;
- (h) counterparty risk when effecting transactions with issuers, private buyers and sellers or through trading, lending or other dealing platforms;
- (i) risk of the loss of virtual assets, especially if held in “hot wallets”;
- (j) hacking and technology-related risks; and
- (k) new risks which may arise from investing in new types of virtual assets or market participants’ engagement in more complex transaction strategies.