

November 2022

Hong Kong SFC furthers the greenlight for retail investors to trade in Virtual Asset Futures ETFs



Introduction

In January 2022, the Hong Kong Securities and Futures Commission (the "**SFC**") and the Hong Kong Monetary Authority issued a "[Joint circular on intermediaries' virtual asset-related activities](#)" (the "**Joint Circular**"). The Joint Circular stated (amongst other things) that the offer of a limited suite of virtual asset-related derivative products traded on certain regulated exchanges (including eligible virtual asset ("**VA**") futures ETFs) was not subject to the "professional investor only" selling restriction, and could thus be offered to retail investors in Hong Kong. For details, please refer to our article "[An update on the virtual asset regulatory landscape in Hong Kong](#)".

Building on that, on 31 October 2022, the SFC published the [Circular on Virtual Asset Futures Exchange Traded Funds](#) (the "**New Circular**"). Recognizing that VA-related investment products were becoming increasingly popular with investors, the SFC is prepared to accept applications for authorizations of ETFs that obtain exposure to VAs primarily through futures contracts ("**VA Futures ETFs**"). The New Circular sets out the additional requirements under which the SFC would consider authorising VA Futures ETFs for public offering to retail investors in Hong Kong under sections 104 and 105 of the Securities and Futures Ordinance.

This client alert summarises the key takeaway points of the New Circular.

Authorisation requirements for VA Futures ETFs

The following requirements should be fulfilled when applying for such authorisation:

- 1. General requirements:** The VA Futures ETF should meet the applicable requirements in the Overarching Principles Section and the Code on Unit Trusts and Mutual Funds in the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.
- 2. Management companies:** The management company of a VA Futures ETF is required to (i) have a good track record of regulatory compliance; and (ii) demonstrate at least 3 years of proven track record in the management of ETFs. Relevant experience in managing the same or similar types of products from the group of companies to which the management company belongs, can be taken into account.
- 3. Eligible futures:** Only VA futures traded on conventional regulated future exchanges will be allowed, subject to the management company being able to demonstrate that (i) the relevant VA futures have adequate liquidity for the operation of the VA Futures ETF and (ii) the roll costs of the relevant VA futures contracts are manageable and how such roll costs will be managed. Initially, only Bitcoin futures and Ether futures traded on the Chicago Mercantile Exchange will be allowed.
- 4. Investment strategy:** The management company of a VA Futures ETF is expected to adopt an active investment strategy to allow flexibility in portfolio composition, rolling strategy, and handling of any market disruption events. The net derivative exposure of a VA Futures ETF shall not exceed 100% of the ETF's total net asset value.
- 5. Disclosure:** The VA Futures ETF's KFS shall contain upfront disclosure of the investment objective and key risks associated with investment in VA futures, such as potentially large roll costs of VA futures and operational risks (e.g. margin risks and mandatory measures imposed by the relevant parties).
- 6. Distribution:** The intermediaries should satisfy the applicable requirements under the SFC's Code of Conduct and other related guidelines (including the Joint Circular). In particular, the SFC mentions that the existing conduct requirements for derivative products (e.g. paragraphs 5.1A and 5.3 of the Code of Conduct) should be satisfied and intermediaries must also comply with the VA-knowledge test requirement.
- 7. Investor education:** The management company of a VA Futures ETF should carry out extensive investor education before launching the VA Futures ETF.
- 8. Others:** The SFC may consider introducing additional requirements as necessary or appropriate.

How we can help

The New Circular was published soon after the [policy statement](#) on the development of the VA sector in Hong Kong was released by the Financial Services and the Treasury Bureau. The policy statement and the New Circular are signs that the SFC are gradually shifting towards a more liberal and open policy in embracing VAs, signs that are no doubt being received favourably by the VA industry. Like many in the industry, we are cautiously optimistic that the SFC will continue to open up more of the VA market to Hong Kong's retail segment – the regulatory regime in this respect is therefore something to watch out for in the coming months.

Many of our clients are intermediaries that provide VA-related services. We regularly advise our clients on the issues identified in the New Circular and we have had numerous discussions with clients on VA-related product launches.

Please get in touch if you are interested in discussing any of the above.

Contact us



Katherine Liu

Partner, Head of finance and financial services regulation
T: +852 2533 2717
E: katherine.liu@shlegal.com



James Wong

Associate
T: +852 3166 6933
E: james.wong@shlegal.com



Monica Jia

Trainee Solicitor
T: +852 2533 2795
E: monica.jia@shlegal.com

Stephenson Harwood is a law firm of over 1100 people worldwide, including 190 partners. Our people are committed to achieving the goals of our clients – listed and private companies, institutions and individuals.

We assemble teams of bright thinkers to match our clients' needs and give the right advice from the right person at the right time. Dedicating the highest calibre of legal talent to overcome the most complex issues, we deliver pragmatic, expert advice that is set squarely in the real world.

Our headquarters are in London, with eight offices across Asia, Europe and the Middle East. In addition, we have forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service.

© Stephenson Harwood LLP 2022. Any reference to Stephenson Harwood in this document means Stephenson Harwood LLP and its affiliated undertakings. The term partner is used to refer to a member of Stephenson Harwood LLP or a partner, employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Stephenson Harwood LLP's affiliated undertakings.

Full details of Stephenson Harwood LLP and its affiliated undertakings can be found at www.shlegal.com/legal-notices.

Information contained in this briefing is current as at the date of first publication and is for general information only. It is not intended to provide legal advice.

Unless you have consented to receiving marketing messages in relation to services of interest to you in your personal capacity, the services marketed in this message are offered only to the business for which you work.