



Hong Kong

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HONG KONG SFC ISSUES CRYPTO FUND LICENSING CONDITIONS FOR HONG KONG CRYPTO FUND MANAGERS

Hong Kong's Securities and Futures Commission (**SFC**) has published Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets¹ (**Terms and Conditions for Virtual Assets**) – standard terms and conditions that it will impose as a licensing condition on fund managers of funds:

- i) whose stated investment objective is to invest in virtual assets; or
- ii) which intend to invest 10% or more of the fund's gross asset value in virtual assets (together "**Hong Kong Virtual Asset Fund Managers**").

The Terms and Conditions for Virtual Assets are subject to minor variations and elaborations depending on individual Hong Kong Virtual Asset Fund Managers' business models and circumstances.

The SFC's Regulatory Framework for Virtual Asset Portfolio Managers

On 1 November 2018, the SFC published its Statement on Regulatory Framework for Virtual Asset Portfolios Managers, Fund Distributors and Trading Platform Operators² (**Regulatory**

- 1 SFC. "Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets". October 2019. [https://www.sfc.hk/web/EN/files/IS/publications/VA_Portfolio_Managers_Terms_and_Conditions_\(EN\).pdf](https://www.sfc.hk/web/EN/files/IS/publications/VA_Portfolio_Managers_Terms_and_Conditions_(EN).pdf)
- 2 SFC. "Statement on regulatory framework for virtual asset portfolios managers, fund distributors and trading platform operators". <https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-and-announcements/reg-framework-virtual-asset-portfolios-managers-fund-distributors-trading-platform-operators.html>

Framework Statement) setting out the regulatory standards applicable to virtual asset fund managers and distributors of virtual funds. The SFC's ability to regulate activities relating to virtual assets is constrained by the fact that its regulatory authority extends only to virtual assets that are "securities" or "futures contracts" as defined in the Securities and Futures Ordinance (**SFO**). This leaves the vast majority of virtual assets, including those most commonly traded such as Bitcoin and Ether, outside the scope of Hong Kong's regulatory framework. Given this limitation, the SFC's Regulatory Framework Statement extended its regulation of SFC-licensed fund managers to cover their management of investment portfolios investing in virtual assets that are not securities or futures contracts as well as those that are. This clarified, in particular, that provisions of the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC (the **SFC Code of Conduct**), in particular the provisions on ensuring the suitability of client solicitations and recommendations in respect of securities, apply to investment funds which invest in virtual assets which are not securities, and not only to funds investing in virtual assets which are securities, subject to a *de minimis* provision.

The November 2018 Regulatory Statement also spelt out that entities distributing funds which invest in virtual assets must hold a Type 1 securities dealer's licence irrespective of whether the virtual assets concerned are securities or not. Additional obligations are imposed on the managers of funds investing in virtual assets which are not securities in addition to ones that are, and also on all distributors of funds investing in any type

of virtual asset. For further details of the SFC's Regulatory Framework for virtual asset fund managers and distributors, please see Charltons' November 2018 newsletter.³

The 2018 Regulatory Framework Statement provided that the SFC would impose terms and conditions on Virtual Asset Portfolio Managers. The Terms and Conditions for Virtual Assets will therefore be imposed on Virtual Asset Fund Managers as a licensing condition, breach of which is likely to constitute misconduct under the SFO reflecting adversely on the fitness and properness of a Hong Kong Virtual Asset Fund Manager as a licensed intermediary. This could result in disciplinary action by the SFC and potentially in the revocation of a fund manager's SFC licence.

The Terms and Conditions for Virtual Assets expand on the Regulatory Framework Statement and seek to address investor concerns relating to virtual assets by specifying principles and requirements with which Virtual Asset Fund Managers must comply. These are summarised below.

Proforma Terms and Conditions for Hong Kong Licensed Corporations Managing Virtual Asset Portfolios

1. Application of Terms and Conditions for Virtual Asset Fund Managers

The proforma Terms and Conditions for Hong Kong Virtual Asset Fund Managers apply to SFC-licensed and -registered entities that manage a fund or portion of a fund that invests in Virtual Assets and meets the *de minimis* threshold – i.e. the fund must either have a stated investment objective of investing in Virtual Assets, or intend to invest at least 10% of its gross asset value (**GAV**) in Virtual Assets.

Virtual Assets are defined as “digital representations of value” and include digital tokens (such as digital currencies, utility tokens, security or asset-backed tokens), any other virtual commodities, crypto assets or other assets of essentially the same nature.

The Terms and Conditions for Virtual Assets do not however apply to a fund:

- where its mandate is to mainly invest in securities, futures contracts or both and there is no intention to invest 10% or more of its GAV in Virtual Assets; and
- its investment in Virtual Assets exceeds 10% of its GAV due to a rise in the prices of Virtual Assets held by the fund, but all reasonably practical steps are taken to reduce its investment in Virtual Assets so as to reduce the proportion invested in Virtual Assets to below the 10% threshold.

2. Organisation and Virtual Asset Fund Management Structure

Organisation and Resources

A Hong Kong Virtual Asset Fund Manager is required to maintain:

- an effective management and organisational structure;
- adequate financial resources - i.e., the higher of: (a) HK\$3 million; and (b) its variable required liquid capital;
- sufficient human and technical resources;
- satisfactory internal controls and risk management governance structure; and
- adequate insurance cover commensurate with its business.

Segregation of Duties

A Hong Kong Virtual Asset Fund Manager must ensure the proper segregation of key duties and functions, particularly those functions and duties which when performed by the same individual can lead to undetected errors, may be susceptible to abuse or may expose the Virtual Asset Fund Manager, its funds or investors to inappropriate risks.

Conflicts of Interest

Hong Kong Virtual Asset Fund Managers should take all reasonable steps to identify, prevent, manage and monitor actual or potential conflicts of interest. Where an actual or potential conflict arises, it should be managed and minimised, and any material interest or conflict must be disclosed to fund investors.

³ Charltons Quantum. “SFC Sets Standards for Virtual Asset Portfolio Managers and Fund Distributors”. November 2018. <https://charltonsquantum.com/sfc-sets-standards-for-virtual-asset-portfolio-managers-and-fund-distributors/>

Hong Kong Virtual Asset Fund Managers' Management Responsibilities

The responsibilities of senior management of a Hong Kong Virtual Asset Fund Manager should include:

- being principally responsible for the fund manager's compliance with all applicable laws and regulations and nurturing a good compliance culture within the firm;
- assigning appropriate reporting responsibilities to qualified and experienced persons and maintaining clear reporting lines;
- informing those performing discretionary portfolio management on its behalf of its policies and procedures that apply to them; and
- reviewing the performance of the Virtual Asset Fund Manager in managing funds at least annually.

Risk Management

A Hong Kong Virtual Asset Fund Manager should establish and maintain effective policies and a designated risk management function to quantify risks, financial or otherwise, to which the Hong Kong Virtual Asset Fund Manager and the funds are exposed. Appropriate and timely action must be taken to contain and manage risk.

Hong Kong Virtual Asset Fund Managers' Compliance Function

A Hong Kong Virtual Asset Fund Manager must maintain an effective compliance function, including a compliance officer, to ensure compliance with applicable laws and regulations and its own internal policies and procedures. The compliance function and the compliance officer must be independent of other functions and should report directly to the Hong Kong Virtual Asset Fund Manager's senior management. If this is not practicable due to the fund manager's size, senior management should perform the role of compliance officer. There should also be detailed compliance procedures to enable the Hong Kong Virtual Asset Fund Manager's personnel to comply with applicable legal and regulatory requirements.

Anti-Money Laundering and Counter-Terrorist Financing

All reasonable measures to ensure the existence of proper safeguards to mitigate the risks of money laundering and terrorist financing are required to be taken by Hong Kong Virtual Asset Fund Managers, especially in relation to fund

investors' subscriptions in Hong Kong Virtual Assets. Hong Kong Virtual Asset Fund Managers should comply with the Guideline on Anti-Money Laundering and Counter-Terrorism as if it were conducting a regulated activity, even if the funds or parts of funds under its management invest in Virtual Assets that are not "securities" or "futures contracts".

Audit

A Hong Kong Virtual Asset Fund Manager should maintain an independent audit function where practicable to report on the adequacy, effectiveness and efficiency of its management, operations and internal controls. If the Fund Manager's size does not justify a separate internal audit function, these responsibilities should be performed or reviewed by external auditors.

Delegation

The competence of third-party delegates must be monitored on an ongoing basis to ensure their compliance with the principles and requirements of the Terms and Conditions for Virtual Assets.

Withdrawal from Business

A Hong Kong Virtual Asset Fund Manager who withdraws from the business must ensure that any affected clients, funds and fund investors are promptly notified, and that proper arrangements remain in place for the safekeeping of fund assets.

3. Hong Kong Virtual Asset Fund Management

Investment within Mandate

A Hong Kong Virtual Asset Fund Manager is required to ensure that transactions carried out on behalf of each fund are in accordance with the fund's stated investment strategy, objectives, investment restrictions and guidelines.

Best Execution

A Hong Kong Virtual Asset Fund Manager must ensure that fund orders are executed on the best available terms, taking into account relevant market prices at the trading venues the fund has access to at the time for transactions of the kind and size concerned, while mitigating any concentration risk.

Prohibition of Market Misconduct

Effective policies and procedures to prohibit and prevent market misconduct must be established and implemented by Hong Kong Virtual Asset Fund Managers.

Order Allocation

All orders executed for funds must be allocated fairly and in accordance with the fund's stated intention, and the Hong Kong Virtual Asset Fund Manager must enter a record of the intended basis of allocation before a transaction is effected.

Fund Portfolio Turnover

A Hong Kong Virtual Asset Fund Manager should take into account the fund's stated objectives and not trade excessively on its behalf.

Underwriting

Unless specifically permitted in the fund mandate, a Hong Kong Virtual Asset Fund Manager should not participate in underwriting activities on behalf of a fund. Where underwriting is undertaken on behalf of a fund, all commissions and fees received should be credited to the fund account.

Participation in Initial Coin Offerings (ICOs)

Where a Hong Kong Virtual Asset Fund Manager participates in an ICO on behalf of funds managed by it, it should ensure that:

- the allocation of Virtual Assets received in the offering provides for a fair and equitable allocation among the funds it manages;
- preferential allocations are prohibited; and
- records are maintained of:
 - i) the intended basis of allocation before a transaction is effected;
 - ii) the actual allocation after the transaction is effected; and
 - iii) the reasons for differences between the intended and actual allocations.

Transactions with Connected Persons

A Hong Kong Virtual Asset Fund Manager should not carry out any transaction on behalf of a fund with a party which is a connected person unless such transaction is carried out on arm's length terms and at a commission rate no higher than customary institutional rates. A Virtual Asset Fund Manager should not deposit or borrow money on behalf of a fund from a connected person unless:

- in the case of a deposit, interest is received at a rate not lower than the prevailing commercial rate; and
- in the case of a loan, interest charged and fees levied on the loan are no higher than the prevailing commercial rate for a similar loan.

Cross Trades

Hong Kong Virtual Asset Fund Managers should only undertake sale and purchase transactions between fund accounts including discretionary accounts under their management (i.e. cross trades) if: (i) the cross trade is in the best interests of both funds and their investors and are within both funds' investment objectives; (ii) trades are executed on arm's length terms at current market prices, (iii) the reasons for such trades are documented prior to execution; and (iv) such activities are disclosed to fund investors of both funds. Cross trades should also only be permitted with the prior consent of fund investors and must be prohibited between staff accounts and fund accounts.

House Accounts

When dealing for a house account (i.e., an account owned by a Hong Kong Virtual Asset Fund Manager or any of its connected persons over which it can exercise control and influence), a Hong Kong Virtual Asset Fund Manager should give priority to satisfying an order to be executed for a fund. Except with the prior written consent of the compliance officer or other persons designated by senior management, a Hong Kong Virtual Asset Fund Manager should not deal ahead of any transaction to be carried out on behalf of a fund.

Operational Control

A Hong Kong Virtual Asset Fund Manager should establish and maintain effective operational policies and procedures, which include but are not limited to, controls over trading and safeguarding of fund assets, IT system and infrastructure.

Risk Management

Hong Kong Virtual Asset Fund Managers are required to establish and implement adequate risk management procedures to identify, measure, manage and monitor all risks:

- relevant to each investment strategy; and
- to which each fund may be exposed, including but not limited to, market, liquidity and counterparty risks, operational risks and cybersecurity risks.

Leverage

A Hong Kong Virtual Asset Fund Manager should disclose to fund investors the expected maximum level of leverage it may employ on behalf of the fund, and the basis of calculating leverage which should be reasonable and prudent.

Liquidity Management

Appropriate and effective liquidity management policies and procedures need to be put in place to monitor funds' liquidity risk and liquidity risks must be disclosed. The extent to which the liquidity management principles set out in section IV, paragraph 3.17 will apply to a particular fund depends on its nature, liquidity profile and asset-liability management.

Termination

On termination of a fund, Hong Kong Virtual Asset Fund Managers must ensure that fund investors are treated fairly and make adequate disclosure to all fund investors of all relevant material information relating to the termination.

4. Custody of Virtual Assets

Safety of Fund Assets

Hong Kong Virtual Asset Fund Managers have an obligation to ensure that fund assets entrusted to them are accounted for and kept safe. A Hong Kong Virtual Asset Fund Manager is required to appoint an independent custodian, and ensure that fund assets are separated from its own assets. If fund assets are kept in an omnibus client account, the fund manager must put safeguards in place to properly record the assets belonging to each fund and carry out frequent reconciliations.

In particular, fund managers must implement adequate controls when: (i) creating new accounts with trading platforms and custodians; (ii) whitelisting new internet protocol addresses and new wallet addresses; and (iii) effecting transfers of assets between trading platforms, custodians and wallets.

Where a Hong Kong Virtual Asset Fund Manager receives fiat currency on behalf of the funds it manages, it should establish segregated bank accounts with an authorised financial institution in Hong Kong or a bank in a jurisdiction agreed by the SFC for holding the client money it receives. Client monies are required to be transferred to a segregated bank account or paid to the fund within one business day of receipt.

Self-custody

Where the Hong Kong Virtual Asset Fund Manager adopts self-custody, it needs to implement effective policies, procedures, and internal controls to protect the Virtual Assets from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions. Staff performing the custodial function should be independent of those responsible for fund management. Virtual assets held in self-custody must be identified as owned beneficially by the fund, not by the Virtual Asset Fund Manager, through proper record-keeping and arrangements to ensure the effective segregation of the fund's Virtual Assets from those of the Hong Kong Virtual Asset Fund Manager in the event of its insolvency.

Selection and Appointment of an Independent Custodian

A Hong Kong Virtual Asset Fund Manager should exercise due skill, care and diligence in the selection, appointment, and ongoing monitoring, of the custodian and take all reasonable steps to ensure that the custodian is capable of performing its functions. Hong Kong Virtual Asset Fund Managers should satisfy themselves as to custodians' continued suitability and financial standing.

A formal custody agreement must be entered with the appointed custodian specifying the duties and responsibilities of the parties including the scope of the custodian's responsibility and liability.

Disclosure of Custodial Arrangements

The custodial arrangements for a fund's virtual assets and any material risks associated with those arrangements must be properly disclosed by Hong Kong Virtual Asset Fund Managers to fund investors. Where the Hong Kong Virtual Asset Fund Manager intends to hold fund assets in self-

custody, it must specifically disclose the existence and risks of such an arrangement, the additional safeguards that have been put in place and the details of insurance coverage over the assets (where applicable). If the Hong Kong Virtual Asset Fund Manager intends to keep more than 10% of the fund's assets (by GAV) with a particular custodian or under self-custody, this should be disclosed to investors. Investors must also be updated of any significant changes to the custodial arrangements.

5. Hong Kong Virtual Asset Fund Managers' Operations

Record Keeping

A Hong Kong Virtual Asset Fund Manager is required to keep proper records including:

- An audit trail of all transactions effected by the fund manager (i.e. orders placed, trades executed and allocated, trades settled, deposits and withdrawals of fund assets);
- Information relating to fund accounts produced by third parties and all relevant internal reports, including trade confirmations, statements of account and records of investment processes adopted;
- In respect of each fund for which it holds assets, sufficient records to show details of the fund's assets and liabilities including financial commitments and contingent liabilities; and
- Sufficient records to demonstrate compliance with the Terms and Conditions for Virtual Assets.

Records or documents must also be kept relating to a Hong Kong Virtual Asset Fund Manager's business as required under the SFO and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615). The Virtual Asset Fund Manager should therefore retain:

- a) records or documents showing particulars of any orders concerning Virtual Assets that are initiated by the Hong Kong Virtual Asset Fund Manager for a minimum period of two years; and
- b) all other records or documents required to be kept for a minimum period of seven years.

Auditors and Audited Accounts

A Hong Kong Virtual Asset Fund Manager is required to appoint an independent auditor to audit funds' financial statements. An annual report for each fund should be made available to fund investors upon request. Factors relevant to an auditor's appointment include its experience and capability in auditing the financial statements of Virtual Asset funds. The Virtual Asset Fund Manager is also responsible for arranging for the counterparties of the funds it manages to provide necessary information to the funds' auditor.

Fund Portfolio Valuation

A Virtual Asset Fund Manager is required to adopt appropriate policies and procedures to ensure a proper and independent valuation of fund assets and the consistent application of valuation methodologies to the valuation of similar types of fund assets. If independent valuation of fund assets cannot be performed (i.e. the valuation is not performed by a person who is functionally independent from the person making investment decisions for the funds or an entity which is independent of the Virtual Asset Fund Manager), the Hong Kong Virtual Asset Fund Manager should implement proper procedures and controls to ensure that the valuation methodologies are properly and consistently applied.

All fund assets managed by a Hong Kong Virtual Asset Fund Manager should be valued on a regular basis. Where a Hong Kong Virtual Asset Fund Manager arranges the appointment of a third party to perform valuation services, the Virtual Asset Fund Manager must exercise due skill, care and diligence in selecting the third party and ensure that it has the necessary expertise and experience in valuing Virtual Assets.

Side Pockets

Before any side pocket is introduced in a fund (i.e. where certain illiquid or hard-to-value investments of a fund as determined by the Hong Kong Virtual Asset Fund Manager are segregated from other fund assets), a Hong Kong Virtual Asset Fund Manager should disclose to fund investors:

- i) the limit to total assets to be put in the side pocket;
- ii) the overall fee structure and charging mechanism (in respect of, among others, any management and performance fees);

- iii) that the redemption lock-up period for a side pocket would be different from that of the ordinary shares of the fund;
- iv) how the Hong Kong Virtual Asset Fund Manager defines and categorises investment products which are to be put into the side pocket and the policies and rationale for transferring investments into and out of side pockets; and
- v) where the assets in side pockets are allowed to be transferred to another investment vehicle, the circumstances under which transfers are allowed and the pricing mechanism for such transfers.

Where a Hong Kong Virtual Asset Fund Manager decides to side pocket any fund asset, it should disclose to fund investors the fees charged in relation to side-pocketed assets from time to time. It must also clearly disclose to fund investors:

- the creation of the side pocket;
- the asset which has been side-pocketed; and
- how the asset was valued at the time of being side-pocketed and the asset's ongoing valuation.

Net Asset Value Calculation and Pricing

A Hong Kong Virtual Asset Fund Manager should ensure that the net asset value calculation of different share classes is carried out in accordance with the terms set out in the fund's constitutive documents and the valuation policies and procedures established by the Hong Kong Virtual Asset Fund Manager.

Reconciliations

A Virtual Asset Fund Manager should arrange to carry out reconciliations of the Hong Kong Virtual Asset Fund Manager's internal records against those issued by third parties. Reconciliations must be carried out regularly (i.e. at least monthly) depending on the nature of the fund assets.

6. Dealing with a Virtual Asset Fund and its Investors

Provision of Information

A Hong Kong Virtual Asset Fund Manager should provide the fund and fund investors with adequate information about the Virtual Asset Fund Manager, disclose the financial condition of

its business by providing a copy of its latest audited financial statements and disclosing any material change adversely affecting its financial condition after the date of those statements to a fund upon request.

Hong Kong Virtual Asset Fund Managers are also required to adequately disclose information on the fund which is necessary for fund investors to make an informed decision about their investment in the fund. This includes the list of trading platforms and custodians which the fund uses and key risks associated with the fund's investment in Virtual Assets.

Confidentiality

A Hong Kong Virtual Asset Fund Manager should maintain proper procedures to ensure confidentiality of information kept by it in respect of the fund or fund investors.

Complaints

A Hong Kong Virtual Asset Fund Manager should maintain procedures to ensure that complaints from a fund or fund investors are handled in a timely and appropriate manner. It should also ensure that steps are taken to investigate and respond promptly to a complaint. If a complaint is not remedied promptly, the fund or fund investor should be advised of any further steps which may be available to it under the regulatory regime. A register of complaints should also be kept and reviewed by senior management on a regular basis.

Marketing Activities: Target Investors of the Virtual Asset Fund

A Hong Kong Virtual Asset Fund Manager should only allow professional investors to invest in a Virtual Asset fund.

Representations by the Virtual Asset Fund Manager

A Hong Kong Virtual Asset Fund Manager should ensure that any representation made or information supplied by it to a fund, any fund investor or distributor appointed by it to distribute its Virtual Asset fund is accurate and not misleading.

Issue of Marketing Materials

A Hong Kong Virtual Asset Fund Manager should ensure that all advertisement and marketing materials are accurate and not biased or misleading. They should be clear and fair and present a balanced picture of the fund with adequate risk disclosures. They should contain information that is timely and consistent with the fund's offering document, and only contain performance claims that can be verified.

Fees and Expenses

Disclosure of Charges

A Hong Kong Virtual Asset Fund Manager should disclose to a fund and fund investors (where applicable) the basis and amount of its fees and charges.

Fair and Reasonable Charges

All charges, fees and mark-ups affecting a fund and fund investors should be fair and reasonable in the circumstances, and be characterised by good faith.

Soft Commission and Rebates

A Virtual Fund Manager may receive goods or services (i.e. soft dollars) from a broker or trading platform for directing transactions conducted on behalf of the fund to the broker or trading platform only if:

- i) the goods or services are of demonstrable benefit to the fund;
- ii) transaction execution is consistent with best execution standards;
- iii) the fund has consented in writing to the receipt of the goods and services; and
- iv) periodic disclosure is made of the Virtual Asset Fund Manager's practices for receiving the goods and services, including a description of the goods and services received.

7. Reporting to the SFC

A Hong Kong Virtual Asset Fund Manager should report to the SFC any actual or suspected material non-compliance with the Terms and Conditions for Virtual Assets or any other applicable legal and regulatory requirements. It should also notify the SFC of any significant change in its business activities, at least 7 days before the change takes place. A Hong Kong Virtual Asset Fund Manager should provide any information requested by the SFC in a timely, complete, accurate, and not misleading manner.

Requirements for Hong Kong Virtual Asset Fund Managers Conducting Discretionary Accounts Management

Where applicable, Virtual Asset Fund Managers managing discretionary accounts (**Hong Kong Virtual Asset Discretionary Account Manager**) are required to observe the additional requirements summarised below where the Hong Kong Virtual Asset Fund Manager:

- provides discretionary account management services to the client in the form of an investment mandate or a pre-defined model investment portfolio; and
- receives a management fee and/or performance fee as remuneration for managing the discretionary account for its client.

Target Clients

A Hong Kong Virtual Asset Discretionary Account Manager should only provide its services to professional investors as defined in Schedule 1 to the SFO and in the Securities and Futures (Professional Investor) Rules.

A Hong Kong Virtual Asset Discretionary Account Manager should assess whether clients have knowledge of investing in Virtual Assets or related products before providing discretionary account management services to them. Alternatively, the Hong Kong Virtual Asset Discretionary Account Manager can take into account whether clients have prior investment experience in private equity or venture capital or have provided capital for a start-up business in the past. If clients do not have such knowledge or experience, a Virtual Asset Discretionary Account Manager can only proceed to provide such services if, by doing so, it would be acting in the clients' best interests. However, no guidance is given as to when the provision of Hong Kong Virtual Asset Discretionary Account management services would be in a client's best interests.

Suitability

A Hong Kong Virtual Asset Discretionary Account Manager should ensure that the mandate or predefined model investment portfolio established for or chosen by a client is suitable for that client based on information about the client's personal circumstances of which it is or should be aware through the exercise of due diligence.

The Hong Kong Virtual Asset Discretionary Account Manager should document its assessment of the suitability of a mandate or predefined model investment portfolio for each particular client and must provide a copy of the rationale to the client in writing. Further, to avoid concentrated exposure to Virtual Assets, a Hong Kong Virtual Asset Discretionary Account Manager is required to ensure that the aggregate amount to be invested by a client in the discretionary account is reasonable, as determined by the Account Manager having regard to the client's net worth.

The mandate or predefined model investment portfolio must be reviewed regularly (i.e. at least annually and whenever there are significant market movements) having regard to the client's circumstances at the time of the review and, where appropriate, should recommend revisions to the mandate or predefined model investment portfolio and agree them with the client.

Virtual Asset Discretionary Account Managers must ensure that transactions carried out on clients' behalf are suitable and in accordance with the mandate/ predefined model investment portfolio.

Client Agreements

A Hong Kong Virtual Asset Discretionary Account Manager should ensure that a written agreement (**Discretionary Client Agreement**) is entered into with a client before any services are provided to, or transactions are made on behalf of, that client. A Discretionary Client Agreement should set out the precise terms and conditions under which discretion will be exercised and contain at least the information set out in the section "Minimum Content of Discretionary Client Agreement" below and should be provided in a language understood by the client. These requirements do not apply to Institutional Professional Investors (i.e. those persons within paragraphs (a) to (i) of the "professional investor" definition in Schedule 1 to the SFO).

Performance Review and Valuation Reports

A Hong Kong Virtual Asset Discretionary Account Manager should review the performance of each Discretionary Account against any previously agreed benchmark, and provide valuation reports to the client no later than the end of the tenth business day after the end of the monthly accounting period, or at such shorter intervals provided for in the Discretionary Client Agreement.

Minimum Content of Discretionary Client Agreement

A Discretionary Client Agreement should contain at least the following provisions:

- a) the client's full name and address;
- b) the full name and address of the Hong Kong Virtual Asset Discretionary Account Manager's business;
- c) appointment of the firm as the Hong Kong Virtual Asset Discretionary Account Manager and the details of the services provided;
- d) statement of the client's investment policy and objectives;
- e) a suitability clause;
- f) the amount of all fees to be paid by the client;
- g) any consent from the client where the Hong Kong Virtual Asset Discretionary Account Manager intends to receive soft commission or retain cash rebates;
- h) details of custodial arrangements if the Hong Kong Virtual Asset Discretionary Account Manager provides custodial arrangement itself;
- i) details of periodic reporting to be made to client;
- j) the risk disclosure statements; and
- k) undertakings by the Hong Kong Virtual Asset Discretionary Account Manager and the client to notify the other in the event of any material change to the above information provided in the Discretionary Client Agreement.

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