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## A high-level framework for virtual asset perpetual contracts offering by virtual asset trading platforms

1. This paper sets out the Securities and Futures Commission's (**SFC**) high-level approach (**Framework**) for SFC-licensed virtual asset trading platform operators (**Platform Operators**) to offer virtual asset perpetual contracts (**Perp**) to clients.

### Background

2. Under the **ASPIRe**<sup>1</sup> roadmap, Pillar P reflects the SFC's commitment to expanding the scope of product offerings, including Perps. This initiative aims to deepen market liquidity, broaden risk management tools for investors, and further strengthen Hong Kong's position as a leading global virtual asset hub. To promote responsible product innovation, the SFC welcomes interested Platform Operators to submit their proposed Perp structure to the SFC, taking into account the various safeguards and investor protection measures discussed in this paper, as well as explaining how the proposed product structure can fit within Hong Kong's existing regulatory and legal framework.
3. Perps offered by overseas platform operators typically operate without a central clearing house, with product features and risk management governed by the platform operators' internal arrangements. This highlights the importance for Platform Operators to have in place robust and transparent processes governing valuation, margining, collateralisation and liquidation management.
4. While the introduction of Perps brings new opportunities to the market, it also carries a range of risks that are distinct from those associated with traditional futures or spot trading of virtual assets. This Framework sets out key risks and considerations which Platform Operators should address in respect of the product design of Perps, the potential for market manipulation, and the need for clear client disclosures.

### Scope of application

5. In this Framework, Perps typically refer to instruments offered by a Platform Operator with the following characteristics:

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<sup>1</sup> SFC's ASPIRe roadmap for virtual assets: <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/A-S-P-I-Re-for-a-brighter-future-SFCs-regulatory-roadmap-for-Hong-Kongs-virtual-asset-market>

- (a) The contracts are traded on-platform, seek to track the price of an underlying asset or index, and have no expiry date<sup>2</sup>;
- (b) The contracts are designed with an intra-day and/or daily price convergence mechanism to align the product price with spot market price through periodic funding rate payments exchanged between long position holders and short position holders<sup>3</sup>;
- (c) The contracts are leveraged, with a client's potential loss limited to the margin posted;
- (d) The trading, margining, position liquidation and settlement processes are designed to prevent Platform Operators from credit exposure to any participants. Where margin is insufficient, positions are liquidated through pre-specified loss allocation mechanisms, such as backstop liquidity sources, a reserve or insurance fund established by the Platform Operator and, where applicable, closing out of opposite positions.

### **Eligible investors and reference assets**

- 6. Since Perps are relatively new financial instruments in Hong Kong and carry different risks from traditional products, they should only be offered to professional investors<sup>4</sup>.
- 7. Since Perps are leveraged contracts traded with margining and subject to forced liquidation, to ensure that the client understands the product risk and is able to make an informed investment decision, a Platform Operator offering Perps should assess each client's knowledge of derivatives according to paragraphs 5.1A and 5.3 of the Code of Conduct before providing Perps trading services to the client.
- 8. The reference asset of a Perp may be (a) a virtual asset available for spot trading by retail clients on the Platform Operator's platform, or (b) an index of such virtual assets administered by an administrator compliant with the IOSCO Principles for Financial Benchmarks.
- 9. When a Platform Operator suspends the on-platform trading of a Perp's reference asset, the trading of the corresponding Perp is generally expected to be suspended as well.

### **Product design**

- 10. The design and operation of Perps can introduce unique financial risks to clients. The mechanisms for funding rate and position value determination, margining, and liquidation directly determine how client positions are managed, and how losses are

<sup>2</sup> Or a spot contract with automatic rollover.

<sup>3</sup> A perpetual funding rate payment is a periodic payment exchanged between long and short position holders in a perpetual contract to keep the contract's price aligned with the underlying asset's spot market price. When the funding rate is positive, long position holders pay short position holders. When negative, short position holders pay long position holders.

<sup>4</sup> As defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance.

absorbed. A lack of robust and transparent mechanisms may expose clients to unexpected losses or unfair liquidations. Therefore, comprehensive controls and transparent processes are necessary to safeguard market integrity and client interests. Key aspects of product design in trading and settlement, as well as margin arrangements and loss allocation are detailed below.

## Trading and settlement

11. A Platform Operator should:
  - (a) establish, maintain and effectively enforce transparent and comprehensive rules for fair trading, position margining, default management, position liquidation and loss allocation;
  - (b) have a well-founded, clear, transparent and enforceable legal basis for all aspects of its Perps activities;
  - (c) ensure orderly trading, settlement and position liquidation, including under extreme but plausible stressed market conditions; and
  - (d) conduct regular stress testing of its trading systems to ensure operational resilience.
- A Platform Operator should be responsible for settling all trades on its platform regardless of whether it is a contracting party to the trades.
12. The product price (or mark price<sup>5</sup>), reference asset price, funding rate and position valuation (each a **Key Parameter**) should be:
  - (a) determined based on transparent methodologies and procedures which are consistently applied;
  - (b) derived from timely and reliable data input which are sourced from active markets with stable transaction volume, and anchored by bona fide observable transactions; and
  - (c) capable of being objectively verified. These Key Parameters should be made available to clients in real time and free of charge.
13. Inputs, calculation windows, and settlement frequency for funding rates should be clearly disclosed to clients. Funding rate payment should be settled at least once every 24 hours.
14. References used for margining, mark-to-market valuation and liquidation, such as mark price and index<sup>6</sup>, should be based on multiple independent sources, to reduce the risk of a price or index being controlled or influenced by a single entity or its related parties. Where an index is used, the Platform Operator should clearly

<sup>5</sup> A mark price is a reference price used to calculate mark-to-market profit and loss, and to trigger liquidations.

<sup>6</sup> An index is a composite price calculated from the prices of the underlying asset(s) across multiple external sources. It serves as a benchmark for the fair value of the asset and provides a basis for determining the mark price.

disclose the method of index compilation, its computation, the update and publication frequency, and the circumstances for its modification or discontinuation. Contingency measures should be established for alternative determination methodologies in the event of insufficient input, market disruption or other factors which affect the determination of fair prices, rates or values. Automatic failover should be implemented to reduce the risk of stale or manipulated prices leading to unfair liquidations.

15. Automatic, real-time mark-to-market adjustments should be accurately reflected in the client accounts to ensure that position valuations consistently align with current market prices.

### **Margin arrangements and loss allocation management**

16. A Platform Operator should ensure, through automated pre-trade checks, that the required margin has been received in full before an order is accepted. A Platform Operator should not extend credit for margin.
17. Margin collateral should be in the form of (a) fiat, or (b) stablecoins or tokenised deposits regulated by the Hong Kong Monetary Authority.
18. To facilitate orderly liquidation of positions which fail to meet the required margin, margin requirements should be set with due consideration of position concentration risk.
19. A Platform Operator should follow a clear and pre-defined order of priority for default management, position liquidation and loss allocation, such as:
  - (a) order-book liquidation,
  - (b) backstop liquidity providers,
  - (c) reserve or insurance fund,
  - (d) auto-deleveraging (**ADL**), or
  - (e) other last resort loss allocation mechanisms.

The circumstances triggering each mechanism, and the applicable parameters, should be clearly disclosed. The default management procedures should be (a) designed to facilitate the Platform Operator's timely containment of client losses, and (b) consistently applied.

20. Automated liquidation should occur at pre-defined thresholds, such as when the maintenance margin requirement is not met. A Platform Operator should regularly review and test margining and liquidation mechanisms to ensure their effectiveness, particularly during periods of market volatility.

21. A Platform Operator should disclose to clients real-time insurance fund levels available for loss absorption in a clear, accurate and non-misleading manner. Should the insurance fund become fully depleted or otherwise unavailable, the Platform Operator should promptly notify all clients with open positions, and issue a clear warning that open positions may be subject to ADL. A Platform Operator should also disclose how the insurance fund will be funded, and the treatment of any surplus.
22. A Platform Operator should provide real-time information about the likelihood of open positions being auto-deleveraged, and issue a post-event report to all clients within 24 hours whenever ADL or any last-resort tools are activated.

### **Market surveillance**

23. A Platform Operator should ensure that surveillance systems are implemented to detect patterns specific to Perps, such as material deviations between index and mark prices, abnormal funding rate patterns, and clusters of forced liquidations. Real-time cross-market surveillance should be conducted, covering both spot and Perps trading. The Platform Operator should implement a comprehensive business continuity and contingency plan to address abrupt or abnormal market situations, and such information should be clearly disclosed to clients.

### **Disclosure requirements**

24. To ensure transparency and support informed decision-making for investors, a Platform Operator should provide clear, comprehensive and timely disclosure on its website of all material risk factors associated with Perps. Such disclosure should explain how each risk may affect clients, including its potential impact on position valuation and profit and loss, with sufficient details to enable the clients to make informed investment decisions.
25. At minimum, the risk disclosure should explain the key characteristics of Perps and the potential consequences for clients, illustrated with hypothetical transactions and scenarios where practicable, including the possibility of:
  - (a) funding rate volatility;
  - (b) loss from funding rate payment;
  - (c) position close-out difficulty due to the absence of an expiry date and limited liquidity;
  - (d) potential difference between the calculated underlying asset price and actual spot market price;
  - (e) substantial divergence between Perp price and underlying asset price during volatile market conditions;

- (f) where applicable, the absence of an expiry date for price convergence between Perp price and spot price;
- (g) market volatility and price gap risk;
- (h) cascading liquidations during market stress;
- (i) lack of liquidity provider for position close-out during default management;
- (j) forced close-out of positions under pre-specified loss allocation mechanisms following a participant's default, where the Platform Operator may close a non-defaulting client's open position to cover default losses, thereby potentially reducing profit or increasing loss for the non-defaulting client; and
- (k) total loss of investment.

26. A Platform Operator should make the following information (where applicable) available to a client on its website, with sufficient details presented in a clear and comprehensible manner to enable a client to accurately understand how Perps are traded on its platform:

- (a) trading rules;
- (b) product specifications;
- (c) fees chargeable for trading Perps on the platform, and whether any fee incentive or rebate may be paid to any party;
- (d) how the underlying asset price, Perp price, funding rate, margining, position and collateral valuation and profit and loss will be determined and disclosed;
- (e) a client's ability to choose preferred leverage level or cross margining;
- (f) the Platform Operator's payment obligations;
- (g) settlement arrangements for margin, funding rate or other payments; and
- (h) default management procedures, such as position liquidation trigger, the settlement price for liquidated positions, loss allocation methodology, utilisation and replenishment of any reserve or insurance fund, and any risk mutualisation arrangements.

27. A Platform Operator should provide real-time disclosure of all Perp transactions, including those resulting from forced liquidation, across all standard display channels (such as trading feed, user interface and API). Each disclosed transaction should specify the execution time, price and size to ensure transparency of trading activity.

28. Given the innovative and risky characteristics of Perps, a Platform Operator is expected to allocate adequate resources to address client education, respond to client enquiries, and manage client complaints effectively.

### **Way forward**

29. Platform Operators are welcomed to discuss their proposed Perp structure with the SFC. The principles in this Framework represent the initial approach for Perp offerings and may be refined or expanded in light of product evolution and changing market conditions. The SFC may issue further guidance to the industry after considering proposals from Platform Operators.
30. Should you have any queries regarding this Framework, please contact your case officers-in-charge.

Intermediaries Division  
Securities and Futures Commission

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