



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets

October 2019

Contents

| | |
|---|-----------|
| Explanatory Notes | 3 |
| I. GENERAL | 4 |
| II. GENERAL PRINCIPLES | 6 |
| 1. General Principles | 6 |
| III. ORGANISATION AND STRUCTURE | 7 |
| 2. Organisation and Management Structure | 7 |
| IV. VIRTUAL ASSET FUND MANAGEMENT | 10 |
| 3. Virtual Asset Fund Management | 10 |
| 4. Custody | 15 |
| 5. Operations | 19 |
| V. DEALING WITH THE FUND AND FUND INVESTORS | 23 |
| 6. Dealing with the Fund and Fund Investors | 23 |
| 7. Marketing Activities | 24 |
| 8. Fees and Expenses | 25 |
| VI. REPORTING TO THE SFC | 26 |
| Appendix 1 - Requirements for Virtual Asset Fund Managers conducting discretionary accounts management | 28 |
| Appendix 2 - Risk management control techniques and procedures | 34 |
| Appendix 3 - Risk disclosure statements | 37 |



Explanatory Notes

These terms and conditions set out the principles and requirements (where applicable) with which corporations licensed by the Securities and Futures Commission (SFC) should comply when managing portfolios (or portions of portfolios)¹ that invest in Virtual Assets (as defined in Section I below) and meet the de minimis threshold (see Section I below).

These terms and conditions (Terms and Conditions) shall be imposed on Virtual Asset Fund Managers (as defined in Section I below) by way of a licensing condition.

Contravention of a licensing condition is likely to be considered as misconduct under the Securities and Futures Ordinance (Cap. 571) (SFO) which will reflect adversely on the fitness and properness of a Virtual Asset Fund Manager to remain licensed and may result in disciplinary action by the SFC. A pragmatic approach however 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.

¹ The licensed corporation may be managing portfolios for a collective investment scheme (for example, fund) or a discretionary account.

I. GENERAL

Interpretation

A reference in these Terms and Conditions to:

- "fund" or "client" generally means a collective investment scheme² managed by a Virtual Asset Fund Manager that invests in Virtual Assets and meets the de minimis threshold, except where a Virtual Asset Fund Manager is a delegate of another fund manager for the management of a fund or a portfolio within a fund, in which case a reference to "client" means the delegating fund manager, and a reference to "fund" means the portfolio managed by the delegated Virtual Asset Fund Manager;
- "fund investors" means investors as a whole of a collective investment scheme managed by a Virtual Asset Fund Manager;
- "Virtual Assets" means 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 SFO;
- "Virtual Asset Fund Manager" means a licensed corporation that manages a fund (or portion of a fund) that invests in Virtual Assets and meets the de minimis threshold;
- "de minimis threshold" refers to the situation where either: (a) the stated investment objective of a fund is to invest in Virtual Assets or (b) the intention of a fund is to invest 10% or more of its gross asset value (GAV) in Virtual Assets;

For the avoidance of doubt, a fund will not be regarded as having met the de minimis threshold in the following situation:

- (a) 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
- (b) its investment in Virtual Assets exceeds 10% of its GAV due to the increase in prices of the Virtual Assets held in that fund, but all reasonably practicable steps are being taken to reduce the fund's investment in Virtual Assets in a timely manner so as to reduce such investment proportion to below 10% of its GAV.

However, if the situation referred to in (b) is anticipated to persist, the SFC should be duly alerted by the licensed corporation concerned so that the SFC could consider imposing these Terms and Conditions on that licensed corporation.

² These Terms and Conditions are designed for collective investment schemes in corporate form. If the collective investment schemes managed by the licensed corporation adopt a different structure, for example, a unit trust structure, these Terms and Conditions will be modified accordingly.



Application

Please note that:

- (a) certain Terms and Conditions (i.e. paragraphs 3.16, 3.17 (except for 3.17(b) and 3.17(c)), 3.18, 3.19, 3.20, 3.21, 4.2, 4.6 to 4.11, 5.4, 5.8 to 5.12, 5.13, 5.16 to 5.17, and 6.2) are only applicable to a Virtual Asset Fund Manager that is responsible for the overall operation of a fund or has been delegated responsibility for that function; and
- (b) the particular requirements that are not applicable to, and additional requirements that are applicable to, Virtual Asset Fund Managers conducting discretionary accounts management are set out in Appendix 1 of these Terms and Conditions.

II. GENERAL PRINCIPLES

1. General Principles

A Virtual Asset Fund Manager should comply with the spirit of these principles when managing a Virtual Asset fund.

GP1. Honesty and Fairness

In conducting its business activities, a Virtual Asset Fund Manager should act honestly, fairly, and in the best interests of its funds and fund investors and the integrity of the market.

GP2. Diligence

In conducting its business activities, a Virtual Asset Fund Manager should act with due skill, care and diligence, in the best interests of its funds and fund investors and the integrity of the market.

GP3. Capabilities

A Virtual Asset Fund Manager should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

GP4. Conflicts of Interest

A Virtual Asset Fund Manager should try to avoid conflicts of interest. Where conflicts of interests cannot be avoided, and provided that funds' and fund investors' interests can be sufficiently protected, the conflict should be managed and minimized by appropriate safeguards and measures, which should be properly disclosed to fund and fund investors.

GP5. Fund Assets

A Virtual Asset Fund Manager should ensure that fund assets are promptly and properly accounted for and adequately safeguarded.

GP6. Disclosure

Disclosure should be clear, concise and effective, containing information necessary for fund investors to be able to make an informed judgement and be kept up-to-date. Where ongoing disclosure is required, information should be disseminated in a timely and efficient manner.

GP7. Compliance

A Virtual Asset Fund Manager should comply with the instrument of incorporation, offering documents and other relevant documents of the Virtual Asset fund.

A Virtual Asset Fund Manager should also comply with all legal and regulatory requirements (including its licensing conditions) applicable to the conduct of its

business activities as well as its own internal policies and procedures so as to promote the best interests of its clients, funds and fund investors and the integrity of the market.

GP8. Responsibility of Senior Management

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 Virtual Asset Fund Manager.

III. ORGANISATION AND STRUCTURE

2. Organisation and Management Structure

Organisation and Resources

2.1 A Virtual Asset Fund Manager should maintain:

- (a) an effective management and organizational structure which ensures that the operations of the business are conducted in a sound, efficient and effective manner;
- (b) financial resources in accordance with all applicable legal and regulatory requirements;

If the Virtual Asset Fund Manager holds Virtual Assets on behalf of the funds it manages, the Virtual Asset Fund Manager shall at all times maintain liquid capital which is not less than an amount equal to the higher of (a) HK\$ 3 million and (b) its variable required liquid capital. The terms "liquid capital" and "variable required liquid capital" shall have the same meaning as defined in section 2 of the Securities and Futures (Financial Resources) Rules (Cap. 571N);

- (c) sufficient human and technical resources and experience for the proper performance of its duties. This would be expected to vary depending on the amount of assets under management by the Virtual Asset Fund Manager, and the type and nature of the Virtual Assets and markets in which the funds managed by the Virtual Asset Fund Manager invest. The functions within the Virtual Asset Fund Manager, including fund management, operations, compliance, risk management, valuation and audit, should only be performed by qualified and experienced persons, who should receive appropriate updates and training on an ongoing basis;
- (d) satisfactory internal controls and written compliance procedures which address all applicable legal and regulatory requirements (including its licensing conditions) and implement appropriate monitoring systems;
- (e) satisfactory risk management governance structure and procedures commensurate with the nature, size, complexity and risk profile of the Virtual Asset Fund Manager and the investment strategy adopted by each of the funds under its management; and

- (f) adequate insurance cover commensurate with its business.

Segregation of Duties

- 2.2 A Virtual Asset Fund Manager should ensure that key duties and functions are appropriately segregated, particularly those duties and functions which when performed by the same individual may result in undetected errors, may be susceptible to abuses or may expose the Virtual Asset Fund Manager, its funds or fund investors to inappropriate risks.

Conflicts of Interest

- 2.3 A Virtual Asset Fund Manager should maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor any actual or potential conflicts of interest. Where an actual or potential conflict arises, the conflict should be managed and minimised by appropriate safeguards and measures to ensure fair treatment of fund investors, and any material interest or conflict should be properly disclosed to fund investors.

Responsibilities of Management

"Senior management" means the Managing Director of a Virtual Asset Fund Manager or its Board of Directors, Chief Executive Officer or other senior operating management personnel in a position of authority over the Virtual Asset Fund Manager's business decisions.

- 2.4 The senior management of a Virtual Asset Fund Manager should:
- (a) be principally responsible for compliance by the Virtual Asset Fund Manager with all applicable legal and regulatory requirements (including its licensing conditions), as well as the nurturing of a good compliance culture within the Virtual Asset Fund Manager;
 - (b) maintain clear reporting lines with supervisory and reporting responsibilities assigned to qualified and experienced persons;
 - (c) ensure that all persons performing functions on behalf of the Virtual Asset Fund Manager are provided adequate and up-to-date information about the Virtual Asset Fund Manager's policies and procedures applicable to them; and
 - (d) ensure that the performance of the Virtual Asset Fund Manager in managing funds is reviewed at least annually.

Risk Management

- 2.5 The Virtual Asset Fund Manager should establish and maintain effective policies and procedures as well as a designated risk management function to identify and quantify the risks, whether financial or otherwise, to which the Virtual Asset Fund

Manager and the funds are exposed. The Virtual Asset Fund Manager should take appropriate and timely action to contain and otherwise adequately manage such risks.

- 2.6 A Virtual Asset Fund Manager should review the risk management policies and procedures with appropriate frequency and enhance such policies and procedures whenever necessary.

Compliance

- 2.7 A Virtual Asset Fund Manager should:
- (a) maintain an effective compliance function, including a compliance officer, within the Virtual Asset Fund Manager to ensure that the Virtual Asset Fund Manager complies with its own internal policies and procedures, and with all applicable legal and regulatory requirements (including its licensing conditions); and
 - (b) ensure that the compliance function possesses the technical competence and experience necessary for the performance of its functions.
- 2.8 The compliance function and the compliance officer should be independent of other functions and report directly to the Virtual Asset Fund Manager's senior management, unless this is not reasonably practicable given the size of the Virtual Asset Fund Manager. In these exceptional cases, the Virtual Asset Fund Manager's senior management should assume the role of compliance officer. Compliance activities may be delegated to an appropriately qualified professional, although the responsibility and obligations may not be delegated.
- 2.9 There should be sufficiently detailed compliance procedures to enable the personnel of the Virtual Asset Fund Manager to comply with all applicable legal and regulatory requirements (including its licensing conditions) at all times. Any deviation from the procedures should be approved by the compliance officer or other persons designated by senior management. Such approval and the reasons thereof should be properly documented.

Anti-Money Laundering and Counter-Terrorist Financing

- 2.10 A Virtual Asset Fund Manager should take all reasonable measures to ensure that proper safeguards exist to mitigate the risks of money laundering and terrorist financing, especially in respect of subscriptions made by the fund investors using Virtual Assets. In particular, a Virtual Asset Fund Manager should comply with the provisions of the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) as if it were conducting regulated activity, even if the funds (or parts of the funds) under its management invest in Virtual Assets which do not amount to “securities” or “futures contracts”.

Audit

- 2.11 Where practicable, a Virtual Asset Fund Manager should maintain an independent and objective audit function to report on the adequacy, effectiveness and efficiency

of the Virtual Asset Fund Manager's management, operations and internal controls. The audit function should, among other things, report to senior management on all matters highlighted in the audit report, which should be resolved satisfactorily and in a timely manner. Where the size of the Virtual Asset Fund Manager does not justify a separate internal audit function, the relevant roles and responsibilities should be performed or reviewed by external auditors.

Delegation

- 2.12 A Virtual Asset Fund Manager should exercise due skill, care and diligence in the selection and appointment of third-party delegates. Where functions are delegated to third parties, there should be ongoing monitoring of the competence of delegates, to ensure that the principles and requirements set out under these Terms and Conditions are followed.

Withdrawal from Business

- 2.13 A Virtual Asset Fund Manager who withdraws from the business should 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.

IV. VIRTUAL ASSET FUND MANAGEMENT

3. Virtual Asset Fund Management

Investment within Mandate

- 3.1 A Virtual Asset Fund Manager should 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, whether in terms of asset class, geographical spread or risk profile, as set out in the respective constitutive and/or relevant documents of the funds managed by the Virtual Asset Fund Manager. In this connection, a Virtual Asset Fund Manager should have in place effective and properly-implemented procedures and controls.

Best Execution

- 3.2 A Virtual Asset Fund Manager should ensure that fund orders are executed on the best available terms, taking into account the 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 on Market Misconduct

- 3.3 A Virtual Asset Fund Manager should establish and implement effective policies and procedures to prohibit and prevent market misconduct.

Order Allocation

- 3.4 A Virtual Asset Fund Manager should:

- (a) ensure that all orders executed for the funds that it manages are allocated fairly;
- (b) make a record of the intended basis of allocation before a transaction is effected; and
- (c) ensure that an executed transaction is allocated promptly in accordance with the stated intention, except where the revised allocation does not disadvantage any funds and the reasons for the re-allocation are clearly documented.

Fund Portfolio Turnover

- 3.5 A Virtual Asset Fund Manager should take into account the fund's stated objectives and not trade excessively on behalf of a fund.

Underwriting

- 3.6 Unless specifically permitted in the fund mandate, a 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 under such contract should be credited to the fund account.

Participation in Initial Offerings

- 3.7 Where a Virtual Asset Fund Manager participates in an initial offering³ of Virtual Assets on behalf of funds managed by it, it should ensure that:
- (a) the allocation of Virtual Assets received in the offering provides for a fair and equitable allocation amongst the funds it manages;
 - (b) preferential allocations are prohibited; and
 - (c) records 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 the differences between the intended and actual allocations, are made.

Transactions with Connected Persons

- 3.8 A 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, consistent with best execution standards, and at a commission rate no higher than customary institutional rates.
- 3.9 A Virtual Asset Fund Manager should not, on behalf of a fund, deposit money (or Virtual Assets) with or borrow money (or Virtual Assets) from a connected person unless:

³ Commonly known as "Initial Coin Offerings".

- (a) in the case of a deposit, interest is received at a rate not lower than the prevailing commercial rate for a deposit of that size and term; and
- (b) in the case of a loan, interest charged and fees levied in connection with the loan are no higher than the prevailing commercial rate for a similar loan.

Cross Trades

- 3.10 A Virtual Asset Fund Manager should only undertake sale and purchase transactions between fund accounts⁴ (cross trades) where:
- (a) the sale and purchase decisions are in the best interests of both funds and their fund investors and fall within the investment objective, restrictions and policies of both funds;
 - (b) the trades are executed on arm's length terms at current market prices;
 - (c) the reasons for such trades are documented prior to execution; and
 - (d) such activities are disclosed to fund investors of both funds.
- 3.11 Cross trades between house accounts and fund accounts should only be permitted with the prior written consent of the fund investors, to whom any actual or potential conflicts of interest should be disclosed. Cross trades between staff personal accounts and fund accounts should be prohibited.

House Accounts

"House account" means an account owned by a Virtual Asset Fund Manager or any of its connected persons over which it can exercise control and influence.

- 3.12 When dealing for a house account, a Virtual Asset Fund Manager should:
- (a) give priority to satisfying an order to be executed for a fund. Where a fund's order has been aggregated with an order for the house account, the fund's order must take priority in any subsequent allocation if all orders cannot be filled. Aggregation of house orders with fund orders should only be made if it is in the best interests of the fund and fund investors concerned; and
 - (b) except with the prior written consent of the compliance officer or other persons designated by senior management, not deal ahead of any transaction to be carried out on behalf of a fund. The compliance officer or other persons designated by senior management should properly document the reasons for any consent given.

Note:

For the avoidance of doubt, a reference to "dealing" in this sub-section includes any acquisition or disposal of fund assets.

⁴ For the avoidance of doubt, a reference to "fund account" in this paragraph also includes a reference to a discretionary account managed by the Virtual Asset Fund Manager.

Operational Control

- 3.13 A Virtual Asset Fund Manager should establish and maintain effective policies and operational procedures and controls in relation to the Virtual Asset Fund Manager's day-to-day business operations and comply with these policies, operational procedures and controls. Such policies, operational procedures and controls, include but are not limited to, controls over trading and safeguard of fund assets, IT system and infrastructure.

Risk Management

- 3.14 For risk management at the fund level, a Virtual Asset Fund Manager should establish and implement adequate risk management procedures in order to identify, measure, manage and monitor appropriately all risks:
- (a) relevant to each investment strategy; and
 - (b) to which each fund is or may be exposed, such as market, liquidity and counterparty risks, and other risks, including operational risks, especially cybersecurity risks, which may be material for each fund it manages taking into account the nature, scale and complexity of its business and the investment strategy of each of the funds it manages.

A Virtual Asset Fund Manager should also provide timely and adequate information to its senior management to enable it to take appropriate and timely action to contain and otherwise adequately manage such risks.

Note:

Where appropriate, measures to manage risks of a fund may include:

- (a) *identifying and managing potential risks of a fund throughout the fund life cycle;*
 - (b) *ensuring that the risk profile of the fund is consistent with the nature, size, portfolio structure and investment strategies, restrictions and objectives of the fund as provided and represented to fund investors in the constitutive, offering and/or relevant documents; and*
 - (c) *ensuring ongoing and proper identification, measurement, management and monitoring of risks associated with each investment of the fund and their overall effects on the fund's portfolio (including via the use of suitable stress testing procedures).*
- 3.15 A Virtual Asset Fund Manager should take into account, where applicable, the risk management control techniques and procedures set out in Appendix 2 in monitoring such risks.

Leverage

- 3.16 A Virtual Asset Fund Manager should disclose to fund investors:

- (a) the expected maximum level of leverage which it may employ on behalf of the fund; and
- (b) the basis of calculation of leverage which should be reasonable and prudent.

Liquidity Management

3.17 A Virtual Asset Fund Manager should:

- (a) establish and implement appropriate and effective liquidity management policies and procedures to monitor the liquidity risk of the fund, taking into account the investment strategy, liquidity profile, underlying assets and obligations, and redemption policy of the fund;
- (b) integrate liquidity management in investment decisions;
- (c) regularly assess the liquidity of the assets of a fund;
- (d) regularly assess the liquidity profile of the fund's liabilities;
- (e) regularly conduct assessments of liquidity in different scenarios, including stressed situations, to assess and monitor the liquidity risk of the funds accordingly; and
- (f) disclose the liquidity risks involved in investing in the fund, the liquidity management policies, and an explanation of any tool or exceptional measure that could affect redemption rights in the fund's offering document or otherwise make such information freely available to fund investors.

Note:

The extent of application of these liquidity management principles will depend on the nature, liquidity profile and asset-liability management of the fund. A Virtual Asset Fund Manager should consider which principles are relevant to the fund it manages.

3.18 A Virtual Asset Fund Manager should consider the appropriateness of the liquidity management tools and exceptional measures used for the funds under its management, taking into account the nature of assets held by the fund and its investor base.

Note:

Protecting the interests of fund investors should be the primary consideration in the use of liquidity risk management tools. A Virtual Asset Fund Manager should also ensure that the investment strategy and portfolio profile of a fund are consistently maintained as much as possible when using these tools.

Where a Virtual Asset Fund Manager has granted preferential treatment (for example, side letters) to certain investors, it should disclose such fact and the material terms in relation to redemption in the side letters to all relevant potential and existing fund investors.

- 3.19 A Virtual Asset Fund Manager should conduct periodic reviews of the effectiveness of its liquidity management policies and procedures and such policies and procedures should be updated as appropriate.

Termination

- 3.20 A Virtual Asset Fund Manager's decision to terminate a fund should take due account of the best interests of investors in the fund. A Virtual Asset Fund Manager should ensure that the termination process of a fund is carried out, and fund investors are treated, fairly.
- 3.21 A Virtual Asset Fund Manager should make adequate disclosure of all relevant material information in relation to the termination of the fund to all fund investors in an appropriate and timely manner.

Note:

Such information should include without limitation termination decisions, implementation plans and material change of circumstances arising during the termination process.

4. Custody

Safety of Fund Assets

- 4.1 A Virtual Asset Fund Manager should ensure that any fund assets entrusted to it are accounted for properly and promptly and adequately safeguarded. In this connection:
- (a) A Virtual Asset Fund Manager should select and arrange for the appointment of, and entrust the fund assets to, a custodian that is functionally independent from it;
 - (b) A Virtual Asset Fund Manager should ensure that fund assets are segregated from the assets of the Virtual Asset Fund Manager, and, unless held in an omnibus client account, assets of other clients;
 - (c) Where fund assets are held in an omnibus client account, the Virtual Asset Fund Manager should ensure that adequate safeguards are put in place such that assets belonging to each fund are appropriately recorded with frequent and appropriate reconciliations being performed; and
 - (d) A Virtual Asset Fund Manager should implement and maintain adequate processes and controls when:
 - (i) Creating new accounts with trading platforms and custodians;

- (ii) Whitelisting new internet protocol addresses (IP addresses) at trading platforms and custodians;
- (iii) Whitelisting new wallet addresses at trading platforms and custodians; and
- (iv) Effecting transfer of assets between trading platforms, custodians and wallets held by the Virtual Asset Fund Manager.

4.1A Where a Virtual Asset Fund Manager receives fiat currency on behalf of the funds it manages (client money), it should:

- (a) establish one or more segregated bank accounts for holding the client money received by it. Such bank accounts should be established and maintained with an authorized financial institution in Hong Kong or another bank in a jurisdiction as agreed by the SFC from time to time;
- (b) ensure that such client monies are (i) transferred into a segregated bank account; or (ii) paid to the fund, within one business day after the receipt of such currencies;
- (c) ensure that client money is retained in the segregated bank account until it is:
 - (i) paid to the fund managed by the Virtual Asset Fund Manager, being the client on whose behalf it is being held; or
 - (ii) required to pay money that the fund managed by the Virtual Asset Fund Manager, being the fund on whose behalf it is being held, owes to the Virtual Asset Fund Manager;
 - (iii) required to meet the fund's obligations to meet settlement or margin requirements.

A Virtual Asset Fund Manager may not pay, or permit to be paid, any client money of the Virtual Asset Fund Manager to any of its officers or employees or any officer or employee of any corporation with which the Virtual Asset Fund Manager is in a controlling entity relationship⁵, unless that officer or employee is the fund investor of the fund on whose behalf such client money is being held; and

- (d) pay out of the segregated bank account any amount held in the segregated bank account that is not client money within one business day of becoming so aware.

4.2 A Virtual Asset Fund Manager should select the most appropriate custodial arrangement for holding fund's Virtual Assets. In assessing which custodial arrangement (or combination of custodial arrangements) to adopt, the Virtual Asset Fund Manager should assess the advantages and disadvantages of holding Virtual Assets under each custodial arrangement (for example, independent custodian or self-custody, host locations, use of hot or cold wallets) with reference to, among other

⁵ As defined under Part 1 of Schedule 1 to the SFO.

things,:

- (a) the ease with which Virtual Assets are accessible, i.e. the time required to transfer the Virtual Assets to the trading venue; and
- (b) the security of the custodial facility, i.e. whether there are adequate safeguards in place to protect the facility from external threats, including cyberattacks or the ability of the custodian to compensate for any loss of Virtual Assets.

A Virtual Asset Fund Manager should also assess the features and characteristics of the different custodial arrangements. For example:

- (a) the hardware and software infrastructure;
- (b) the Virtual Assets which are supported;
- (c) the security controls over key generation, storage, management and transaction signing;
- (d) the documented process of handling software upgrades to the storage devices used by the custodians and the Virtual Asset Fund Manager; and
- (e) the process of handling blockchain forks.

A Virtual Asset Fund Manager should document the reasons for selecting its custodial arrangements, including self-custody of Virtual Assets.

Self-custody

- 4.3 Where self-custody is adopted, the Virtual Asset Fund Manager should ensure that it has effective policies, procedures, and internal controls in place to protect the Virtual Assets from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions. For example, the persons fulfilling the custodial function are independent from the persons fulfilling the fund's management functions.
- 4.4 A Virtual Asset Fund Manager should ensure that the assets held in self-custody are identified as owned beneficially by the fund and not by the Virtual Asset Fund Manager through proper record-keeping and arrangements to ensure that these assets can be effectively segregated from the Virtual Asset Fund Manager's own assets upon the Virtual Asset Fund Manager's insolvency. For example, the Virtual Asset Fund Manager may make a declaration of trust over the fund's crypto wallet (including access keys) and all assets held in the wallet.
- 4.5 A Virtual Asset Fund Manager should use reasonable endeavours to acquire and maintain adequate insurance cover over these assets.

Selection and Appointment of an Independent Custodian

- 4.6 A 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. On

an ongoing basis, a Virtual Asset Fund Manager should satisfy itself as to the continued suitability and financial standing of any appointed custodian, for example, a Virtual Asset Fund Manager should request for and review the audited financial statements of the appointed custodian. Moreover, a Virtual Asset Fund Manager should consider appointing more than one custodian to avoid undue concentration of risks.

Note:

In considering whether a custodian is capable of properly performing its functions, the Virtual Asset Fund Manager should consider the following as part of the selection process for custodians⁶ and document the reasons for its selection:

- (a) the experience and track record of the custodian in providing custodial services for Virtual Assets, for example, the number of years for which the custodian has provided custodial services for Virtual Assets and the types of Virtual Assets which have been under its custody;*
- (b) the regulatory status of the custodian, in particular, whether the custodian is subject to any regulatory oversight over its Virtual Asset custodial business;*
- (c) the corporate governance structure and background of the senior management of the custodian;*
- (d) whether the custodian has appropriate segregation arrangements in place such that the fund assets are, throughout the custody chain, segregated from:
 - (i) the assets of the custodian/ sub-custodian; and*
 - (ii) the assets of other funds and other clients of the custodian (unless the fund assets are held in an omnibus client account);**
- (e) the financial resources and insurance cover of the custodian (i.e. the custodian's ability to compensate its customers in the event of any loss of customers' assets);*
- (f) the custodian's management of actual and potential conflicts of interest;*
- (g) the custodian's operational capabilities and arrangements, for example, the "wallet" arrangements and cybersecurity risk management measures;*
- (h) the physical setup and processes of the custodian, especially in dealing with transfer of assets, blockchain forks and software upgrades of devices; and*
- (i) where the appointment of sub-custodians is allowed, the custodian would use due skill, care and diligence in the selection, appointment and monitoring of its sub-custodians.*

⁶ Where the custodian also operates as a Virtual Asset trading platform, a Virtual Asset Fund Manager may also consider other factors, such as the liquidity provided by the trading platform, during the selection process.

To the extent possible, a Virtual Asset Fund Manager should select a custodian that is subject to regulatory oversight over its Virtual Asset custodial business.

Custody Agreement

- 4.7 A Virtual Asset Fund Manager should ensure that a formal custody agreement is entered into with the custodian that is to be entrusted with a fund's assets.
- 4.8 A Virtual Asset Fund Manager should formulate custodial arrangements with due skill, care and diligence and clarify the duties and responsibilities of the various parties to the custodial arrangements. In particular, the Virtual Asset Fund Manager should ensure that the custody agreement contains provisions to specify the scope of the responsibility and liability of the custodian.
- 4.9 A Virtual Asset Fund Manager should monitor custodial arrangements and the custodian's compliance with the terms of the custody agreement on an ongoing basis.

Disclosure of Custodial Arrangements

- 4.10 A Virtual Asset Fund Manager should ensure that:
- (a) the custodial arrangements in respect of assets of the fund, which should include the intended distribution of the amount of assets kept with each custodian and under self-custody of the Virtual Asset Fund Manager if the Virtual Asset Fund Manager intends to keep more than 10% of the fund's assets (in terms of GAV) with a particular custodian or under self-custody; and
 - (b) any material risks associated with the arrangements

are properly disclosed to the fund investors and that fund investors are updated about any significant changes.

- 4.11 Where the Virtual Asset Fund Manager intends to hold fund assets in self-custody, the Virtual Asset Fund Manager should also 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 these assets (where applicable).

5. Operations

Record Keeping

- 5.1 A Virtual Asset Fund Manager should establish and implement effective policies and procedures to ensure the integrity, security, availability, reliability and completeness of all information, both in physical and electronically stored form, relevant to the Virtual Asset Fund Manager's business operations.
- 5.2 A Virtual Asset Fund Manager should keep its accounts and records properly. Proper record keeping includes:
- (a) maintaining an audit trail of all transactions (such as orders placed, trades

executed and allocated, trades settlement, deposits and withdrawals of fund assets) effected by the Virtual Asset Fund Manager, all 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 addition, in respect of each fund for whom the Virtual Asset Fund Manager holds assets, the Virtual Asset Fund Manager should maintain sufficient records to show particulars of the fund's assets and liabilities, including any financial commitments and contingent liabilities;

- (b) maintaining sufficient records to demonstrate that the Virtual Asset Fund Manager has complied with these Terms and Conditions;
- (c) keeping records in such a manner as will enable an audit to be conveniently and properly carried out; and
- (d) making entries in the records in accordance with generally accepted accounting principles.

5.3 A Virtual Asset Fund Manager should retain records or documents related to its business as mentioned under paragraph 5.2 in premises which have been approved by the SFC for keeping records or documents required under the SFO or Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615). The Virtual Asset Fund Manager should retain-

- (a) subject to paragraph (b), such records or documents for a period of not less than seven years; and
- (b) in the case of records or documents showing particulars of any orders concerning Virtual Assets that are initiated by Virtual Asset Fund Manager, for a period of not less than two years.

Auditors and Audited Accounts

5.4 A Virtual Asset Fund Manager should ensure that an independent auditor is appointed to perform an audit of the financial statements of the fund (whether by appointing the independent auditor or procuring the relevant fund to appoint the independent auditor) in order to make available, at a minimum, an annual report for each of the funds it manages. When selecting the auditor, the Virtual Asset Fund Manager should take into account, among other things, the experience and capability of the auditor in auditing the financial statements of Virtual Asset funds. A Virtual Asset Fund Manager should understand the steps taken by the auditor in proving the existence and ownership of Virtual Assets and ascertaining the reasonableness of the valuation of the Virtual Assets and provide such information to the fund investors upon request.

5.5 The annual report for each of the funds should also be made available to fund investors of the relevant funds upon request.

5.6 The accounting information given in the annual report for each of the funds should be prepared in accordance with generally accepted accounting

principles and with the accounting rules set out in the constitutive documents of the fund.

- 5.7 A Virtual Asset Fund Manager should arrange for the counterparties of any funds it manages to provide the necessary information to the fund's auditor for conducting the audit.

Fund Portfolio Valuation

- 5.8 A Virtual Asset Fund Manager should ensure that, in respect of the fund it manages, appropriate policies and procedures are established so that a proper and independent valuation of the fund assets can be performed and valuation methodologies are consistently applied to the valuation of similar types of fund assets. If independent valuation of fund assets could not 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 from the Virtual Asset Fund Manager), the Virtual Asset Fund Manager should implement proper procedures and controls to ensure that the valuation methodologies are properly and consistently applied.
- 5.9 The valuation policies and procedures should also describe the process for handling situations where the value of an asset determined in accordance with methodologies of the Virtual Asset Fund Manager's valuation policies and procedures may not be appropriate.

Note:

The valuation policies and procedures should include, and describe clearly, the process for handling exceptions, including:

- (a) requiring the Virtual Asset Fund Manager to document the reason for any price override or deviation;*
 - (b) ensuring an appropriate review of the price override or deviation by a functionally independent party; and*
 - (c) describing the alternative method used for determining the appropriate price.*
- 5.10 All fund assets managed by a Virtual Asset Fund Manager should be valued on a regular basis. The frequency of such valuations should be appropriate to the fund assets and the dealing frequency of the fund. A Virtual Asset Fund Manager should also disclose the frequency of valuation and dealing and basis of valuation (including the valuation policies, principles, methodologies and models) to fund investors.
- 5.11 Where a Virtual Asset Fund Manager arranges the appointment of a third party to perform valuation services, the Virtual Asset Fund Manager should exercise due skill, care and diligence in the selection of the third party and ensure that the third party has the necessary expertise and experience in valuing Virtual Assets. A Virtual Asset Fund Manager should also review the third party's performance periodically to ensure that the requirements in paragraphs 5.8 to 5.10 above are complied with.

Note:

For the avoidance of doubt, the Virtual Asset Fund Manager remains responsible for the valuation of a fund's assets notwithstanding the appointment of a third party to perform valuation services.

- 5.12 The Virtual Asset Fund Manager should exercise due care to ensure that valuation policies, principles, methodologies and models selected are reasonably appropriate in light of the circumstances and in the best interests of the fund and fund investors. The valuation policies, procedures and process should be periodically reviewed (at least annually) by a competent party who is independent from the person making investment decisions for the funds, such as a qualified independent third party or a person performing an independent audit function to ensure their continued appropriateness and effective implementation. The review by such party should include testing the valuation procedures by which fund assets are valued. In selecting a competent independent party, the Virtual Asset Fund Manager should exercise due skill, care and diligence.

Side Pockets

- 5.13 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 Virtual Asset Fund Manager are segregated from other fund assets), a Virtual Asset Fund Manager should disclose to the fund investors:
- (a) the limit to total assets to be put in the side pocket;
 - (b) the overall fee structure and charging mechanism (in respect of, among others, any management and performance fees);
 - (c) that the redemption lock-up period for a side pocket would be different from that of the ordinary shares of the fund;
 - (d) how the 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
 - (e) 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.

The Virtual Asset Fund Manager should also disclose to the fund investors the actual amount of fees charged in relation to side-pocketed assets from time to time.

- 5.14 A Virtual Asset Fund Manager should, in setting up and managing side pockets in respect of fund assets under its management, ensure that:
- (a) it has the risk management competency in managing side pockets;
 - (b) it has a valuation policy covering side-pocketed assets which complies with

the requirements in paragraphs 5.8 to 5.10 above; and

- (c) it has operational checks and controls for transferring investments into and out of side pockets.

5.15 Where a Virtual Asset Fund Manager decides to side pocket any fund asset, it should arrange clear disclosure to fund investors of:

- (a) the creation of the side pocket;
- (b) the asset which has been side-pocketed; and
- (c) how the asset has been valued at the time of being side-pocketed and the ongoing valuation of the asset.

Net Asset Value Calculation and Pricing

5.16 A 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 constitutive documents of the fund and the valuation policies and procedures established by the Virtual Asset Fund Manager.

5.17 A Virtual Asset Fund Manager should ensure the valuation policies and procedures in respect of each fund it manages should seek to prevent, detect and correct pricing errors. Upon the identification of material pricing errors, actions should be taken to avoid further errors.

Reconciliations

5.18 A Virtual Asset Fund Manager should arrange to carry out reconciliations of the Virtual Asset Fund Manager's internal records against those issued by third parties, for example, banks, custodians, counterparties and executing brokers, to identify and rectify any errors, omissions or misplacement of assets. Reconciliations should be performed regularly (and, in any event, at least monthly) having regard to the nature of the fund assets.

V. DEALING WITH THE FUND AND FUND INVESTORS

6. Dealing with the Fund and Fund Investors

Provision of Information

6.1 A Virtual Asset Fund Manager should:

- (a) provide the fund and fund investors (where applicable) with adequate information about the Virtual Asset Fund Manager, including its business address, relevant conditions or restrictions under which its business is conducted; and
- (b) disclose the financial condition of its business, by providing a copy of its latest audited financial statements and disclosing any material change

which adversely affects the Virtual Asset Fund Manager's financial condition after the date of these statements, to a fund upon request.

- 6.2 A Virtual Asset Fund Manager should make adequate disclosure of information (as well as any material changes to the information) on the fund which is necessary for fund investors to be able 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. Some examples of these risks are specified under Appendix 3. A Virtual Asset Fund Manager should also make the same disclosure to the distributors it has appointed for distribution of its Virtual Asset fund.

Confidentiality

- 6.3 A 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

- 6.4 A Virtual Asset Fund Manager should maintain:

- (a) procedures to ensure that:
- (i) complaints from a fund or fund investors relating to the management of any fund managed by it are handled in a timely and appropriate manner;
 - (ii) steps are taken to investigate and respond promptly to a complaint by:
 - a person designated by senior management other than an individual directly concerned with the subject of the complaint; or
 - the compliance officer; and
 - (iii) if a complaint is not remedied promptly, the fund or fund investor is advised of any further steps which may be available to the fund or fund investor under the regulatory system; and
- (b) a register of complaints to give effect to (a) above. This should be reviewed by senior management on a regular basis.

7. Marketing Activities

Target Investors of the Virtual Asset Fund

- 7.1 A Virtual Asset Fund Manager should only allow professional investors⁷ to invest in

⁷ As defined under section 1 of Part 1 of Schedule 1 to the SFO.

the Virtual Asset fund⁸. Where the Virtual Asset fund is distributed through distributors, a Virtual Asset Fund Manager should establish and implement measures to ensure that the fund is only distributed to professional investors.

Representations by the Virtual Asset Fund Manager

- 7.2 A 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

- 7.3 A Virtual Asset Fund Manager should ensure that all advertisements and marketing materials:
- (a) are accurate, and not biased, misleading or deceptive;
 - (b) are clear, fair and present a balanced picture of the fund with adequate risk disclosures;
 - (c) contain information that is timely and consistent with the fund's offering document; and
 - (d) contain only performance claims that can be verified.

8. Fees and Expenses

Disclosure of Charges

- 8.1 A 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

- 8.2 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. In connection with mark-ups levied on transactions on behalf of a fund, where the Virtual Asset Fund Manager is:
- (a) acting as agent, such mark-ups are prohibited; and
 - (b) acting as principal, the circumstances should be disclosed to the clients and transactions be reported in periodic statements or transaction advice.

Soft Commission and Rebates

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

⁸ For the avoidance of doubt, this does not apply to those collective investment schemes authorized by the SFC under section 104 of the SFO.

- (a) the goods or services are of demonstrable benefit to the fund ;
- (b) transaction execution is consistent with best execution standards;
- (c) the fund has consented in writing to the receipt of the goods and services; and
- (d) 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.

Note:

Goods and services must not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments.

Disclosure and consent may be made or given in the client agreement or an addendum thereto. Whichever form of document is used, it must include a specific statement describing the Virtual Asset Fund Manager's soft dollar practices. In addition, at least annually the clients and fund investors must be given a statement describing the Virtual Asset Fund Manager's soft dollar practices, including a description of the goods and services received.

- 8.4 A Virtual Asset Fund Manager that intends to receive and retain cash rebates in relation to client transactions may retain those rebates only if:
- (a) the fund has consented in writing to the retention of rebates;
 - (b) transaction execution is consistent with best execution standards; and
 - (c) periodic disclosure of the rebates and their approximate value is made to the clients and fund investors.

VI. REPORTING TO THE SFC

- 9.1 A Virtual Asset Fund Manager should report to the SFC as soon as practicable upon the happening of any actual or suspected material non-compliance with these Terms and Conditions or any other applicable legal and regulatory requirements.
- 9.2 A Virtual Asset Fund Manager should notify the SFC of any significant change in its business activities, at least 7 business days before the change takes place.
- 9.3 A Virtual Asset Fund Manager should also provide any other information as may be requested by the SFC from time to time. The SFC may request for information to be provided on a periodic or ad hoc basis.

Note:

For example, such information may include:

- (a) *the fund's investment in each product or market;*
- (b) *valuation policies, procedures, principles and methodologies of the fund's assets; and*
- (c) *details of custodial arrangements.*

9.4 The Virtual Asset Fund Manager should respond to requests and enquiries from the SFC promptly in an open and co-operative manner.

9.5 A Virtual Asset Fund Manager should ensure that all information which it provides and which is provided on its behalf to the SFC is in all material respects complete, accurate and not misleading. If it becomes aware that any information provided does not meet this requirement, the Virtual Asset Fund Manager should inform the SFC promptly.

Requirements for Virtual Asset Fund Managers conducting discretionary accounts management

Introduction

Where applicable, Virtual Asset Fund Managers that are involved in the management of discretionary accounts which are operated in the following manner should observe these Terms and Conditions as well as any additional requirements set out in this Appendix:

- (a) where a Virtual Asset Fund Manager provides discretionary accounts management services to a client, in the form of an investment mandate or a pre-defined model investment portfolio; and

Note:

The investment mandate may set out, among others, the types, risks and allocation of investments after taking into account the client's circumstances, such as investment objectives and/or strategies. In the case of a pre-defined model portfolio, it may specify the proportion of the asset classes and markets and the risk profile of the selected portfolio.

- (b) the Virtual Asset Fund Manager receives a management fee and/or performance fee as remuneration for managing the discretionary account for its client.

For the avoidance of doubt, this Appendix only applies to a Virtual Asset Fund Manager that manages a discretionary account which invests in Virtual Assets and meets the de minimis threshold, irrespective of whether or not these Virtual Assets amount to “securities” or “futures contracts” as defined under the SFO. Where a Virtual Asset Fund Manager is involved in the management of both collective investment schemes and discretionary accounts, this Appendix only applies to the extent that that person is involved in the management of discretionary accounts.

Note:

In relation to certain principles and requirements (as specifically set out under these Terms and Conditions) that are only applicable to a Virtual Asset Fund Manager that is responsible for the overall operation of a fund or has been delegated responsibility for that function, a Virtual Asset discretionary account manager should also observe these principles and requirements, to the extent relevant to the functions and powers of the Virtual Asset discretionary account manager.

Interpretation

Except for those requirements mentioned in the section below, these Terms and Conditions are applicable to Virtual Asset discretionary account managers, terminologies that are specific to collective investments schemes/funds in these Terms and Conditions should be read as modified below:

- (a) any reference to “fund” or “client” means “discretionary account”;
- (b) any reference to “fund investors” means “discretionary account clients”;
- (c) any reference to “Virtual Asset Fund Manager” means “Virtual Asset Discretionary Account Manager”;
- (d) any reference to “constitutive documents” or “offering documents” means “Discretionary Client Agreement”; and
- (e) any reference to “redemption” means “capital withdrawal”.

Particular requirements in these Terms and Conditions which are not applicable to Virtual Asset Discretionary Account Managers

The following requirements do not apply to a Virtual Asset Discretionary Account Manager:

- (a) Liquidity management

The requirements in relation to the use of specific tools or exceptional measures which could affect redemption rights and corresponding explanation in the offering documents are not applicable to a Virtual Asset Discretionary Account Manager (Paragraphs 3.17(f) and 3.18 of these Terms and Conditions)

Note: The extent of application of other liquidity management principles will depend on the capital withdrawal policy set out in the Discretionary Client Agreement.

- (b) Termination

The requirements in relation to the termination process are not applicable to a Virtual Asset Discretionary Account Manager. (Paragraphs 3.20 and 3.21 of these Terms and Conditions)

Note: A Virtual Asset Discretionary Account Manager should observe the relevant termination provisions set out in the Discretionary Client Agreement.

- (c) Side pockets

The requirements in relation to side pocket arrangements are not applicable to a Virtual Asset Discretionary Account Manager. (Paragraphs 5.13 to 5.15 of these Terms and Conditions)

- (d) Auditors and audited accounts

The requirement in relation to the audit of the financial statements of the funds and the accounting information in the annual report for each of the funds are not applicable to a Virtual Asset Discretionary Account Manager. (Paragraphs 5.4 to 5.7 of these Terms and Conditions)

(e) Valuation frequency

The requirements in relation to the valuation frequency and related disclosure are not applicable to a Virtual Asset Discretionary Account Manager. (Paragraph 5.10 of these Terms and Conditions)

Note: Where applicable, a Virtual Asset Discretionary Account Manager should observe the relevant requirements set out in paragraphs 5.8 to 5.12 (save for the appropriateness to the dealing frequency and related disclosure set out in paragraph 5.10 of these Terms and Conditions) and the relevant valuation provisions set out in the Discretionary Client Agreement.

(f) Net Asset Value Calculation and Pricing

The requirements in relation to net asset value calculation of different share classes are not applicable to a Virtual Asset Discretionary Account Manager. (Paragraphs 5.16 and 5.17 of these Terms and Conditions)

Note: Where applicable, a Virtual Asset Discretionary Account Manager should observe the requirements in relation to overall net asset value calculation of the Discretionary Account.

Additional requirements applicable to Virtual Asset Discretionary Account Managers

The requirements set out in the following paragraphs are also generally applicable to a Virtual Asset Discretionary Account Manager:

Target Clients

1. A Virtual Asset Discretionary Account Manager should only provide its services to professional investors⁹.
2. A Virtual Asset Discretionary Account Manager should assess whether clients have knowledge of investing in Virtual Assets or related products prior to providing discretionary account management services to them. Alternatively, a Virtual Asset Discretionary Account Manager may take into account whether the clients have prior investment experience in private equity or venture capital or have provided capital for a start-up business in the past. If the clients do not possess such knowledge or experience, a Virtual Asset Discretionary Account Manager may only proceed to provide such services if, by so doing, it would be acting in the best interests of the clients.

Suitability

3. A 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. Such suitability

⁹ As defined under section 1 of Part 1 of Schedule 1 to the SFO

assessment could be conducted on a holistic basis when the mandate or portfolio is agreed (for example, in establishing a predefined model investment portfolio with a particular overall risk profile, the Virtual Asset Discretionary Account Manager could have the discretion to invest in particular products with a lower or higher risk profile so long as the overall risk profile of the portfolio is maintained). The Virtual Asset Discretionary Account Manager should document its assessment and provide a copy of the rationale to the client in writing. To avoid concentrated exposure to Virtual Assets, the Virtual Asset Discretionary Account Manager should also ensure that the aggregate amount to be invested by a client in the discretionary account is reasonable, as determined by the Virtual Asset Discretionary Account Manager, considering the client's net worth.

4. A Virtual Asset Discretionary Account Manager should review the mandate or predefined model investment portfolio on a regular basis (for example, at least on an annual basis and whenever there have been significant market movements), having regard to the client's latest circumstances at the time of review and, where appropriate, recommend revisions to the mandate or predefined model investment portfolio and agree them with the client. The Virtual Asset Discretionary Account Manager should also document the rationale for recommending the revised mandate or predefined model investment portfolio and provide a copy of the rationale to the client in writing.
5. A Virtual Asset Discretionary Account Manager should ensure that the transactions carried out on behalf of the clients are suitable and in accordance with the mandate or predefined model investment portfolio.

Client Agreements

6. A 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 such information set out in the section "Minimum Content of Discretionary Client Agreement" of this Appendix and be provided in a language understood by the client. These minimum requirements do not apply to Institutional Professional Investors¹⁰.

Performance Review and Valuation Reports

7. Except as agreed otherwise in writing by the client, a Virtual Asset Discretionary Account Manager should:
 - (a) review the performance of each Discretionary Account against any previously agreed benchmark, either in writing to the client or by way of meeting, at least twice a year; and
 - (b) 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 as provided in the Discretionary Client Agreement. The report should, as a minimum, include the following:

¹⁰ The term "Institutional Professional Investors" refers to persons falling under paragraphs (a) to (i) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the SFO.

- (i) the date on which the report is made;
- (ii) the valuation of the client's portfolio, including:
 - the details of the quantity, purchase cost, latest price and value of each description of Virtual Asset held for that account as at the end of that period;
 - the money balance (in fiat currency) held for that account as at the end of that period; and
 - the amount of accounts payable and receivable in respect of that account as at the end of that period; and
- (iii) the details of all income credited to and charges levied against that account during the monthly accounting period.

Minimum Content of Discretionary Client Agreement

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

- (a) the full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;
- (b) the full name and address of the Virtual Asset Discretionary Account Manager's business including the Virtual Asset Discretionary Account Manager's licensing status with the SFC and the CE number (being the unique identifier assigned by the SFC);
- (c) appointment of the firm as the Virtual Asset Discretionary Account Manager and the details of the services provided;
- (d) statement of the client's investment policy and objectives.

In the case where the client has selected a pre-defined model portfolio, the Discretionary Client Agreement should also specify the proportion of the asset classes, markets, and corresponding risk profile of the selected pre-defined model portfolios;

- (e) the following clause: "If we [the intermediary] solicit the sale of or recommend any Virtual Assets to you [the client], the Virtual Assets must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause.";
- (f) the amount of all fees to be paid by the client, whether to the Virtual Asset Discretionary Account Manager or to a connected person with respect to the account, and a description of fees to be paid by the client to third parties, where applicable;
- (g) any consent from the client where the Virtual Asset Discretionary Account Manager intends to receive soft commission or retain cash rebates;

- (h) details of custodial arrangements if the Virtual Asset Discretionary Account Manager provides custodial arrangement itself;
- (i) details of periodic reporting to be made to client;
- (j) the risk disclosure statements (please see Appendix 3 for some examples of these risks); and
- (k) undertakings by the 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.

Risk management control techniques and procedures

A. Risk management

1. A Virtual Asset Fund Manager should establish and maintain effective risk management policies and reporting mechanisms which take into account the following risk management control techniques and procedures where applicable.
2. The fund's risk policies and measurements and reporting mechanisms should be subject to regular review, particularly when there are significant changes to the fund or relevant market conditions, legislation, rules or regulations that might impact the fund's risk exposure.
3. The risk management policy of the Virtual Asset Fund Manager should provide, for each fund, a system of limits concerning the measures used to monitor and to control the relevant risks. For example, a Virtual Asset Fund Manager should set position limits in respect of each product or market the fund invests in, such as a cap on the portfolio's investment in illiquid or hard to value Virtual Assets issued and exposure to counterparties.

B. Market risk

4. A Virtual Asset Fund Manager should establish and maintain effective risk management measures to quantify the impact of changing market conditions on the fund. These measures should cover all risk elements associated with the fund. Matters to be covered in such risk measures should include:
 - (a) unspecified adverse market movements - using an appropriate value-at-risk or other methodology to estimate potential losses; and
 - (b) stress testing - determining the effect of abnormal and significant changes in market conditions on the fund using various quantitative and qualitative variable assumptions.

C. Liquidity risk

5. A Virtual Asset Fund Manager should establish and regularly monitor measures of liquidity mismatches between the funds' underlying investments and their redemption obligations (or obligations to honour withdrawal requests made by Discretionary Account Clients) using quantitative metrics or qualitative factors.
6. A Virtual Asset Fund Manager should establish and implement appropriate procedures to alert staff member(s) responsible for liquidity management to potential default problems and to provide them with adequate time to take appropriate action to minimise the impact of fund counterparty liquidity problems.
7. In assessing the liquidity of the assets of a fund, a Virtual Asset Fund Manager should consider the following, where applicable:

- (a) obligations to creditors, counterparties and third parties;
- (b) the time required to liquidate assets;
- (c) the price at which liquidation could be effected;
- (d) the financial settlement lag time; and
- (e) the dependence of these considerations on other market risks and factors.

D. Counterparty risk

8. A Virtual Asset Fund Manager should establish and maintain an effective credit assessment system to evaluate the creditworthiness of the funds' counterparties. For example, when assessing the creditworthiness of a Virtual Asset trading platform, a Virtual Asset Fund Manager should consider the following:

- (a) the experience and track record of the Virtual Asset trading platform;
- (b) the legal and regulatory status of the Virtual Asset trading platform's operator, including its compliance history. For example, whether any disciplinary actions have been taken by any regulatory authorities against the operator;
- (c) the corporate governance structure and the background of the founders and senior management of the Virtual Asset trading platform;
- (d) the operational capabilities of the Virtual Asset trading platform;
- (e) the liquidity of Virtual Assets traded on the Virtual Asset trading platform
- (f) the custodial arrangements of the Virtual Asset trading platform where the trading platform takes custody of Virtual Assets;
- (g) the mechanisms (for example, surveillance) implemented by the Virtual Asset trading platform to guard against fraud and market misconduct with respect to the products traded on the trading platform;
- (h) the cybersecurity risk management measures of the Virtual Asset trading platform, including its business continuity plan;
- (i) the risk management tools adopted by the Virtual Asset trading platform to manage its counterparty risk arising from its payment, clearing, and settlement processes; and
- (j) the financial resources and insurance cover of the Virtual Asset trading platform. For example, the Virtual Asset trading platform's ability to compensate its clients should there be any loss of their assets due to hacking or other events and the auditor's opinion on the going concern of the Virtual Asset trading platform.

9. A Virtual Asset Fund Manager should set appropriate limits in relation to the fund's exposure to the different counterparties of the fund, including Virtual Asset trading platforms and custodians. For example, a Virtual Asset Fund Manager should consider using more than one custodian to hold the portfolio's assets to avoid undue concentration of risk.

E. Operational and cybersecurity risk

10. In designing the policies, procedures, and internal controls to reduce operational risk, a Virtual Asset Fund Manager should consider, amongst other considerations, physical and functional segregation of incompatible duties, maintenance and timely production of proper and adequate accounting and other records, the security and reliability of accounting and other information, staffing adequacy and competence as well as prompt reconciliation of trading information.
11. A Virtual Asset Fund Manager should implement adequate and appropriate security controls to protect the systems used in its operations. The security controls should include, but not be limited to, the following:
 - (a) effective techniques to protect the confidentiality and integrity of information stored in the system and passed between internal and external networks; and
 - (b) appropriate operating controls to prevent and detect unauthorised access, security breach and security attack.
12. A Virtual Asset Fund Manager should establish, implement and maintain a business continuity and transition plan. The plan should include policies and procedures that ensure, in the case of a business disruption or an interruption to the Virtual Asset Fund Manager's operation, that the following matters are addressed:
 - (a) the preservation of essential data and functions, and the maintenance of services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its services and activities;
 - (b) continuity of effective communications with clients, employees, service providers and regulators;
 - (c) identification, assessment and maintenance of third-party services critical to the operation of the Virtual Asset Fund Manager; and
 - (d) appropriate transitioning arrangements that account for the possible winding down of the Virtual Asset Fund Manager's business or the transition of the Virtual Asset Fund Manager's business to others in the event where the Virtual Asset Fund Manager is unable to continue providing its services.

Risk disclosure statements

The Virtual Asset Fund Manager should properly disclose the risks associated with investment in the Virtual Asset fund under its management and Virtual Assets invested in the fund to potential fund investors and distributors appointed by it to distribute its Virtual Asset fund. Some examples of the associated risks are listed below.

- (a) Price volatility
- (b) Potential price manipulation on trading platforms
- (c) Lack of secondary markets for certain Virtual Assets
- (d) Difficulties in verifying ownership of Virtual Assets
- (e) Most trading platforms and custodians of Virtual Assets are presently unregulated
- (f) Counterparty risk when effecting transactions with issuers, private buyers / sellers or through trading platforms
- (g) Risks arising from custodial arrangements, including self-custody of assets by the fund manager and use of hot wallets¹¹
- (h) Continuing evolution of Virtual Assets and global regulatory developments
- (i) Cybersecurity and technology related risks
- (j) Legal uncertainty on whether Virtual Assets can be regarded as “property” under the law

¹¹ A “hot wallet” refers to the wallet used for holding Virtual Assets in an online environment which provides an interface with the internet, which is more susceptible to cyber-attacks.

