

Virtual Asset ETF Developments in Hong Kong

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The background of the slide is a vibrant blue with a series of diagonal, overlapping bands of varying shades, creating a sense of movement and depth. The central text is white and stands out against the lighter blue background.

Key Words – Global 2025

What are 3 key words of digital assets globally?

1. Bitcoin or major altcoin as national or state (provincial) reserve asset?
2. Stablecoin legislations and growth?



3. ***Spot or derivatives ETFs or ETPs involving more digital assets (such as XRP, SOL, DOGE, etc.)?***

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Hong Kong Virtual Asset ETF Developments

Hong Kong ETFs approved – April 2024

- April 30, 2024 - Hong Kong Exchange and Clearing Ltd. (HKEX) listed six spot crypto ETFs:
 - 3 Bitcoin ETFs
 - 3 Ether ETFs

Hong Kong ETFs approved – April 2024

- In-kind subscriptions and redemptions are allowed
- Management fee – Around 0.3% - 0.99%

Merits of Hong Kong ETFs

- In-kind creation and redemption:
 - Enable direct virtual asset settlement instead of cash settlements (unlike their U.S. counterparts)
 - Enhances tax and trading efficiency and
Addresses liquidity concerns

Chinese investors?

- Chinese investors have historically shown strong demand for neutral global assets like gold
- Bitcoin's 'digital gold' narrative could attract similar interest, especially if HKEX-listed Bitcoin ETFs become eligible for the Southbound Stock Connect.
 - Will help AUM grow significantly.

Staking approvals on Ether ETFs under SFC new roadmap - ASPIRe

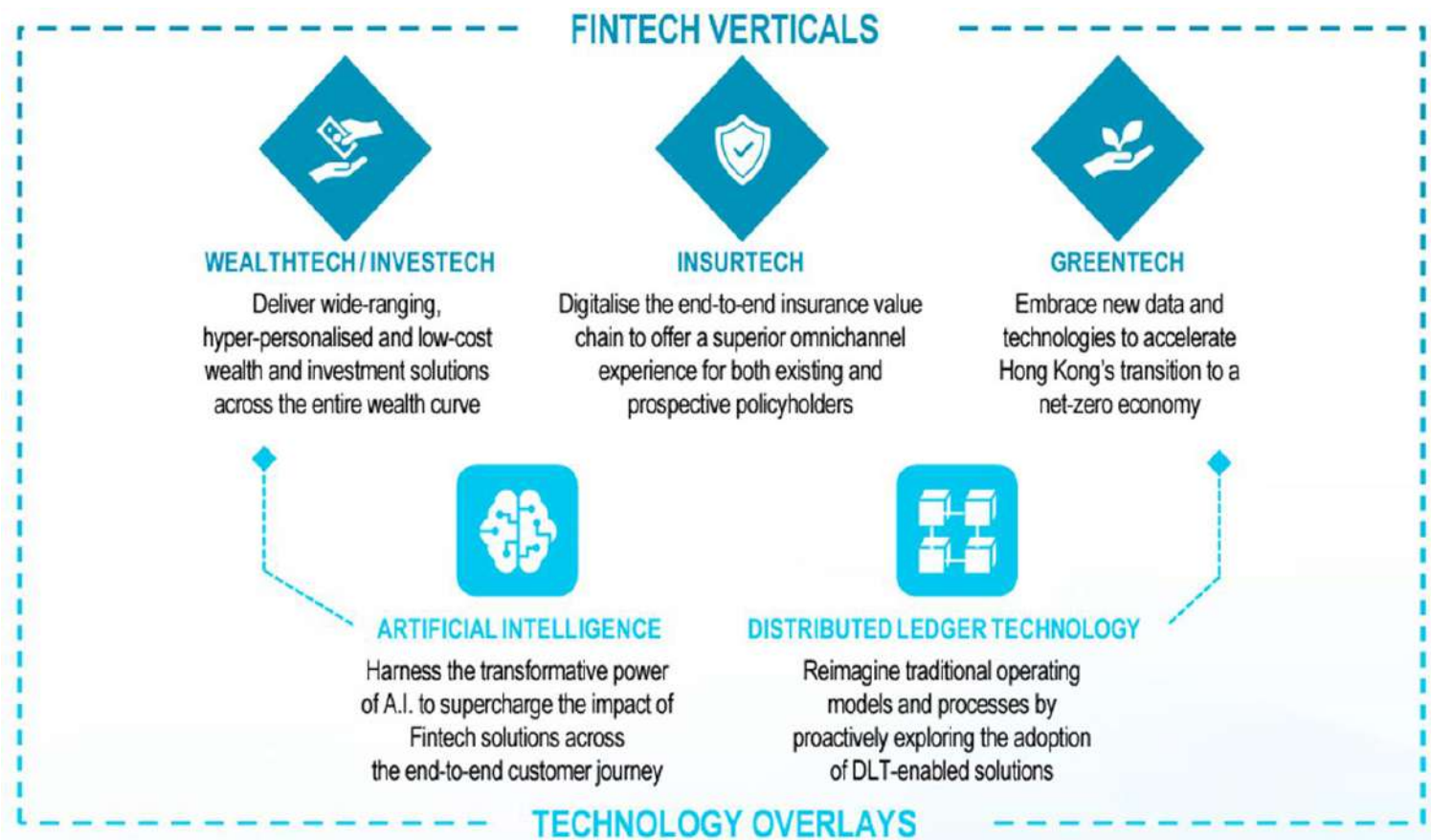
- Stakings approved for ETFs recently

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Hong Kong Regulatory Developments and Trends

Future of blockchain/DLT from regulator's eyes?

HKMA Fintech Promotion Roadmap!



Future of blockchain/DLT from regulator's eyes?

3 Pillars of future Web3 money system?

- wCBDC
- Tokenized deposit
- Stablecoins



SFC “ASPIRe” virtual asset roadmap



HK SFC New Roadmap – “ASPIRe”

- February 2025

What is ASPIRe?

A	Access	<ul style="list-style-type: none"> • More VATPs to get licensed • VARA model of licensing with more exchanges then required • for domestic demand?
S	Safeguards	<ul style="list-style-type: none"> • Principles based approach to replace rigid 98/2 ratios? • Flexibility for insurance & compensation arrangements?
P	Products	<ul style="list-style-type: none"> • Tokens for professional investors • Virtual asset derivatives to support leveraged strategies for • “experienced market participants” & margin financing
I	Infrastructure	<ul style="list-style-type: none"> • Trade surveillance & anti-fraud surveillance
Re	Relationships	<ul style="list-style-type: none"> • “Proactive & ongoing educational initiatives” => used as a basis to support more aggressive marketing of margin finance • Finfluencers to be used => potential marketing opportunity as well as educational tool

Recent Policy and Environment Changes

Key dates	Key milestones
April 2025	<i>SFC allows stakings for VATPs and authorized virtual funds</i>
February 2025	<i>SFC new roadmap for virtual assets - ASPIRe</i>
February 2025	<i>Stablecoin Bill in Legislative Council</i>

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Hong Kong Virtual Asset Regulatory Key Pillars and Beyond

Hong Kong — Key pillars

3 key pillars of changing regulatory environments!!

***Support
Web3
ecosystem***

***Retail
investors'
access***

***Licensing
regimes***



Global Trends and Prospects of Virtual Assets Regulations

Changing to “regulatory regimes”

Investor protection

*Foster blockchain ecosystem
innovation*

More clarity

Licensing/ Authorization

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Hong Kong Virtual Asset Regulatory Frameworks – Sector Specific

Hong Kong regulatory frameworks

“Primary Approach”

Existing business regulations





+

**Virtual asset related regulations
supplement**

(except for VATP, OTC, stablecoin)

Hong Kong regulatory frameworks

- Hong Kong regulatory development segments


<p>Exchanges (VATPs)</p> <p>-----</p> <p>OTC Channels</p> 	<p>Intermediaries</p> <ul style="list-style-type: none"> - Banks - IBs - Fund managers 	<p>Tokenization</p> <ul style="list-style-type: none"> - Tokenized securities - Funds - Others 	<p>Stablecoins (on-going)</p> 
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Key Legal and Regulatory Considerations for Virtual Asset Funds

Key rules and regulations

- SFC circular on SFC-authorized funds with exposure to virtual assets (SFC authorised VA funds)
 - Covering retail investment funds which seek to invest into virtual assets (with more than 10% of NAV)
- SFC circular on intermediaries engaging in tokenised securities-related activities
- SFC circular on tokenization of SFC-authorized investment products
 - Covering “tokenization of SFC-authorized investment products”
- Joint circular on intermediaries’ virtual asset-related activities

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SFC Circular on SFC-authorised Funds with Exposure to Virtual Assets

SFC-authorized funds with exposure to virtual assets (SFC authorised VA funds)

- SFC circular on 22 December 2023
- Requirements for investment funds with exposure of more than “10% of net asset value (NAV)” to VA
 - seeking authorization
 - for public offerings in Hong Kong
- The Circular expands the range of “retail VA products” substantially
 - supersedes a circular on Virtual Asset Futures Exchange Traded Funds issued in October 2022.

SFC authorised VA funds requirements

- To, first, comply with applicable requirements outlined in the Overarching Principles Section and the Code on Unit Trusts and Mutual Funds (UT Code), among other requirements,
 - The joint circular on intermediaries' VA-related activities.

SFC authorised VA funds requirements

- Management companies
 - Management companies play a crucial role and
 - Should have
 - (i) a good track record of regulatory compliance, and
 - (ii) at least one competent staff member with relevant experience in managing VA or related products
 - Should be subject to additional terms and conditions by the SFC Licensing Department.

SFC authorised VA funds requirements

- Eligible underlying VA
 - SFC-authorised VA Funds should only invest, whether directly or indirectly, in **VA tokens** that are accessible to Hong Kong public for ***trading on SFC-licensed VATPs***.
- Investment strategy
 - SFC-authorised VA Funds may invest directly or indirectly in eligible VA tokens, subject to certain requirements. SFC-authorised VA Funds should not have leveraged exposure to VA at the fund level.
 - For VA futures, only those traded on conventional regulated futures exchanges are allowed, provided that the management company demonstrates (i) that relevant VA futures have adequate liquidity and (ii) manageable roll costs.

SFC authorised VA funds requirements

- Investment strategy
 - For SFC-authorised VA Funds that primarily adopt a futures-based investment strategy, they are expected to adopt an active investment strategy to allow flexibility in portfolio composition (e.g., diversification of futures positions with multiple expiry dates and rolling strategies).
 - For indirect exposures to eligible VA through other exchange-traded products, applicable requirements in the UT Code and other requirements by SFC will need to be complied with.

SFC authorised VA funds requirements

- Transactions and direct acquisitions of spot VA
- Should be conducted through ***SFC-licensed VATPs or authorised financial institutions (AIs)*** in compliance with regulatory requirements of the Hong Kong Monetary Authority (HKMA). Particularly:
 - For in-cash subscriptions and redemptions, purchases and sales of spot VAs are expected to be conducted through SFC-licensed VATPs, either on-platform or off-platform.
 - In-kind subscriptions should involve the transfer of spot VA by participating dealers (PDs) to the spot [VA ETFs'] custody accounts with SFC-licensed VATPs or AIs (and vice versa for in-kind redemptions).

SFC authorised VA funds requirements

- Custody

- The trustee or custodian of an SFC-authorized VA Fund should delegate its VA custody function, if applicable, to:
 - an SFC-licensed VATP; or
 - an AI that meets the expected standards of VA custody issued by the HKMA.
- Should ensure segregation of VA holdings from their own assets and assets held for other clients;
- Should store most of the VA holdings in cold wallets, with minimal storage in hot wallets (except for subscription and redemption needs); and
- Should ensure seeds and private keys' (1) secure storage in Hong Kong, (2) access restriction to authorised personnel, (3) resistance to speculation and collusion, and (4) proper backup mechanisms.

SFC authorised VA funds requirements

- Valuation
 - The management companies of SFC-authorised VA Funds should adopt an indexing approach based on VA trade volume across major VA trading platforms (i.e., a benchmark index published by a reputable provider that reflects a significant share of trading activities in the underlying spot VA).
- Service providers
 - The management companies should confirm that all necessary service providers (such as fund administrators, PDs, market makers and index providers) are competent, available and ready to support the SFC-authorised VA Funds.

SFC authorised VA funds requirements

- Disclosure and investor education
 - Offering documents, including product key facts statements (KFS), should disclose the investment limits and key risks associated with VA exposures (including upfront disclosure, in the KFS, of price risk, custody risk, cybersecurity risk and fork risk for investments in spot VA, as well as large roll costs and operational risks for investments in VA futures).
 - The management companies of SFC-authorized VA Funds are expected to carry out investor education before launch as per existing requirements under the UT Code.
- Distribution
 - Distribution of SFC-authorized VA Funds is subject to relevant requirements for intermediaries and distribution provided by the SFC.

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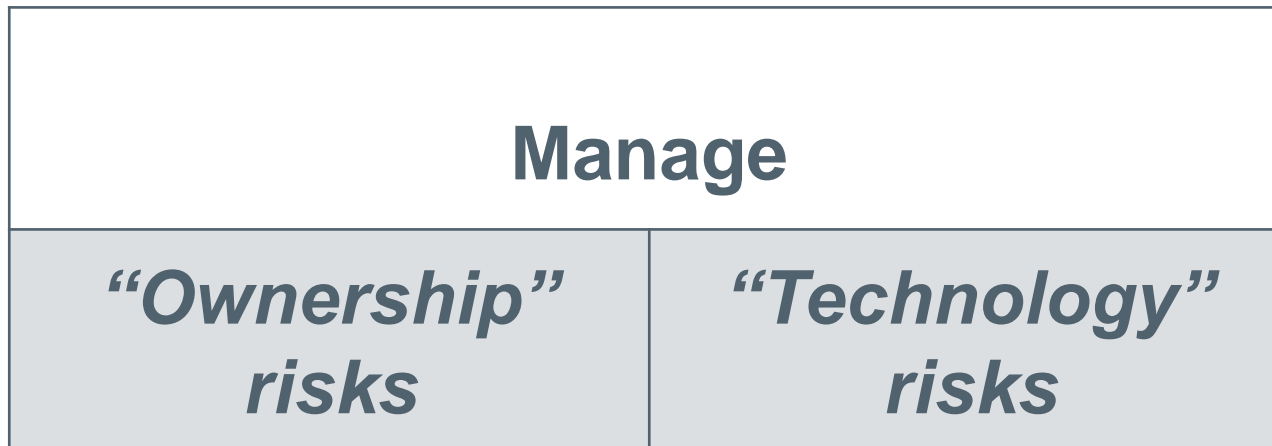
SFC Tokenised Securities Intermediaries Circular

Tokenised securities

- Tokenised securities
 - Refer to traditional financial instruments, such as bonds or funds, that are "securities" as defined in the Securities and Futures Ordinance (SFO).
 - These securities are recorded and represented using DLT, such as blockchain.
 - Tokenization involves recording ownership claims on these traditional securities onto a programmable platform, often utilizing DLT.
 - In short:
 - tokenised securities retain ***the characteristics and legal framework of traditional securities*** but are represented ***digitally on a blockchain or similar technology***.

Responsibilities of intermediaries

- Overall responsibilities



Responsibilities of intermediaries

- Expertise and Understanding:
 - Should have the necessary “manpower and expertise” to understand tokenised securities-related activities.
 - Should be knowledgeable about the nature of tokenised securities, associated risks to ownership and technology, and the underlying technology.
 - Understand and be satisfied with the controls implemented by the issuers and their third-party vendors/service providers

Responsibilities of intermediaries

■ Due diligence

- Should conduct “thorough due diligence” when dealing with tokenised securities.
- Should involve:
 - Assessing “key features and risks” of the tokenised securities
 - “Due diligence on the product” itself and “technology aspects”.
- Due diligence on third-party vendors/ service providers to manage “ownership and technology risks”.
 - Remain ***responsible for the overall operation*** of the tokenization arrangement despite any outsourcing arrangement.

Responsibilities of intermediaries

- Custodial arrangement
 - Consider “features and risks”
 - Choose most appropriate custodial arrangement
 - Especially if using permissionless tokens on public-permissionless networks.
- Information for clients
 - Adequate disclosure
 - Provide material information
- Risk Management
 - Expected to effectively manage and mitigate the risks associated with tokenization.
 - Includes identifying and addressing “**ownership risks**”, such as “how ownership interests are transferred and recorded”.
 - Should also address “**technology risks**”, such as forking, blockchain network outages, and cybersecurity risks.

Responsibilities of intermediaries

- Adequate system and controls
 - Compliance with regulatory requirements: Must comply with existing legal and regulatory requirements applicable to traditional securities
 - Includes compliance with prospectus requirements and offers of investments regime.
 - Adhere to conduct requirements for securities-related activities, ensuring fair and transparent practices.
- “Notification to the SFC”
 - Notify and discuss their business plans with their case officer in the SFC in advance

1. Offers to retail investors

- Possible
 - As Tokenised Securities are fundamentally traditional securities with a tokenisation wrapper, “no need to impose a mandatory “professional investors” only restriction”.

1. Offers to retail investors

- However, to follow traditional securities public offering requirements:
 - Comply with prospectus regime under C(WUMP)O
 - Authorisation requirements under SFO
 - The requirements of the prospectus regime under the C(WUMP)O and the offers of investments regime under Part IV of the SFO would apply to the offering of Tokenised Securities to the public of Hong Kong.
 - An offer of Tokenised Securities that is not authorised under Part IV of the SFO or which has not complied with the prospectus regime could only be made to PIs or pursuant to any other applicable exemption.

2. Security tokens - complex products per se?

- Tokenised securities are fundamentally traditional securities with a tokenization wrapper.
- Tokenization should not alter complexity of the underlying security.
- Whether a tokenised security is a complex product or not?
 - To be based on an assessment of the complexity of **underlying traditional security**.
 - **A see-through approach** should be adopted in assessing complexity.

2. Security tokens - complex products per se?

- Digital securities
 - In view of the bespoke nature, terms and features as well as heightened legal uncertainties of certain digital securities which are not reasonably likely to be understood by a retail investor
 - Digital securities that are “***not tokenised securities***” are ***likely to be regarded as complex products***.

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SFC Authorised Investment Products Tokenization Circular

Key themes

Three key themes!

- #1 - “Tokenised authorised investment products” - Allowed to be offered to “retail investors”
- #2 - With certain guardrail requirements
 - Tokenization arrangement
 - Disclosure
 - Intermediaries
 - Staff competence
- #3 - Secondary trading of tokenised investment products are NOT allowed yet

Guardrail 1 – Tokenization arrangement

Tokenization Arrangement

- Tokenization of investment products involves:
 - the creation of ***blockchain-based tokens***
 - ***representing ownership in an investment product***
 - that can be recorded digitally on the blockchain and
 - offered directly to investors or through licensed intermediaries, among others.

Guardrail 1 - Tokenization arrangement

- Product providers of tokenised SFC-authorised investment products (Product Providers) to:
 - ***Be held ultimately responsible for*** the management and operational soundness of the tokenization arrangement, among others, regardless of any outsourcing
 - Maintain proper records of token holders' ownership interests and make tokenization arrangements operationally compatible with service providers involved
 - Ensure adequate measures are in place to manage and mitigate cybersecurity risks, data privacy, system outages and recovery, and maintain a comprehensive and robust business continuity plan
 - Ensure additional and proper control is imposed when using public-permissionless blockchain networks

Guardrail 1 - Tokenization arrangement

- SFC may also specifically request a Product Provider to
 - Following its confirmation thereof, demonstrate the management and operational soundness of the tokenization arrangement, ownership record-keeping, and integrity of smart contracts
 - Obtain ***third-party audits or verifications***
 - Obtain ***satisfactory legal opinions to support the application***
- Prior consultation with the SFC is required for the launch of new SFC-authorised investment products:
 - that have tokenization features and the tokenization of existing SFC-authorised investment products, which may require SFC's prior approval.

Guardrail 2 - Disclosure

- Offering documents of tokenised SFC-authorized investment products should clearly set out:
 - ***Details of the tokenization arrangement***, including whether off-chain or on-chain settlement is final
 - ***“Ownership” representation*** of the tokens (e.g., ***“the legal and beneficial title”*** of the tokens, ***“ownership of / interests” in the product***)
 - Associated risks with the tokenization arrangement such as:
 - cybersecurity
 - system outages
 - the possibility of undiscovered technical flaws
 - the evolving regulatory landscape, and
 - potential challenges in application of existing laws

Guardrail 3 - Intermediaries

- Distributors of tokenised SFC-authorised investment products
 - Must be ***regulated intermediaries***
- Adhering to existing rules and regulations, including, conducting:
 - client onboarding; and
 - suitability assessment

Guardrail 4 - Staff competence

- Product Providers must confirm to the SFC:
 - they have “competent staff” with relevant experience and expertise
 - to operate and/or oversee
 - the tokenization arrangement, manage ownership-related risks, and handle the technology appropriately.

Overall

- May reflect the SFC's efforts:
 - to ensure appropriate safeguards are in place
 - to mitigate risks associated with this emerging technology.
- The clear requirements as to tokenization arrangement and disclosure in offering documents are anticipated:
 - to further promote investor protection and innovation
 - in Hong Kong's financial industry.

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