

# **SFC Circular on SFC-Authorized Funds with Exposure to Virtual Assets-Part 1**

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Earlier this year, the US Securities and Exchange Commission approved 11 spot Bitcoin ETFs. In Hong Kong, in view of rapid developments of virtual asset (VA) products and growing investment products offering exposure to VAs, the Securities and Futures Commission (SFC) issued a circular, on 22 December 2023, detailing 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 (Circular).

The Circular expands the range of “retail VA products” substantially and supersedes a circular on Virtual Asset Futures Exchange Traded Funds issued in October 2022.

The Circular provides requirements for authorization of investment funds, other than recognized jurisdiction schemes (including UCITS funds) and funds authorized under mutual recognition of funds arrangements (MRF), that have an exposure of more than 10% of their NAV in VA by:

- Investing directly in the same spot VA tokens accessible to Hong Kong public for trading on SFC-licensed virtual assets trading platforms (VATPs) (ie, direct exposure); and/or
- Acquiring indirect investment exposure to such VA (ie, indirect exposure), through, for example, futures traded on conventional regulated futures exchanges and other exchange-traded products (collectively, SFC-authorized VA Funds).

## **Requirements on SFC-Authorized VA Funds**

SFC-authorized VA Funds are expected 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, as well as the joint circular on intermediaries’ VA-related activities. The Circular also notes the following:

### **Management Companies**

Management companies of SFC-authorized VA Funds 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, and be subject to additional terms and conditions by the SFC Licensing Department.

### **Eligible Underlying VA**

SFC-authorized 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-authorized VA Funds may invest directly or indirectly in eligible VA tokens, subject to certain requirements. SFC-authorized 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.
- For SFC-authorized 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.

In this blog, we explained the Circular's background and its key important requirements. In the next blog, we will provide an overview of additional requirements, including those on transactions and acquisitions, custody and valuation of VAs.

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