waystone | Compliance Solutions

Hong Kong SFC Increases Scrutiny on Asset Managers – Are You Prepared?

February 28, 2025

The Securities and Futures Commission (SFC) in Hong Kong plays a pivotal role in regulating and supervising the financial markets. In line with its regulatory duties, the SFC periodically issues circulars to provide licensed entities with key updates and expectations surrounding their conduct and operations.

The recent circular issued by the SFC in October 2024, highlights the main deficiencies identified in its supervision of asset managers of private funds and discretionary accounts (Type 9). It provides guidance and sets out clear expectations for licensed corporations operating within the asset management business. Its purpose is twofold; first, to reinforce the SFC's existing regulatory framework, and second, to address new risks and challenges that have emerged as the industry evolves.

This article outlines the main attributes in focus, the implications for asset management firms, and the steps that firms should take in order to remain compliant with the SFC's requirements.

1. Conflict of interest and fiduciary duties

The circular reiterates that asset managers should take reasonable steps to identify, prevent, manage, and monitor any actual or potential conflicts of interest.

- If material interests in the transactions lead to conflicts of interest, address these conflicts by exploring alternative options.
- When contemplating financing arrangements from the asset manager or its affiliates, consider other counterparties. Conduct thorough assessments and select the best available financing option in the best interest of the fund.
- If conflicts cannot be prevented, critically evaluate whether conducting such transactions is in the best interest of the fund.
- Ensure that all transactions are conducted in good faith, at arm's length, and on normal commercial terms.
- Disclose material conflict of interest to fund investors. The disclosure should include the nature and source of conflicts, material interests of the asset manager and affiliates, risks to investors, and steps taken to mitigate these risks.

2. Enhanced risk management framework

The circular stresses the importance of a robust risk management framework within asset management firms. Asset managers should:

— Put a framework in place to identify, measure, manage and monitor appropriately all risks to which the fund or account is, or may be exposed.
— Ensure investment is made in accordance with investment objectives, restrictions, and risk profiles.
— Maintain effective record retention policies and keep proper records of risk assessments, to demonstrate compliance with all relevant legal and regulatory requirements.
— Ensure that transactions with connected persons are conducted at arm's length and that client orders are allocated fairly. Reject offers or inducements that may create material conflicts with the duties owed to clients.

3. Adequate disclosures to investors

Asset managers are responsible for the overall operation of the funds and should provide fund investors with adequate information (including any material changes to the information) on the funds to allow them to make informed decisions about their investments. Information including, but not limited to:

— concentrated positions and significant exposures
— significant events impacting the fund (e.g. major investment losses, default in payments by counterparties, fund redemption and suspension)
— material delays in issuing of audited financial statements
— issuance of modified opinion from auditors.

4. Valuation methodologies

— Asset managers must ensure that the valuation policies and procedures they adopt for the funds they manage are appropriate and in line with the FMCC guidelines, particularly in respect of unlisted or unquoted securities that are not actively traded, and suspended securities.
— Justification should be provided for valuation decisions, especially when no adjustments are made for investments where issuers or guarantors have defaulted on payments.
— If a third party is appointed to perform valuation services, conduct proper due diligence on the third-party valuer. The ultimate responsibility remains with the asset managers for the valuation of the fund's assets.

Next steps

To address asset management misconduct, the SFC has expressed its intention to conduct thematic on-site inspections of asset managers to detect material breaches. Disciplinary actions against the licensed asset managers and their senior management, including Managers-In-Charge (MIC) and Responsible Officers (RO) shall be taken for any misconduct and failure to fulfil their supervisory responsibilities.

To address these concerns, asset managers should:

- Thoroughly review the concerns in the circular and the instances of deficiencies stated in the appendix.
- Take efforts to strengthen the supervisory and compliance frameworks, including policies, procedures, and controls.
- Where practicable, conduct an independent audit of compliance in line with the said circular. Any material breaches/non-compliance with the regulatory requirements should be reported to the SFC immediately.

How can Waystone help?

At Waystone, our team of experienced compliance professionals are specialised in navigating regulatory complexities and can assist you with addressing the challenges highlighted in the SFC's thematic review.

We can assist with:

- Performing gap analysis and reviewing existing policies and procedures against the circular requirements.
- Drafting of policies and procedures to ensure that your firm meets the regulatory requirements.
- Conducting mock inspections to identify any potential gaps in internal processes and controls.

If you would like to find out more about the themes raised in this article, please reach out to your usual Waystone representative, or contact our APAC Compliance Solutions team using the contact button below.

Contact Us →