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The SFC's Financial Resources Rules – what you need to know

Nithi Genesan May 20, 2025

Regulatory background

The Financial Resources Rules (hereinafter "FRR") stipulated by Cap. 571N Securities and Futures (Financial Resources) Rules (hereinafter "SFO (FRR)") form a cornerstone of Hong Kong's regulatory framework for licensed corporations (hereinafter "LCs"). Designed to ensure market stability and investor protection, the Securities and Futures Commission (hereinafter "SFC") requires that LCs maintain adequate financial resources to meet liabilities, absorb shocks, and operate prudently. The rules align with international standards while addressing the unique risks of Hong Kong's dynamic financial markets.

Common issues with the FRR

Navigating the FRR presents persistent challenges for LCs, with recurring issues undermining compliance efficiency and operational stability. While the FRR framework is designed to ensure financial resilience and investor protection, its implementation often exposes gaps between regulatory intent and practical execution. This article explores the root causes behind these challenges, including the SFC's inherently cautious regulatory philosophy, ambiguities in rule interpretation, and systemic complexities amplified by frequent updates. By dissecting these pain points, we aim to demystify why less-resourced firms, and in some cases, even well-resourced firms struggle to align with the FRR requirement. The five main challenges are set out below:

1. Prudent approach
2. Difficulty in interpreting the FRR
3. Highly complex for certain regulated activities
4. Frequent regulatory updates on FRR requirements
5. Senior Management lack of FRR knowledge.

1. Prudent approach

The SFC enforces a conservative, risk-averse framework under the FRR to ensure LCs maintain robust financial buffers. A foundation of this approach is the asymmetric treatment of Ranking Liabilities (hereinafter "RLs") and Liquid Assets (hereinafter "LAs").

The major components of Liquid Capital (hereinafter "Liq Cap") are as follows:

- RLs:
  - Most liabilities (e.g., amount due to group companies) within the financial statements are broadly captured, for example, limited exclusion from the ranking liabilities are available.

  - Apart from the liabilities from the financial statements, some RLs are included due to the risk of an event or activities undertaken by the LCs (e.g., gearing adjustment of securities margin financing, concentration proprietary position).

- LAs
  - Some assets (e.g., aged receivables and long-term prepayments, for example > 3 months, haircut amount of proprietary investment) are excluded from the LAs.

This creates a higher effective capital requirement, compelling LCs to hold reserves beyond nominal risks.

Where the rules from SFO (FRR) are ambiguous or silent in some areas, the SFC expects LCs to adopt a "prudent interpretation", prioritising caution over technical loopholes. For instance, there is currently no official requirement or guidance from the SFC on the Hair-Cut (hereinafter "HC") of proprietary position on virtual assets. To avoid overstating LAs, the prudent approach is to treat most virtual assets as miscellaneous investment (as defined under s.2E of SFO (FRR) i.e. having a HC of 100%). This principle reinforces the FRR's overarching goal of ensuring systemic stability by mandating LCs to err on the side of financial resilience, even in grey areas.

2. Difficulty in interpreting the FRR

Interpreting FRR demands a rare blend of accounting knowledge and compliance expertise, creating a high barrier for licensed corporations. While FRR calculations are rooted in accounting principles, they require adjustments to align with regulatory requirements (e.g., excluding illiquid assets from LAs or including liabilities in RLs). This dual dependency leaves many preparers, often accountants with limited compliance knowledge, ill-equipped to navigate ambiguities.

The rules are written in dense, legally-technical language, lacking plain-English guidance for novices. While specialists with both compliance and accounting acumen exist, they typically command premium fees due to their niche experience, which spans years of interpreting grey areas (e.g., prudential adjustments for novel assets). For smaller firms with limited budgets for FRR preparers (or reviewers), misinterpretations of the FRR's requirements frequently occur, leading to non-compliance with the FRR.

3. Highly complex for certain regulated activities

The complexity of FRR compliance escalates significantly for LCs engaged in specific regulated activities, requiring them to submit additional forms with detailed disclosures beyond general requirements of Form 1, 2, 7 and 12. For example:

- Type 1 LCs providing margin financing are required to fill in Form 3 (Credit Facility Summary), Form 4 (Margin Client Analysis) and Form 5 (Analysis of Securities Collateral).
- Type 1, 2, 3, 4, 5, 6, 7, 9 LCs that holds client assets are required to fill in Form 8.
- Type 13 LCs are required to fill in Form 8A.
- Type 3 LCs are required to fill in Form 9.
- All Types LCs with proprietary position on derivative positions are required to fill in Form 10.
- Type 3 LCs are required to fill in Form 11.
- LCs with client, Asset Under Management (AUM) and Type 9 LCs (Hedge Fund Managers) are required to fill in Form 12.

This fragmentation places immense operational strain on firms with complex activities, but smaller LCs. While larger institutions are able to hire experienced personnel to deal with the FRR issue, resource-constrained firms with less experienced personnel often struggle to reconcile the sheer volume of forms with nuanced regulatory expectations.

4. Senior Management lack of FRR knowledge

Conversely, reviewers such as Responsible Officers (hereinafter “ROs”) or Manager-In-Charges (hereinafter “MICs”) (collectively the “Senior Management”), who oversee FRR compliance, frequently lack deep accounting and compliance expertise, resulting in gaps between technical execution and regulatory intent.

5. Frequent regulatory updates on FRR requirements

The SFC has maintained a dynamic approach to FRR compliance, introducing frequent updates to address evolving market risks, streamline reporting, and enhanced governance standards. These changes reflect the regulator’s focus on liquidity management, transparency, and alignment with global practices. Recent updates emphasise stricter Senior Management oversight, expanded reporting for complex and high-risk activities (e.g., margin financing, leveraged foreign exchange contracts), and trending regulatory topics (e.g., hedge fund disclosure, depository services for relevant Collective Investment Schemes).

Key FRR Regulatory and Form Changes in recent years

Effective Date	Form/Updates	Key Changes
1 July 2025	— Form 12 – Added a new section C. — Annex A – A new form separate from the FRR from is added.	**Form 12** — Only applicable to hedge fund managers. — Requires details in location of group headquarters, NAV of hedge strategy and no. of QHF*. **Annex A** — Requires extensive details on the investment strategy, asset class exposures, counterparty risk, collateral safety, illiquid investment etc. — Annex A as a separate form. — Only required to submit if one of more QHF* existed 6 months prior to the FRR reporting month-end i.e. 30 June/31 December.
1 November 2024	— Form 8A – A new form added.	— Only applicable to Type 13 LCs. — Requires details in: i. Securities/Virtual Asset (hereinafter “VA”); and ii. money and other proceed related to relevant CIS deposited with the Type 13 LCs in Hong Kong/Overseas.
1 December 2023	— Form 1, 7, 8, 10, 12 – Added questions related to VA. — Form for an analysis of client assets for associated entity – Added questions related to VA. — Audit Questionnaire – Added questions related to VA.	— Changes only applicable to LCs that include VA in their regulated activities or proprietary positions.

*A QHF (Qualifying Hedge Fund) is a portfolio where the licensed corporation is responsible for the overall operation; where the total NAV of all strategy assets globally (including all fund share classes, managed accounts and other assets under the same strategy as the underlying fund, regardless of location) is at least USD 500 million; and managed by other related companies with the licensed corporation in Hong Kong serving as the group hedge fund management headquarters, if it fulfills criteria of (b) above, such fund shall also be included in number of QHFs reported in section C(iii).

How can Waystone help?

- **Reviewing of the FRR return:** we can assist the client by reviewing the FRR return.
- **Filing of the FRR return:** we assist the client on the computing of the FRR return based on the client's management accounts.
- **Providing advice on FRR treatment:** we provide advice on the FRR treatment enquiries.
- **Liaison with SFC on enquiries related to FRR:** we assist the client with liaising with/responding to the SFC's enquiries, upon significant decline in Liq Cap or negative return.
- **Reviewing the financial year-end FRR:** we assist the client with the review of the year-end FRR and assist with the resubmission of FRR, if necessary.
- **Staff training**: we provide FRR training for the client's reviewer (RO, MIC etc.) and preparer of the FRR return.

Why choose Waystone?

Waystone offers a full suite of corporate compliance solutions tailored to the needs of businesses expanding into or operating within Hong Kong. We are committed to enhancing your corporate compliance, so you can concentrate on growing your business with confidence. To learn more about our corporate compliance solutions, please reach out to our APAC Compliance Solutions team today.

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