

# SFC Flags Issues in Managing Private Funds and Discretionary Accounts



Nithi Genesan

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In a [circular](#) titled “Deficiencies and Substandard Conduct Noted in the Management of Private Funds and Discretionary Accounts,” the Securities and Futures Commission (SFC) highlighted critical issues in asset management practices. Originally issued on October 9, 2024, the circular continues to underscore important regulatory expectations.

Below outlines the SFC’s concerns, their implications, and steps to ensure compliance.

## Why It Matters

The SFC oversees Hong Kong’s financial markets, enforcing compliance with the Securities and Futures Ordinance and codes like the Fund Manager Code of Conduct (FMCC). The circular targets private funds and discretionary accounts, managed by [Type 9 license](#) holders, due to their complexity and risks. With plans for more inspections and harsher penalties, asset managers must act swiftly to address deficiencies, avoid sanctions, and maintain investor trust.

## Key Deficiencies

The SFC identified four main issues:

### Conflicts of interest

Asset managers were found to engage in practices that compromised fair treatment of clients and fund integrity, including:

- Using fund assets to finance related entities on non-arm’s length terms.
- Unfair trade allocations favouring certain funds or insiders.
- Front-running client orders or prioritizing select investors’ redemptions.

### Risk management

Insufficient frameworks and oversight have led to unmitigated risks in portfolio construction and redemption processes, including:

- Poor liquidity risk assessments for illiquid assets, hindering redemptions.
- Over-concentration in investments without proper risk controls.
- Ignoring red flags, like financial distress in investee companies.

## Investor disclosures

Asset managers failed to provide timely and complete information about material risks and events, reducing the quality and reliability of investor reporting, including:

- Failing to disclose concentrated positions or significant events (e.g., defaults).
- Omitting modified audit opinions or delays in financial statements.

## Valuation practices

Inaccurate or outdated valuation methods have resulted in misstated fund values, including:

- Valuing assets at cost despite impairments or defaults.
- Not adjusting valuations for illiquid securities, misstating fund value.

## SFC Expectations and Actions for Asset Managers

The SFC expects asset managers to strengthen compliance programs with robust policies and controls, conduct independent audits to verify adherence to standards, and ensure senior management oversees compliance efforts.

To meet SFC standards, asset managers should:

- **Review policies:** Conduct a gap analysis to address conflicts, risks, disclosures, and valuations.
- **Enhance disclosures:** Provide clear, timely information on risks and material events.
- **Engage auditors:** Use external audits for objective compliance assessments.
- **Staff training:** Educate employees on regulatory obligations.
- **Strengthen governance:** Ensure senior management drives compliance.

## How Waystone Can Help

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 compliance framework, so you can focus on growing your business with confidence.

If you have any questions about the topics discussed or to learn more about our Corporate Compliance Solutions, please reach out to our [APAC Compliance Solutions](#) team or contact us below.

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