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BRIEFING

SFC INSPECTIONS ON SFC LICENSED CORPORATIONS – KEY FOCUS AREAS

Based on our recent experience assisting private fund managers holding SFC Type 9 licenses going through their SFC inspections, we have observed that the SFC's current focus includes the following key areas: (1) dealing with fund investors, (2) risk management, (3) investment processes, and (4) operations. You should be prepared to conduct a walkthrough with the SFC on these focus areas and expect the SFC to inquire in detail, whether via email or in person meetings with the Licensed Corporation's (the "**LC**") management team, on these areas.

Dealing with fund investors

Fund managers should anticipate that the SFC will inquire about KYC/AML process carried out on the fund investors. Therefore, the LC should ensure that it has access to all KYC/AML documents related to fund investors and can provide them to the SFC upon request during an inspection, even if it relies on a fund administrator to conduct KYC/AML checks on the fund investors.

Where the LC is required to obtain a professional investor declaration from the fund investor and to conduct a professional investor assessment and verification, and a suitability assessment on the fund investor, it should ensure that it retains such documentation for the SFC's review. Note that whether the LC is required to conduct the foregoing assessments is a separate analysis which depends on numerous factors including, in particular, whether the LC treats the fund investor as a client of the LC in addition to the fund itself. Regulatory advice should be sought if the LC is unsure of this.

All investor notices and communications with fund investors should also be retained for SFC sample checking and the LC should ensure that it has made all relevant disclosures to fund investors to comply with the SFC's Fund Manager Code of Conduct (the "**FMCC**").

Risk management

The SFC expects that the risks associated with the funds managed by the LC are properly considered, monitored and documented. Risk committee (if any) meeting minutes should be prepared and regular investment risk reports containing all relevant risks taken into consideration should be prepared to demonstrate that risk assessments have been conducted by the LC on an ongoing basis to monitor the fund's portfolios and underlying investments.

In addition, as it has been over three years since climate-related risks requirements on SFC licensed fund managers came into effect, the SFC is more closely scrutinising climate-related risk assessments conducted and disclosures made to fund investors. LCs should ensure that they have a climate-related risk policy in place, document their climate-related risk assessments and have made the appropriate disclosures on climate-related risks to fund investors, in order to comply with the FMCC requirements. Where climate-related risks are taken into consideration in the LC's investment and risk management processes, the LC should ensure proper documentation is maintained to demonstrate this to the SFC if requested.

Operations - investment processes

The SFC expects that the various stages of the investment process, particularly for private equity ("**PE**") and Venture Capital ("**VC**") fund managers, are well documented in the LC's internal policies and control procedures with a clear and complete audit trail of completion of each stage for each investment made, such as the due diligence stage, the investment review stage, and the approval stage. This should include all subsequent/follow-on investments in a portfolio company in addition to initial investments in a portfolio company. The LC should be able to demonstrate that it has completed due diligence on subsequent/follow-on investments notwithstanding that due diligence was previously conducted on that particular portfolio company for the initial investment. Furthermore, the SFC expects that an investment committee memorandum be prepared and formal signoffs for investment reviews and approvals to be clearly documented for each investment, particularly for PE/VC fund managers. Verbal investment reviews and approvals are insufficient even where the LC has a small team or is facing tight investment deadlines.

Operations - valuations

One area of focus during SFC inspections, particularly for PE/VC fund managers, or hedge fund managers investing in illiquid assets via side pockets, is valuation of the fund's assets (particularly illiquid, hard-to-value assets). Pursuant to the FMCC, the value of unlisted or unquoted securities that are not actively traded should be based on their fair value with reference to certain prescribed factors as set out in the FMCC. Where the LC deviates from "standard" valuation approaches to determine fair value, the SFC may inquire as to why the deviation is appropriate. An LC should ensure that when it deviates from "standard" valuation approaches to value certain investments, it should have policies and procedures in place to deal with these deviations and should clearly document the reasons for the deviation and the valuation approach utilized, with the appropriate signoffs in accordance with its valuation policy.

Also worth noting is that, despite the fund's portfolio being predominantly composed of private equity investments, PE/VC fund manager's valuation policy (and other relevant internal policies and procedures) should include provisions relating to listed securities and debt securities where there is such exposure regardless of the size of those investments within the portfolio. For example, LCs should ensure that where they anticipate private equity investments to exit via IPO and subsequently become listed companies, they should update their valuation policy and other internal policies and procedures well in advance to cater for listed securities. The LC's valuation policy should include valuation methodologies for all types of investment products held.

Custodian

Where the LC is subject to the licensing condition that it shall not hold client assets, the LC is required to appoint a custodian to hold the investments of the fund that is managed by it. Although this requirement is clearly understood with respect to listed securities, the need to appoint an independent custodian with respect to unlisted securities of the fund is often overlooked. With respect to such unlisted securities, in most cases it means that the share certificates of the portfolio companies invested in by the fund should be held by an independent custodian (and not kept at the LC's office which would be in breach of the license condition).

The SFC's Circular on SFC Inspections

The SFC issued a circular (SFO/IS/003/2026) dated 29 January 2026 (the "**Circular**") reminding all LCs of their statutory obligations during inspections conducted under section 180 of the Securities and Futures Ordinance (the "**SFO**"). The Circular reaffirms the SFC's emphasis on full cooperation and strict adherence to regulatory standards throughout the entire inspection process.

In the Circular and the appendix to the Circular (the "**Appendix**"), the SFC identifies several significant deficiencies in the conduct of some LCs during SFC inspections. These include (i) attempts to delay or reject inspection and interview notices, (ii) baseless challenges to the SFC's scope, review areas, sample selections or inspection inquiries, (iii) delays in providing responses or providing evasive, misleading, intentionally incomplete or partial responses to inspection inquiries, (iv) submitting deficient or deceptive information, including withholding information or providing ambiguous, inaccurate, incomplete, or forged materials, (v) manipulating processes or circumstances to hinder the progress of inspections, and (vi) failing to engage with inspectors in a professional and cooperative manner.

These identified deficiencies underscore a critical disconnect between some LCs' practices and their fundamental legal duties. To clarify the requisite standards of conduct, the SFC's Appendix elaborates on the core statutory obligations and expectations. The SFC mandates that LCs must: (i) provide full and timely access to all requested records and answers to related SFC inquiries, (ii) maintain and be able to readily retrieve all regulatory records of the LC upon inspection inquiries being made without undue delay, (iii) ensure the continuous availability of Responsible Officers to participate in the inspection process, (iv) adhere to all applicable statutory and regulatory requirements including when responding to the SFC's inspection notices throughout the inspection, and (v) retain full accountability for any external representatives engaged to assist with inspection matters. Adherence to these obligations is not merely procedural but is integral to demonstrating an LC's ongoing fitness and properness.

The SFC also reminds LCs that senior management bears primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the LC. Crucially, where an LC is, or was, guilty of misconduct as a result of a senior management member's consent, connivance or neglect, that senior management member is also guilty of misconduct. The SFC explicitly calls on the Manager-in-Charge (MIC) of Overall Management Oversight, supported by the MIC of Compliance, to exercise robust oversight and proactive leadership throughout the inspection process, with failures potentially calling into question their fitness and properness to remain in their roles.

LCs should bear in mind what is set out in the Circular during their SFC inspection, given non-compliance carries serious consequences. The SFC may take regulatory actions including imposing licence conditions or limiting business activities, and/or enforcement actions, which can range from criminal proceedings to disciplinary measures such as licence revocation, pecuniary penalties or reprimands. Senior management, particularly the MIC of the Overall Management Oversight, is held directly accountable for ensuring compliance and cooperation during inspections.

Conclusions

The above are some of the focus areas of recent SFC inspections of LCs holding a Type 9 license. Needless to say, there are other areas which the SFC have historically always covered, for example whether the LC's compliance documents are up to date, whether proper client on-boarding procedures have been adhered to, whether all personnel have been appropriately licensed (that is, whether all of the LC's personnel who are carrying out regulated activities or regulated functions have been properly licensed, and whether anyone who holds an SFC license actually needs one), whether personal dealing records are properly kept and personal dealing restrictions are adhered to, whether CPT requirements are met and records kept up to date, whether all directorships and outside business interests of all SFC licensed persons have been notified to the SFC, list of authorised signatories for all of the LC's various accounts, etc. LCs which are expecting an SFC inspection should prepare for the inspection and conduct the inspection in a manner that brings to bear the expectations as set out in the SFC's Circular.

For further details on how we can assist you, please contact us at: info@wbylawyers.com.hk.

This article is for general information only and is not intended to provide legal advice.

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