

# LCQ1: Impacts of investment losses incurred by investment funds

Following is a question by the Hon Christopher Cheung and a written reply by the Acting Secretary for Financial Services and the Treasury, Mr Joseph Chan, in the Legislative Council today (April 21):

Question:

It has been reported that Archegos Capital Management (ACM), a family office fund based in the United States, failed to meet the margin calls after plunges in the prices of a number of United States-listed stocks in which it had invested in a highly leveraged way. As a result, ACM was forced to close out the securities contracts (commonly known as "forced liquidation") and dump the stocks concerned of value amounting to almost US\$30 billion. Besides, a number of international investment banks which provided brokerage services for ACM suffered significant losses. In this connection, will the Government inform this Council:

- (1) whether it has assessed the impacts of ACM's forced liquidation on the capital market of Hong Kong, and how the incident affects the development of family offices' wealth management business in Hong Kong;
- (2) given that the incident has revealed the enormous risk involved in investment banks' provision of highly leveraged loans for hedge funds, of the Government's measures in place to prevent local investment banks from providing such funds with excessive amounts of loans;
- (3) of the mechanism in place to guard the financial system of Hong Kong against the impacts arising from the investment losses suffered by sizable international financial institutions; and
- (4) whether it will take measures to raise investors' vigilance about the possible risk of failure of sizable funds in times of high market volatility; if so, of the details; if not, the reasons for that?

Reply:

President,

My response to the various parts of the question, in consultation with the Securities and Futures Commission (SFC), is as follows:

- (1) The SFC has noted that Archegos Capital Management (ACM), a family office in the US and prime brokerage client of many global banks, defaulted on margin calls. The SFC has been closely monitoring the situation and made enquiries with prime brokers in Hong Kong, with a view to procuring an orderly wind-down of ACM's positions to avoid any adverse impact on the Hong

Kong securities market.

Meanwhile, the unwinding of ACM's positions globally has prompted regulators to raise scrutiny on family office funds and prime brokers' risk management. In Hong Kong, all players in the market carrying on financial businesses which are subject to the regulation of Hong Kong laws, regardless of the form of business, have to comply with the law and regulations and come under financial regulators' supervision. For the above-mentioned activities, the SFC is enhancing its monitoring of prime brokers' exposures to highly leveraged funds to mitigate the risks posed to the market and to the brokers in the event of defaults.

At the macro-policy level, the Government and financial regulators will strive to perfect our risk management system and propel the orderly development of our financial market under a proper legal framework. Noting that family office business is gathering speed in recent years and forms an important growth component of the wealth and asset management sector, the Government will continue its efforts to attract more family offices to set up and operate in Hong Kong. Additional resources have been provided by the Financial Services and the Treasury Bureau to InvestHK for setting up a dedicated team to step up promotional efforts in local and other major markets, and provide one-stop-shop service to family offices interested in setting up presence in Hong Kong. The dedicated team is expected to commence operation in the second quarter of 2021.

(2) Some prime brokers would lend securities or cash to investment funds for trading, the risk management of which is subject to the SFC's regulation. The SFC issued a circular in June 2019 to intermediaries, setting out the standards of conduct and internal controls the SFC expects of prime brokers. In particular, prime brokers are expected to: (a) maintain effective policies and procedures for proper risk management and ensure adequate information is provided to allow the management to take appropriate and timely action to contain or manage risks; and (b) establish appropriate risk limits for on-going monitoring and periodical assessment of their appropriateness. The SFC has been monitoring regularly prime brokers' compliance with the circular requirements.

(3) and (4) Economic security forms an important part of the national security system; and financial security serves as the cornerstone of our economic security. The Government strives to safeguard the financial security of Hong Kong through putting in place a stringent and effective regulatory regime (which includes alert and emergency response mechanisms) with a view to controlling cross-sectoral market risks. For this purpose, the Government has raised with financial regulators the need to closely monitor the market situation and to employ measures to control the systemic risks of the market when appropriate. Financial regulators ascertain through stress tests from time to time that the regulated bodies can withstand market risks amidst market volatilities.

Moreover, the Government and financial regulators have set up various platforms to deliberate on the latest developments of financial markets and

regulations, as well as to monitor regularly the operation of Hong Kong's financial system with a view to upholding our financial stability. These platforms include the Council of Financial Regulators chaired by the Financial Secretary and Financial Stability Committee chaired by the Secretary for Financial Services and the Treasury.

Concerning the securities market, Hong Kong has developed a comprehensive monitoring framework and a set of indicators to identify potential systemic risks or other specific risks in the stock and derivatives markets (including over-the-counter derivatives transaction), such as reporting requirements of building up of large positions, restricting covered short selling to designated securities and requiring the reporting of such.

We will continue to closely monitor the dynamics of global and local financial markets and adopt effective and timely measures as appropriate with a view to ensuring financial stability.

In respect of investor education, the Investor and Financial Education Council has been organising various educational and promotional activities to enhance investors' understanding of the financial market and products and assist them in acquiring the knowledge and know-how required of financial investments. Meanwhile, the SFC will continue to monitor the situation in relation to hedge funds and their prime brokers, and will alert investors of the relevant risks if deemed necessary.