

Examples of good practices for managing liquidity risk of MMFs

A. Minimum levels of liquid assets

An MMF must hold at least 7.5% of its total net asset value (NAV) in daily liquid assets (DLA) and at least 15% of its total NAV in weekly liquid assets (WLA) as required by the Code on Unit Trusts and Mutual Funds (UT Code).

Examples

- *The Manager of MMF A monitors prevailing market conditions in assessing the liquidity profile of the fund. In view of the shift in market sentiment to invest in the stock market and anticipated interest rate cuts that may trigger investors' redemptions, the Manager increased the DLA of MMF A to above 30% of its NAV to allow additional liquidity in meeting potential redemption requests, and it will adjust the DLA as and when appropriate.*
- *Most Managers indicated that on an ongoing basis, their MMFs often keep DLA and WLA levels substantially above the respective minimum requirements as prescribed under the UT Code (eg, DLA at 20% of NAV and WLA at 25% of NAV).*

B. Portfolio construction

Managers should regularly assess the liquidity profile of the MMFs' liabilities and assets. For these assessments, they may use quantitative metrics such as days to trade, cost to trade or time to maturity, as well as qualitative factors such as asset class and credit quality.

Examples

- *MMF B primarily invests (ie, not less than 70% of its NAV) in short-term deposits and high-quality money market instruments denominated and settled in HKD. In managing the fund's investment portfolio, the Manager implements the following measures to maintain the fund's liquidity on an ongoing basis:*
 - (i) *"Laddering" arrangement for time deposits with banks: The Manager further strengthens the liquidity profile of the investment portfolio by laddering maturities, whereby a certain portion of the invested assets held by MMF B will reach maturity on each business day so as to maintain the fund's corresponding daily liquidity in view of its daily dealing frequency.*
 - (ii) *Negotiating favourable terms for early termination of fixed-term deposits, without imposing penalty charges or downward interest rate adjustments.*
- *The Manager of MMF C places time deposits of the fund only with top-tier banks in order to better manage the fund's counterparty risk.*

C. Investors profile

Managers of MMFs should regularly assess the liquidity profile of the funds' liabilities, particularly the funds' investor profile and investors' historical and expected redemption patterns. They should also consider the funds' potential liquidity demand, taking into account historical and expected future demand under anticipated market conditions where appropriate.

Examples

- *The Manager of MMF D closely monitors the composition of the fund's investor profile through active engagement and ongoing communication with the distributors, with a view to gauge and manage investors' liquidity demand. Based on observations of investor behaviour in past years, the Manager of MMF D noted that investors may redeem their investment in MMF D to fund their purchases of equity securities during initial public offerings (IPOs). The Manager has a specific monitoring team to gather IPOs' timetable which helps it estimate potential fund outflows and their investors' need for cash in IPO activities.*
- *The Manager of MMF E has set an internal reference limit that a single investor or distributor shall not hold more than 10% of the fund's NAV. The Manager monitors the holdings of a single investor which reach 5% of the fund's NAV, and will then communicate more frequently with the investor in order to understand the latter's liquidity needs and subscription or redemption plan on a timely and ongoing basis.*
- *The Manager of MMF F has set an internal indicative concentration reference limit for a single investor's holdings, where the percentage threshold may be adjusted with reference to the fund size and other relevant factors.*
- *The Manager of MMF G maintains close dialogue with investors, particularly in cases of anticipated large redemptions, where the Manager will proactively discuss with investors to agree on meeting redemptions in tranches to minimise the disruptive or adverse effect on the fund.*

D. Anti-dilution LMTs

Managers should use LMTs where appropriate to protect the interests of investors. LMTs include anti-dilution tools to allocate redemption costs to redeeming investors to ensure all investors are treated fairly.

To provide greater transparency to investors, the fund offering documents should describe the LMTs and explain when the tools may be used, their impact on the fund and investors, as well as any attendant risks to investors.

Example

- *MMF H invests in time deposits with banks with fixed interest rates. Among others, the fund may terminate the time deposits before their maturities to meet large redemption requests. Early termination of fixed-term deposits may lead to a loss to the fund resulting from penalty charges or downward adjustments of the accrued interests imposed by the depositing banks.*

The fund's offering document allows the imposition of redemption charges, and thus the Manager could use such anti-dilution LMT to allocate the cost of liquidity to redeeming investors.