4 July 2016

Circular to management companies of SFC-authorized funds on liquidity risk management

Introduction

1. The purpose of this circular is to provide guidance to the management companies (**Managers**) of SFC-authorized funds (**funds**) on liquidity risk management of funds (**Guidance**).

2. Previously, the International Organization of Securities Commissions (IOSCO) published Principles on the Suspension of Redemptions in 2012, Principles on Liquidity Risk Management in 2013, and Principles on the Valuation of Collective Investment Schemes in 2013. These three sets of principles set out, among other things, an overall framework for managing the liquidity risk of open-ended funds, and Managers are expected to take them into account and comply with them in managing their funds. Additionally, the SFC issued a circular to management companies and trustees/custodians of SFC-authorized funds on fair valuation of fund assets in 2015.

3. The SFC has recently conducted a focused review of the liquidity risk management practices of a number of Managers, during which we have identified certain good practices for managing liquidity risk. Based on the review results and the international regulatory principles and good practices, the SFC has formulated this Guidance to assist Managers to ensure effective liquidity risk management of their funds. Accordingly, this Guidance contains a set of principles with which Managers are expected to comply. They are illustrated by examples of good practices which, whilst not binding, should assist Managers when applying the principles to the specific circumstances of the funds under their management.

Background

4. Managers should at all times exercise due care, skill and diligence in managing the liquidity of funds under their management, and to ensure that funds are able to meet investors' redemption requests in accordance with the terms set out in the fund offering documents, and that investors are treated fairly.

5. Failure to properly manage a fund's liquidity risk could result in adverse outcomes for the fund and its investors. For example:

   a) *Inability to meet redemption:* Open-ended investment funds allow investors to redeem their investment in accordance with the terms set out in the fund offering documents. For the vast majority of the funds, this means daily redemption. Since the global financial crisis, a growing number of funds have invested in fixed income and other assets that tend to be less liquid. Managing the liquidity of these funds while allowing daily redemption has become more challenging. In fact, recent events showed that under certain market conditions, there may have been challenges for some funds to meet their daily redemption obligations due to the liquidity mismatch between the funds' underlying investments and their redemption obligations.

b) *Adverse impact on funds and remaining investors:* Even where a fund is able to meet its redemption obligations, actions taken by the Manager in meeting the obligations may have an adverse impact on the fund and its investors. This may happen, for example, when the Manager tries to meet a fund's redemption requests primarily by using the fund's cash or by selling the fund's most liquid assets. This would unduly change the risk profile of the fund and leave the fund with less liquid assets, which may be unfair to remaining investors. Furthermore, remaining investors in the fund may be unfairly bearing the costs associated with asset disposals to meet redemption requests, as well as any subsequent rebalancing of the fund's portfolio.

c) *Redemption cycle that exacerbates stress at fund:* Some have suggested that if redeeming investors do not bear the full costs of redemption, this may create a first mover advantage. Investors may be incentivised to redeem their investments ahead of other investors. This could potentially trigger a cycle of redemptions, exacerbating liquidity stress of the fund.

6. Effective liquidity risk management is therefore important not merely because it can minimise the risk that redemption requests cannot be met, but also because it can safeguard the interests and fair treatment of fund investors, and maintain the robustness of funds and market integrity.

Governance

7. Liquidity risk management is the responsibility of Managers. It should be an integral part of Managers' overall risk management programme.

8. A Manager should establish effective and well-documented liquidity risk management policies and procedures for the funds that it manages. These policies and procedures should be reviewed periodically and as needed.

9. The liquidity risk management policies and procedures should be supported by strong and effective governance and operational capability. While governance structures may differ across Managers, each Manager should have in place:

   a) a liquidity risk management function (that is functionally independent from the day-to-day portfolio investment function) to monitor the implementation of liquidity risk management policies and procedures on a day-to-day basis. The liquidity risk management function may be part of the risk management function;

   b) an appropriate degree of oversight by a committee responsible for liquidity risk management or senior management over the liquidity risk management function and the ongoing management and monitoring of liquidity risk. A majority of the members of the committee or the senior management who perform the oversight role should be independent from the day-to-day portfolio investment function. Where the oversight is performed by a committee, the committee should comprise heads or senior staff of the relevant functions of the Manager; and

   c) an appropriate mechanism and process in place (including effective contingency planning) in order to enable the Manager to assess, review and decide on the actions required at short notice to meet the liquidity demands on the funds under sudden and stressed conditions.

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Good practices:

Firm A has a risk management function that is hierarchically and functionally independent from its investment function. The risk management function regularly communicates with portfolio managers on funds' liquidity risk issues and escalates problems and exceptions identified to the liquidity risk management committee, which was set up as a sub-committee of the risk management committee. The liquidity risk management sub-committee is responsible for overseeing the liquidity risk management aspect of the risk management function and reviewing the periodic liquidity risk management reports that contain the results of liquidity risk assessment and stress testing. The committee meets every month and holds ad hoc meetings under certain circumstances, such as periods of market stress, to determine any appropriate action in order to safeguard the interests of investors.

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Firm B has a smaller operation than Firm A. Although Firm B does not have a separate risk management department or a liquidity risk management committee, the day-to-day liquidity risk monitoring function is carried out by designated staff responsible for risk management who are functionally independent from the day-to-day portfolio investment staff. The oversight of liquidity risk management staff and other related responsibilities are performed by Firm B's chief risk officer.

Product design and disclosure

10. A Manager should consider the liquidity risk facing the fund and ensure that the fund's dealing (subscription and redemption) arrangements are appropriate for its investment strategy and underlying assets throughout the entire product life cycle, starting at the product design stage.[1] To that end, the Manager should:

    a) understand the liquidity profile of the fund's assets (and collateral holdings, particularly where they amount to a significant percentage of a fund's net asset value) under different market conditions. For example, the liquidity of certain assets, e.g. fixed income securities (particularly high yield, unrated, or non-performing complex structured debt securities), emerging market assets, alternative asset classes and commodities investments could evaporate during stressed market conditions;

    b) understand the liquidity profile of the fund's liabilities and appropriately align the liquidity profile of the fund's liabilities with that of the fund's assets;

[1] Please refer to the SFC Circular to Product Providers of SFC-authorized unit trusts and mutual funds, SFC-authorized investment-linked assurance schemes and SFC-authorized unlisted structured investment products – Guidance on Internal Product Approval Process, first released on 30 April 2014 and revised on 4 March 2016.

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c) seek to understand the profile of the fund's investors and their historical and expected redemption patterns, as large and unexpected redemptions are often the key source of liquidity risk. In cases where it is difficult for the Manager to have direct access to investor profile information due to the fund's distribution arrangements (such as where a nominee holding structure is used), the Manager should take reasonable steps to obtain investor profile information to the extent practicable when performing the liquidity assessment;

d) determine an appropriate dealing frequency, notice period and fund size (where appropriate), taking into account the liquidity profiles of the fund's assets and liabilities (including fund investors' historical and expected redemption patterns), as well as the arrangements and tools in place to manage the fund's liquidity;

e) identify the appropriate liquidity risk management tools that the fund may use and include in the fund's constitutive documents the ability to use such tools, as further discussed below; and

f) appropriately disclose in the fund's offering documents the significance and potential impact of the liquidity risk on funds and its investors, a summary of the liquidity risk management process and the tools that may be employed to address these risks.

> *Good practices:*
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> *Fund A targets investors that use the fund for short term "cash-parking" purposes. It has a relatively low minimum subscription size and offers daily dealing. Fund A's Manager expects to see relatively high investor turnover. As a result, Fund A invests primarily in highly liquid equities and has strict diversification requirements and illiquid asset investment limits. In addition, Fund A's Manager also sets holding limits by any single investor of the fund.*
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> *Fund B invests primarily in offshore RMB bonds. It targets investors that seek long term capital growth and stable interest income. The Manager maintains close contact with the fund's distributors and receives regular updates from the distributors on the fund's investor profile and their historical and expected redemption patterns. Based on such contact and updates, the Manager expects the fund's investor base to be relatively stable. The Manager has also agreed with the fund's large institutional investors that they would give the Manager advance notice if they are to make substantial redemptions. As an additional safeguard, Fund B is open for dealing only once a week.*
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> *Fund C has a similar investment strategy to Fund B's. Unlike Fund B, however, the Manager of Fund C has decided to manage the liquidity risk of the fund by maintaining the size of the fund at a level commensurate with the Manager's professional and prudent assessment of the size and liquidity of the offshore RMB bond market and the size of other similar funds under its management.*

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Ongoing liquidity risk assessment

11. Once a fund is in operation, the Manager should assess the liquidity profile of the fund's liabilities and assets on a regular basis.

12. The Manager should regularly assess the liquidity profile of the fund's liabilities, particularly the fund's investor profile and investors' historical and expected redemption patterns. Other potential sources of liquidity risk, such as margin calls for derivatives and other obligations, should also be considered. When performing the assessment, the Manager should consider the liquidity demands that the fund will likely face, taking into account historical demands as well as expected future demands of the fund or other similar funds under likely future market conditions where appropriate.

13. In addition, the Manager should regularly assess the liquidity of the fund's assets under the current and likely future market conditions, and classify the assets into different liquidity categories.

    a) Examples of the quantitative metrics or qualitative factors that the Manager may use for liquidity assessment and categorisation include:
        i. Quantitative metrics such as Days to Trade[2], Costs to Trade[3] or time to maturity.
        ii. Qualitative factors such as asset class or credit quality.
        iii. Composite categories such as high, medium and low liquidity, which reflect the combined results of multiple metrics and factors, as well as the professional judgement of the Manager.

    b) The Manager should exercise its professional judgement in determining reasonable and appropriate metrics or factors that should be used for liquidity assessment and categorisation, taking into account the characteristics of the assets and their markets. For example:

        i. Quantitative metrics could be an objective and a particularly useful way to assess liquidity risks, especially where there is accurate and reliable trading data available. Managers are encouraged to develop these quantitative metrics to the fullest extent practicable.

        ii. In some cases, such as where it may be difficult to apply quantitative metrics or none of the quantitative metrics or qualitative factors are on their own sufficiently representative of an asset's liquidity, it may be more appropriate for the Manager to combine the results of multiple metrics and factors, as well as its professional judgement, to classify assets into composite categories. Such composite categories measure asset liquidity along dimensions different from those used for measuring liability liquidity, which is typically assessed based on the cash needed within a certain period of time. In these cases, Managers may have to exercise more judgement and perhaps undertake additional analyses when applying the assessment results.

[2] "Days to Trade" is defined as the number of days within which an asset could be disposed without materially affecting the value of that asset, which is typically calculated with reference to the trading volume of the underlying asset.
[3] "Costs to Trade" is defined as the costs for buying and selling an asset, which typically comprises the bid-ask spread and other transaction costs.

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14. The Manager should set internal liquidity targets or indicators, in the form of the minimum or maximum amount that should be invested in assets under each liquidity category. The liquidity targets or indicators should be set based on the fund's investment strategy, asset and liability profiles, market conditions, the design and disclosure of the product as set out in paragraph 10 above, and other relevant factors, and should be reviewed regularly to take into account changes in circumstances.

15. More than one fund managed by a Manager may employ the same investment strategy or analytical framework, or invest in similar underlying assets. These funds may be affected by or respond to market conditions in a similar way. In such cases, the Manager should consider if it is appropriate to assess the liquidity of these funds in aggregate.

Good practices:

Fund A invests in main board equities for which trading data for assessing the liquidity is readily available. The Manager of the fund monitors the liquidity of the fund primarily through the Days to Trade metric, and performs liquidity categorisation of the fund's assets based on this metric, e.g. assets with Days to Trade of less than 3 days, between 3 to 5 days, between 5 to 10 days, and more than 10 days.

The Manager sets liquidity indicators based on the minimum proportion of the fund's assets with Days to Trade of less than 3 days, and on the maximum proportion of the fund's assets with Days to Trade under each of the other Days to Trade categories. The liquidity indicators are set based on historical redemption patterns, e.g. the proportion of assets with Days to Trade of less than 3 days is set at a level equal to 10 percentage points above the highest redemption rate that the fund has experienced over a three-day period.

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Fund B invests in OTC derivatives. The Manager does not have accurate data on the trading volume of the fund's underlying derivatives. The Manager monitors the liquidity of the fund primarily through the bid-ask spreads of the fund's underlying derivatives (Cost to Trade) by referencing the prices quoted by various derivatives dealers, and performs liquidity categorisation of the fund's assets based on this metric, e.g. assets with a Cost to Trade of less than 10 bps, between 10 to 20 bps, between 20 to 50 bps, and more than 50 bps. The Manager also sets liquidity indicators based on this metric.

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Fund C invests in fixed income securities which have no readily available and reliable trading data. The Manager believes that no single quantitative metric is able to give a representative picture of the liquidity profile of the fund's assets. The Manager therefore considers a range of quantitative metrics and qualitative factors in arriving at a liquidity assessment.

The quantitative metrics that the Manager considers include, where available, the underlying asset's issue size, bid-ask spreads, transaction cost, the number of market makers, the fund's holding as a proportion of the outstanding issuance, time to maturity and time of issuance. The Manager supplements the available

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quantitative data with its professional judgement and other qualitative factors such as the overall market conditions, the applicable regulatory requirements, the currency denomination, and the credit quality.

The Manager classifies the fund's assets into different liquidity categories using the generic categories of low, medium and high liquidity, and sets indicators on the minimum and maximum holding of assets that belong to each of these liquidity categories, taking into account the historical liquidity demands and expected future liquidity demands of the fund under likely future market conditions.

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Firm D has a relatively centralized investment approach – all its funds use the same analytical framework and the same database as the basis for making investment decisions, and are supported by the same central research team. As a result, while the funds managed by Firm D do not necessarily employ the same investment strategy, they are likely to react to a market event in a similar manner. When calculating quantitative metrics such as Days to Trade and holding as a proportion of the outstanding issuance, Firm D aggregates the asset holdings of all its funds to take into account the combined impact of collective actions across all the funds.

16. On an ongoing basis, a Manager should assess the fund's liquidity position against the internal liquidity targets or indicators. The Manager may choose to employ a hard liquidity target approach, whereby the Manager has to adjust the fund's portfolio to bring it within the target within a reasonable time when a fund is unable to meet such target. Alternatively, the Manager may choose to employ a soft liquidity indicator approach, so that any indication could cause the Manager to perform additional analysis and to consider whether further action should be taken to manage the liquidity risk of the fund, including any changes to the design and disclosure of the product as set out in paragraph 10 above. The Manager should consider whether to use a target or an indicator approach after taking into account the relevant liquidity factors, including those set out in paragraph 10 above. In any case, where a fund is unable to meet the targets or indicators, the Manager should have in place well-documented policies and procedures to escalate the incident to the committee responsible for liquidity risk management or senior management who perform the oversight role for consideration in a timely manner.

17. While a Manager may perform liquidity assessment, categorisation and setting targets or indicators using individual metrics or factors, the Manager should consider the results of these analyses in a holistic manner and use its own professional judgement when assessing the liquidity of the fund's assets. The Manager should avoid making a liquidity assessment based on any single metric or factor. In addition, the Manager should be conscious that, while certain assets, such as large cap exchange-traded equities or short term government bonds, tend to be more liquid, this may not always be the case and the Manager should not automatically assume that an asset is liquid based on such factors alone. Finally, where the Manager has to make assumptions in performing the liquidity assessment, the Manager should ensure that the assumptions are reasonable and prudent.

18. Managers should maintain appropriate documentation of the ongoing liquidity risk assessments (particularly in respect of instances where a fund is unable to meet hard

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liquidity targets) whether any actions have been taken and the underlying considerations.

Stress testing

19. Managers should perform liquidity stress testing on their funds on an ongoing basis, to assess the impact of plausible severe adverse changes in market conditions on the liquidity of the funds and the adequacy of the Managers' action plans and liquidity risk management tools (see below for details).

20. Managers should develop stress test scenarios based on backward-looking historical market conditions and redemption demands of the fund or other similar funds as appropriate. The stress testing should include assessments of the impact of a specific stress factor (e.g. a rise in redemption), and a combination of multiple stress factors (e.g. a simultaneous rise in redemption and fall in underlying asset liquidity). Where collateral holdings amount to a significant percentage of a fund's net asset value, liquidity stress testing should also cover collateral.

21. In addition, Managers should consider developing stress test scenarios based on forwarding-looking hypothetical scenarios where appropriate and practicable. These hypothetical scenarios could be useful for assessing the impact of plausible severe adverse events that have not been seen historically (e.g. events made plausible by recent technological, market or policy developments).

22. Managers should perform stress testing regularly. Generally, a Manager is expected to perform more frequent stress tests on funds with more rapidly-changing portfolio profiles, market conditions or investors. Where there are major changes to the markets in which the fund invests, or the structure or strategy of the fund or the Manager, or major changes in the investor base, further stress testing should be performed in order to assess the impact.

23. As in the case of ongoing liquidity risk assessment, where more than one fund managed by a Manager employ the same investment strategy or analytical framework, or invest in similar underlying assets, the Manager should consider if it is appropriate to perform stress testing on these funds in aggregate. Also, where the Manager has to make assumptions in performing the stress testing, the Manager should ensure that the assumptions are reasonable and prudent.

Good practices:

Firm A performs stress testing on its funds so as to assess their ability to meet redemptions and the impact on the remaining investors when there is (i) a significant decrease in the liquidity of the underlying assets, as reflected in lower trading volumes, and/or (ii) a significant increase in redemption requests. Firm A adopts three stress testing scenarios.

In a baseline scenario, the firm stress tests the portfolio using assumptions based on the estimated trading volume and redemption levels consistent with a one-tailed 99 percent confidence interval, based on a 5-year historical period that incorporates a period of significant market stress. The firm performs stress tests based on this scenario every month.

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In a second, worse-case scenario, Firm A stress tests the portfolio with assumptions based on a minimum underlying asset trading volume and maximum redemption over the same 5-year historical period. The firm performs stress tests based on this scenario every month.

In a third scenario, Firm A stress tests its funds' ability to withstand or react to a hypothetical market stress scenario. Specifically, Firm A would estimate the trading volume, bid-ask spread and redemption level faced by its funds under plausible hypothetical market stress scenarios, and assesses its funds' ability to meet redemptions or react under these estimated parameters. Examples of the plausible hypothetical market stress scenarios used by Firm A include a market-wide trading suspension of the fund's assets, the fund's counterparties suspending the unwinding of the fund's derivatives contracts, or the fund's derivative counterparties triggering a break clause to early terminate the fund's derivative contracts etc. The firm performs stress tests based on these scenarios on an ad hoc basis.

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Fund B engages in stock lending and invests in swaps and other market access products. It receives collateral from counterparties to mitigate credit risks. Fund B's collateral holdings amount to more than 30% of its net asset value. To meet large redemptions, Fund B may have to recall some of the stocks lent or unwind some of its swaps or market access products. In such cases, if a counterparty fails to meet its payment obligations, the Manager would liquidate the collateral posted by the counterparty to satisfy the redemption.

Since the proceeds from collateral disposal may be used to meet redemptions, particularly in times of stress when counterparty default is more likely, the Manager of Fund B performs regular liquidity stress testing on the collateral posted by the fund's counterparties.

24. Stress test results should be reviewed by the committee responsible for liquidity risk management or senior management who perform the oversight role to determine whether further action is warranted. Even if it is decided that no immediate action is warranted, the Manager should have in place action plans regarding how it would meet the fund's liquidity needs should any of the stress scenarios materialise, including through the use of liquidity risk management tools. Where discretion is granted to the portfolio manager in the execution of the action plan to facilitate prompt response to market stress, the exercise of the portfolio manager's discretion should be reviewed. Stress test results should be adequately integrated into the fund's investment decision-making and risk management processes.

Good practices:

Firm A noticed during its stress test that the trading volume and bid-ask spread of the fixed income securities held by one of its funds had deteriorated substantially, and therefore the fund may encounter difficulties in meeting redemptions if redemption requests were to rise above normal level. Staff at the liquidity risk management function, portfolio investment function and trading desk discussed the situation, and considered that it is unlikely the liquidity of underlying assets would improve in the

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near future. As such, it was agreed that the fund would replace part of its existing portfolio with more liquid assets while at the same time increasing its cash holding.

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Fund B invests in highly liquid main board equities. The Manager has recently started distributing the fund through a new channel, which results in higher and more pro-cyclical investor turnover. While stress tests have shown that Fund B continues to be able to meet redemptions by disposing of its highly liquid assets under stressed market conditions, the Manager has noticed that the anticipated frequent asset disposal and subsequent portfolio rebalancing would incur significant costs for the remaining investors. After discussing with the trustee, the Manager introduced a swing pricing mechanism to the fund.

25. Managers should be prepared to articulate the rationales behind the choice of stress test scenarios, and maintain appropriate documentation of stress testing, particularly whether any actions are taken in light of the stress test results.

Liquidity risk management tools

26. Protecting the interests of investors should be the primary consideration in the use of liquidity risk management tools and should always take priority over other considerations, such as reputational and competitive concerns. Managers should also ensure that the investment strategy and portfolio profile of a fund are consistently maintained as much as possible when using these tools.

27. In general, liquidity risk management tools can be categorised as follows:

    a) tools and practices to delay and/or limit redemption, and/or to allow Managers to process redemptions in an orderly manner;

Good practices:

Firm A has close relationships with the large investors of its funds and maintains regular dialogue with them regarding their redemption plans. Firm A may agree in advance with these investors that they will notify Firm A ahead of time if they plan to make significant redemptions as part of its liquidity management plan.

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In all the funds that Firm B manages, it has provided for the discretion to:

- *suspend redemption under exceptional circumstances (e.g. the closure, suspension or restriction of trading on any stock exchange or market on which a substantial proportion of the fund's investments are traded); and*
- *defer the processing of redemption requests, on a pro rata basis, to the next dealing day when a fund faces large redemptions, provided that certain conditions are met (e.g. the redemption requests exceed the threshold / limit disclosed in the fund's constitutive documents).*

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b) tools to allocate the costs of redemption to redeeming investors and to mitigate first mover advantage; and

Good practices:

Firm A has established a general policy where, to the extent practicable, it would liquidate underlying assets to ensure that the fund's investment mandate and risk profile are maintained as much as possible.

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Fund B invests in emerging market equities, where volatile price swings and trading suspensions are more common, making asset valuation a particular challenge. The bid-ask spreads and trading costs of these equities also tend to be higher. To ensure that the redemption price paid to the redeeming investors reflects the fair value of the fund's assets and that the remaining investors are not adversely affected, the Manager places special emphasis on its asset valuation process. The Manager has also provided for the imposition of swing pricing and an anti-dilution levy if the fund experiences major redemptions, to pass on flow-induced transaction costs to the redeeming investors. The Manager has established clear internal processes and maintains an audit trail of its decisions concerning swing pricing and an anti-dilution levy.

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Fund C has recently experienced substantial redemptions from some of its large institutional investors when the trading of many of the fund's underlying assets were suspended. To allow the fund to meet such redemption requests while protecting the remaining investors, the Manager agreed with the redeeming institutional investors that the fund would meet part of the redemption requests in-kind, by transferring underlying assets of an equivalent value to such institutional investors.

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Fund D has recently experienced redemptions from some of its large institutional investors, which together hold the majority of the fund. The redemptions were so substantial that the subsequent fund size would be so small that the fund would no longer be viable and would have to be terminated. However, terminating the fund after meeting the redemptions would mean the remaining minority investors would have to bear the fund termination costs which, in this case, arise because of the redemptions.

The Manager decided to announce the termination of the fund prior to meeting the redemptions. Since the fund would make provision for the termination costs when it announced the termination, the redeeming investors would also bear their share of the termination costs.

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c) other sources of liquidity (e.g. borrowings / credit lines).

28. The liquidity risk management tools should be subject to ongoing review, taking into account the results of the liquidity risk assessment and stress testing, as set out above, as well as the changing market conditions.

29. A Manager should consult the trustee/custodian before the use of liquidity risk management tools. The Manager is also expected to maintain clear internal procedures on (i) the circumstances under which each of the liquidity risk management tools will be implemented; and (ii) the responsibilities of the parties involved in deciding and implementing the relevant tools.

30. To provide greater transparency to investors, the offering documents should disclose the following: (i) descriptions of the liquidity risk management tools, (ii) explanation of when the tools may be used, (iii) the tools' impact on the fund and investors, and (iv) any attendant risks to investors.

Implementation

31. The Guidance set out in this circular is based on international standards published by IOSCO. In general, Managers based in a jurisdiction that is subject to an acceptable inspection regime or a mutual recognition of funds arrangement are expected to have in place liquidity risk management practices in accordance with requirements in their home jurisdiction which are consistent with international standards. All Managers licensed by or registered with the SFC should enhance their internal liquidity risk management process to implement this Guidance when managing SFC-authorized funds as soon as practicable, and in any event no later than 1 January 2017.

32. All Managers should ensure that the offering documents of existing SFC-authorized funds are up-to-date and provide all information necessary for investors to make informed investment decisions. Managers should review the fund offering documents and/or constitutive documents in view of this circular, and make the necessary updates and revisions as soon as practicable. Where the updates or revisions fall under 11.1 of the Code on Unit Trust and Mutual Funds, prior approval from the SFC is required unless such updates or revisions do not require SFC's prior approval pursuant to the streamlined measures[4].

33. In respect of new fund applications, where the SFC has concerns on the liquidity risk of any new fund, the SFC may seek further information from applicants regarding the measures that the Manager has or proposed to put in place to manage the liquidity risk of the fund before granting authorization under section 104 of the Securities and Futures Ordinance.

34. The SFC will keep in view international regulatory developments in respect of liquidity risk management of open-ended funds and may provide further guidance or impose additional requirements where appropriate.

[4] In accordance with the Circular to Management Companies of SFC-authorized Funds entitled "Streamlined Measures to Enhance the Processing of Application for Scheme Changes and Revision of Offering Documents of SFC-authorised Funds" issued by the SFC on 14 June 2013 (the "Streamlined Measures Circular") and/or the Updated FAQs (as defined in the Streamline Measures Circular), as may be amended by the SFC from time to time.

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35. Should you wish to clarify any aspects of this circular and/or in case of doubt, please contact the relevant case officers in charge.

Investment Products Division
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