SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Circular

23 August 2019

Circular to licensed corporations

Managing the liquidity risk of funds

This circular highlights deficiencies or inadequacies noted by the Securities and Futures Commission (SFC) in fund managers' liquidity risk management practices. Liquidity risk arises as a result of the mismatch between the liquidity profiles of the assets and the liabilities of open-ended funds[1]. This is a key risk faced by funds and it is heightened during times of market stress or volatility. Effective liquidity risk management is important to maintain the robustness of funds and the integrity of the market.

Fund managers should implement robust risk management systems and establish well-documented liquidity risk management policies and procedures for the funds they manage. It is of paramount importance for fund managers to exercise due care, skill and diligence in managing the liquidity of SFC-authorised funds under their management, minimise the risk of not meeting investors' redemption requests and safeguard the interests and ensure the fair treatment of fund investors.

The SFC surveyed selected fund managers which are licensed by the SFC and manage SFC-authorised funds (Authorised Fund Managers) to understand their liquidity risk management processes and conducted inspections on some of these fund managers to assess their compliance with the July 2016 circular on liquidity risk management[2] as well as their implementation of enhanced requirements under the Fund Manager Code of Conduct (FMCC)[3].

The FMCC requirements set out the principles which fund managers should observe when establishing their liquidity risk management policies and managing funds[4]. They apply to all licensed and registered fund managers of SFC-authorised funds as well as non-SFC authorised funds. Requirements for the liquidity risk management of SFC-authorised funds were codified in the revised Code on Unit Trusts and Mutual Funds in 2019[5].

Findings

The SFC's survey and inspections noted inadequacies or deficiencies on the part of some Authorised Fund Managers in maintaining proper liquidity risk management systems and controls in the following areas:

(a) overall liquidity risk management framework;

(b) assessments of liquidity profiles of fund assets and liabilities;

[1] The majority of the SFC-authorised funds are open-ended funds and offer daily dealing arrangements whereby investors could subscribe and redeem units or shares on a daily basis.
[2] See the Circular to management companies of SFC-authorized funds on liquidity risk management dated 4 July 2016.
[3] The revised FMCC became effective in November 2018.
[4] Paragraphs 3.14.1 to 3.14.3 of the FMCC
[5] The revised Code on Unit Trusts and Mutual Funds became effective on 1 January 2019.

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(c) stress testing;

(d) governance structure for risk management;

(e) risk management reports; and

(f) documentation.

While some of the SFC's observations relate to the expected standards in the July 2016 circular on liquidity risk management, most of them are also useful references for fund managers of non-SFC authorised funds. Fund managers are reminded to review their current policies, procedures, systems and processes in light of the regulatory requirements and the observations noted in the Appendix and take immediate action to rectify any inadequacies or deficiencies.

Separately, in light of global market volatility, fund managers are also reminded that, at times of significant changes in the markets in which their funds invest, they should perform more frequent and enhanced liquidity stress testing (including, where appropriate, stress testing based on forward-looking hypothetical scenarios) to assess the potential impact on liquidity as well as the adequacy of their action plans and liquidity risk management tools. Fund managers are also reminded to have in place appropriate action plans regarding how they would meet the fund's liquidity needs should any of the stress scenarios materialise.

Liquidity risk management, together with securities lending and repurchase arrangements, safe custody of fund assets and disclosure of leverage by fund managers[6], will remain a key focus of the SFC's supervision of fund managers in the coming year. Where appropriate, the SFC will provide further guidance to fund managers to assist them in enhancing their systems and controls and will not hesitate to take action against fund managers which fail to comply with the regulatory requirements or meet expected standards.

Should you have any questions regarding the contents of this circular, please contact Ms Remy Cheung at 2231 1186 or your case officers.

Intermediaries Supervision Department
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Enclosure

End

SFO/IS/044/2019

[6] These are the key areas enhanced in the revised FMCC which became effective in November 2018.