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

28 October 2026

Supplemental circular to management companies of SFC-authorised funds on liquidity risk management

Background

1. This circular[1] supplements and should be read together with the SFC's Circular to management companies of SFC-authorized funds on liquidity risk management issued on 4 July 2016 (the "**2016 Circular**"). The purpose of this circular is to set out enhanced liquidity risk management guidance to management companies (**Managers**) of SFC-authorised funds (**funds**), to align with latest international standards.

2. Following the pandemic-induced market stresses in 2020, the Financial Stability Board (**FSB**) and International Organization of Securities Commissions (**IOSCO**) have undertaken extensive work to review and address risks arising from non-bank financial intermediation. In particular, liquidity risk management of open-ended funds (**OEFs**) has been a key international regulatory focus.

3. In December 2023, the FSB published the Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds (**Revised FSB Recommendations**)[2] to enhance the regulatory and supervisory framework in this regard. In May 2025, IOSCO published its Revised Recommendations for Liquidity Risk Management for Collective Investment Schemes (**Revised IOSCO Recommendations**)[3] and the accompanying guidance[4], to operationalise the Revised FSB Recommendations.

4. The SFC has incorporated in the Code on Unit Trusts and Mutual Funds (**UT Code**) the major enhancements[5] under the Revised IOSCO Recommendations, namely (i) promoting consistency between fund asset liquidity and redemption terms; and (ii) promoting greater use and greater consistency in the use of anti-dilution tools (**ADTs**) to mitigate material investor dilution.

5. This circular provides additional details on the scope and regulatory expectations regarding these enhancements. It also elaborates on the use of quantitative-based liquidity management tools (**LMTs**) and other liquidity management measures, which complement ADTs in the effective liquidity risk management of funds. Managers are expected to comply with this circular.

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[1] Capitalised terms shall have the same meaning as defined in the 2016 Circular unless otherwise provided. This circular should be read in conjunction with the 2016 Circular.

[2] Available at https://www.fsb.org/uploads/P201223-1.pdf

[3] Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD798.pdf

[4] Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD799.pdf

[5] 5.10 and 6.13 of the UT Code.

Scope

6. This circular generally applies to all SFC-authorised OEFs. For exchange-traded funds (**ETFs**) and money market funds (**MMFs**), they are expected to maintain structural features and liquidity management practices that achieve equivalent outcomes to those contemplated by the relevant requirements in this circular.

7. Managers of SFC-authorised OEFs, including ETFs and MMFs, should also refer to other applicable SFC requirements and guidance regarding their liquidity risk management, including the 2016 Circular.

General

8. Managers should exercise their sound professional judgement in the best interests of investors to manage their funds' liquidity in both normal and stressed market conditions.

9. Managers should be able to demonstrate, to the satisfaction of the SFC, that they comply with the regulatory expectations set out in the UT Code, this circular and the 2016 Circular when managing their funds, including:

    a) appropriate assessment of a fund's asset liquidity, portfolio liquidity and accordingly redemption terms (see **Product design** section below); and

    b) appropriate design, calibration and use of liquidity risk management tools and measures (see **Liquidity management tools and measures** section below).

Product design

Consistency between a fund's asset liquidity and redemption terms

10. Under 5.10(g) of the UT Code, the Manager should ensure that:

    a) a fund's investment strategy and the liquidity of its assets should be consistent with the terms and conditions governing subscriptions and redemptions both at the time of designing the fund and on an ongoing basis. In particular, the redemption terms[6] that a fund offers to investors should be based on the liquidity of its asset holdings in normal and stressed market conditions;

    b) a fund that invests mainly[7] in less liquid assets and offers daily dealing should implement and use ADTs to mitigate material investor dilution to ensure that investors bear the cost of liquidity associated with fund subscriptions and redemptions. Such tools should be used consistently and should impose on subscribing and redeeming investors the explicit and implicit costs of subscriptions and redemptions, including any significant market impact estimated on a best-effort basis; and

[6] Redemption terms generally comprise of the redemption frequency, notice period, lock-up period, settlement period and redemption caps, if any.

[7] Investing more than 50% of assets under management of a fund in less liquid assets is likely to be considered as investing mainly in those less liquid assets.

c) a fund that allocates a significant proportion[8] of its assets under management to illiquid assets should redeem shares at a lower frequency than daily and/or require appropriate notice or settlement periods.

Assessment of asset and portfolio liquidity

11. At the product design stage and on an ongoing basis, Managers should assess the liquidity of a fund's assets and overall portfolio holistically, taking into account relevant quantitative[9] and qualitative[10] factors under normal and stressed market conditions.

12. Specifically, Managers should classify a fund's assets into the following liquidity categories, based on which to prudently determine the fund's portfolio liquidity and redemption terms:

    a) "Liquid" assets are likely to be assets that are readily convertible into cash without significant market impact in normal and stressed market conditions;

    b) "Less liquid" assets are those assets whose liquidity is contingent on market conditions, but they would generally be readily convertible into cash without significant market impact in normal market conditions. In stressed market conditions, they might not be readily convertible into cash without significant discounts and their valuations might become more difficult to assess with certainty; and

    c) "Illiquid" assets include those for which there is little or no secondary market trading, and buying and selling assets is difficult and time-consuming (ie, weeks or months, rather than days) even in normal market conditions. Individual transactions of "illiquid" assets may, therefore, be more likely to affect market values.

13. Managers should also consider stress-testing results for the asset liquidity assessment of a fund (see section paragraph 19 to 25 of the 2016 Circular).

14. Managers should also consider a fund's potential liabilities in maintaining consistency between portfolio liquidity and redemption terms, such as:

    a) investor base, investor concentration, their behavioural characteristics, and historical redemption patterns; and

    b) margin and collateral calls, and other liabilities under normal and reasonably foreseeable stressed market conditions.

[8] Investing more than 30% of assets under management of a fund in illiquid assets is likely to be considered as allocating a significant proportion of assets of the fund to illiquid assets.

[9] Quantitative factors such as market depth, turnover, days to trade, costs to trade or time to maturity.

[10] Qualitative factors such as efficiency and effectiveness of the pricing mechanism, the market impact of large transactions, operational features, or valuation certainty. Assets subject to less efficient pricing mechanisms, greater trading or operational frictions, and/or higher valuation uncertainty are generally less likely to be readily convertible into cash, particularly during periods of market stress.

Liquidity management tools (LMT) and measures

15. Under 5.10(f) of the UT Code, the Manager should adopt and use[11] a broad range of LMTs and measures to mitigate material investor dilution, and manage liquidity risk under normal and stressed market conditions.

16. In general, LMTs and measures are categorised as follows[12] (see **Appendix** for more details on each of the LMTs and measures listed below):

    a) Anti-dilution LMTs (**ADTs**)

        i. ADTs are designed to allocate the estimated liquidity cost associated with subscriptions and redemptions to transacting investors by adjusting the fund's net asset value (**NAV**) or the final price at which they transact, thereby mitigating material investor dilution.

        ii. Examples include swing pricing, subscription and redemption fees, anti-dilution levy, dual pricing and other economically equivalent measures.

    b) Quantitative-based LMTs

        i. Quantitative-based LMTs enable the Manager to limit the amount of liquidity available to redeeming investors and thereby process redemptions in an orderly manner. They are particularly useful during stressed market conditions with significant increases in redemption requests, material deterioration in asset liquidity, or where the fund's NAV cannot be reliably determined.

        ii. Examples include suspensions, redemption gates, and extension of notice or settlement periods.

    c) Other liquidity management measures

        i. Other liquidity management measures include in-kind redemptions, side pockets, soft closures and the use of alternative liquidity sources such as borrowing or credit facilities. These measures complement ADTs and quantitative-based LMTs in mitigating material investor dilution and managing orderly redemptions.

17. As part of the day-to-day liquidity risk management of their funds, Managers should:

    a) adopt an appropriate combination of LMTs and measures, having regard to a fund's size, investment strategy, portfolio liquidity profile and investor base, to address the potential liquidity needs under different market conditions[13];

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[11] "Adopt" refers to making LMTs available as part of a fund's liquidity risk management framework and ensuring that such tools are operationally ready when needed. "Use" refers to the activation and application of such LMTs in accordance with the fund's established policies and procedures.

[12] This list of LMTs and measures is not intended to be exhaustive.

[13] In particular, Managers should not exclusively rely on quantitative-based LMTs to manage funds' liquidity, as it may unduly restrict investors' redemption rights and result in unintended consequences, such as motivating investors to front-run potential redemption restrictions.

b) have internal systems, procedures and controls in place for methodical design and use of LMTs and measures, including liquidity cost estimation for ADTs, evaluation of circumstances that would trigger these tools and measures, access to necessary data to support such assessments, and appropriate disclosure to investors; and

c) conduct ongoing review of the LMTs and measures adopted for their funds, including the fund's ongoing liquidity risk assessment, stress testing, prevailing market conditions, and any material changes to the investor base or fund strategy, and to enhance the LMTs and measures where appropriate.

ADTs

18. The underlying principle for using ADTs is the fair treatment of transacting and remaining investors, with the objective of mitigating material investor dilution.

19. Accordingly, Managers should ensure that ADTs pass on to transacting investors a fair and reasonable estimate of liquidity costs generated by their transactions[14], taking into consideration foreseeable market conditions. The estimation of liquidity cost comprises two elements, namely the estimation basis and the individual components to be included in the estimate.

Estimation basis

20. Managers should:

a) duly consider a pro-rata approach[15] as the starting point for estimating liquidity cost attributable to transacting investors, particularly in stressed market conditions and for funds investing in less liquid assets[16]; and

b) exercise professional judgement to adjust the estimates where a strict pro-rata approach does not reflect the expected liquidity cost, taking into account the fund's investment strategy, overall portfolio management, liquidity profile, transaction approaches and market conditions.

Liquidity cost components

21. Based on the estimation basis, Managers should calibrate liquidity costs comprising the following components:

a) Explicit transaction costs

i. These are direct transaction costs explicitly charged to the fund for its

[14] Such liquidity cost is expected to be dynamic and generally to increase in stressed market conditions. Where a normal range of liquidity cost (eg, a normal range of swing factor) is disclosed to help investors understand the potential impact of ADTs, Managers should note that liquidity costs may exceed the disclosed range, particularly in stressed market conditions, and should apply such higher liquidity costs in the use of ADTs in such circumstances.

[15] A pro-rata approach refers to transacting a pro-rata slice of all assets in a fund's portfolio to meet redemptions and subscriptions.

[16] For fund investing in less liquid assets, if Managers were to sell the most liquid assets first to meet redemptions, the remaining portfolio's liquidity profile might be materially weakened, which might result in higher investor dilution risk, particularly in stressed market conditions.

acquisition or disposal of assets, including brokerage fees, trading levies, taxes and settlement fees.

b) Implicit transaction costs

i. These are indirect transaction costs incurred upon acquisition or disposal of assets, including bid-ask spread and market impact (*see paragraph 21(c)*).

ii. Managers should estimate bid-ask spread using information from commercial databases and brokers, and applying estimates based on comparable assets and/or historical data, or utilising internal or third-party valuation models.

c) Significant market impact

i. Market impact refers to the implicit transaction cost, in addition to bid-ask spreads, arising when a fund executes transactions that are large relative to immediately available liquidity, thereby influencing market prices and resulting in execution at less favourable levels.

ii. Managers should, on a best-effort basis, take into account significant market impact as a component of liquidity cost by:

- assessing market impact prior to executing transactions, considering factors such as transaction size, market structure and prevailing market conditions; and

- estimating market impact based on internal expertise (eg, trading desks), relevant market data and analysis of historical transactions, including assessing execution slippage (ie, the difference between the order price and the executed price, excluding explicit transaction costs).

Activation threshold

22. Where Managers set activation thresholds for ADTs[17], such thresholds should be set at an appropriate and sufficiently prudent level to mitigate material investor dilution, considering factors such as fund size, the fund's investment strategy, asset and liability profiles, estimated liquidity cost, investor profile, historical fund flows and anticipated market conditions.

23. Managers should regularly review the activation thresholds and adjust them to reflect changes in the fund's characteristics or prevailing market conditions.

Quantitative-based LMTs and other liquidity management measures

24. Quantitative-based LMTs and other liquidity management measures are generally intended for use under exceptional circumstances, such as market dislocations, prolonged market or exchange closures, significant operational disruptions, or material

[17] For example, ADTs' activation threshold may be based on a pre-determined net subscription or redemption amount, the cumulative fund flow over a specific time period or the estimated liquidity cost.

liquidity stresses affecting a fund's assets.

25. Managers should establish and maintain a clear governance and decision-making, including escalation to senior management, framework governing the activation, implementation, review and deactivation of these tools and measures.

26. Managers should provide investors with sufficient transparency regarding the general circumstances in which these tools and measures may be used, the relevant governance and decision-making processes, and the communication arrangements.

27. Managers should immediately report to the SFC when quantitative-based LMTs and other liquidity management measures, except borrowing and credit facilities, are activated.

Activation threshold

28. Where Managers set activation thresholds or criteria for quantitative-based LMTs and other liquidity management measures, such thresholds or criteria should be appropriate, objective and prudent, taking into account the potential impact on both investors and market functioning.[18]

Post-activation review

29. Following activation, Managers should regularly assess the appropriateness of continued use of quantitative-based LMTs and other liquidity management measures, and take all reasonable steps to restore normal fund operations as soon as practicable once the circumstances giving rise to their activation have materially improved and normal operations can be sustained.

30. Where these tools or measures remain in place for a prolonged period, Managers should provide investors with periodic updates on the reasons for their continued use and, where practicable, the expected timeframe for deactivation.

Disclosures to investors

31. Under 5.10(h) of the UT Code, the Manager should provide adequate information for investors to make an informed judgement of their investment in a fund.

32. Regarding liquidity risk management, Managers should disclose in the funds' offering documents the following:

    a) the redemption terms, such as dealing frequency, notice and settlement periods, lock-up periods, liquidity profile and the potential liquidity risks associated with the funds;

    b) an overview of the liquidity risk management process and key measures adopted by Managers to identify, monitor, and mitigate such risks;

[18] The use of quantitative-based LMTs or other liquidity management measures does not relieve Managers of their duty to make all reasonable effort to meet redemption requests orderly and in the best interests of investors.

c) the availability and potential use of LMTs and measures, including their objectives, circumstances of use (including any activation thresholds)[19], general descriptions of the liquidity cost components and estimation basis for the use of ADTs, and the potential impact on the funds and investors[20]; and

d) the general approach Managers may take in managing liquidity under stressed market conditions or substantial net redemption requests.

Implementation

33. Managers licensed by or registered with the SFC should enhance their liquidity risk management policies and procedures to implement this circular when managing SFC-authorised funds as soon as practicable, and in any event no later than 31 October 2027, the end of the 12-month transitional period from the effective date of the revised UT Code.

34. Managers should refer to the Frequently Asked Questions on the Implementation and Transitional Arrangements of the Code on Unit Trusts and Mutual Funds (Effective on 1 November 2026) for details on the implications to existing SFC-authorised funds and new fund applications.

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

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

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[19] Such disclosure, however, should avoid precise activation thresholds or real-time data on LMT usage where this may compromise the effectiveness of the tools and measures.
[20] Where a normal range of liquidity cost (eg, a normal range of swing factor) is disclosed, the disclosure should also clearly state that such range may be exceeded in response to changing market conditions where liquidity costs increase. The disclosure should be accompanied by illustrative examples of the circumstances in which this may occur.