REGULATORY NEWSLETTER

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REGULATORY UPDATES

Managing the liquidity risk of funds

23 Aug 2019

The SFC reminded fund managers to perform more frequent and enhanced liquidity stress testing in light of global market volatility to assess potential impact on liquidity as well as the adequacy of their action plans and liquidity risk management tools.

The SFC conducted inspections on some fund managers licensed by the SFC to manage SFC-authorised funds to better understand their liquidity risk management process and assess their compliance with the circular on liquidity risk management (see below) and their implementation of enhanced requirements under the Fund Manager Code of Conduct (FMCC). In the course of such inspections, the SFC noted inadequacies or deficiencies in the following areas:

<u>Overall liquidity risk management framework</u>

LCs should establish and maintain a clear and effective liquidity risk management framework to ensure liquidity risk is properly managed in a consistent manner. The SFC found that (i) some fund managers did not have an adequate liquidity risk management framework in place; (ii) while some fund managers did implement certain aspects of a liquidity risk management framework, internal liquidity targets were not set to assess and monitor liquidity risk; (iii) even when targets had been set, the fund managers did not regularly review them to ensure they remained valid; and iv) no clear guidance was provided to staff on how to handle exceptional events.

Fund managers should set appropriate internal liquidity targets or indicators and review them regularly to take into account any changes in circumstances.

Assessment of liquidity profiles of fund assets

Fund assets are expected to be sufficiently liquid to meet redemption requests of investors and any other payment obligations. The SFC noted that some fund managers had failed to conduct adequate assessments of the liquidity profiles of fund assets.

Fund managers should regularly assess the liquidity profiles of the assets of the funds, and should determine reasonable and appropriate metrics and other factors to assess liquidity and categorise assets.

Assessment of liquidity profiles of fund liabilities

Fund managers need to properly assess the potential redemption requests of investors and prepare for any potential delivery and payment obligations. Some fund managers had failed to conduct adequate assessments of the liquidity profiles of fund liabilities.

Fund managers should regularly assess the liquidity profiles of the liabilities of their funds and take reasonable steps to (i) understand the types of underling investors in the funds they manage and the historical and futures redemption patterns associated with each type of investor; and (ii) consider the liquidity demands which the funds will likely face, taking into account historical demands as well as reasonable and prudent estimates of expected demands.

Stress testing

Some fund managers had not conducted ongoing stress tests or the stress test scenarios were not sufficiently comprehensive.

Fund managers should regularly conduct assessments of liquidity under different scenarios, and they should (i) develop stress test scenarios based on historical market conditions and previous redemption demands on the fund or similar funds; and (ii) consider developing stress test scenarios based on forward-looking hypothetical scenarios where appropriate.

Governance structure for risk management

Some fund managers did not have an adequate risk management governance structure.

Fund managers should maintain a risk management governance structure commensurate with the nature, size and complexity of the operations and investment strategy adopted by each funds.

Risk management reports

Some fund managers only prepared detailed liquidity risk management reports for the funds they manage on a quarterly basis despite the funds being daily dealing funds. Reports were not generated at sufficiently frequent intervals to allow the proper monitoring and assessment of liquidity risk. The SFC also noted a number of errors in the risk assessment reports used such as investments not being classified into the respective risk buckets in accordance with the fund manager’s risk management policy.

Fund managers should review the data source and formulae to ensure that accurate risk management reports are generated, and that regular reports are available to monitor and assess liquidity risk on a timely basis.

Documentation

Some fund managers failed to maintain documentation.

Fund managers should maintain clear and sufficiently detailed liquidity risk management policies and procedures in writing so that their staff could understand and adhere to them. Fund managers should maintain proper documentation of the rationales underlying the choice of key risk management measures where applicable.

Circular on liquidity risk management July 2016:
https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=16EC29

View Circular

ENFORCEMENT NEWS

Sincere Securities Limited ("SSL") slapped with $5 million fine for internal control failings and regulatory breaches

Following an investor's complaint concerning the conduct of a former account executive, the SFC found that SSL did not require its account executives to obtain clients' written consent before transferring their funds maintained at SSL to their gold trading accounts opened with its associated company. The SFC also found other deficiencies including i) outdated compliance and procedural manual failing to capture regulatory requirements that came into effect after May 2009; ii) lack of specific procedures to filter, analyse and monitor staff dealing activities; iii) failure to segregate sales, dealing and settlement functions; and iv) lack of written procedures to prohibit staff from receiving client order instructions through mobile phone applications while on the trading floor while no contemporaneous record of the order details maintained.

View News

SFC bans Samuel Lee Kwok Tung for eight months

The SFC has banned Mr. Samuel Lee Kwok Tung from re-entering the industry for eight months following an investigation which found that Lee falsely stated that he was the client when confirming orders after placing such orders for a client via the telephone in 84 transactions. The SFC considers that such dishonest act called into question his fitness and properness to be a regulated person.

View News

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