

27 March 2020

**Circular to management companies and trustees and custodians
of SFC-authorized funds**

This circular is directed to all management companies (“Managers”) and trustees and custodians of SFC-authorized funds (the “funds”).

In view of the volatility in local and international markets caused by the COVID-19 outbreak, Managers are reminded to:

- (i) closely monitor the dealing and trading of the funds under their management and in the case of ETFs, assess whether the continuous trading of the ETFs under their management is able to be conducted in a fair and orderly manner and in the best interests of investors;
- (ii) keep investors informed at all times and immediately report to the SFC any untoward circumstances relating to the funds under their management, including without limitation, the use of liquidity risk management tools such as any intention to increase or apply any swing factor (or anti-dilution levy) exceeding the one that is disclosed in the offering documents¹ and any decision to defer redemption, suspend creation and/or redemption in the primary market and/or the secondary market trading and potential impact on the fund. The Manager should consult the relevant trustee or custodian before using liquidity risk management tools²;
- (iii) ensure that all assets of the funds are fairly and accurately valued in good faith and in the best interests of investors and in accordance with the constitutive and offering documents as well as applicable laws and regulations;
- (iv) consider the need for any fair value adjustment (particularly in respect of less liquid or suspended securities such as high yield bonds or fixed income instruments and suspended stocks) and constantly review the fair value adjustment policies and procedures to ensure their continued appropriateness and effective implementation in light of the rapidly changing market conditions. The process and conduct of fair value adjustment (including any decision to use or not to use fair value price) should be done by the Managers with due care, skill and diligence and in good faith, in consultation with the trustee or custodian of the funds³;

¹ Managers are allowed to increase the swing factor (or anti-dilution levy) beyond the maximum level that has been set out in the funds’ offering documents as a temporary measure without SFC’s prior approval subject to certain conditions. For details, please refer to FAQ 1 and 2 under Section 3 of the Frequently Asked Questions on Post Authorization Compliance Issues of SFC-authorized Unit Trusts and Mutual Funds.

² For details, please refer to paragraph 29 of SFC’s Circular to management companies of SFC-authorized funds on liquidity risk management dated 4 July 2016 (as amended from time to time).

³ For details, please refer to paragraph 11 of SFC’s Circular to Management Companies and Trustees/Custodians of SFC-authorized Funds - Relating to Fair Valuation of Fund Assets dated 17 December 2018 (as amended from time to time).

- (v) exercise due care, skill and diligence in managing liquidity of funds, in particular, ensuring that actions taken in meeting redemption obligations should not have any material adverse impact on the fund and its remaining investors. For example, trying to meet a fund's redemption requests primarily by using the fund's cash or by selling the fund's most liquid assets may have an adverse impact⁴; and
- (vi) use appropriate liquidity risk management tools (such as swing pricing or anti-dilution levy) to properly allocate the costs of redemption (such as transaction costs for liquidation of assets) to the redeeming investors, and to ensure fair treatment to investors who remain in the funds.

Trustees and custodians are also reminded of their duty to safeguard fund assets and provide independent oversight of the management of funds, for example, on valuation of the funds and use of liquidity risk management tools.

In light of the current market conditions, the SFC has stepped up the monitoring of SFC-authorized funds. Managers are expected to fully cooperate with the SFC on the heightened reporting requirements.

In addition, Managers and trustees and custodians are also reminded to give the SFC early alerts of any material issues affecting their funds, including any intention to increase or apply any swing factor (or anti-dilution levy) exceeding the one that is disclosed in the offering documents⁵, any serious contemplation of suspension of dealings and significant decrease in the value of the fund (e.g. a drop of 10 per cent or more in a fund's net asset value in a single day). They are strongly encouraged to consult the SFC if in doubt.

Investment Products Division Securities and Futures Commission

⁴ For details, please refer to paragraph 5(b) of SFC's Circular to management companies of SFC-authorized funds on liquidity risk management dated 4 July 2016 (as amended from time to time).

⁵ Managers are allowed to increase the swing factor (or anti-dilution levy) beyond the maximum level that has been set out in the funds' offering documents as a temporary measure without SFC's prior approval subject to certain conditions. For details, please refer to FAQ 1 and 2 under Section 3 of the Frequently Asked Questions on Post Authorization Compliance Issues of SFC-authorized Unit Trusts and Mutual Funds.