



Hong Kong

April 2020

SFC PUBLISHES GUIDANCE TO FUND INDUSTRY IN VIEW OF COVID-19 OUTBREAK

On 27 March 2020, the Securities and Futures Commission (the **SFC**) issued its Circular to management companies and trustees and custodians of SFC-authorized funds¹ reminding fund management companies (**Hong Kong Fund Managers**) and trustees and custodians of SFC-authorized funds of their obligations to safeguard the interests of their clients amid the COVID-19 outbreak.

Obligations of Hong Kong Fund Managers of SFC-authorized Funds

Given the market volatility caused by COVID-19, Hong Kong Fund Managers are reminded of their obligations to:

- a) closely monitor the dealing and trading of funds under their management. In the case of ETFs, Hong Kong Fund Managers should assess whether continuous trading of managed ETFs can be conducted in a fair and orderly manner and in the best interests of investors;
- b) keep investors informed at all times and report to the SFC immediately any untoward circumstances relating to managed funds. These would include:
 - i) 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 documents. Funds 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 and

- ii) 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 Hong Kong Fund Manager should consult the relevant trustee or custodian before using liquidity risk management tools. For further details, please refer to paragraph 29 of SFC's Circular to management companies of SFC-authorized funds on liquidity risk management³ dated 4 July 2016 (as amended from time to time).

¹ Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC22>

² SFC. Frequently Asked Questions on Post Authorization Compliance Issues of SFC-authorized Unit Trusts and Mutual Funds. Available at: https://www.sfc.hk/web/files/PCIP/FAQ-PDFS/FAQ_on_Post_Authorization_Compliance_Issues_20200401.pdf

³ Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=16EC29>

- c) ensure all fund assets are valued fairly, accurately and in good faith, in the best interests of investors and in accordance with the constitutive and offering documents as well as applicable laws and regulations;
- d) 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. In the process and conduct of fair value adjustment (including any decision to use or not to use fair value price), Hong Kong Fund Managers must exercise due care, skill and diligence and act in good faith and in consultation with the trustee or custodian of the funds. Hong Kong Fund Managers should 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 2018⁴ (as amended from time to time);
- e) exercise due care, skill and diligence in managing liquidity of funds, in particular, ensuring that no material adverse impact on the fund and its remaining investors is caused by actions taken in meeting redemption obligations. For example, an adverse impact may be caused by trying to meet a fund's redemption requests primarily by using the fund's cash or by selling the fund's most liquid assets. For further 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 and
- f) use appropriate liquidity risk management tools such as swing pricing or anti-dilution levy to:
 - i) properly allocate the costs of redemption, such as transaction costs for liquidation of assets, to the redeeming investors, and
 - ii) to ensure fair treatment of investors remaining in the funds.

Obligations of Trustees and Custodians of SFC-authorized Funds

Trustees and custodians of SFC-authorized funds are reminded of their duty to safeguard fund assets and provide independent oversight of the management of funds in aspects such as fund valuation and the use of liquidity risk management tools.

Early Notification of Material Issues to SFC

Hong Kong Fund Managers, trustees and custodians must give the SFC early alerts of material issues affecting managed funds, including the following:

- a) any intention to increase or apply any swing factor (or anti-dilution levy) exceeding the one that is disclosed in the offering documents. Fund 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; and
- b) any serious contemplation of suspension of dealings and significant decrease in the value of the fund (for example, a drop of at least 10% in a fund's net asset value in one day).

When in doubt, Fund Managers, trustees and custodians should always consult the SFC.

⁴ Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC92>

⁵ See note 3.

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