

Liquidity Risk Management & Enhanced Fund Reporting requirements

With reference to:

Circular to Management Companies of SFC
authorized funds on Liquidity Risk Management
& Enhanced Fund Reporting requirements

Fund Manager Code of Conduct (FMCC)

August 2018

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Liquidity Risk Management & Enhanced Fund Reporting requirements

Introduction

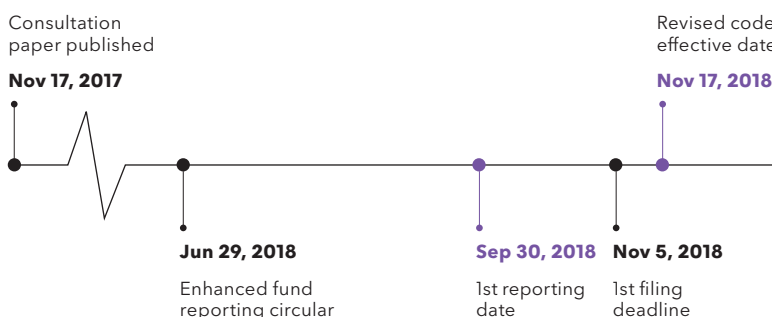
In November 2017, the Hong Kong Securities and Futures Commission (SFC) sought to enhance the Fund Manager Code of Conduct (FMCC) to ensure that Hong Kong has a robust regulatory regime in line with the latest international benchmarks. A key point of emphasis in the new regulations was the maintenance of a risk management framework with appropriate governance.

Following this, in June 2018, the SFC introduced a requirement for authorized funds to provide enhanced reporting of the liquidity profiles for each fund based upon Assets Under Management (AUM).

But time is tight. Firms must be in a position to assess asset liquidity profiles for each fund for close of business September 30. They must then consolidate these into the pro-forma reporting template required by the SFC, and submit that information by November 5. This is then required on a quarterly basis going forward.

Deadline: September 30, 2018

Fund Managers Code of Conduct (FMCC)



Enhanced fund reporting

Reporting buckets & best practice

The template specifies that assets should be assigned to one of four reporting buckets, where each bucket has a USD equivalent fund value allocated to it along with a percentage of the overall AUM of the fund. While the SFC has not provided a prescriptive approach to allocating assets to liquidity buckets, it has suggested various liquidity measures and thresholds for each bucket:

Asset + Liquidity Measure	Bucket 1 High Liquidity	Bucket 2 Medium Liquidity	Bucket 3 Low Liquidity	Bucket 4 Illiquid
Equities: Liquidation horizon	<3 days to trade	3 - 5 days	5 - 10 days	>10 days
OTC Derivatives: Liquidation cost	<10 basis points (bps)	10 - 20 bps	20 - 50 bps	>50 bps

Allocating assets with Bloomberg LQA

Bloomberg's award winning solution for Liquidity Assessment (LQA) provides the ability to quantitatively evaluate market liquidity across multiple asset classes. LQA can assist firms with both enhanced fund reporting compliance and in building a comprehensive Liquidity Risk Management (LRM) framework.

The initial challenge is to classify assets into the reporting buckets required by the SFC. Here's an example portfolio comprised of both equity and fixed income cash securities denominated in various Asian currencies:

PORTFOLIO DATA						
ISIN	SECURITY DESCRIPTION	ISSUER	CCY	ASSET CLASS	POSITION (local ccy nominal amount for bonds, # shares for equities)	Portfolio Weight (by USD Market Value)
XS1341466487	ABNANV 4 3/4 04/01/26	ABN AMRO BANK NV	SGD	Corp	4,000,000	1.3%
HK0000069689	1299 HK	AIA Group Ltd	HKD	Equity	5,120,000	19.4%
JP3160670000	4088 JP	Air Water Inc	JPY	Equity	534,400	4.3%
AU000000AMC4	AMC AU	Amcor Ltd/Australia	AUD	Equity	1,091,104	5.2%
CNE1000001W2	914 HK	Anhui Conch Cement Co Ltd	HKD	Equity	2,904,000	7.1%
AU000000ANZ3	ANZ AU	Australia & New Zealand Bankin	AUD	Equity	217,488	2.1%
XS1722863054	BACR 3 3/4 05/23/30	BARCLAYS PLC	SGD	Corp	4,000,000	1.2%
HK0392044647	392 HK	BEIJING ENT	HKD	Equity	920,000	2.0%
AU000000BHP4	BHP AU	BHP Billiton Ltd	AUD	Equity	405,408	4.3%
XS1701435742	BMW 4 1/4 10/18/20	BMW FINANCE NV	CNY	Corp	48,000,000	3.1%
XS1575637266	BNP 3.65 09/09/24	BNP PARIBAS	SGD	Corp	8,000,000	2.6%
FR0013179736	BPCEGP 4 1/2 06/03/26	BPCE SA	SGD	Corp	16,000,000	5.2%
TW0002882008	2882 TT	Cathay Financial Holding Co Lt	TWD	Equity	3,856,000	2.9%
HK0257001336	257 HK	CHINA EB INT'L	HKD	Equity	5,568,000	2.9%
KYG211081248	867 HK	CMS	HKD	Equity	3,728,000	3.2%
KYG210961051	2319 HK	China Mengniu Dairy Co Ltd	HKD	Equity	3,872,000	5.5%
HK0291001490	291 HK	CHINA RES BEER	HKD	Equity	2,048,000	4.3%
HK0000055878	966 HK	CHINA TAIPING	HKD	Equity	2,256,000	3.3%

Liquidity risk management & enhanced fund reporting requirements

Taking the first two line items and using the SFC’s best practice thresholds as a guide, LQA can help allocate assets to buckets.

- **Top line item** Liquidation cost (one-day time horizon) is 85 basis points, suggesting an “illiquid” position.
- **Second line item** Liquidation horizon of 1.8 days, suggesting a “highly liquid” asset.

LIQUIDATION COST ANALYSIS				LIQUIDATION HORIZON ANALYSIS				SFC Liquidity Bucket
Input		Output		Input		Output		
TARGET LIQUIDATION VOLUME (Local Ccy for bonds, shares for Equity)	TARGET LIQUIDATION HORIZON (# days)	LIQUIDATION COST (% of price, 1=100%)	TOTAL LIQUIDATION COST (Local Ccy)	TARGET LIQUIDATION VOLUME (Local Ccy for bonds, shares for Equity)	TARGET LIQUIDATION COST (% of price, 1=100%)	LIQUIDATION HORIZON (# days)	TIME TO CASH BUCKET (# days)	
4,000,000	1	0.8496%	34,788	4,000,000	0.1504%	5.2	7.2	Illiquid High Low High High High Low Medium High Low Medium High Low Medium High High Medium High High
5,120,000	1	0.1648%	574,245	5,120,000	0.1534%	1.8	3.8	
534,400	1	0.5539%	6,025,055	534,400	0.2244%	7.6	10.6	
1,091,104	1	0.1203%	18,885	1,091,104	0.1090%	2.0	4.0	
2,904,000	1	0.2749%	347,366	2,904,000	0.2844%	1.3	3.3	
217,488	1	0.0762%	4,808	217,488	0.1290%	0.3	2.3	
4,000,000	1	0.4631%	17,259	4,000,000	0.2935%	3.1	5.1	
920,000	1	0.2958%	102,966	920,000	0.2171%	4.0	6.0	
405,408	1	0.0894%	12,053	405,408	0.1352%	0.4	2.4	
48,000,000	1	0.2871%	137,989	48,000,000	0.1844%	9.1	11.1	
8,000,000	1	0.7372%	60,224	8,000,000	0.2200%	12.7	14.7	
16,000,000	1	0.5615%	90,807	16,000,000	0.1560%	44.6	46.6	
3,856,000	1	0.2132%	430,020	3,856,000	0.1960%	1.6	3.6	
5,568,000	1	0.2956%	156,113	5,568,000	0.2278%	3.4	5.4	
3,728,000	1	0.4515%	258,437	3,728,000	0.3402%	3.7	5.7	
3,872,000	1	0.3812%	386,191	3,872,000	0.3553%	1.8	3.8	
2,048,000	1	0.3654%	276,262	2,048,000	0.3184%	2.2	4.2	
2,256,000	1	0.3116%	179,676	2,256,000	0.2951%	1.7	3.7	
2,304,320	1	0.1391%	194,322	2,304,320	0.1087%	3.2	5.2	
1,272,320	1	0.1358%	144,343	1,272,320	0.1245%	1.9	3.9	
992,000	1	0.1465%	128,070	992,000	0.1352%	1.8	3.8	
57,296	1	0.0625%	2,678	57,296	0.1293%	0.2	2.2	

SFC Pro-forma reporting template

High		Medium		Low		Illiquid	
USD Amount	% Portfolio	USD Amount	% Portfolio	USD Amount	% Portfolio	USD Amount	% Portfolio
151,087,439	66%	35,860,880	16%	19,555,328	9%	20,851,234	9%

Once individual assets within a fund have been allocated to a liquidity bucket, the final stage is to convert all asset values to USD, then to calculate the net USD amount and the percentage of the total USD fund value attributed to each bucket.

Evaluating liquidity at the security level

Consideration of market liquidity at the underlying asset (security) level is also important. LQA leverages a robust financial dataset coupled with a big-data framework to allow for liquidity estimation even for instruments with limited trading activity. Customization of input parameters enables the calculation of user-specific scenarios.

- Evaluate securities which have either no or scarce secondary market trading activity.
- Consider round-trip liquidation costs for average institutional sized transactions.
- Access relative liquidity metrics:
 - Compare the average one-day liquidation cost for a range of transaction sizes on a per-security basis.
 - Show how the average cost relates to a universe of other securities.

Bloomberg's complete LQA solution

- Liquidation metrics relating cost, time and transaction size
- Consistent cross asset-class analytics
- Ability to customize input parameters and perform scenario analysis
- Regulation-ready data sets
- Quant product support and challenge desk
- Available via Enterprise Data-Feed

Learn more

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