Understanding Liquidity Risk

A few basics

The purpose of this document is to explain to you what safeguards we employ as an asset manager in order to mitigate liquidity risk within the funds we manage. Investing in funds means that your capital may be at risk and you may not get back the original amount invested.

The importance of liquidity

Liquidity risk is inherent in all investment products, however its multifaceted nature can make it difficult to grasp as a concept. In simple terms, liquidity of investments refers to the ease with which one can sell assets they are invested in, and the value they are likely to derive from that sale.

> Liquidity of a fund ultimately depends on the liquidity of its underlying assets.
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> For example, in times of market stress it may be more difficult to sell an asset quickly (at the last traded price). As a result, the price received may be lower than expected. As each fund consists of multiple assets, these changes are reflected in the price (and short term performance) of the fund.

HSBC principles in managing liquidity risk

We apply two broad principles to our management of liquidity risk:

- To meet fiduciary obligations defined in client agreements and statutory fund documents (e.g. prospectus). As a client, you place trust and confidence in us to manage and protect your investments, we have an obligation to act in your best interest
- To ensure all decisions and actions are fair to all investors

In the case of open-ended collective funds, this means having mechanisms in place to fairly protect the interests of investors who intend to remain invested from the effect of investors creating or redeeming from a fund.

For instance, in order to meet these objectives, we may temporarily delay redemptions by clients, or introduce a 'fair value price adjustment'. These price adjustments aim to protect remaining investors from some of the performance dilution they may suffer as a result of significant net inflows or outflows in a fund.

In the most extreme circumstances a fund may be suspended and not allow investors to redeem their funds for some time. This is rare and is sometimes referred to as gating. The most recent example of gating was a decision by several UK property fund managers to close their funds to creations and redemptions in the weeks following the EU referendum, partly because of unexpectedly high redemption requests but also because of concerns relating to the pricing of their underlying investments. These suspensions were removed once it was determined that it was in the interests of all investors.

A couple of definitions

Liquidity

A measure of how easily an investment can be converted to or from cash without experiencing significant losses of capital and/or income in the process or entry/exit barriers.

The liquidity risk management process

The liquidity management process is designed to manage the liquidity risk inherent within the underlying assets.

When relevant, we use price adjustments for large subscriptions or redemptions. This means the fund's price can be adjusted when activity on a dealing day is in excess of a predetermined threshold. The goals is to mitigate the potential impact of significant subscriptions and redemptions for existing fund holders.

Global Asset Management

HSBC approach in managing liquidity risk

The chart below illustrates the process by which we manage the impact of liquidity risk under ‘Normal’, ‘Stressed’ and ‘Extreme’ conditions and how temporary suspensions are subsequently lifted.

HSBC Global Asset Management. Representative overview of the investment process, which may differ by product, client mandate or market conditions. For illustrative purposes only.

Important information

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

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