

Regulatory News Alert

Liquidity Risk Management – IOSCO and ERSB recommendations for open-ended funds

19 March 2018

Subsequent to the recommendations published by the FSB in January 2018, IOSCO has reviewed its 2013 Liquidity Risk Management recommendations to enhance them further, addressing eight of the nine FSB recommendations. In addition, in February 2018 IOSCO published its report on good practices and issues for consideration regarding liquidity risk management for open-ended funds. These recommendations can be grouped in four themes:

- Ensuring consistency between a fund's redemption terms and its investment strategy
- Liquidity risk management process and governance
- Liquidity management tools (e.g., swing pricing, redemption in kind)
- Stress testing and contingency planning

In parallel, on 18 February 2018 the European Systemic Risk Board has published five recommendations to the European Commission and ESMA around leverage and liquidity management. These recommendations are:

- *Liquidity management tools for redemption:* The Commission is recommended to propose a common EU legal framework governing the inclusion of additional liquidity management tools.
- *Additional provisions to reduce the likelihood of excessive liquidity mismatches stress testing:* ESMA is recommended to develop guidance on the practice to be followed by managers for the stress testing of liquidity risk for individual AIFs and UCITS.
- *Establish a standard regular (at least quarterly) UCITS reporting:* The Commission is recommended to report to competent authorities including especially data about leverage and liquidity risk.
- *Guidance on Article 25 of Directive 2011/61/EU:* ESMA is recommended to give guidance on the framework to assess the extent to which the use of leverage within the AIF sector contributes to the build-up of systemic risk in the financial system, and on the design, calibration, and implementation of macro prudential leverage limits.

IOSCO recommendations in more details

- Select the appropriate CIS' subscription and redemption arrangements for its investment strategy and underlying assets throughout the entire product life cycle, starting at the product design phase
- Consider liquidity aspects related to its proposed distribution channels
- Assess the likely risk appetite of targeted investors to estimate potential redemption risks
- Establish appropriate liquidity thresholds
- Regularly assess the liquidity of the assets held based on effective and relevant information for liquidity management
- Liquidity risk management process should be effectively disclosed to investors
- Facilitate the ability of the responsible entity to identify an emerging liquidity shortage before it occurs
- Conduct ongoing liquidity assessments in different scenarios, which could include fund level stress testing
- Put in place and periodically test contingency plans with an aim to ensure that any applicable liquidity management tools can be used where necessary, and if being activated, can be exercised in a prompt and orderly manner
- Consider the implementation of additional liquidity management tools, in order to protect investors from unfair treatment, among other things, or prevent the CIS from diverging significantly from its investment strategy

How can Deloitte help?

Deloitte's risk management specialists can assist you in reviewing or enhancing your liquidity risk management framework, with a particular focus on liquidity stress testing, asset liquidity assessment, and investor redemption modelling.

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