

Managing fund liquidity risk in Europe – an AMIC/EFAMA report: Executive Summary

The International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA) have joined forces to write this paper on the legislative requirements and market based tools available to manage liquidity risk in investment funds in Europe and offer some recommendations further improving the general liquidity management environment. Given the largely EU focus of AMIC and EFAMA membership the paper focuses on EU legislation and EU fund structures, namely UCITS and AIFMD.

This paper is written in response to public concerns that liquidity has become more fragmented, whether as a result of the reduced role of banks as market makers and liquidity providers or the prolonged accommodative monetary policy of the world's most prominent central banks. Through documenting the currently available requirements and tools it is clear that the existing EU regulations and tools available in most European jurisdictions prove both comprehensive and appropriate for liquidity management in both normal and exceptional circumstances and were positively tested throughout various market conditions, in line with the International Organization of Securities Regulators (IOSCO) findings in its December 2015 Report on *Liquidity Management Tools in Collective Investment Schemes*.

As part of the review of existing practices, the paper outlines the practical liquidity risk management processes that fund management companies follow when setting up a fund and operate during the life of the fund itself.

The focus of the paper is first on the significant regulatory requirements on investment funds in EU legislation and EU fund structures, namely UCITS funds and AIFs. The requirements included are: the need for an independent risk management function; particular liquidity risk management requirements; monitoring the ongoing liquidity profile of assets within the fund; stress-testing; and disclosures to regulators and investors. This comprehensive review attests to the far reaching requirements regarding fund liquidity currently in place in the European regulatory framework.

This paper also explores the current widespread use of complementary market based liquidity risk management tools available in a number of EU jurisdictions. Some of the tools described include: swing pricing; dual pricing / redemption fees; dilution levy; in-kind redemptions; out of the money gates; suspension of dealings; side-pockets; and temporary borrowing from non-government sources. Recourse to these tools is common across many jurisdictions and they have proven successful by enabling fund management companies to counter all sort of market events.

Our recommendations

We propose three recommendations that should lead to improvements in the general liquidity management environment in Europe. Firstly, we encourage the wider use of available non-legislative recognised market-based tools to all European jurisdictions. Secondly, we strongly encourage the use of existing data already currently reported to national authorities in Europe for improving the analysis of liquidity risk by the European Securities Markets Authority (ESMA) and the European Systemic Risk Board (ESRB). Last, we encourage the continuing efforts by European and national trade associations to develop further guidelines for best practice in liquidity risk management.