PRESS RELEASE

ESMA consults on liquidity stress test guidance for investment funds

The European Securities and Markets Authority (ESMA) has started today a public consultation on its draft guidance regarding liquidity stress tests of investment funds – applicable to alternative investment funds (AIFs) and Undertakings for the Collective Investment in Transferable Securities (UCITS). ESMA's draft guidelines for fund managers aim to promote convergence in the way national competent authorities (NCAs) supervise funds liquidity stress testing across the European Union (EU). The consultation sets out 14 principle-based criteria for managers' liquidity stress tests to follow when executing liquidity stress tests on their funds.

Managers of investment funds in the EU need to regularly test the resilience of their funds for different types of market risks, including for liquidity risk – the risk that assets cannot be sold quickly enough to meet investors' redemption requests.

Steven Maijoor, Chair, said:

> "Today's proposed Guidelines are aimed at ensuring consistency and convergence in EU securities regulators' approach to their supervision of funds liquidity stress, in order to ensure funds can properly mitigate these risks in the future.
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> "Liquidity risk in funds, due to the growth in size and importance of the fund sector, has been a subject of regulators' focus and we need to ensure that these risks are adequately managed by funds to ensure financial stability and investor protection.
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> "Managers should be aware of the liquidity risk of the funds they manage and use stress testing as a tool to manage funds' liquidity and to take appropriate actions to mitigate this risk, especially for scenarios in which redemption requests by investors may exceed funds' ability to quickly liquidate assets. Redemptions scenarios need to be tested at fund level to avoid contagion to the wider market and any impact on financial stability."

Draft Guidelines on Liquidity Stress Testing

The draft principles require stress tests to:

- be tailored towards the individual fund;
- reflect the most applicable risks to a fund;
- be sufficiently extreme or unfavourable (yet plausible);

- sufficiently model how a manager is likely to act in times of stressed market conditions; and
- be embedded into the fund's overall risk management framework.

One Guideline will also apply to depositaries, outlining how they should fulfil their obligations regarding liquidity stress tests.

ESMA is seeking stakeholders' views on the guidance fund managers should follow, which include:

- the design of liquidity stress testing scenarios;
- the liquidity stress test policy, including internal use of liquidity stress test results;
- considerations for the asset and liability sides of investment fund balance sheets; and
- the timing and frequency for individual funds to conduct the liquidity stress tests.

The ESMA Guidelines follow recommendations by the European Systemic Risk Board (ESRB) published in April 2018 on how to address liquidity and leverage risk in investment funds. The ESRB mandate asked for the principles to be based on the stress testing requirements set out in the Alternative Investment Fund Directive (AIFMD) and how market participants carry out stress testing.

Next Steps

The consultation is open for feedback until 1 April 2019. ESMA will consider the feedback it receives to this consultation in early Q2 2019 and expects to publish a final report by the summer of 2019. Responses to this consultation will therefore help ESMA in finalising the guidelines for publication.

Notes for editors

1. Consultation paper on funds' liquidity stress tests

2. ESRB recommendations on leverage and liquidity in investment funds

3. Alternative Investment Funds Directive (AIFMD)

4. ESMA's mission is to enhance investor protection and promote stable and orderly financial markets.

   It achieves these objectives through four activities:

   i. assessing risks to investors, markets and financial stability;

   ii. completing a single rulebook for EU financial markets;

   iii. promoting supervisory convergence; and

   iv. directly supervising specific financial entities.

5. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

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