

MEMO# 33557

May 27, 2021

ESMA Statement on Liquidity Risk Management CSA and Related CBI Letter

[33557]

May 27, 2021

TO: ICI Global Members

ICI Global Regulated Funds Committee

International Compliance Advisory Committee SUBJECTS: International/Global RE: ESMA Statement on Liquidity Risk Management CSA and Related CBI Letter

On January 30, 2021, the European Securities and Market Authority (ESMA) launched a Common Supervisory Action (CSA) on UCITS liquidity risk management (LRM). The goal of the exercise was to conduct coordinated supervisory activities to assess whether UCITS managers comply with their liquidity management obligations.[\[1\]](#) On March 24, 2021, ESMA released a public statement presenting its findings.[\[2\]](#)

Overall, the exercise found that most UCITS managers demonstrated that they have implemented and applied sufficiently sound LRM processes. However, Member State national competent authorities (NCAs) identified areas of improvements concerning the following topics:

- Documentation of LRM arrangements, processes, and techniques;
- Quality of (or existence of) written LRM procedures;
- Quality of LRM mechanisms and methodology;
- Overreliance on liquidity presumption with regard to listed securities;
- Application of liquidity presumption to financial instruments that are not admitted to or dealt in on a regulated market;
- Delegation, particularly insufficient involvement of the internal risk management function where the entity to whom the portfolio management function was delegated effectively also performed the LRM functions;
- Data reliability, namely a lack of data quality checks in a context of overreliance on very few data providers;
- Missing, inaccurate, or unclear disclosures on liquidity risks;
- Governance, including the absence of reporting to senior management and issues regarding the decision-making process;
- Internal control framework, including no regular second and third-level controls of LRM policies and procedures and a general need to strengthen the overall control framework; and

- External controls by the depositary and external auditor not being performed in all cases.

Although ESMA observed a high level of convergence in the way NCAs supervised the LRM practices of UCITS and UCITS managers in their respective Member States, it was agreed that further work will be carried out at the ESMA level to promote further convergence in the way NCAs follow-up on the CSA's supervisory findings.

ESMA urged market participants to review their LRM frameworks and confirm that their LRM obligations are sufficiently met. Additionally, NCAs agreed to take follow-up actions with individual entities to ensure that identified areas of weakness with respect to LRM are remedied.

Central Bank of Ireland (CBI) Letter on CSA on LRM

On May 18, 2021, the CBI issued a letter regarding the findings of the CSA on UCITS LRM, which is to be read in conjunction with ESMA's public statement.[\[3\]](#) The letter is addressed to all Irish UCITS managers and calls on them to conduct a specific review of their practices, documentation, systems, and controls of LRM activities. The review must be documented and include details of actions taken to address any of the findings identified in the ESMA public statement. This review, along with a board approved action plan, must be completed by the end of 2021.

The CBI letter reiterates the essential findings of ESMA's public statement and offers additional substance on the various areas of improvement (each detailed in "Appendix 1" to the letter).

- Instances of LRM framework that were not clearly defined, adaptable, and/or independent: managers must maintain adequate and documented risk management policies.
- A lack of formal documented pre-investment forecasting framework: managers must have a clearly defined or documented methodology of oversight.
- A lack of formal liquidity escalation policies: managers must have clearly-defined and documented escalation procedures.
- Cases where no pre-investment forecasting performed: managers are required to formulate forecasts and perform analyses on portfolio composition.
- Overreliance on the presumption of ongoing liquidity: managers must conduct stress tests when appropriate and not rely on historical performances.
- Oversight of delegates below expectations: board is required to exercise skill, care, and diligence in its oversight.
- Shortcomings in the role of the designated person for fund risk management: designated persons should approach information received about LRM with "healthy skepticism."
- Cases of no liquidity reporting to the board of the UCITS manager: the risk management policy must state the terms, contents, and frequency of reporting to the board of directors.[\[4\]](#)
- Shortcomings in the internal control framework: Managers must establish, implement, and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the management company.[\[5\]](#)

The CBI concludes the letter by stating the importance of adhering to liquidity management obligations and reaffirming that LRM will continue to be an area of supervisory focus.

endnotes

[1] The CSA assessment framework followed a two-stage process: (i) National Competent Authority's (NCAs) requested quantitative data from a large majority of the UCITS managers to obtain a macro risk perspective; and (ii) NCAs focusing on a sample of UCITS managers to conduct an in-depth micro risk analysis.

[2] ESMA's statement is available at:
https://www.esma.europa.eu/sites/default/files/library/esma_34-43-880-_public_statement_-_2020_csa_ucits_liquidity_risks_management.pdf.

[3] The CBI's letter is available at:
<https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/industry-communications/industry-letter---common-supervisory-action-on-ucits-liquidity-risk-management-19-may-2021.pdf?sfvrsn=5>.

[4] Paragraph 2 of Schedule 9 of the Irish UCITS Regulations.

[5] Paragraph 2 of Schedule 9 of the Irish UCITS Regulations.