WILLIAM FRY

Asset Management & Investment Funds Update

August 2023

Key Dates & Deadlines: Q3 2023

The following are key dates and deadlines in Q3 2023 along with possible impacts and action items arising for fund managers.

Date	Source	Summary	Action/Impact
2023 (date dependent on publication date of relevant financial report)		SFDR Level 2 – fund annual report disclosures SFDR Level 2 financial report disclosure rules, effective 1 January 2023, must be addressed in annual reports published after that date irrespective of the relevant financial or reference period.	Fund managers must ensure annual financial statements published after 1 January 2023, for funds subject to SFDR Article 7, 8 or 9, incorporate the relevant disclosures and using the Level 2 templates where applicable.
Q3 (exact date TBC)		ESMA Guidelines on Fund Names – publication of final report Guidelines on use of ESG or sustainability-related terms in the name of funds are expected to be finalised and published with an application date of 3 months post publication and a 6-month transition period for existing fund names. See here for further details.	Draft Guidelines set out quantitative thresholds for investment in E/S aligned or sustainable investments for Article 8 and 9 funds which use ESG/sustainability-related terms in the fund name.
20 July		AIFMD/UCITS Review – provisional agreement reached The Council and Parliament reached agreement on the AIFMD/UCITS Review which is now subject to formal confirmation before the text can be adopted. See here for further details.	The AIFMD/UCITS Review proposes amendments to these fund governing regimes on a range of topics including delegation and substance, liquidity management and loan-originating AIFs.

31 July		CSRD –reporting standards adopted by the Commission First set of sector-agnostic reporting standards under CSRD finalised (subject to scrutiny) for application from 1 January 2024. See article on topic in this month's update for further details.	Fund managers should scope activities against the CSRD thresholds to determine application of reporting standards. CSRD applies to companies in scope of NFRD from 1 January 2024 and on phased basis to all large companies, EU listed SMEs, parents of large groups and non-EU companies with significant EU operations.
30 August		ESG Ratings Regulation – consultation response deadline EU and non-EU providers of ESG ratings distributed or publicly disclosed in the EU will be subject to authorisation and ongoing supervision by ESMA under EU proposals subject to consultation until 29 August 2023. See article on topic in this month's update for further details.	Fund managers that publish or distribute publicly ESG ratings should scope activities against the proposals in prepare for any forthcoming authorisation obligations.
3 September		Updated MiFID Suitability Guidelines – in effect Updated Guidelines were published in April 2023 taking account of the sustainability preference rules with an effective date of 6 months post publication. See here for further details.	MiFID firms and fund managers with a MiFID top-up licence must ensure compliance with the updated guidelines ahead of the effective date.
4 September	FSB	Policies to address vulnerabilities from liquidity mismatch in open-ended funds FSB Consultation closes to comment. Anti-Dilution LMTs – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for CIS IOSCO consultation closes to comment. See article on topic in this month's update for further details.	Consultation response deadline.
11 September		DORA – Level 2 consultation closes First set of Level 2 standards are available for consultation covering ICT risk management framework, classification criteria for ICT-related incidents, outsourcing register, ICT third-party providers. See here for further details.	UCITS managers and AIFMs are in scope of DORA which is effective from 17 January 2025. In addition to progressing compliance preparations for DORA, fund managers must also prepare to comply with the Central Bank's Cross-Industry Guidelines on Operational Resilience for which action plans/evidence of action taken are expected by 1 December 2023.

14 September		IAF & SEAR – second consultation response deadline CP154 on reforms to the Central Bank's Administrative Sanctions procedure to support and underpin the IAF closes to comment. See here for further details.	Consultation response deadline.
15 September		Call for Evidence – sustainability preferences in MiFID II suitability and produce governance ESMA is seeking contributions by this date on challenges in addressing the sustainability preference rules, the impact of these rules on investor choices and complying with the updated Suitability Guidelines effective 3 September 2023. See here 220283 for further details.	MiFID firms have the opportunity to highlight the various challenges experienced in implementing the sustainability preference rules to ESMA.
3 October		MiFID II Product Governance – Revised ESMA Guidelines in effect The guidelines have been revised to include the specification of any sustainability-related objectives a product is compatible with; the clustering approach; the determination of a compatible distribution strategy where a distributor considers that a more complex product can be distributed under non-advised sales; and the periodic review of products, including the application of the proportionality principle. See here for further details.	MiFID firms and fund managers with a MiFID top-up licence must ensure compliance with the updated guidelines ahead of the effective date.

Extensive EU Corporate Sustainability Reporting Standards Finalised

Background

The new EU sustainability reporting regime for companies, set out under the Corporate Sustainability Reporting Directive (**CSRD**), will first apply from 1 January 2024 to large EU listed companies and parents of large groups, with more than 500 employees i.e., those companies already subject to CSRD's predecessor, the Non-Financial Reporting Directive (**NFRD**).

On a phased-basis, CSRD will apply to all large EU companies and EU parents of large groups (for financial years 2025), EU listed SMEs (for financial years 2026, subject to two year opt-out), and non-EU companies with significant operations in the EU (for financial years 2028). For further details, see our previous briefing on scoping CSRD obligations.

Latest development

On 31 July 2023, the first set of mandatory, sector-agnostic, EU sustainability reporting standards (the **ESRS**), detailing the required content and presentation of CSRD sustainability reports, were adopted by the Commission. The ESRS will now be subject to a period of scrutiny before entering into effect in advance of the first CSRD application date of 1 January 2024. Additional ESRS, including sector-specific, SME proportionate and third country-equivalent ESRS are scheduled for publication by 30 June 2024.

The ESRS, which provide for double-materiality reporting (i.e., reporting on both a company's impact on the environment and society as well as on the risks and opportunities for the company created by environmental and societal factors) include two cross-cutting, one governance, five environmental, and four social standards.

The ten environmental, social and governance (ESG) ESRS apply subject to a materiality assessment which must be undertaken to determine whether information should be reported on the basis that is relevant to the individual company or can be omitted if assessed as not relevant (the materiality threshold).

A summary of the disclosure requirements under each of the first 12 ESRS is set out below, along with key points for consideration when implementing the ESRS.

Key points for ESRS implementation

1. ESRS & the materiality assessment

The materiality threshold, under the ESRS adopted on 31 July last, applies more broadly than was proposed in the draft ESRS submitted by EFRAG (EU body charged with drafting the ESRS). This broader application, which the Commission hopes will significantly reduce the CSRD reporting burden for in-scope companies, means that all individual disclosures and datapoints required under the ESG ESRS are only reportable by a particular in-scope company if assessed as relevant to that company's business model and activities. A matter is to be considered material if it has a material impact and/or is financially material to the particular in-scope company. 'Impact materiality' being assessed by reference to actual or potential, positive or negative material impacts (including those of its own operations, upstream and downstream value chains, its products and services and its business relationships) on the environment of society over the short, medium, or long-term. A matter will be 'financially material' if it could trigger material financial effects on the company. Further guidance from EFRAG has been promised on the materiality assessment process.

While companies may omit non-material information when reporting under the ESG ESRS, the Commission notes that the materiality threshold does not render those standards voluntary. Companies must adopt robust, third-party assured, materiality due diligence processes in accordance with the ESRS; which, in the case of impacts, must be based on factors such as the scale, scope and severity of the impact and, in the case of financial materiality, based on factors such as the level of influence the matter may have on the company's financial development. Detailed explanations of any non-material conclusions for 'ESRS E1 Climate change' must, where applicable, be reported by in-scope companies, alongside reporting on any material information.

2. Interoperability with other EU sustainability reporting rules and global standards

While the inclusion of the ESG ESRS materiality threshold is undoubtedly a welcome development for those subject to CSRD, there are many in the financial services sector which require data reported under the ESRS to comply with their own mandatory sustainability reporting under other EU sustainable finance rules e.g., the Sustainable Finance Disclosures Regulation (**SFDR**), the Benchmark Regulation (**BMR**), or the Capital Requirements Regulation (**CRR**).

For those subject to SFDR, BMR or CRR, the Commission notes that the ESRS provide for disclosure of a table (i) detailing where in the CSRD report any datapoint derived from those regimes can be found and/or (ii) explicitly stating if a datapoint is considered non-material by the investee company. In addition, the Commission intends to provide 'further clarifications' for reporting, under SFDR, BMR and CRR, on exposures to, or investments in, companies which report required data as non-material under the ESRS. The Commission also notes that, for SFDR principal adverse impact reporting, any indicator reported as non-material by an investee company under the ESRS may be assumed not to contribute to the corresponding SFDR PAI indicator.

In respect of global sustainability reporting standards, the Commission confirms that the ESRS have a 'very high level of alignment' with the standards of the International Sustainability Standards Board (**ISSB**) and the Global Reporting Initiative (**GRI**). As a result, companies will report, 'to a very large extent', the same information when reporting under the ESRS on climate change as when using the ISSB standard for climate-related disclosures. The intention being that companies subject to the ESRS, that also wish to comply with the ISSB standards, would not have to separately report under the ISSB standards. However, when compared to the ISSB standards, the ESRS require additional information including on non-climate environmental (as well as social and governance) impacts from a double-materiality perspective.

3. CSRD exemptions and phase-ins

The following permanent/temporary exemptions are provided for under CSRD and/or the ESRS:

- EU listed SMEs may comply or explain non-compliance with CSRD until 1 January 2028.

- Large/EU listed subsidiaries* are exempt from CSRD sustainability reporting if included in a CSRD/third-country equivalent consolidated sustainability report.
- Large/EU listed subsidiaries*+ of non-EU parents are exempt until 6 January 2030 if included in an 'artificial' consolidated sustainability report (covering all large or EU listed EU subsidiaries).
- Where in-scope non-EU parents fail to make the necessary information available to its EU subsidiaries/branches to comply with the requirement to publish CSRD sustainability reports at group level/individual level of the non-EU entity (if not part of group), the subsidiaries/branches may publish, alongside their CSRD sustainability report, a statement confirming the information was not made available by the non-EU parent/entity.
- In-scope companies with <750 employees may omit scope 3 emissions in year one reports and biodiversity, value-chain workers, affected communities and end-users in years one and two reports.
- All in-scope companies:
    - are subject to limited assurance (initially under national rules and then, once adopted, CSRD limited assurance standards) until CSRD reasonable assurance standards adopted (scheduled for finalisation by 1 October 2028);
    - can omit financial effects of non-climate environmental issues and certain own workforce data in year one reports;
    - are subject to voluntary reporting of certain datapoints including biodiversity transition plans, certain indicators about 'non-employees' in their workforce, and explanations of why particular sustainability topics are assessed as non-material;
    - may avail of certain flexibilities for some mandatory datapoints e.g., on the financial effects of sustainability risks, engagement with stakeholders and the materiality assessment process;
    - may omit data on value chains in years one, two and three reports.
- UCITS and AIFs are specifically exempt from CSRD.

**no exemption for companies which are both large <u>and</u> EU listed*

+ *subsidiary must be one that generated the greatest turnover in the EU in at least one of the preceding five financial years*

4. *CSRD sustainability reports must:*
    - be included in the management/directors' report and must be digitally tagged;
    - be published within 12 months of the balance sheet date (it is expected that national transposition measures will permit satisfaction of the publication requirement by filing with the Companies Registration Office);
    - subject to exemptions, be prepared on a consolidated basis for EU parents of large groups;
    - subject to exemptions, be prepared at group-level for in-scope non-EU parents;
    - include any disclosures required under Article 8 of the Taxonomy Regulation;
    - consider the company's own operations, its value chain, including its products and services, business relationships and supply chain; and
    - be subject to limited assurance, moving to reasonable assurance once relevant ESRS are adopted (currently scheduled to be finalised by 1 October 2028).

Summary of disclosure requirements under first set of ESRS

1. Cross-Cutting Standards:

- ESRS 1 General requirements

This standard includes general principles for reporting under the ESRS including on double materiality; due diligence; value chain; time horizons; presentation; and transitional provisions.

- ESRS 2 General disclosures

This standard includes mandatory disclosure requirements (not subject to materiality threshold) for all in-scope companies on the governance of sustainability matters; sustainability strategy; process to take account of interests and views of stakeholders; material sustainability impacts, risks and opportunities and their interaction with strategy and business model; materiality assessment process and the information omitted as not material; policies adopted to manage material sustainability risks; resources and actions in relation to material sustainability matters and metrics used to track the effectiveness of such actions.

2. **ESG Standards (subject to materiality threshold):**

- ESRS E1 Climate change

This standard requires disclosures including on the integration of sustainability-related performance in incentive schemes; transition plans for climate change; metrics and targets related to climate change adaptation and mitigation; energy consumption and mix; Scopes 1, 2, and 3 emissions; emissions removals and mitigation projects; internal carbon pricing and anticipated effect of material physical and transition risks and potential climate-related opportunities.

- ESRS E2 Pollution

This standard requires disclosures including of the processes to identify and assess material pollution-related impacts, risks and opportunities; policies, targets, actions and resources related to pollution; anticipated financial effects from pollution-related impacts, risks and opportunities.

- ESRS E3 Water and marine resources

This standard requires disclosures including of the processes to identify and assess material water and marine resources-related impacts, risks and opportunities; policies, actions, targets and resources related to water and marine resources, water consumption and anticipated financial effects from water and marine resources-related impacts, risks and opportunities.

- ESRS E4 Biodiversity and ecosystems

This standard requires disclosures including of transition plans and consideration of biodiversity and ecosystems in strategy and business model; processes to identify and assess material biodiversity and ecosystem-related impacts, risks and opportunities; policies, actions, targets, impact metrics and resources related to biodiversity and ecosystems; anticipated financial effects from biodiversity and ecosystem-related risks and opportunities.

- ESRS E5 Resource use and circular economy

This standard requires disclosures including of the processes to identify and assess material resource use and circular economy-related impacts, risks and opportunities; policies, actions, targets and resources (inflows and outflows) related to resource use and circular economy; and anticipated financial effects from resource use and circular economy-related impacts, risks and opportunities.

- ESRS S1 Own workforce

This standard requires disclosures including of the policies related to own workforce; processes for engaging with own workers and workers' representatives about impacts; processes to remediate negative impacts and channels for own workers to raise concerns; taking action on material impacts on own workforce, and approaches to mitigating material risks and pursuing material opportunities related to own workforce, and effectiveness of those actions; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities; characteristics of the undertaking's employees; characteristics of non-employee workers in the undertaking's own workforce; collective bargaining coverage and social dialogue; diversity metrics; adequate wages; social protection; persons with disabilities; training and skills development metrics; health and safety metrics; work-life balance metrics; compensation metrics (pay gap and total compensation); incidents, complaints and severe human rights impacts.

- ESRS S2 Workers in the value chain

This standard requires disclosures including of the policies related to value chain workers; processes for engaging with value chain workers about impacts; processes to remediate negative impacts and channels for value chain workers to raise concerns; taking action on material impacts on value chain workers, and approaches to managing material risks and pursuing material opportunities related to value chain workers, and effectiveness of those action; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities.

- ESRS S3 Affected communities

This standard requires disclosures including of the policies related to affected communities; processes for engaging with affected communities about impacts; processes to remediate negative impacts and channels for affected communities to raise concerns; taking action on material impacts on affected communities, and approaches to managing material risks and pursuing material opportunities related to affected communities, and effectiveness of those actions; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities.

- ESRS S4 Consumers and end-users

This standard requires disclosures including of the policies related to consumers and end-users; processes for engaging with consumers and end-users about impacts; processes to remediate negative impacts and channels for consumers and end-users to raise concerns; taking action on material impacts on consumers and end-users, and approaches to managing material risks and pursuing material opportunities related to consumers and end-users, and effectiveness of those actions; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities.

- ESRS G1 Business conduct

This standard requires disclosures including of the role of the administrative, supervisory and management bodies; description of the processes to identify and assess material impacts, risks and opportunities; corporate culture and business conduct policies and corporate culture; management of relationships with suppliers; prevention and detection of corruption and bribery; confirmed incidents of corruption or bribery; political influence and lobbying activities; payment practices.

Commission: No Need To Amend MMFR

Following a scheduled review of the Money Market Funds Regulation (**MMFR**), the Commission has decided not to amend the MMFR.

In its review findings, published on 20 July 2023, the Commission notes the MMFR has "enhanced financial stability and overall successfully passed the test of the recent market stress episodes." including as a result of increased interest rates, the UK Gilt crisis, the war in Ukraine, and the COVID-19 pandemic. And while certain vulnerabilities in the MMF market are highlighted by the Commission for further assessment, it awaits the outcome of the ongoing FSB analysis of liquidity in MMFs and the AIFMD/UCITS Review which is expected to 'further strengthen the resilience of EU MMFs'.

Commission's MMFR Report

As per previous briefings, ESMA proposed several MMFR reforms, in a February 2022 Opinion, focussing on liquidity and first-mover advantage issues and taking account of ESRB and FSB MMFR-reform recommendations.

The Commission's recent report includes responses to the reform options tabled by ESMA/FSB/ESRB, a summary of which responses is set out below:

- ***prohibit use of amortised cost by LVNAVs:*** the Commission views this option as potentially reducing 'the effectiveness of MMFs as liquidity management alternatives to bank deposits and limit[ing] the cash-management options of corporates'. In addition, 'the limited availability of economically viable alternatives and substitutes to LVNAVs [which would disappear if option pursued] could lead investors to turn to less regulated products'.
- ***decouple LMT use from regulatory thresholds:*** the Commission is broadly supportive of this option, which it notes has the largest support across stakeholders and 'could increase the ability of MMF managers to finance increased redemptions in stress periods'.
- ***relax existing limits on eligible public debt assets as part of liquidity buckets:*** while the Commission notes strong ECB-support for this option and acknowledges that public debt can serve as a crucial tool to manage MMFs' liquidity, it equally notes that such investments are not immune to price volatility, as demonstrated by the UK Gilt crisis. 'There is a risk that an increase in the existing limits on eligible public debt assets would result in MMF investments becoming overly concentrated in these securities, whereas the diversification of investments in different asset classes is an important safeguard.'
- ***increase minimum holdings of liquid assets generally:*** while not controversial in substance, the Commission views such proposals as 'difficult to implement' and leading to 'rigidity in the implementation of asset managers' liquidity risk management policies'.
- ***give fund managers the possibility to shift the cost of redemptions to investors:*** while not discounting the FSB/ESRB-recommended option of imposing LMTs/swing pricing, the Commission

defers to the AIFMD/UCITS Review proposals which will allow for the selection of 'the most appropriate' LMTs from a dedicated list.

- ***increase the loss-absorption capacity of MMFs:*** the Commission acknowledges solutions such as constraints on the shares that can be redeemed immediately, and capital buffers would reduce first mover advantage but also that they are 'either untested and contingent on significant operational adjustments' or would make MMFs too expensive to operate.
- ***80% public debt quota:*** discounted as 'infeasible' by the Commission.

Next Steps

Ongoing FSB analysis of liquidity in MMFs

The FSB is currently reviewing adoption of its October 2021 reforms to enhance MMF resilience. This process is scheduled to complete by end-2023 and will be followed by an assessment of the effectiveness of these measures in addressing risks to financial stability by 2026.

AIFMD/UCITS Review

The Council and Parliament reached agreement on the AIFMD/UCITS Review on 20 July 2023. The text is now subject to formal confirmation before adoption and entry into force by the current target date of end-2023. The Commission expects the AIFMD/UCITS Review to 'further strengthen the resilience of EU MMFs'.

Liquidity, Leverage & Interconnectedness: three-pronged macroprudential policy onslaught for the funds sector

John Schindler, the Secretary General of the Financial Stability Board (**FSB**), delivered a speech last month on financial headwinds. Perhaps unsurprisingly, given the ever-increasing financial stability-driven focus of policymakers on the funds sector, the speech focussed almost exclusively on non-bank financial intermediation (NBFI), AKA shadow banking, a broad heterogeneous sector of which investment funds is a key component.

While better known for its banking reform agenda, Mr Schindler submits that NBFI has been a focus of the FSB from its earliest days. But now that global regulatory reforms have increased the resilience of the banking sector, the FSB is emphatically focussed on the key vulnerabilities associated with leverage, liquidity and interconnectedness in NBFI; vulnerabilities which the FSB sees as common to both banks and non-banks.

There are many stakeholders of the funds sector, however, who would dispute the likening of NBFI to the banking sector. In a recent letter to the Financial Times, Bryan Corbett, President and Chief Executive of the Managed Funds Association in the US highlights several key differences, which many consider relevant beyond the US: 'funds are not implicitly or explicitly backstopped by the federal government'; unlike funds 'banks have depositors who can withdraw their money at any time' and if a fund 'fails, the losses are borne by that specific fund's investors and do not impact investments in other funds'. Mr Corbett concludes noting that 'policymakers should focus on the banking crisis at hand and resist using current circumstances as a stalking horse to impose stricter regulations on a non-systemically risky industry'.

In light of recent macroprudential developments in the funds sector (summarised below), however, it seems policymakers' minds are made up and as noted by the Governor of the Central Bank of Ireland when launching its discussion paper on a macroprudential framework for investment funds "Macroprudential policy can achieve [resilience] by preventing the build-up of excessive vulnerabilities across relevant cohorts of the funds sector and/or limit the potential for the sector to amplify adverse shocks through its interconnectedness with other parts of the financial system."

A Macroprudential Framework for Investment Funds

Discussion paper published by Central Bank of Ireland on 18 July 2023

Similar to the FSB, the financial stability concerns of the Central Bank of Ireland (the **Central Bank**), as highlighted in its discussion paper, stem from (i) the size and significant growth of the funds sector, (ii) Ireland's status as one of the largest hubs globally for investment funds and (iii) the absence of high-quality data which would allow for meaningful analysis of the resilience of the funds sector to market shocks.

While the Central Bank's discussion paper does not propose specific policy measures, it does detail potential macroprudential tools for addressing the perceived key risk factors of leverage, liquidity, and interconnectedness.

In the case of liquidity, the discussion paper notes that these measures may include more prescriptive regulatory rules to reduce dealing frequencies, widen redemption notice periods for less liquid funds, introduce liquid asset buffers for specific fund cohorts, require use of (price/quantity-based) liquidity management tools (**LMTs**) and require fund stress testing to take account of wider financial stability matters.

To manage leverage levels in funds, the Central Bank favours leverage limits although notes the operational challenges associated with their calibration and design. Regulators' long-time issue with measuring leverage generated by derivatives is noted along with the challenge this creates for regulators' understanding and analysis of the levels of leverage actually in the system. A situation which the Central Bank notes may benefit from enhanced regulatory stress testing.

Potential tools targeting interconnectedness outlined in the discussion paper include a form of the position-driven concentration limit already in place in the EU under MiFID which could be adapted to apply to certain types of investment funds. Another potential option tabled by the Central Bank for discussion is to apply margin rules, currently in place for OTC derivatives under EMIR, to investment funds which could be triggered/increased in the event of deemed systemic risk from a particular cohort of funds.

The feedback period for the Central Bank's discussion paper is open until 15 November 2023.

Policies to address vulnerabilities from liquidity mismatch in open-ended funds

FSB Consultation published on 5 July 2023

The FSB is consulting on updates to its 2017 Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities. Key updates, directed at open-ended funds, include:

- **Recommendation 3** – recommends a bucketing approach, whereby funds would be grouped into categories e.g., 'liquid, illiquid or less liquid', depending on the liquidity of underlying assets with each category subject to specific expectations in terms of redemption terms and conditions. For example, funds in the liquid category (i.e., which invest >50% in liquid assets) could be daily dealing, those in the illiquid category (i.e., with >30% in illiquid assets) should have a lower than daily frequency and/or longer notice/settlement periods, and those in the less-liquid category (i.e., with >50% in less liquid assets) could be daily dealing subject to the use of anti-dilution LMTs.
- **Recommendation 4** – recommends regulators ensure the availability of a broad set of anti-dilution and quantity-based LMTs for use by fund managers in normal and stressed market conditions.
- **Recommendation 5** – recommends regulators ensure availability and use of anti-dilution LMTs, in both normal and stressed market conditions, to mitigate the potential first-mover advantage from structural liquidity mismatch by imposing on redeeming investors the costs of liquidity associated with their redemptions.
- **Recommendation 2** – recommends regulators require clearer investor disclosures on the availability and use of LMTs in normal and stressed market conditions to enhance investor awareness on the objectives and operation of anti-dilution LMTs.

The feedback period for the FSB consultation is open until 4 September 2023.

Anti-Dilution LMTs – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for CIS

IOSCO consultation published 5 July 2023

In line with the FSB's draft recommendations, IOSCO is consulting on guidance to support increased adoption and use of anti-dilution LMTs by funds, in both normal and stressed market conditions. Key fund manager guidance under consultation includes:

- establish appropriate internal systems, procedures and controls for the design and use of anti-dilution LMTs as part of the everyday liquidity risk management of funds;
- consider and use at least one appropriate anti-dilution LMT for each fund under management;
- ensure anti-dilution LMTs impose on subscribing and redeeming investors, the estimated cost of liquidity, i.e., explicit and implicit transaction costs of subscriptions or redemptions, including any significant market impact of asset purchases or sales to meet those subscriptions or redemptions;
- ensure ability to demonstrate that the calibration of the tool is appropriate and prudent for both normal and stressed market conditions;
- ensure, where thresholds are set for the activation of anti-dilution LMTs, that those thresholds are appropriate and sufficiently prudent so as not to result in any material dilution impact in the fund;

- establish adequate and appropriate governance arrangements for liquidity risk management processes, including clear decision-making processes for the use of anti-dilution LMTs; and
- publish clear disclosures of the objectives and operation (including design and use) of anti-dilution LMTs.

The feedback period for the IOSCO consultation is open until 4 September 2023.

Interconnectedness among EU investment funds

ESMA working paper published on 2 August 2023

In this detailed analysis, ESMA assesses the interconnectedness within the funds sector and whether this gives rise to contagion risks in the event of market volatility which could impact financial stability. The findings highlight that less liquid funds (high yield, corporate and emerging market bond funds) tend to receive more volatility spillovers from other fund categories when compared to more liquid equity or government bond funds. Alternative and mixed funds, on the other hand, transmit financial stress in terms of volatility shocks to other fund categories when compared to other liquid funds. In addition, the spillovers tend to increase sharply during stress periods. 'Therefore, supervisory activities aimed at reducing systemic risk can benefit from particularly considering investment funds which contribute the most to the volatility in the study' i.e., alternative and mixed funds.

Next Steps

The adoption of a macroprudential framework for the funds sector now appears inevitable, the form of which, however, will depend on the outcome of the various discussion and consultation processes as summarised above.

WILLIAM FRY

DUBLIN | CORK | LONDON | NEW YORK | SAN FRANCISCO | SILICON VALLEY

William Fry LLP | T: +353 1 639 5000 | E: info@williamfry.com

williamfry.com