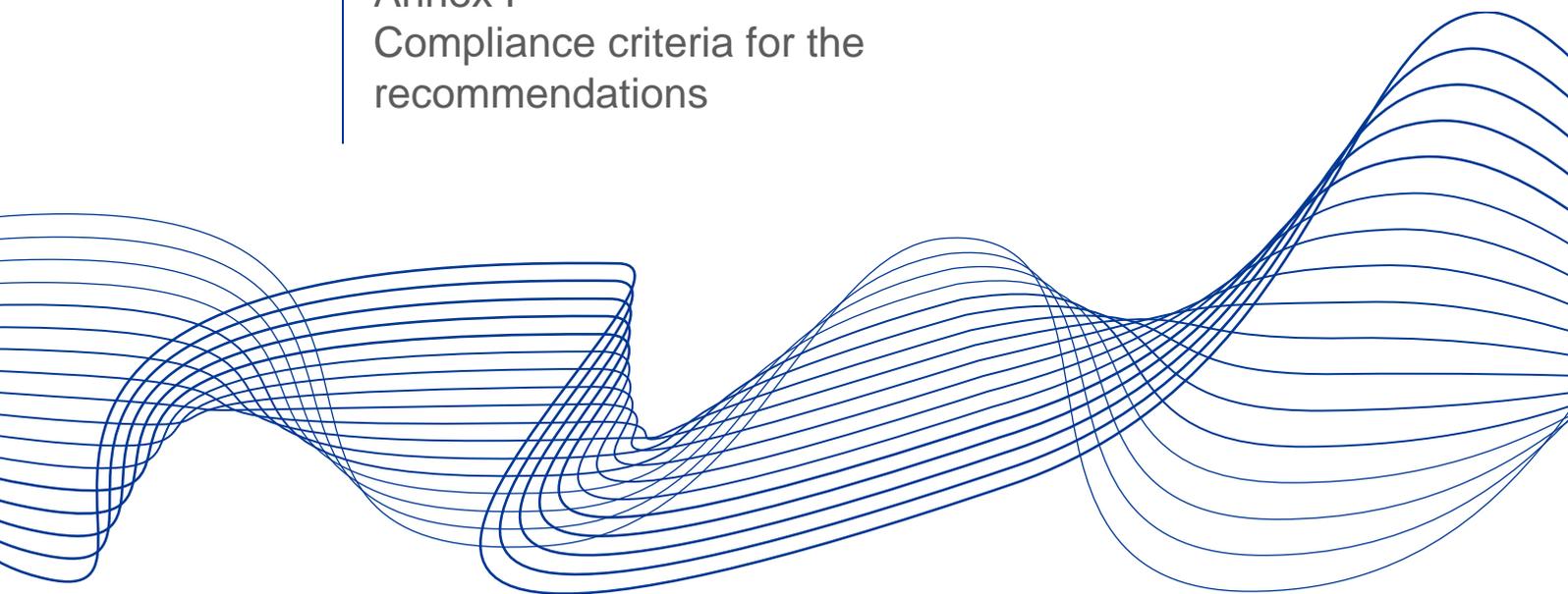


**Recommendation of the
European Systemic Risk
Board of 7 December 2017
on liquidity and leverage
risks in investment funds
(ESRB/2017/6)**

February 2018

Annex I
Compliance criteria for the
recommendations



ESRB
European Systemic Risk Board
European System of Financial Supervision

Recommendation A

For **Recommendation A**, the following compliance criteria are specified.

A(1) – Availability of additional liquidity management tools

Union legislation should allow for a wide range of additional liquidity management tools (a-LMTs) to be legally available at Union level while recognising that asset managers should bear the primary responsibility for activating and implementing a-LMTs and that some of the tools will not be suitable or necessary for all types of open-ended funds. The a-LMTs should support open-ended alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS), as well as their managers, to manage requests for redemption appropriately and effectively at all times and especially in stressed market conditions.

The Commission's proposed changes to the relevant Union legislation should include obligations for:

- (a) alternative investment fund managers (AIFMs) of open-ended AIFs and UCITS management companies to assess all available a-LMTs and specifically to assess which of them are suitable for the investment strategies of the funds they manage and should be included in their constitutional documents or other pre-contractual information in order to be exercised both in normal and in stressed market conditions and to provide investors with sufficient transparency in relation to such tools;
- (b) AIFMs of open-ended AIFs and UCITS management companies to include, as a minimum, the power to suspend redemptions, particularly in stressed market conditions, in the constitutional documents or other pre-contractual information of the funds they manage;
- (c) AIFMs of open-ended AIFs and UCITS management companies to ensure that the necessary operational capacity and contingency planning is available for the timely activation of any a-LMT which they may use;
- (d) AIFMs of open-ended AIFs and UCITS management companies to report to the national competent authorities (NCAs) on the implementation and use of a-LMTs in stressed market conditions;
- (e) the European Securities and Markets Authority (ESMA), after taking into account the opinion of the European Systemic Risk Board (ESRB) in relation to macroprudential issues, to develop guidance on:
 - (i) definitions and characteristics of a-LMTs;



- (ii) the criteria for the suitability assessment under point A(1)(a);
- (iii) the transparency requirements for the a-LMTs established under point A(1)(a);
- (iv) high-level principles on how the a-LMTs should be implemented in the fund's liquidity management process;
- (v) how to assess and deal with potential unintended consequences when using a-LMTs;
- (vi) the requirement to report to the NCAs under point A(1)(d); and
- (vii) the level of transparency in relation to investors when a-LMTs are activated and during their use.

The guidance should take into account the necessary contingency planning that should apply in advance, as required under point A(1)(c), to enable such a-LMTs to be activated promptly and effectively.

A(2) – Further provisions on the NCAs' suspension of redemptions with cross-border financial stability implications

The Commission's proposed changes to Union legislation should include:

- (a) clarification of the respective roles of the NCAs and cooperation between them with regard to suspending redemptions for cross-border financial stability purposes, where the AIF or UCITS is established in one Member State but has an AIFM or UCITS management company established in another Member State, i.e. cross-border implications;
- (b) an obligation for the NCAs, when exercising the powers to direct the suspension of redemptions for cross-border financial stability purposes, to notify other relevant NCAs, ESMA, and the ESRB, prior to exercising such powers.

A(3) – Further provisions on ESMA's role in relation to the NCAs suspending redemptions with cross-border financial stability implications

The Commission's proposed changes to the relevant Union legislation should include an obligation for ESMA to ensure that it fulfils a general facilitation, advisory and coordination role in relation to the NCAs' powers to suspend redemptions where there are cross-border financial stability implications.



Recommendation B

For **Recommendation B**, the following compliance criteria are specified.

The Commission's proposed changes to the relevant Union legislation should include:

- (a) granting powers to ESMA to prepare and to update a list of inherently less liquid assets, on the basis of ESMA's own analysis, after taking into account the ESRB's opinions in relation to macroprudential issues and those of the European Banking Authority and the European Insurance and Occupational Pensions Authority in relation to cross-sectoral consistency issues. In compiling this list, ESMA should consider, as a minimum, real estate, unlisted securities, loans and other alternative assets that appear to be inherently less liquid. The analysis should take into account, inter alia, the time it would take to liquidate those assets under stressed market conditions;
- (b) a requirement for AIFMs of open-ended AIFs whose objective is to invest significantly in assets included in the list of inherently less liquid assets under point B(a), to demonstrate to the NCAs their capacity to maintain their investment strategy under foreseeable market conditions. The assessment should include, inter alia, tailored redemption policies, the implementation of a-LMTs and/or internal limits of assets included in the list of inherently less liquid assets under point B(a). Such internal limits, if used, should then be disclosed to the NCAs at the inception of the relevant funds and reported thereafter whenever these limits change. Disclosure to investors should also be implemented based on guidance to be developed by ESMA
- (c) the discretion to impose transitional provisions for AIFMs of open-ended AIFs specifying the time allowed to comply with the legislation when assets are added to the list of inherently less liquid assets under point B(a), and when internal limits are breached, where useful, in order to avoid any unintended, harmful effects.

Recommendation C

For **Recommendation C**, the following compliance criteria are specified.

The guidance issued on liquidity stress testing by ESMA should include, but not be limited to:

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

Such guidance should be based on the stress testing requirements set out in Directive 2011/61/EC and how market participants carry out stress testing.



Recommendation D

For **Recommendation D**, the following compliance criteria are specified.

D(1) – Reporting obligations for UCITS and UCITS management companies

The Commission's proposed changes to the relevant Union legislation should include reporting obligations that cover both manager and fund-specific data while also reflecting the specificities of UCITS. The reported data should allow for sufficient monitoring of potential vulnerabilities that may contribute to systemic risk, and should cover, as a minimum:

- (a) the value of assets under management for all UCITS managed by a management company;
- (b) instruments traded and individual exposures;
- (c) investment strategy;
- (d) global exposure/leverage;
- (e) stress testing;
- (f) efficient portfolio management techniques;
- (g) counterparty risk/collateral;
- (h) liquidity risk;
- (i) credit risk; and
- (j) trading volumes.

The Commission should propose, where appropriate, a harmonisation of overall reporting requirements on investment funds and their managers, particularly between the recommended UCITS reporting and the measures already implemented for reporting under Directive 2011/61/EC. In this respect, the Commission should also take into account the reporting requirements under Regulation (EU) 2017/1131 of the European Parliament and of the Council¹. Such harmonisation should enable the use of existing reporting platforms, achieve synergies and avoid undue burdens on asset managers.

The Commission's changes to Union legislation should furthermore include a provision stating that if the NCA of the UCITS manager is different from the NCA of the UCITS itself, the UCITS manager must, upon request, also provide the reported information to the NCA of the UCITS.

¹ Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (OJ L 169, 30.6.2017, p. 8).



D(2) – Frequency and coverage of reporting obligations for UCITS and UCITS management companies

The Commission's proposed changes to Union legislation should include the following requirements:

- (a) the data mentioned in Recommendation D(1) is reported as a minimum on a quarterly basis to enable effective monitoring of financial stability risks while also addressing proportionality aspects in relation to the entities required to report;
- (b) the total assets under the management of the management company and the assets under management by individual UCITS funds should be taken into account when setting the scope for reporting, thus ensuring that a sufficient part of the industry will be covered by the reporting, in order to address risks to financial stability.

D(3) – Harmonised reporting and information sharing

The Commission's proposed changes to Union legislation should include an obligation for the information mentioned in Recommendation D(1) to be made available to the NCAs of other relevant Member States, ESMA and the ESRB in order to ensure the harmonisation of UCITS data reporting with data sharing practices under Directive 2011/61/EC. In this context, the Commission should also take into account reporting requirements under Regulation (EU) 2017/1131.

Recommendation E

For **Recommendation E**, the following compliance criteria are specified.

E(1) – Assessment of leverage-related systemic risk

The guidance issued by ESMA should include:

- (a) a common minimum set of indicators to be taken into account by the NCAs during their assessment;
- (b) instructions to calculate the indicators referred to in point E(1)(a) based on reporting data under Article 24 of Directive 2011/61/EC; and
- (c) qualitative and, where feasible, quantitative descriptions of the interpretation of the indicators in the context of the assessment framework.

The common set of indicators referred to in point E(1)(a) should:

1. facilitate assessment of the level, source and different usages of leverage;
2. facilitate assessment of the main channels through which systemic risk may materialise, i.e. fire sales, direct spillovers to financial institutions, and the interruption of credit intermediation; and
3. be operable and sufficient for NCAs to inform ESMA, in connection with its advice under Article 25(6) of Directive 2011/61/EC and the principles laid down in Article 112 of



Commission Delegated Regulation (EU) 231/2013², whether the conditions for imposing leverage limits or other restrictions on the management of AIFs have been met.

E(2) – Macroprudential leverage limits

The guidance issued by ESMA should include:

- (a) a description of the various types of leverage limits, including an evaluation of their effectiveness and efficiency in mitigating excessive leverage;
- (b) a set of principles to be taken into account by the NCAs when calibrating leverage limits. As a minimum such principles should include all of the following: (i) a statement that provides for leverage limits to be based on the leverage measures set out in Directive 2011/61/EC, (ii) criteria for applying leverage limits, and (iii) principles regarding the periodic review of leverage limits;
- (c) a set of principles to be taken into account by the NCAs when considering the imposition of leverage limits, as a minimum covering all of the following: (i) principles for a balanced approach between rules-based versus discretionary limit setting; (ii) principles relating to the interaction with other policy measures; (iii) principles for coordination among Union authorities.

E(3) – Notification procedure

The guidance issued by ESMA should enable the NCAs to notify ESMA, the ESRB and other relevant NCAs. In particular, this guidance should include, but not be limited to, an efficient working procedure and templates for notification letters and reporting requirements on the NCAs' assessment of the need to implement macroprudential measures pursuant to Article 25(3) of Directive 2011/61/EC.

E(4) – Benchmarking

ESMA should share, on an annual basis, with national macroprudential authorities and the ESRB:

- (a) the results, if any, of its benchmarking exercise;
- (b) the practices, if any, in relation to the use of leverage limits and the imposition of other restrictions on the management of AIFs using information received from the NCAs pursuant to Article 25(3) of Directive 2011/61/EC.

² Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (OJ L 83, 22.3.2013, p. 1).



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