



AQMetrics Platform

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Liquidity Stress Test Briefing

26th February 2020





If You Remember Nothing Else...

- Soon & Often
- Independent & Customised
- Backwards & Forwards
- Pluses & Minuses
- Like for Like





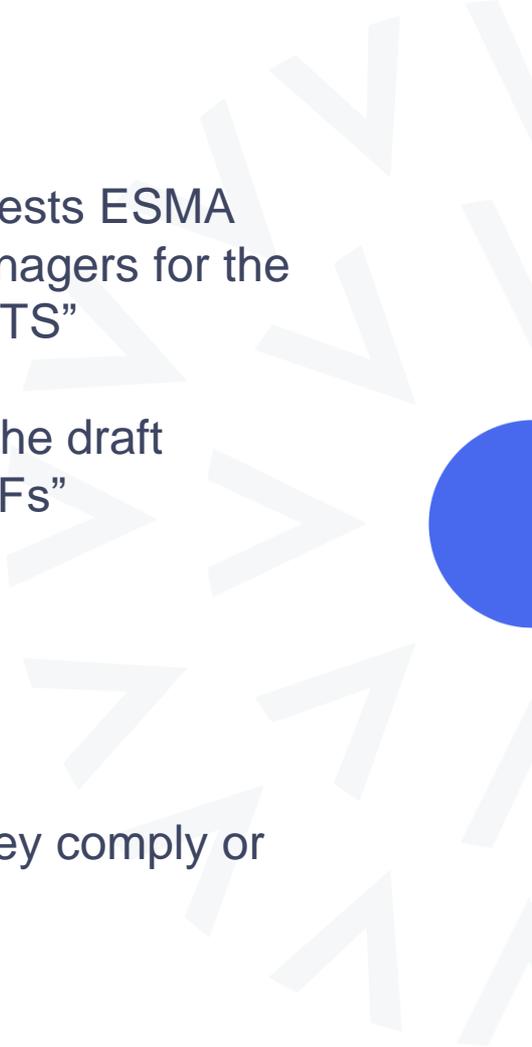
Agenda

- How did we get here?
- ESMA Consultation & Guidelines
- What should you do?
- What you need to remember





How did we get **here**?

- April 2018 European Systemic Risk Board (ESRB) requests ESMA "develop guidance on the practice to be followed by managers for the stress testing of liquidity risk for individual AIFs and UCITS"
 - February 2020 ESMA publish a Consultation Paper on the draft "Guidelines on Liquidity Stress Testing in UCITS and AIFs"
 - Consultation closed 1st April 2019
 - Final Report 2nd September 2019
 - Two month period during which NCAs notify ESMA if they comply or intend to comply
 - Guidelines apply from 30th September 2020
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Elsewhere in the world of liquidity...

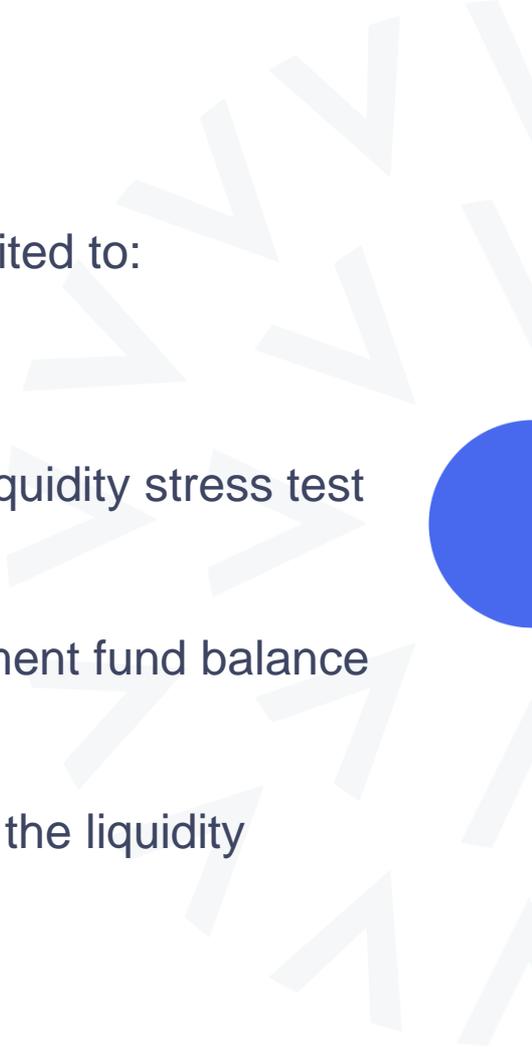
- 30th January 2020 ESMA launches Common Supervisory Action (CSA) with NCAs on UCITS Liquidity Risk Management
- 1st stage quantitative data from a large majority of the UCITS managers in member states
- 2nd stage focus on a sample of UCITS managers to carry out more in-depth supervisory analysis
- AMF has publicly stated that this will be quite intrusive





ESMA Consultation

ESRB requested that the Guidelines include, but not be limited to:

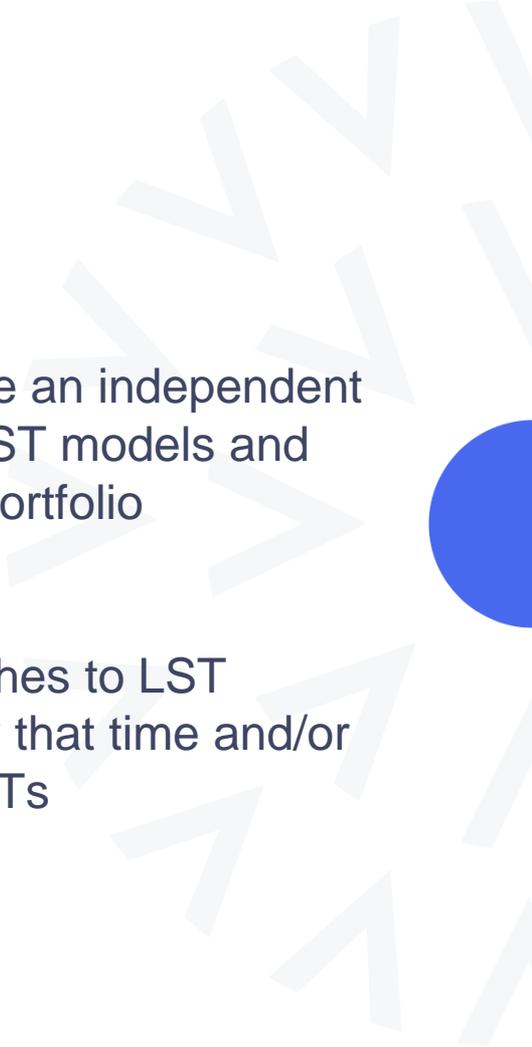
- the design of liquidity stress testing (LST) scenarios;
 - the liquidity stress test policy, including internal use of liquidity stress test results;
 - considerations for the asset and liability sides of investment fund balance sheets;
 - the timing and frequency for individual funds to conduct the liquidity stress tests.
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ESMA Consultation & Guidelines: Soon & Often

- A significant majority of respondents suggested an implementation period ranging from 18 - 24 months. ESMA believes that requiring the application of the Guidelines from 30th September 2020 grants a sufficient implementation period, bearing in mind the importance of ensuring convergence on how LSTs are performed by the asset management industry.
- Respondents said LST should be carried out annually as in existing legislation. ESMA recommends quarterly testing but recognises this may have to be more or less frequent.



ESMA Consultation & Guidelines: Independent & Customised

- Concerns were raised regarding the requirement to have an independent validation. ESMA requires that the initial validation of LST models and assumptions should be performed independently from portfolio management.
 - Respondents felt that manager or fund specific approaches to LST scenarios would be appropriate. ESMA restated its view that time and/or cost related liquidation methods should be utilised in LSTs
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ESMA Consultation & Guidelines: Independent & Customised

In building LST models managers should determine:

- the risk factors that may impact the fund's liquidity;
 - the types of scenarios to use and their severity;
 - different outputs and indicators to be monitored based on the results of the LST;
 - the reporting of LST results, outputs and indicators to management; and
 - how the results of the LST are used by risk management, portfolio management and by senior management
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ESMA Consultation & Guidelines: Backwards & Forwards

- Respondents opposed the inclusion of reverse stress testing (RST) on a mandatory basis. Whilst not making it mandatory ESMA considers RST beneficial to assess the potential sources of liquidity risks.
 - LST should employ hypothetical and historical scenarios and, where appropriate, RST. LST should not overly rely on historical data.
 - Historical scenarios for LST could include the global financial crisis 2008-2010 or the European debt crisis 2010-2012. Hypothetical scenarios could include rising interest rates, credit spread widening, or political events.
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ESMA Consultation & Guidelines: Pluses & Minuses

- Majority of respondents did not agree with RST or gross redemptions for Liabilities. ESMA considers gross redemptions and RST as important tools to assess sources of liquidity risks to which the fund is exposed.
 - Majority of respondents agree with combining the two sides of the balance sheet but ESMA should not specify a methodology, such as the Redemption Coverage Ratio (RCR). ESMA amended to “after separately testing the asset and liabilities of the fund balance sheet, managers should combine appropriately the results of the LST to determine an overall effect on fund liquidity”
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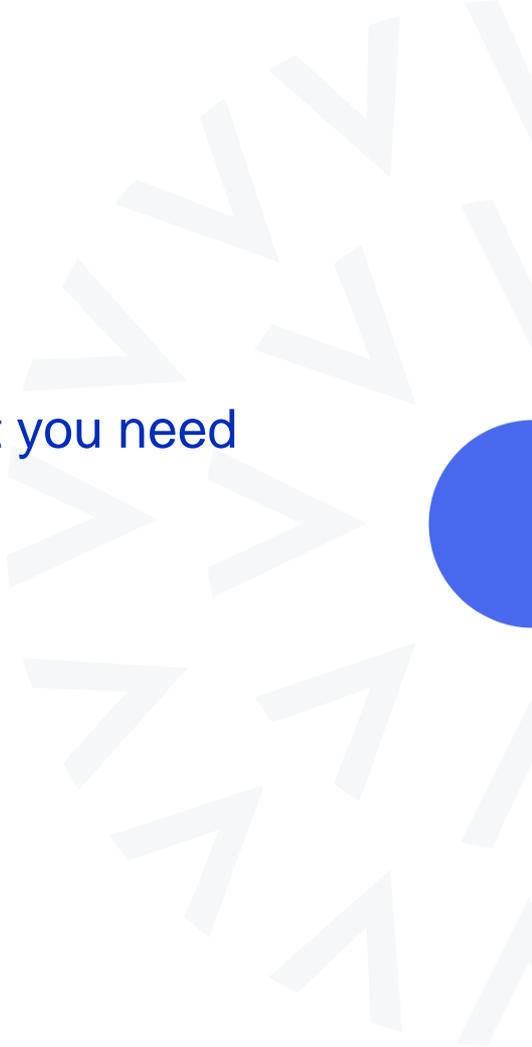
ESMA Consultation & Guidelines:

Like for Like

- The majority of respondents agreed that it should be up to the asset manager to assess whether aggregate LST would be appropriate. ESMA said the manager should aggregate LST across funds utilising the same liquidity stress test on more than one fund with similar strategies or exposures.
- Particularly pertinent when funds operated by the manager own a material level of assets in a given market. Aggregation of LST may allow the manager to better ascertain the liquidation cost or time to liquidity of each security, by considering the trade size, stressed market conditions and counterparty risk



What should you do?

- Talk to your Head of Risk and do it soon!
 - Think about the model factors and frequency that you need
 - Talk to other managers, vendors, consultants
 - Don't forget the data sourcing and fees!
 - Build and test before September
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A decorative graphic consisting of a grid of small, light blue chevron arrows pointing to the right, arranged in a pattern that tapers to the right.

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A large, faint, stylized sunburst graphic in a darker shade of blue, positioned on the right side of the slide. It features a central circle and multiple rays extending outwards.



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Scale. All Regulations

