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The UK's Regulator Writes to Asset Managers about Liquidity Management

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Alongside work being done internationally on liquidity management by the Financial Stability Board and IOSCO, the UK's Financial Conduct Authority ("FCA") has written to the Chief Executives of authorised asset management firms with the key findings of a multi-firm review of liquidity management by Authorised Fund Managers ("AFMs").

The FCA conducted the multi-firm review of 14 firms of different sizes in order to ensure that fund redemptions work in line with fund terms and how they are marketed so that investors are able to redeem them at an accurate price, ensuring fairness for both exiting and remaining investors. The specific requirements of liquidity management rules vary depending on the nature of the fund, but all firms are required to manage liquidity in a way that is appropriate for their offering. The FCA's review found a "wide disparity among firms in the quality of compliance with regulatory standards and depth of liquidity risk management expertise" with most firms falling short in some aspects. Chief among the findings were the following:

1. Insufficient weight attached to liquidity risk management in governance systems, with challenge and escalation being particular issues;
2. Variability in approaches to liquidity stress testing practices, with some methodologies being flawed and misleading – for example, through an exclusive focus on cash without consideration of selling a vertical slice;
3. A lack of governance and organisation arrangements to meet cumulative or market-side redemptions (as opposed to large one-off redemptions that were not a symptom of wider market issues);
4. A variation in the application of anti-dilution tools that could lead to difficulties in treating all customers fairly; and
5. A lack of internal challenge to valuations.

There are no current proposals to change the rules for asset managers, though this may change as international standards evolve. However, as a result of this review, the FCA does now expect firms to review and, if necessary, revise governance arrangements to oversee liquidity risk management improvements, working with service providers as necessary. The importance of diligent stress testing is also emphasised.