

## ASSET MANAGEMENT AND INVESTMENT FUNDS

# Central Bank Expects Full Compliance With Liquidity Stress Testing Rules From September 2020

July 2020

On 13 July, the Central Bank published [a notice of intention](#) regarding ESMA's Guidelines on liquidity stress testing in UCITS and AIFs (the "Guidelines").

The Central Bank intends to consult on the incorporation of a requirement in the Central Bank UCITS Regulations 2019 and the AIF Rulebook that UCITS Management Companies, AIFMs and depositaries adhere to the Guidelines. However, the Central Bank has stated that in the interim it expects full compliance with the Guidelines from **30 September 2020**.

The ESMA [Guidelines](#) apply to fund management companies and provide guidance on how they should manage and monitor the liquidity of the individual funds that they manage and, in particular, how liquidity stress testing ("LST") should be carried out.

Under the Guidelines, fund management companies must:

- integrate LST into a fund's risk management framework and LST should be subject to appropriate governance and oversight;
- have a strong understanding of liquidity risks and a fund's overall liquidity profile;
- develop LST models, ensuring that the LST provides information enabling follow-up action;
- adapt the LST to each fund;
- include an LST policy in the UCITS and/or AIF risk management process and the policy should be kept under review and the LST adapted as appropriate;
- carry out LST at least annually,

although ESMA recommends that it is conducted quarterly, unless a higher or lower frequency is justified by the characteristics of the fund;

- notify national regulators of material risks and the actions taken to address them; and
- during product development be able to demonstrate to their national regulator that the fund will remain sufficiently liquid during normal and stressed circumstances.

The Guidelines also require the depositary of a fund management company to verify that a fund has documented procedures for its LST programme, which may include reviewing the UCITS and/or AIF risk management process to confirm that the fund management company carries out LST on the fund. For more information on the requirements under the Guidelines, please see our more detailed article [here](#).

The Central Bank has also published updates to both its UCITS and AIFMD Q&As to clarify its expectations regarding compliance with the Guidelines.

#### AIFMD Q&A

The updated Q&A ([34th edition](#)) includes two new questions and answers which clarify that:

- LST should generally be performed at least quarterly. The determination of a higher or lower frequency should be

based on the fund's characteristics and the reasons for such a determination should be recorded in the liquidity stress testing policy; and

- LST should be conducted at the design phase of an AIF's lifecycle to understand adequately the potential risks that may impact the AIF in various market conditions throughout its lifecycle.

#### UCITS Q&A

The updated Q&A ([29th edition](#)) includes three new questions and answers which clarify that:

- noting the requirement in the Guidelines for the LST policy to be documented in the UCITS Risk Management Process; it may be appropriate for the LST policy to be documented within the risk management policy of the UCITS management company, given the UCITS management company's obligation to conduct, where appropriate, periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact each UCITS it manages. Notwithstanding this, as set out in the Guidelines, the liquidity stress testing should be adapted appropriately to each fund under management;
- LST should generally be performed at least quarterly. The determination of

a higher or lower frequency should be based on the fund's characteristics and the reasons for such a determination should be recorded in the liquidity stress testing policy; and

- LST should be conducted at the design phase of a UCITS' lifecycle to understand adequately the potential risks that may impact the UCITS in various market conditions throughout its lifecycle.

It is worth noting that although the Guidelines do provide that the frequency of LST should be at least annual, the Central Bank's expectations align with ESMA's recommendation that the LST should be performed at least quarterly, unless a case for less frequent testing can be made and documented based on the fund's characteristics.

In light of the Central Bank's communication, Irish fund management

companies should now be reviewing their overall liquidity management processes and preparing to comply with the Guidelines in advance of their application on **30 September 2020**.

If you would like to discuss the foregoing, or require any assistance assessing your requirements, or updating your liquidity management framework, please feel free to contact a member of our team.

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