

AIFMD - Liquidity Management

Directive 2011/ 61/EU on Alternative Investment Fund Managers (AIFMD) must be implemented by EU Member States by 22 July 2013. AIFMD is supplemented by a delegated regulation (AIFMD Regulation). AIFMD regulates the activities of Alternative Investment Fund Managers (AIFMs) and their Alternative Investment Funds (AIFs). AIFMD deals with liquidity management in Article 16 and the AIFMD Regulation supplements this in Articles 46-49. In respect of liquidity management, the AIFMD requires the AIFM to:

- employ an appropriate liquidity management system for each AIF it manages;
- adopt procedures that enable it to monitor the AIF's liquidity risk;
- ensure that the liquidity profile of the AIF's investments complies with its underlying obligations.
- conduct regular stress tests under normal and exceptional liquidity conditions, to assess the liquidity risk of the AIFs and monitor the liquidity risk of the AIFs accordingly;
- ensure that, for each AIF that it manages, the investment strategy, the liquidity profile and the redemption policy are consistent;
- be able to demonstrate that an appropriate liquidity management system and effective procedures are in place taking into account the investment strategy, the liquidity profile and the redemption policy of each AIF.

Monitoring and managing liquidity risk

The liquidity management system and procedures must be documented, reviewed at least annually and updated for any changes or new arrangements. The systems and procedures must ensure that:

- the AIFM maintains a level of liquidity in the AIF appropriate to its underlying obligations, based on an assessment of the relative liquidity of the AIF's assets in the market, taking account of the time required for liquidation and the price or value at which those assets can be liquidated, and their sensitivity to other market risks or factors;
- the AIFM monitors the liquidity profile of the AIF's portfolio of assets, having regard to the marginal contribution of individual assets which may have a material impact on liquidity, and the material liabilities and commitments, contingent or otherwise, which the AIF may have in relation to its underlying obligations. For these purposes the AIFM must take into account the profile of the investor base of the AIF, including the type of investors, the relative size of investments and the redemption terms to which these investments are subject;
- the AIFM, where the AIF invests in other collective investment undertakings (CIS), monitors the approach adopted by the managers of those other CIS to the management of liquidity, including through conducting periodic reviews to monitor changes to the redemption provisions of the underlying CIS in which the AIF invests. This obligation may not apply where the other CIS in which the AIF invests are actively traded on a regulated market;
- the AIFM implements and maintains appropriate liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of positions and of intended investments which have a material impact on the liquidity profile of the portfolio of the AIF's assets to enable their effects on the overall liquidity profile to be appropriately measured. The procedures employed must ensure that the AIFM has the appropriate knowledge and understanding of the liquidity of the assets in which the AIF has invested or intends to invest including, where applicable, the trading volume and sensitivity of prices and/or spreads of individual assets in normal and exceptional liquidity conditions;
- the AIFM considers and puts into effect the tools and arrangements (these may include gates, partial redemptions, temporary borrowings, notice periods and pools of liquid assets), including special arrangements (such as side pockets), necessary to manage the liquidity risk of each AIF under its management. The AIFM must identify the types of circumstances where these tools and arrangements may be used in both normal and exceptional circumstances, taking into account the fair treatment of all AIF investors in relation to each AIF under management. The AIFM may use such tools and arrangements only in these circumstances and if appropriate disclosures have been made. This is not relevant to leveraged closed-ended AIFs;
- include appropriate escalation measures to address anticipated or actual liquidity shortages or other distressed situations of the AIF.

Liquidity limits

AIFMs must (where appropriate, considering the nature, scale and complexity of each AIF they manage) implement and maintain adequate limits for the liquidity or illiquidity of the AIF consistent with its underlying obligations and redemption policy and in accordance with the requirements relating to quantitative and qualitative risk limits. AIFMs must monitor compliance with those limits and where limits are exceeded or likely to be exceeded, they must determine the necessary course of action, considering the adequacy of the liquidity management policies and procedures, the appropriateness of the liquidity profile of the AIF's assets and the effect of atypical levels of redemption requests.

Stress tests

AIFMs must regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of each AIF under their management. AIFMs shall act in the best interest of investors in relation to the outcome of any stress tests. The stress tests must:

- be conducted on the basis of reliable and up-to-date information in quantitative terms or, where this is not appropriate, in qualitative terms;
- where appropriate, simulate a shortage of liquidity of the assets in the AIF and atypical redemption requests;
- cover market risks and any resulting impact, including on margin calls, collateral requirements or credit lines;
- account for valuation sensitivities under stressed conditions;
- be conducted at a frequency which is appropriate to the nature of the AIF, taking in to account the investment strategy, liquidity profile, type of investor and redemption policy of the AIF, and at least once a year.

Alignment of investment strategy, liquidity profile and redemption policy

The investment strategy, liquidity profile and redemption policy of each AIF managed by an AIFM shall be considered to be aligned when investors have the ability to redeem their investments in a manner consistent with the fair treatment of all AIF investors and in accordance with the AIF's redemption policy and its obligations. In assessing the alignment of the investment strategy, liquidity profile and redemption policy the AIFM shall also have regard to the impact that redemptions may have on the underlying prices or spreads of the individual assets of the AIF.

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