

## Central Bank of Ireland Dear Chair Letter on Liquidity Risk Management

On 18 May 2021, the Central Bank of Ireland (“**Central Bank**”) issued a Dear Chair **letter** (the “**Dear Chair Letter**”) to all Irish authorised UCITS management companies in relation to its review of UCITS liquidity risk management (“**LRM**”). The review was carried out as a part of the European Securities and Markets Authority’s (“**ESMA**”) common supervisory action (“**CSA**”) on LRM and led to the Central Bank engaging directly with a number of UCITS management companies.

The review was conducted in two stages. In the first stage, 273 UCITS management companies responded to a qualitative questionnaire on their LRM framework and submitted a quantitative portfolio level breakdown of each UCITS under management (3,051 UCITS in total). In the second stage, 20% of UCITS management companies (55 UCITS management companies) were subjected to in-depth investigation, which included submitting a quantitative security level breakdown of each UCITS under management and further supervisory engagement consisting of desk-based reviews of procedures and processes and virtual inspections. The engagement has resulted in 35 risk mitigation programmes being issued to date.

The Dear Chair Letter is addressed to all UCITS management companies, and requires them to carry out documented reviews of their activities, practices, documentation, systems and controls in accordance with:

- the findings set out in the Dear Chair Letter;
- the **findings** of the CSA published by ESMA on 24 March 2021;
- the European Systemic Risk Board (“**ESRB**”) **recommendation** on liquidity risks in investment funds; and
- the **letter** the Central Bank issued to a number of UCITS management companies in the context of the review requested by the ESRB of investment funds that have significant exposures to corporate debt and real estate assets.

In particular, reviews should address the following recommendations from the Dear Chair Letter:

- LRM frameworks should be cohesive, clearly defined, adaptable and / or independent. UCITS management companies should consider and identify the liquidity risks associated with their investor base. Decisions in relation to LRM frameworks should be driven primarily by the liquidity profiles of UCITS and their investor base;
- pre-investment forecasting frameworks should be formally documented and pre-investment forecasting should be performed;
- liquidity escalation policies should be formalised. The Dear Chair Letter highlighted the responsibility of designated persons (“**DPs**”) to propose and agree appropriate thresholds and key performance indicators that would trigger escalation with UCITS management companies;
- UCITS management companies should not presume the ongoing liquidity of UCITS. The Dear Chair Letter considered that UCITS management companies were basing this presumption on the historical performance of UCITS. The Dear Chair Letter noted that the UCITS regulations and ESMA guidance require UCITS management companies to carry out regular stress testing and scenario analyses;
- there must be proper oversight of delegates. The Dear Chair Letter stated that UCITS management companies were not engaging and challenging their delegate investment managers. It also stated that there was a lack of evidence of liquidity reporting from delegates to UCITS management companies;
- the DP for fund risk management should constructively challenge, analyse and comment on reporting received from delegates;
- there should be liquidity reporting to the board of the UCITS management company; and
- in relation to internal control frameworks, second and, where appropriate and proportionate, third level controls (eg, compliance functions, internal audit functions) should have sufficient input into and oversight of LRM frameworks.

Reviews should be completed and the action plans discussed and approved by the board of each UCITS management companies by the **end of Q4 2021**.

*Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.*

*Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at [www.matheson.com](http://www.matheson.com).*

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