FSB Consultation on Liquidity Mismatch in Open-Ended Funds

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Dublin, 12 July 2023

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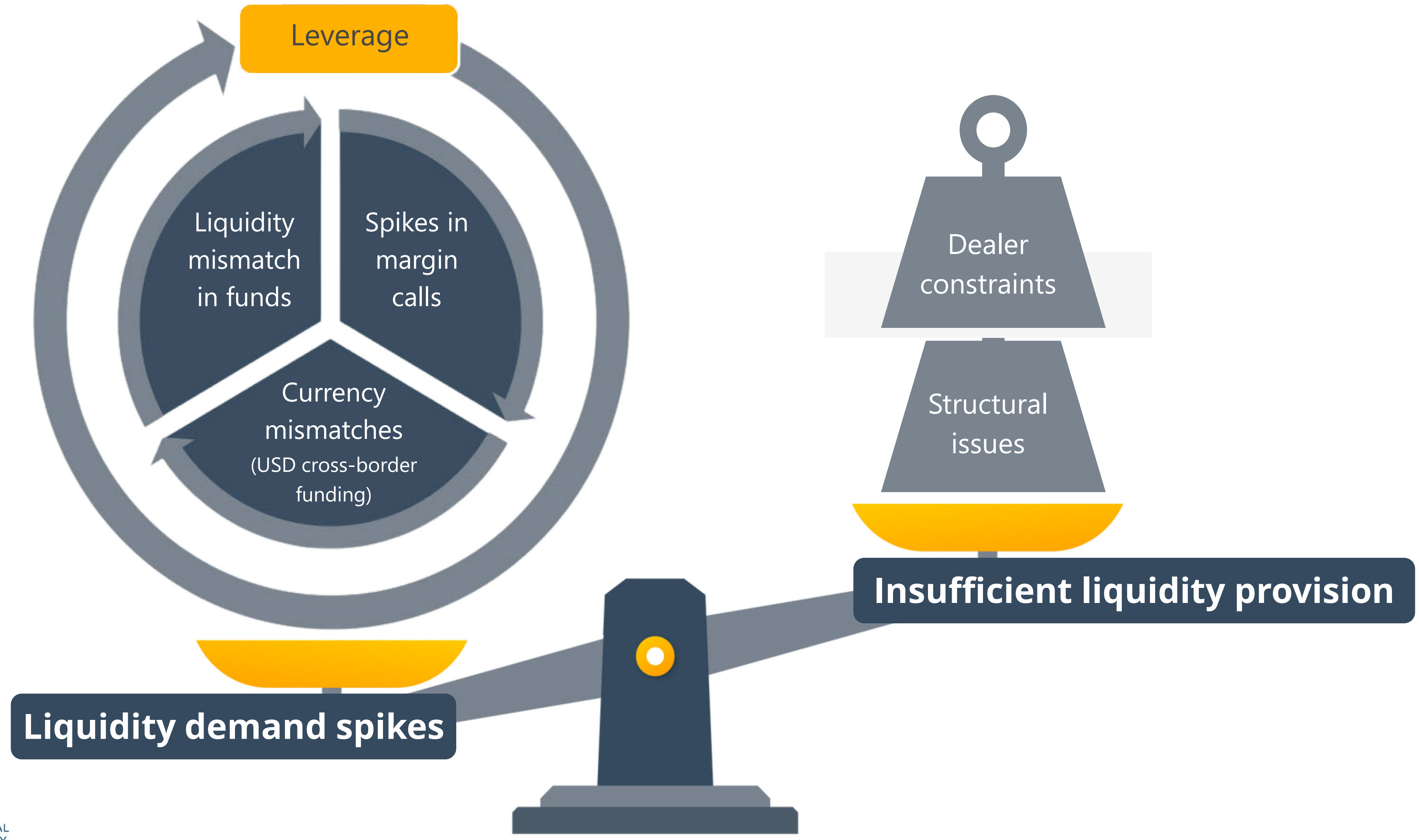
A recap of the FSB's NBFI work programme

- Objective: To enhance the resilience of the Non Bank Financial Intermediation (NBFI) sector while preserving its benefits
  - Builds on the lessons from the March 2020 market turmoil
  - Enhancing NBFI resilience aims to ensure a more stable provision of financing to the economy and reduce the need for extraordinary central bank interventions
  - Recent stress events underscore importance of adopting NBFI reforms
- Resilience refers to the capacity of the NBFI sector, and the financial system at large, to absorb shocks of different types
- The interaction of a shock with existing NBFI vulnerabilities may lead to sudden and large shifts in the demand for, and supply of, liquidity
  - Large liquidity imbalances can result in fire sales, amplifying the shock across the system

The focus is on key amplifiers of stress in NBFI



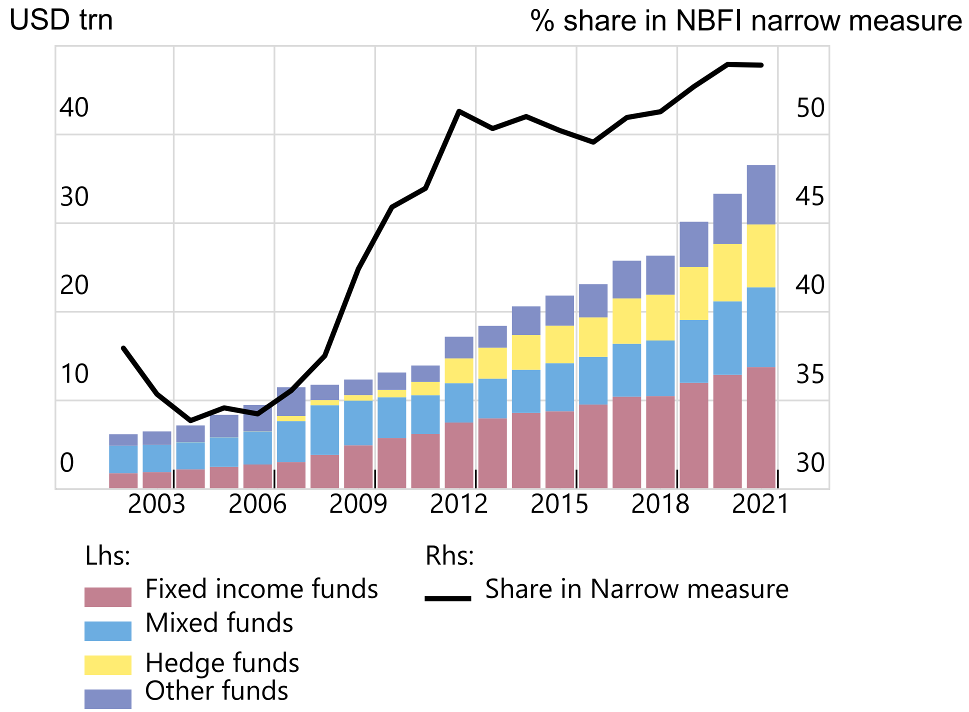
Areas of NBFI work

- Resilience of money market funds and short-term funding markets
- Liquidity risk and its management in open-ended funds
- Margining practices
- Liquidity, structure and resilience of core bond markets
- Non-bank leverage

The growing importance of Open-Ended Funds (OEFs)

- NBFI represents around half of global financial system assets
- OEFs are the largest part of the NBFI universe
- On average, OEFs have increased their holdings of less liquid and illiquid assets in recent years
- These funds generally continue to offer investors daily dealing

OEFs have grown significantly in recent years

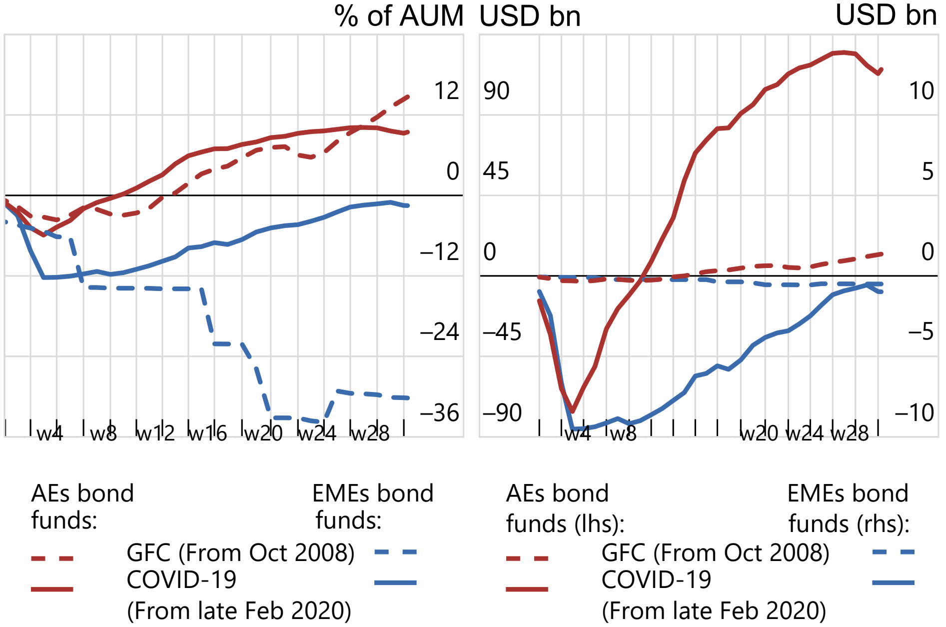


Sources: FSB *Global Monitoring Report on Non-Bank Financial Intermediation 2022*.
Notes: The chart shows collective investment vehicles with features that make them susceptible to runs. Open-ended equity funds are only included in this chart if they hold more than 20% of their assets under management in credit assets. The narrow measure is composed of NBFI entities that authorities have assessed as being involved in credit intermediation activities that may pose bank-like risks (i.e. maturity/liquidity transformation, leverage or imperfect credit risk transfer) and/or regulatory arbitrage.

Vulnerabilities related to liquidity mismatch in OEFs

- Liquidity mismatch is the difference between redemption terms that an OEF offers to investors and the time it may take to liquidate fund holdings in an orderly manner
- This mismatch may amplify system-wide liquidity strains in times of stress by driving ‘excess’ investor redemptions and ‘excess’ OEF asset sales
- Addressing vulnerabilities from liquidity mismatch in OEFs was the focus of the FSB’s 2017 Recommendations
- FSB 2022 assessment report suggests that there has been no measurable reduction in the degree of structural liquidity mismatch across the OEF sector since 2017

Shifts in investor portfolios led to large redemptions from OEFs in March 2020



Sources: *Holistic Review of the March Market Turmoil*, FSB.

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