FINANCIAL STABILITY BOARD

Press release

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FSB proposes strengthening the liquidity management framework for open-ended funds

The Financial Stability Board (FSB) today published its *Assessment of the effectiveness of the FSB's 2017 recommendations on liquidity mismatch in open-ended funds* (OEFs). The assessment, which forms part of the FSB's work programme to enhance the resilience of non-bank financial intermediation (NBFI), includes proposals for further policy work in this area.

The report finds that authorities have made meaningful progress in implementing the 2017 FSB Recommendations to address vulnerabilities in OEFs stemming from liquidity mismatch. Nevertheless, lessons learnt since their publication, including during the March 2020 market turmoil, have produced new insights into liquidity management challenges in segments of the OEF sector. While the FSB Recommendations remain broadly appropriate, enhancing clarity and specificity on the policy outcomes the FSB Recommendations seek to achieve would make them more effective from a financial stability perspective.

Overall, the FSB's analysis of available data suggests that there has been no measurable reduction in the degree of structural liquidity mismatch since the FSB Recommendations were issued. As the OEF sector has grown in absolute terms, the potential impact of vulnerabilities that can arise from OEFs' structural liquidity mismatch has also grown.

The use of anti-dilution liquidity management tools (LMTs) increased during the height of the COVID-19 shock, but there appears to be material variation in swing factors across corporate bond funds using swing pricing. There remains room for greater uptake of LMTs, in particular anti-dilution tools that are intended to pass on the cost of liquidity to redeeming shareholders in both normal and stressed market conditions. Cost, competitive or reputational concerns, as well as operational hurdles, may have prevented OEF managers from including or using LMTs.

The challenges in obtaining and analysing data during the assessment suggest that measuring and monitoring liquidity mismatch as well as evaluating the availability, use and effectiveness of LMTs for assessing vulnerabilities in OEFs continue to be challenging for authorities.

The FSB and the International Organization of Securities Commissions (IOSCO) will carry out follow-up policy work based on the assessment's findings. This will involve revisions to the FSB and IOSCO Recommendations to address structural liquidity mismatch and promote greater inclusion and use of LMTs as well as to clarify the appropriate roles of fund managers and authorities in implementing these Recommendations; development of detailed guidance on the design and use of LMTs; work to enhance the availability of OEF-related data for financial stability monitoring; and steps to promote the use of stress testing.

Notes to editors

In 2017, the FSB published *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*, including liquidity mismatch in OEFs. The FSB Recommendations aimed to strengthen regulatory reporting and public disclosure to facilitate assessment of liquidity risk in OEFs; promote liquidity management both at the fund design phase and on an ongoing basis; widen the availability of liquidity management tools and their use in stressed conditions; and promote fund-level and system-wide stress testing. IOSCO operationalised most of the FSB Recommendations related to liquidity mismatch by issuing, in 2018, Recommendations for Liquidity Risk Management (LRM) for Collective Investment Schemes, supplemented with a set of related good practices as a reference guide.

The FSB agreed that once the implementation of the FSB Recommendations had progressed, it would assess whether they had been effective and report its findings to the G20. The FSB's assessment took place in parallel with IOSCO's review of the implementation of its LRM Recommendations, and covered both the implementation and effectiveness of relevant FSB Recommendations.

The focus of the policy proposals in this report is to enhance the resilience of NBFI by addressing the vulnerabilities that drive excessive spikes in the demand for liquidity during stress (e.g. by reducing liquidity mismatch) or by mitigating their financial stability impact (e.g. by ensuring that redeeming investors pay the cost of liquidity). Further details on the FSB's work programme to enhance resilience in NBFI can be found in its latest progress report.

The FSB coordinates at the international level the work of national financial authorities and international standard-setting bodies and develops and promotes the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with approximately 70 other jurisdictions through its six Regional Consultative Groups.

The FSB is chaired by Klaas Knot, President of De Nederlandsche Bank. The FSB Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.fsb.org.