



**Financial Services
Commission**

Information page

Alternative Investment Fund Managers Directive Operating conditions – Liquidity management

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Any advice or interpretation covered in this information page represents the views of the FSC as to its expectations of how the requirements of the AIFMD are to be complied with and/or how it fails to be applied. This however is not intended as a definitive interpretation of the AIFMD which is ultimately a matter for the courts to determine. The FSC does not provide, or purport to offer, legal advice.

1. Introduction

- 1.1 In this information page, reference is made to the Alternative Investment Fund Managers Directive 2011/61/EU (“AIFMD”) and to the supplementing Level 2 Delegated Regulation (“Level 2”).
- 1.2 The AIFMD requires Alternative Investment Fund Managers (“AIFMs”) to operate in accordance with conditions set out in the AIFMD and Level 2. The purpose of this information page is to provide AIFMs with clear information, based on the information on the AIFMD and Level 2, on what requirements and conditions they must comply with in relation to liquidity management.

2. Liquidity management

Article 16 of the AIFMD

- 2.1 AIFMs must, for each AIF that they manage which is not an unleveraged closed-ended AIF, employ an appropriate liquidity management system and adopt procedures which enable them to monitor the liquidity risk of the AIF and to ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations.
- 2.2 AIFMs must regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of the AIFs and monitor the liquidity risk of the AIFs accordingly.
- 2.3 AIFMs must ensure that, for each AIF that they manage, the investment strategy, the liquidity profile and the redemption policy are consistent.
- 2.4 The rest of this information page specifies that the liquidity management systems and procedures should allow AIFMs to apply tools and arrangements necessary to cope with illiquid assets in order to respond to redemption requests. Such arrangements may include ‘special arrangements’ such as ‘side-pockets’.
- 2.5 Furthermore, AIFMs should, where appropriate considering the nature, scale and complexity of each AIF they manage, set up suitable limits for liquidity/illiquidity of the AIF consistent with its redemption policy.

3. Liquidity management system and procedures

Article 46 of Level 2

- 3.1 AIFMs must be able to demonstrate to the FSC that an appropriate liquidity management system and effective procedures referred to in section 2.1 above are in place taking into account the investment strategy, the liquidity profile and the redemption policy of each AIF.



4. Monitoring and managing liquidity risk

Article 47 of Level 2

4.1 The liquidity management system and procedures referred to in section 3.1 above shall at least, ensure that:

- (a) 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;
- (b) 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 shall 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;
- (c) the AIFM, where the AIF invests in other collective investment undertakings, monitors the approach adopted by the managers of those other collective investment undertakings to the management of liquidity, including through conducting periodic reviews to monitor changes to the redemption provisions of the underlying collective investment undertakings in which the AIF invests. Subject to section 2.1 above, this obligation shall not apply where the other collective investment undertakings in which the AIF invests are actively traded on a regulated market within the meaning of point (14) of Article 4(1) of Directive 2004/39/EC (MiFID) or an equivalent third country market;
- (d) 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 shall 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, as the case may be, or spreads of individual assets in normal and exceptional liquidity conditions;
- (e) the AIFM considers and puts into effect the tools and arrangements, including special arrangements, necessary to manage the liquidity risk of each AIF under its management. The AIFM shall 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 in accordance with Article 108 of Level 2 (please refer to the FSC information page on "AIFMD – Transparency requirements" for further information).

- 4.2 AIFMs shall document their liquidity management policies and procedures, as referred to in section 4.1, review them on at least an annual basis and update them for any changes or new arrangements.
- 4.3 AIFMs shall include appropriate escalation measures in their liquidity management system and procedures, as referred to in section 4.1, to address anticipated or actual liquidity shortages or other distressed situations of the AIF.
- 4.4 Where the AIFM manages an AIF which is a leveraged closed-ended AIF, point (e) of section 4.1 shall not apply.

5. Liquidity management limits and stress tests

Article 48 of Level 2

- 5.1 AIFMs shall, 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 laid down in Article 44 of Level 2 (please refer to the FSC information page on “AIFMD – Operating conditions – Risk management” for further information) relating to quantitative and qualitative risk limits.

AIFMs shall monitor compliance with those limits and where limits are exceeded or likely to be exceeded, they shall determine the required (or necessary) course of action. In determining appropriate action, AIFMs shall consider 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.

- 5.2 AIFMs shall regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of each AIF under their management. The stress tests shall:
 - (a) be conducted on the basis of reliable and up-to-date information in quantitative terms or, where this is not appropriate, in qualitative terms;
 - (b) where appropriate, simulate a shortage of liquidity of the assets in the AIF and atypical redemption requests;
 - (c) cover market risks and any resulting impact, including on margin calls, collateral requirements or credit lines;
 - (d) account for valuation sensitivities under stressed conditions;
 - (e) 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.
- 5.3 AIFMs shall act in the best interest of investors in relation to the outcome of any stress tests.



6. Alignment of investment strategy, liquidity profile and redemption policy

Article 49 of Level 2

- 6.1 For the purposes of section 2.3 above, 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.
- 6.2 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.

7. Application of implementing measures

Any measures adopted by the European Union Commission under Article 16(3) of the AIFMD will also be applicable.