SEPTEMBER 2023

Consultation: Proposed liquidity risk management guidance

About this consultation

This proposed guidance outlines the essential features for effective liquidity risk management that the Financial Markets Authority – Te Mana Tātai Hokohoko (**FMA**) expects all managed funds to have.

Managers of managed investment schemes are expected to exercise care, diligence, and skill to develop, implement and review the policies, processes and tools required to ensure liquidity risk is effectively managed.

This guidance updates and replaces the *Liquidity risk management good practice guide* (April 2020) to reflect international policy recommendations by the International Organization of Securities Commissions (**IOSCO**) and the Financial Stability Board[1], and to state the areas where MIS managers and Supervisors need to do more.

Next steps

We welcome feedback on the proposed updated guidance. Please use the feedback form for any comments. **Submissions close on Friday 10 November**. We will finalise the guidance after considering submissions.

This consultation is for MIS managers, Supervisors, their advisers, and industry and consumer groups.	We are seeking feedback on the scope and content of the proposed updated guidance.

[1] The guidance will be updated to reflect the final recommendations of these international organisations, noting the current reports are consultation versions.

Contents

Proposed guidance

About this guidance

This guidance outlines the essential features for effective liquidity risk management (LRM) and indicates what the FMA considers to be 'good practice'. It is designed to assist managed investment scheme managers (**MIS managers**) and Supervisors at all stages of fund management, from fund design to day-to-day liquidity management and contingency planning, and particularly at times of heightened market uncertainty and volatility.

The cornerstone of this guidance is our overarching expectation that investors are appropriately protected and treated equitably. The guidance is not intended to prescribe how MIS managers and Supervisors demonstrate they are meeting their legal obligations for LRM. Rather, it sets out the features that we expect MIS managers to consider when designing and operating LRM for their MIS.

MIS managers are responsible for determining what LRM practices are appropriate for the schemes they manage, and in doing so must act in the best interests of scheme participants and ensure they are treated equitably. Supervisors are responsible for overseeing MIS managers' LRM practices.

Scope

MIS regulated by the Financial Markets Conduct Act 2013 (**FMC Act**) comprise a wide range of scheme structures with significant variance in asset mixes and asset allocations.[2] They include what are referred to in other jurisdictions as collective investment schemes and most involve participatory securities. While managed funds are the primary focus of this guidance[3], some aspects may also be relevant for other MIS (such as property syndicates that invest in a single asset class).

What's changed

This guidance replaces the *Liquidity risk management good practice* guide (April 2020) (**2020 Guide**). It has been updated to:

a. Communicate the view that having, and overseeing, effective LRM is a legal obligation of MIS managers and Supervisors respectively.

b. Reflect changes in market conditions since 2020 and recommendations by the International Organization of Securities Commissions (**IOSCO**) and the Financial Stability Board (**FSB**).

c. Note areas where we would like to see some MIS managers and Supervisors do more, particularly relating to monitoring and tools to manage liquidity risks in normal and stressed market conditions. This

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[2] See section 9 of the FMC Act.
[3] As defined in regulation 5(1) of the Financial Markets Regulations 2014 (**FMC Regulations**).

includes both MIS managers and Supervisors being more proactive and engaged with LRM, and schemes defining the term ‘illiquid assets’.

While some FMA comments are based on the results of a 2020 survey of MIS managers (referred to below), these generally align with the risks and deficiencies observed by IOSCO and FSB.

Background

Previous developments

In 2017 and 2018, the FSB and IOSCO recommended:

- liquidity risk be further embedded in funds’ design and day-to-day operations,
- the availability and use of liquidity risk tools be widened,
- regulatory reporting and public disclosure of liquidity risk be improved; and
- regular fund and system-level stress testing.

IOSCO recommended that regulators devote closer attention to the liquidity stress testing practices of open-ended collective investment schemes to protect investors, ensure fair and efficient financial markets and reduce systemic risk.

In April 2020, we published the 2020 Guide for liquidity management and stress testing. Following the August 2020 self-assessment survey completed by 51 regulated entities, we published recommendations about MIS LRM practices in June 2021. This report observed that:

a. MIS managers were overly optimistic about their LRM capabilities, and even the relatively strong performers had gaps in particular areas, including frequency of stress testing, use of available liquidity management tools (**LMTs**) and metrics.

b. MIS managers should avoid becoming complacent about their own capabilities. MIS boards/oversight bodies need to maintain effective oversight and provide constructive challenge, including:

    - forming their own view of the LRM capabilities, maturity and culture of their entity; and
    - assessing the extent to which these enable the MIS to operate consistently within its defined risk appetite and policy settings, identify any desirable changes, and ensure management takes steps to address those changes.

Recent developments

International regulatory initiatives

In November 2022, IOSCO published findings from a detailed survey (*Thematic Review on Liquidity Risk Management Recommendations FR13/22*) of jurisdictions representing over 92% of global assets under management. Additionally, the FSB undertook an assessment of its prior recommendations published in December 2022 (*Assessment of the Effectiveness of the FSB’s 2017 Recommendations on Liquidity Mismatch in Open-ended Funds*).

These reports observed there is scope for both greater uptake of LMTs to manage liquidity risk generally, and greater and more consistent use of LMTs to pass on redemption costs (explicit and implicit) to redeeming investors. The FSB noted a wide variation in how some LMTs were applied during the COVID-19 market shock in 2020, and drew attention to the importance of proper LMT use for funds investing in less-liquid assets that offer daily dealing.

In July 2023, the FSB and IOSCO subsequently consulted on revised guidance, with the goal of significantly strengthening liquidity management by open-ended fund managers.

The FSB's consultation updates some of its 2017 recommendations made to financial regulatory and supervisory authorities. These updates have been reflected in our guidance, in particular:

a. Disclosures to investors should address the availability and use of LMTs and their potential impact on investors in normal and stressed market conditions;

b. Jurisdictions should have detailed liquidity frameworks within which open-ended fund managers are expected to operate, and which should include expectations that:

    i. A fund design has redemption terms that are consistent with the investment strategy and liquidity of the fund's projected asset holdings;

    ii. Managers manage the fund's liquidity, in normal and stressed market conditions, to remain consistent with the fund's redemption terms;

    iii. Reviews of redemption terms are carried out at appropriate intervals.

c. Jurisdictions should expect fund managers to classify their funds based on the liquidity of the fund's assets in normal and stressed market conditions, these classifications being:

    i. <u>Funds that invest mainly (more than 50%) in "liquid" assets</u> – Daily dealings remain appropriate. These managers should continue to enhance liquidity management practices (including by implementing anti-dilution LMTs)

    ii. <u>Funds that invest a significant proportion (30% or more) in "illiquid" assets</u> – Less frequency or long-term notice or settlement periods are appropriate and funds may be better as closed-end funds.

    iii. <u>Funds that invest mainly (more than 50%) in "less liquid" assets</u> – Offering daily dealings may be appropriate but managers must be able to demonstrate that they implement anti-dilution LMTs. Funds otherwise should use measures to reduce liquidity offered to investors e.g. by reducing redemption frequency or using long notice or settlement periods.

IOSCO's recommendations focus on anti-dilution LMTs and bundle their previous guidance into higher-level elements, providing five critical elements of an LMT framework covering: the types of anti-dilution LMTs to be used; appropriate calibration of liquidity costs; appropriate activation thresholds; governance; and disclosure to investors.

We have integrated these recommendations into this guidance.

Our expectations

Part of the FMA's role as regulator is to build and promote investor understanding and confidence, and ensure the legal obligations of market participants are met. LRM is important for ensuring equitable treatment for investors, and our guidance is designed to help ensure legal obligations are met by MIS managers and Supervisors.

Key areas for improvement

The June 2021 MIS LRM review outlined our recommendations to MIS managers, graded by priority level. The high-priority recommendations have been incorporated into this guidance. It is our expectation that MIS managers will review and implement all features applicable to their schemes to the extent relevant.

Key improvements we would like to see are:

- Better frameworks, policies and procedures covering LRM.
- More regular stress testing.
- More tailored LMTs made available for use.

MIS managers

We expect MIS managers to exercise care, diligence and skill when developing policies, processes and tools for managing liquidity risk effectively. We expect MIS managers to implement these policies, processes and tools and review them regularly.

Effective LRM is integral to a MIS manager meeting its legal responsibilities to act in the best interests of scheme participants and treat those participants equitably.

Responsibility rests with the MIS manager to determine what standards, testing and reporting requirements are appropriate for:

- the assets under its management
- the expected redemption timeframes that have been communicated to investors; and
- the LMTs it has available.

These features will vary for each MIS manager along with the range of potential liquidity shocks and size of investor holdings.

We expect MIS managers will inform their Supervisor of any sudden significant changes in the liquidity profile of the funds they manage as soon as they occur.

Generally, a MIS manager will meet its legal duties and responsibilities by:

1. Having effective systems, policies, processes and tools to ensure liquidity risk is appropriately managed;
2. Appropriately managing liquidity risk (particularly during deteriorating market conditions and increased investor redemptions).

Supervisors

A Supervisor exercising care, diligence and skill will regularly assess a MIS manager's LRM framework, and consider if it achieves an adequate level of resilience to liquidity stress. This is in the best interests of scheme participants. In undertaking these assessments, we expect Supervisors to take a risk-based approach, tailoring frequency, scope, intensity etc.

We expect Supervisors will frequently review a MIS manager's own liquidity-related monitoring activities. This will provide the Supervisor with visibility of any changes that occur.

Supervisors can supplement their assessments of a MIS manager's LRM practices and liquidity positions by monitoring a combination of internal reports, market information and periodic surveys. Assessments by Supervisors should be at a fund level.

Supervisors should clearly identify the circumstances or concerns that may prompt reporting under section 203 of the FMC Act. This level of oversight is important to ensure the Supervisor can notify the FMA under section 203 of possible (or actual) contraventions of MIS manager issuer obligations, and what steps (if any) the Supervisor intends to take.

FMA's role

We will continue to monitor LRM of MIS managers and how LRM relates to overall systemic risk and, drawing on market engagements and Supervisor reports (if any), combine information sets to form a systemic view. We will monitor Supervisors to ensure LRM framework assessments are conducted effectively. We will also continue to engage with the market from time to time as LRM standards and market conditions develop.

Given the importance of LRM, where appropriate we will utilise our regulatory responses to address areas that remain below our expectations. This is discussed in more detail at the end of this guidance.

Key features of effective LRM

We expect the following key features to be part of all MIS LRM practices. Together, these features enable MIS managers to measure liquidity, carry out suitable stress testing, and – most importantly – use LMTs when required.

MIS Managers retain discretion about how each feature is developed and used in the context of the funds they are responsible for.

Governance and infrastructure

Feature 1 – Overarching framework and strategy

The MIS manager will have a documented process for identifying and managing liquidity risk, supported by robust contingency planning. This process will be supported by liquidity risk management policies and procedures, and integrated into the MIS manager's broader risk management framework, to achieve alignment between the fund's redemption terms and its investment strategy.

1.1 The LRM framework, strategy and supporting processes must:

- Clearly articulate a liquidity risk tolerance that is appropriate for the fund's investment strategy.
- Consider and cover situations and circumstances across a range of market conditions, including extreme adverse (but plausible) conditions.
- Be appropriate, relevant and sufficiently bespoke for the fund(s) under management, by considering and addressing characteristics including:
  - investment strategy
  - target investor base
  - investor demographics
  - investor concentration and expected redemption patterns
  - size of the fund relative to the underlying market
  - distribution channels
  - asset selection.
- Evaluate liquidity risk at both individual asset level and portfolio level, and ensure alignment and consistency with redemption obligations (and other liabilities).
- Ensure cash flows from assets, liabilities and off-balance-sheet items are comprehensively projected over an appropriate set of time horizons.

1.2 The MIS manager should not solely rely on LMTs to manage liquidity.

Feature 2 – Governance

The MIS manager's LRM will have good governance arrangements, including board and senior management approval, oversight and review.

Approval and ongoing review

2.1 The MIS manager's board and senior management will review and approve the entity's LRM framework at least annually. They will be satisfied the framework meets the objectives of effectively protecting investors, ensuring fair, efficient, and transparent financial markets, and reducing systemic risk, and that key matters (such as LMTs) are sufficiently described in the empowering trust documents.

Reporting and oversight

2.2 The MIS manager is responsible for determining its own internal liquidity risk reporting requirements. Liquidity risk reporting will include liquidity risk early-warning metrics (and supporting triggers and flags), and will account for the correlation between measures, e.g. valuation and liquidity. The MIS manager will ensure the board and senior management have appropriate oversight and understand the liquidity risk reporting and its importance.

Assurance

2.3 Where appropriate, there will be independent oversight of LRM framework reviews by Supervisors. Controls for reviewing and maintaining the MIS manager's LRM will be part of its compliance assurance programme, including in-depth testing of processes and controls.

Integration into wider risk management

2.4 The MIS manager's board and senior management will ensure the identification, assessment, and management of liquidity risks are part of its overall risk management framework.

Feature 3 – Contingency plans

The MIS manager will have a formal liquidity contingency plan (LCP) that clearly sets out its strategies for addressing liquidity shortfalls in emergency situations.

3.1 The LCP will:

- Outline policies to manage a range of stress environments.
- Establish clear lines of responsibility.
- Include clear initiation, escalation and withdrawal procedures.
- Be regularly tested and updated to ensure it is operationally reliable.

3.2 The LCP will:

- Include the use of any applicable LMTs, so these can be initiated/activated and deployed (and later withdrawn) in an effective manner. MIS managers should have “triggers” in place to prompt consideration first and then action if needed. This is important in deciding whether high-impact LMTs should be implemented (such as suspending redemptions).
- Specify what divestment strategies are to be used and their sequence, e.g. pro-rata or ‘slicing’ approach.

3.3 The MIS manager will understand the legal basis and requirements for the appropriate use of each LMT it intends to deploy as part of its LCP. This includes knowing in advance what information must be provided to investors, the Supervisor and the FMA, and being able to act quickly and with assurance.

Design, disclosure, and communication

Feature 4 – Product design

The MIS manager will ensure its offered subscription and redemption terms are appropriate for its investment strategy and product offering.

4.1 The MIS manager will consider the liquidity risk of the underlying investment products when designing a new product or making changes to an existing one.

> *45% of MIS managers had not undertaken stress testing during the product design phase, missing a key opportunity to determine any necessary and desirable LMTs, metrics, and potential effects of changes in micro/macro-economic variables from the outset.*
>
> FMA 2021 LRM survey, pg. 5.

4.2 During the product design phase, the MIS manager will also explicitly:

- Assess the suitability of its product offering against the investment strategy and vice-versa, under a range of market conditions (normal and stressed).
- Ensure that liquidity risks, LRM processes and LMTs are (or will be) in place, and are effectively disclosed to investors.
- Determine a suitable dealing frequency for units in the fund, based on the transactability of the underlying assets. This should include seeking ‘strong assurance’ that redemptions can be met under both ‘normal’ and ‘extreme but plausible’ market conditions. Ideally, managers will see redemption frequency as a firm commitment to investors that they can get their money back within the timeframe disclosed.

- Consider how the scheme aligns with the definition of “managed fund” in regulation 5 of the FMC Regulations to ensure that, for example, the redemption terms of underlying assets are suitable for the fund’s design.

4.3 MIS managers will keep under review the redemption terms of existing offerings to ensure that liquidity of assets and transacting terms remain aligned as time passes.

Feature 5 – Disclosure and communication

Disclosure

5.1 The MIS manager will ensure investors are aware of the fund’s liquidity risk through effective disclosure, including ongoing disclosure about:

- market movements that are relevant to the fund’s holdings and liquidity; and
- the fund’s redemption terms and processes, and the liquidity of the underlying assets in the fund. This should include, among other things:
  - the cutoff time for determining the price at which units are redeemed
  - the time taken to process withdrawal requests
  - the time taken to pay withdrawal amounts to the nominated bank account.

5.2 The MIS manager will also ensure that liquidity risk disclosure is provided to retail investors in the product disclosure statement (PDS). For example, where high-impact LMTs are included in the design of the fund (such as the ability to suspend redemptions), information on how these would operate and the potential impact on investors will be clearly disclosed to prospective investors.

5.3 Given the potential catalyst effect of leverage in stressed market conditions, a MIS manager using leverage will ensure this is effectively disclosed to investors.

Communications

5.4 The MIS manager will proactively engage with investors, and not simply leave them to read the detailed terms and conditions.

5.5 Communication with investors, the Supervisor and other stakeholders will be more frequent and more detailed in times of fund-specific or market-wide stress.

LRM capabilities

Feature 6 – Monitoring framework

The MIS manager will appropriately monitor and report on levels of liquidity and liquidity risk in its funds to allow effective oversight and decision-making.

6.1 Monitoring processes will enable the MIS manager to identify emerging or evolving liquidity issues in underlying asset markets, redemption flows or other liabilities before they materially impact the fund.

6.2 Effective monitoring will:

- Set appropriate liquidity thresholds that are proportionate to the liquidity of the underlying asset market(s) and redemption obligations and flows.
- Measure key metrics (including time to liquidate funds, price impact of liquidation, and settlement and timing lags).
- Use reliable and up-to-date data.
- Be conducted at a frequency that reflects the wider market conditions (e.g. increasing during market volatility).

6.3 Additionally, we expect MIS managers will define the term "illiquid asset", having regard to the fund(s) asset composition. The definition will be used alongside other monitoring measures (such as current time to liquidate) to monitor and manage relative liquidity across a fund's asset classes. A clear definition of illiquid assets with metrics to track asset liquidity will enhance oversight of the assets at all levels, including the board.

6.4 Monitoring will be integrated with the LRM framework to identify early warning signs and signal when more extensive liquidity analysis is required, whether LMTs are to be deployed, and whether other remedial steps are necessary if vulnerabilities are identified.

6.5 The MIS manager and its Supervisor will work together to determine an appropriate frequency for reporting the findings of this monitoring. The monitoring report should be coupled with information about any LMTs (particularly redemption suspensions) that have been deployed. This will allow the Supervisor to stay informed about potential liquidity pressures. The Supervisor will also be kept informed about any changes to the LRM framework, including the addition or removal of LMTs, through this reporting process.

> *45% [of MIS managers surveyed] reported not having a definition of 'illiquid' asset… [and] 49% of MIS managers [surveyed] do not use any 'early warning' metrics, increasing the risk they will be unprepared for a liquidity event.*
>
> FMA 2021 LRM review, pg. 6-7.

Feature 7 – Liquidity management tools

The MIS manager will have a range of appropriate LMTs readily available to deploy in specific circumstances, including where redemption obligations cannot be met in the ordinary course of business. This ensures the scheme operates in the best interests of investors and supports equitable treatment of scheme participants.

Defining tools

7.1 MIS managers will explicitly define the LMTs they have available for use, assess conditions under which these will be deployed (and withdrawn), and consider how their use ensures equitable treatment of scheme participants.

7.2 The LMTs should be categorised in terms of when they can be used:

- **Pre-emptive tools**: to anticipate and prevent liquidity issues;
- **Reactive tools**: to address liquidity issues after they emerge; or
- **Both**: pre-emptive and reactive.

and by their type:

- **Quantity-based**: such as redemption gates/withdrawal limits, temporarily suspending redemptions by suspending net asset value (NAV) calculations, or suspending redemptions (in extreme situations);
- **Price-based**: such as anti-dilution levies, redemption fees, and swing pricing;
- **Others:** such as side pockets, and redemptions in kind.

In assessing conditions under which LMTs might be deployed, the MIS manager will develop a graduated strategy for the use of LMTs. For example, swing pricing will usually be applied during normal market conditions. As conditions change to an adverse market circumstance, the MIS manager may move to deploying reactive tools, such as a notice period for redemptions and redemption gates, before progressing in a crisis to consider suspending redemptions.

We note some specific concerns with LMT availability, with 12 managers [nearly 25% of the 51 respondents] being affected by one or more of the following issues:

- *Having no LMTs at all*
- *Having no LMTs to deal with current or severe crises (e.g. redemption suspension or redemption gating)*
- *… having no LMTs that could be used in advance to help mitigate an emerging crisis*

FMA 2021 LRM review, p. 22.

Using tools

7.3 In using LMTs, the MIS manager will act in the best interests of scheme participants and treat scheme participants equitably by preventing the fund from materially diverging from its investment strategy. This includes:

- Ensuring redemption and valuation policies and practices are as fair as possible to all scheme members. Tools such as swing pricing and buy/sell spreads should be used to ensure the costs of trading are borne by investors driving those trades, rather than by the fund.
- Considering the appropriateness of the LMT for the circumstances and ensuring any stated conditions for the use of the LMT are met, including any required approvals from the MIS manager's board and/or Supervisor.

> *Only half of the MIS managers surveyed have ever used an LMT of any kind, calling into question their ability to select an appropriate LMT, including those suited to a variety of crisis situations, at an appropriate time/stage of the crisis escalation. This, coupled with an overreliance on liquid assets as the default response to a liquidity crisis, could lead to liquid assets proving insufficient. The collective impact of such a response may conflict with the fundamental principle of fair treatment of investors.*
>
> FMA 2021 LRM review, p.6.

> ***Ability to suspend redemptions***
>
> *We consider that a careful, skilled and prudent MIS manager (including, for example, managers of KiwiSaver schemes) must have the ability to suspend redemptions and for this ability to be appropriately disclosed to investors (through the PDS or Other Material Information).*
>
> *There are situations where the need to delay or suspend redemptions may be acceptable for KiwiSaver and other restricted schemes, providing the manager is acting in the best interests of scheme participants and treating them equitably.*
>
> *It is our expectation that such tools are only used in exceptional circumstances, sparingly, and with a view to lifting the suspension as quickly as the circumstances will allow. Suspending redemptions is highly effective at controlling fund liquidity in a serious market event which, in turn, supports the MIS manager to fulfil their statutory duties.*

Feature 8 – Stress testing

The MIS manager will have a stress testing framework for each scheme it manages, with appropriate settings for governance and oversight, scenario testing, and ongoing liquidity risk management.

8.1 The MIS manager's stress testing results will be integrated into all stages of the fund product lifecycle, including product design (when determining the dealing and distribution arrangements and asset composition), and ongoing investment management.

8.2 If stress testing is undertaken by a third party, the MIS manager remains responsible and will satisfy itself that the results have been properly considered in decision making.

8.3 Stress test results can be used to:

- Support the determination and assessment of appropriate dealing arrangements for the fund, considering its investment strategy and underlying assets, even under stressed scenarios.
- Help identify any necessary adjustments to the fund's dealing arrangements, investment strategy and underlying assets (including the holdings of liquid assets).
- Help formulate action and contingency plans to deal with plausible stressed market conditions using different LMTs.

Governance and oversight

8.4 Stress testing will include an effective governance structure, have clearly articulated and formally adopted objectives and upwards reporting lines, and be subject to periodic review by the oversight body (e.g. the MIS's board, executive committee, or senior management).

8.5 Where practicable, stress testing will be independent from the MIS manager's investment management function.

8.6 The MIS manager will maintain appropriate records of stress testing, including actions taken with regard to stress testing results.

8.7 The outcomes of the stress testing will be used to inform changes to the LRM framework and, where appropriate, the LMTs available.

Scenario testing

8.8 Stress tests will be carried out on normal, and extreme (but plausible) scenarios, and clearly identify sources of relevant risks impacting fund liquidity.

8.9 The MIS manager is responsible for ensuring testing is carried out at appropriate intervals for the nature and characteristics of the fund, but at least once a year.

8.10 Testing will take account of:

- fund size and composition
- investment strategy
- underlying assets, pricing and valuation errors

- investor profile/large withdrawals
- market factors and disruptions
- regulatory requirements and expectations
- nature, complexity and resources required of the stress testing,

and could include backward-looking historical scenarios or forward-looking hypothetical scenarios.

> *48% of [surveyed] fund-of-funds MIS Managers said they do not ensure their underlying funds perform stress tests.*
>
> FMA 2021 LRM review, pg. 7.

Feature 9 – Use of leverage to adjust risk/return

Where the MIS manager makes use of leverage (traditional balance sheet or synthetic leverage) to boost expected investment returns, the risks and impact for the fund/s and for the broader financial system (i.e. counterparty channel) in the event of financial distress will be well understood and taken into account in the MIS manager's LRM policies and its disclosures to investors.

9.1 A MIS manager using leverage will ensure this is effectively disclosed to investors. If this is a material feature, it should be disclosed in the PDS.

9.2 A MIS manager using leverage will also:

- Value derivatives positions at market.
- Quantify its market risk under adverse market conditions against limits, perform stress simulations, and forecast cash investing and funding needs.
- Assess the credit risk arising from derivatives activities based on frequent measures of current and potential exposure against credit limits.
- Reduce credit risk by broadening the use of multi-product master agreements with close-out netting provisions.
- Authorise only professionals with the requisite skills and experience to transact and manage the risks, as well as to process, report, control and audit derivatives activities.
- Establish management information systems sophisticated enough to measure, manage and report the risks of derivatives activities in a timely and precise manner.

Feature 10 – Record keeping, data and systems

Record keeping

10.1 The MIS manager will ensure appropriate records are kept relating to the performance of its LRM process. These records will evidence the performance of LRM, and be in a form that is easily accessible and suited to communications with investors and frontline regulators, e.g. a chronology of the use of LMTs, decisions, and results.

Data and systems

10.2 The MIS manager will be able to generate accurate and reliable risk data to meet normal and stress/crisis reporting requirements. Data will be aggregated in a reliable manner to minimise potential errors and create a robust and holistic view of the relevant risks.

10.3 The MIS manager will ensure it has access to, or can effectively estimate, relevant information for liquidity management at the product design stage and on an ongoing basis. For example, in the case of a managed fund investing in other funds, there should be the ability to obtain relevant information about the underlying funds, or at a minimum develop reliable proxies (see next).

10.4 Relevant information will be both quantitative and qualitative, and include information on:

- marketing and distribution channels
- historical redemption patterns
- past asset and liability characteristics and performance/behaviour.

10.5 In instances where the ability to 'look-through' to underlying funds or components is constrained, estimates or proxy information should be developed. MIS managers will also consider the heightened risk that results from this.

Evaluation and review

Feature 11 – Evaluation and review

Both MIS managers and Supervisors will undertake periodic evaluation and reviews of fund LRM practices to ensure these remain effective and fit for purpose. This will include looking at each of the features outlined in this guidance and completing a gap analysis of actual and expected performance.

11.1 As noted in feature 2, the MIS manager's board and senior management should ensure LRM practices are regularly reviewed (e.g. no less than annually).

Regulatory responses

As previously mentioned, effective LRM is integral to a MIS manager meeting its legal responsibilities to act in the best interests of scheme participants and treat them equitably. The FMA has a wide range of regulatory responses if we consider a MIS manager or Supervisor is, or is likely to be, in breach of these responsibilities.

Any action taken will depend on the severity and extent of misconduct, considering prevailing market conditions and any ongoing or potential investor harm.

For example, there may be instances where engagement and amendment through dialogue is sufficient to address a breach. In other cases, a formal feedback letter, public warning, stop order or direction order may be more appropriate. If poor practices appear widespread, we may publish findings from our monitoring to help inform the market.

For more information on the regulatory options available to the FMA, please refer to our Regulatory Response Guidelines.

Engagement and feedback

We expect Supervisors to play an active role in overseeing MIS Managers' LRM frameworks. As part of our ongoing engagement, we will liaise with Supervisors to understand how MIS managers have responded to this guidance. These engagements will focus on understanding the risk and potential outcomes for investors, and identifying measures that the Supervisor and MIS manager are undertaking. We will generally provide feedback to the Supervisor in the first instance before considering whether direct engagement with a MIS Manager is necessary.

Direction orders

We may also issue a direction order.[4] A direction order may, for example, direct a MIS manager to comply with the requirement to act in its members' best interests[5] from an LRM perspective, or stipulate steps that must be taken for compliance (e.g. making changes to LRM policies and processes). We have discretion as to whether we publish direction orders. Failure to comply with a direction order is an offence and can result in a fine of up to $300,000.

[4] FMC Act, ss 228(4)(e), (h), and (j), 468, 469.
[5] FMC Act, ss 143(1)(b), 153(1)(b), 468(1)(c).

Censures, action plans and directions

If we are satisfied that a MIS manager or a Supervisor has materially contravened, or is likely to materially contravene, a market services licensee obligation, we may censure the MIS manager, require them to submit an action plan, give a direction, or suspend, cancel (or, for Supervisors only, vary) their licence.[6]

Stop orders

A stop order can be issued in some circumstances where, for example, the information contained in a MIS's PDS is false or misleading, or is likely to mislead or confuse investors on material matters (i.e. matters that would influence a reasonable investor's decision to invest in the financial product or obtain the financial services).

A stop order is required to be published, and prohibits the issuer from continuing the relevant activity, to protect investors and the integrity of the market. For example, we can issue a stop order to prevent or stop an issuer of a financial product from:

- distributing a PDS, other disclosure document, or advertisement (including keeping its website live);
- continuing to offer a financial product;
- accepting applications or deposits from customers for a financial product.

If we consider it is in the public interest to do so, we may issue an interim stop order while we consider the grounds for a stop order.

We can issue a stop order without any need to go to court. Failure to comply with a stop order can result in a fine of up to $300,000.

Civil liability provisions

The FMC Act specifies a number of provisions that, if contravened, may give rise to civil liability[7], enabling the FMA to apply to the court for orders, including pecuniary penalty orders (of up to $600,000) or compensatory orders[8].

The following contraventions may give rise to civil liability orders:

- A manager contravenes the duty to act in the best interests of members and treat them equitably.
- A supervisor contravenes the duty to act in the best interests of members.

Civil liability orders can be made not only against the person in contravention, but also against those involved in the contravention. The aim of such orders may be to sanction the issuer, deter behaviour, and/or potentially seek redress for affected parties.

[6] FMC Act, s 414. FMS Act, ss 27-30.
[7] FMC Act, s 228(4). FMS Act, s 41(1).
[8] FMC Act, s 494. FMS Act, s 42.

Chronological bibliography

Financial Stability Board (FSB), *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*, (January 2017)

International Organization of Security Commissions (IOSCO), *Recommendations for Liquidity Risk Management for Collective Investment Schemes* (February 2018)

Financial Markets Authority (FMA), *Liquidity risk management: A good practice guide for Managed Investment Schemes* (April 2020)

FMA, *MIS liquidity risk management review* (June 2021)

FSB, *Assessment of the effectiveness of the FSB's 2017 recommendations on liquidity mismatch in open-ended funds* (December 2022)

FSB, *Consultation Report on Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-ended Funds* (July 2023)

IOSCO, *Consultation Report on Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes* (July 2023)

Consultation questions

1. Do you think the proposed guidance is sufficiently clear on the FMA's general expectations for liquidity risk management? If you think it can be clarified or improved, what changes or updates do you suggest we consider? Please give reasons for your view.
2. Do you believe there are any features that go too far or are too prescriptive for MIS managers or Supervisors? If so, please explain what should be changed or scaled back, and why.
3. Conversely, do you believe there are features that could go further, be more specific, or otherwise be clarified? If so, please explain your suggested changes and the reasons for these.
4. What additional features, if any, do you want to see in this guidance?
5. Are there any emerging best practices or ongoing trends in the industry that should be considered?
6. Do you expect there will be any material challenges or unnecessary compliance costs to your business as a result of meeting the expectations in the proposed guidance? Please give reasons for your view.
7. Do you have any views in particular about:
    a. the approach to defining illiquid assets
    b. the comments on the role of Supervisors
    c. the ability of MIS KiwiSaver Managers to be able to suspend redemptions?
8. Do you have any other feedback or comments on the proposed guidance?

Feedback form

Consultation: Proposed liquidity risk management guidance

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed liquidity risk management guidance: [your organisation's name]' in the subject line. Thank you. **Submissions close on Friday 10 November.**

Date: Number of pages:

Name of submitter:

Company or entity:

Organisation type:

Contact name (if different):

Contact email and phone:

Question number	Response

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.