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To the members of the Association

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member/circular SSC

No. 05/2020

Measures in times of COVID-19 – examples from outside Switzerland

Dear Sir/Madam,

The COVID-19 crisis has led to increased volatility in the markets, including instances of difficulties in valuing fund assets as well as the threat of liquidity problems in the event of higher redemption volumes. SFAMA addressed these issues in its circulars 03/2020 of 6 April and 04/2020 of 23 April 2020 and clarified various questions in connection with the specific situation in Switzerland.

Different measures taken by the individual EU member states (seemingly in no time at all) also prompted lively debate in recent weeks. Below we provide an overview of the most important of these topics and demonstrate in particular that this initial impression is not actually accurate. Some of these latest developments in the area of fund liquidity risk management in the individual EU member states are in effect not in response to the current COVID-19 crisis. Rather, those developments that have attracted the most attention are the result of ongoing regulatory efforts.[1] In numerous EU member states these activities led either to the introduction of liquidity risk management tools (LMTs) into national legislation or to a reframing of existing LMTs. Valuation questions – i.e. on swing pricing – arising due to high market volatility were also discussed. Solely the triggering of measures or the broadening of specific rules in individual cases are attributable to the current crisis.

LMTs and swing pricing mechanisms in selected European states (Luxembourg, Germany, UK) that have attracted lively interest in the industry over the past few weeks are examined in brief below (Sections 1-3). There then follows an account of how Switzerland is in no way lagging behind when it comes to such developments (Section 4).

[1] IOSCO Recommendations for Liquidity Risk Management for Collective Investment Schemes (February 2018), EU Regulation 2017/1131 on money market funds of 14 June 2017, ESMA guidelines on stress test scenarios under the Money Market Fund Regulation of 19 July 2019, ESMA guidelines on liquidity stress tests for UCITS and AIFs of 2 September 2019, ESMA Annual Statistical Report on EU AIFs of 7 March 2019, and the ESMA Economic Report on stress simulation for investment funds of 5 September 2019. Lastly, the UCITSD and the AIFMD already contain liquidity management rules.

1. Luxembourg (swing pricing)

One of the first measures to arouse the industry's interest was an announcement by Luxembourg's *Commission de Surveillance du Secteur Financier* (CSSF). On 20 March and 7 April 2020, the latter published updates of its FAQ on the swing pricing mechanism[2].

Contrary to the initial impression, these FAQ updates did not lead to any new measures being taken by the CSSF. Concrete swing pricing rules had already been put in place through implementation of the IOSCO recommendations[3] in FAQ of July 2019[4] and Circular CSSF 19/733[5] of December 2019. The March 2020 update merely amplified existing rules to the extent that, under the exceptional circumstances of the COVID-19 situation, the supervisory authority allowed the swing factor to be temporarily raised beyond the limits laid down in the fund prospectus. This was also declared permissible in instances where such an option was not expressly provided for in the fund prospectus. However, if this measure is applied, it must at all times be justified and serve the interest of investors, with the proviso that fund documents are to be subsequently adapted as soon as possible. Both the CSSF and investors need to be appropriately informed about the measure.

2. Germany (swing pricing / redemption gates)

Another announcement that aroused attention in March was the introduction of various LMTs into German law. On the one hand, swing pricing was introduced for the calculation of the net asset values (NAVs) of undertakings for collective investment in transferable securities (UCITS) and mixed investment assets. On the other hand, a measure was created to temporarily limit the redemption of fund units (redemption gates) as well as to introduce redemption deadlines.[6]

This amending bill is not attributable to the current crisis either. Germany's legislature has in fact embodied measures in German law which, unlike in other EU states, were not in place in Germany[7]. The new measures were introduced in implementation of international regulatory developments[8] under a due legislative process concluded on 13 February 2020 by resolution of the German Bundestag.[9]

3. UK (Suspension of dealings / swing pricing)

In connection with the COVID-19 crisis, the dominant announcement in the UK was that individual property funds had been suspended owing to difficulties in obtaining valuations.[10] In a bulletin dated 17 March 2020 (updated on 3 April 2020) the Financial Conduct Authority (FCA) stated that the aim has to be to maintain open and orderly markets despite the current volatility, but that requests to suspend trading would continue to be considered.[11] In the UK, with its large number of open-ended investment funds for retail clients, the suspension of dealings may be a preferred measure under certain circumstances. The FCA takes the view that, in the event of liquidity bottlenecks, this is a key instrument for ensuring the equal treatment of all investors in open-

[2] www.cssf.lu/fileadmin/files/Publications/Communiques/Communiques_2020/C_update_FAQ_swing_price_mechanism_200320.pdf
Update of 7 April 2020: https://www.cssf.lu/fileadmin/files/Metier_OPC/FAQ/FAQ_Swing_Pricing_Mechanism_070420.pdf

[3] See fn 1

[4] http://www.cssf.lu/fileadmin/files/Metier_OPC/FAQ/FAQ_Swing_Pricing_Mechanism.pdf

[5] Circular CSSF 19/733 of 20 December 2019 (https://www.cssf.lu/fileadmin/files/Lois_reglements/Circulaires/Hors_blanchiment_terrorisme/cssf19_733eng.pdf)

[6] Recommended resolution and report of the Finance Committee (in German): https://dip21.bundestag.de/dip21/btd/19/171/1917139.pdf

[7] See table of countries in the AMIC / EFAMA Report Managing fund liquidity in Europe (updated version of 6 January 2020), Annex II (http://www.efama.org/Publications/Public/AMICEFAMA%20ReportManagingfundliquidityriskinEurope2020.pdf)

[8] See fn 1

[9] Minutes of the plenary meeting of the German Bundestag of 13 February 2020 (in German): https://dip21.bundestag.de/dip21/btp/19/19146.pdf

[10] https://www.investmentweek.co.uk/news/4012630/uk-open-property-fund-suspensions; https://www.ft.com/content/21d74d21-6e63-406f-83c5-e3bdf60ee210

[11] https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-issue-no-27-coronavirus-update

ended funds and avoiding the risk of liquidity mismatches. Under specific conditions it is mandatory to activate this measure. Between 2016 and the end of 2019, the UK witnessed a number of instances of open-ended funds (including various commercial property funds and the LF Woodford Equity Income Fund) needing to suspend dealing in response to the volume of redemption requests. The majority were able to resume dealing after suspension (e.g. after the suspensions at the time of the Brexit referendum). Current reports of fund closures in the UK must be seen against this background; they don't mark the end of a fund, but are more an interval before an orderly continuation of business at a later moment in time.

Aside from the suspension of dealing, the UK has a number of other measures that are provided for in the FCA Handbook. The FCA published various papers in 2019: In May 2019 an analysis of swing pricing[12], in September 2019 a Policy Statement on the introduction of new rules for specific open-ended funds investing in illiquid assets (non-UCITS retail schemes),[13] and in November 2019 a letter on effective liquidity management.[14] At the same time, the Bank of England announced in its Financial Stability Reports of July and December 2019 that it would be working with the FCA in the area of swing pricing and redemption notices. And finally, in connection with the present crisis, on 19 March 2020 the FCA commented in detail on topics such as liquidity mismatches, swing pricing and redemption notices.[15]

4. Switzerland (gating / exceptions from the right to redeem at any time / deferred repayment / swing pricing)

As outlined in detail in SFAMA Circular 03/2020[16], various measures are also contained in Switzerland's collective investment scheme legislation. These include the power to grant exceptions from the right to redeem at any time, namely by providing that notice may be served only on specific dates (Art. 109 CISO), gating (Art. 109 paras 5 and 6 CISO), as well as the possibility of deferring repayment (Art. 110 CISO[17]). Price adjustment mechanisms such as single swing pricing (SSP) or dual pricing are also applied in practice. The topic of SSP as implemented by Swiss funds is discussed in detail in SFAMA Circular 04/2020.

5. Conclusion

In the context of crisis measures there is no one-size-fits-all for all countries. Each financial centre needs to ensure that it has the right repertoire of measures in place in terms of its market size and market structure (production and/or sales location) as well as its investor structure (retail and/or institutional focus). Various efforts have been undertaken in recent years within the EU to improve fund liquidity management in member states. The broad ranges of measures in force in EU member states are the outcome. Switzerland is not falling behind, having already set up comparable mechanisms. However, owing to the different focuses of the respective fund locations, it is easy to see why, in the current crisis, Switzerland did not take or consider necessary the same measures as, say, in Luxembourg or the UK. That said, in the aftermath of the present COVID-19 crisis it would make sense to review the fitness for purpose and effectiveness of existing mechanisms and examine the need to add to the current raft of measures.

[12] FCA Occasional Paper 48 - Swing pricing and fragility in open-end mutual funds (https://www.fca.org.uk/publication/occasional-papers/occasional-paper-48.pdf)

[13] FCA Policy Statement PS 19/24 - Illiquid assets and open-ended funds and feedback to Consultation Paper CP18/27 (https://www.fca.org.uk/publication/policy/ps19-24.pdf)

[14] FCA Letter on Effective liquidity management – best practice for Authorised Fund Managers (https://www.fca.org.uk/publication/policy/ps19-24.pdf)

[15] Speech by Edwin Schooling Latter, Director of Markets and Wholesale Policy, to Investment Association members https://www.fca.org.uk/news/speeches/open-ended-funds-investing-less-liquid-assets

[16] It can be downloaded at: https://www.sfama.ch/en/publications/circulars/circulars?set_language=en

[17] See also the SFAMA guidelines on the valuation of the assets of collective investment schemes and the handling of valuation errors in the case of open-end collective investment schemes of 20 June 2008, margin nos. 44 ff.

SFAMA maintains a regular exchange with FINMA and other authorities and is committed to ensuring that in the present difficult times effective solutions to the prevailing problems can also be found for the asset management and fund industry.

Please do not hesitate to contact us if you have any questions.

Yours sincerely

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