

Report with guidelines

Liquidity stress testing by German asset management companies

Management Summary

Asset management companies usually grant their investors a short-term redemption option although they are, by design, invested in assets of different liquidity. The gap between redemption requests and the ability to sell the assets poses a fundamental liquidity risk that is inherently intricate to capture and control. However, stress tests serve as a powerful tool to manage this liquidity risk. Set up appropriately, they can aid risk control functions to minimize portfolio liquidity risks and, ultimately, they even contribute to limiting systemic risk.

Current supervisory requirements on the liquidity risk management of asset management companies refrain from being overly prescriptive about liquidity stress testing in detail. Therefore, the following guidelines should foster a common understanding of quality and adequacy in practical terms. For this purpose, BaFin conducted a stocktake at a selection of German asset management companies in summer 2017, gaining insights into their liquidity risk management and their liquidity stress tests.

The report outlines both current industry practice as well as the idiosyncrasies of the German market. Servicing different investors (institutional, retail) and leveraging different concepts (public, special), German asset management companies do not only show a significant variety of business models, but also hold all different kinds of assets from traded securities to real estate. This diversity does not only lead to a large span of asset liquidity and considerable differences in the availability of market data. The wide range of methodological sophistication applied and of respective process maturity levels observed mirrors the practical usage at the asset management companies.

According to the guidelines, the design of liquidity stresses should account appropriately for the business model and size of the asset management company. The reporting and governance policies, however, need to be clear and consistent in any case. The stress scenarios and the monitoring frequency should be suitable to the individual fund. Above all, the assessment of the liquidity risk should base on the individual company's own considerations – there is no one-fits-all approach to liquidity stress tests. The asset management companies will have to face the continuous challenge of using the most efficient instruments for liquidity risk management.