ESRB COVID-19 Related Policy Actions: Implications for Investment Funds

The Banque Centrale du Luxembourg (BCL) and the Commission de Surveillance du Secteur Financier (CSSF) would like to inform industry participants that on 6 May 2020 the European Systemic Risk Board (ESRB) has discussed a first set of actions in 5 priority areas identified to address the impact of COVID-19 on the financial system from a macroprudential perspective. These actions constitute a comprehensive set of policy measures that apply to different sectors of the financial system as well as across countries, and address the areas of market illiquidity, downgrades of corporate bonds, guarantee schemes and other fiscal measures, dividend payment restraints and margin call induced liquidity risks.

The ESRB press release and the detailed package of policy actions can be found on the ESRB's website under the following links:

- ESRB Press Release from 14 May 2020 on the first set of actions taken by the ESRB on 6 May 2020 to address the coronavirus emergency:

  https://www.esrb.europa.eu/news/pr/date/2020/html/esrb.pr200514~bb1f96a327.en.html

- Policy measures in response to the COVID-19 pandemic:

  https://www.esrb.europa.eu/home/coronavirus/html/index.en.html

In this context, the BCL and the CSSF would like to draw particular attention to the following policy actions which are related to and have implications for investment funds and their activities:

a) The ESRB recommends that ESMA coordinates with national competent authorities to undertake a focused piece of supervisory engagement with those investment funds having significant exposures to corporate debt and real estate assets. Through such engagement, the preparedness of these investment funds to potential future elevated redemption pressures, a deterioration in market liquidity conditions and/or increased valuation uncertainty shall be assessed and potential enhancements shall be evaluated.

   https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200514_ESRB_on_liquidity_risks_in_investment_funds~4a3972a25d.en.pdf

b) In a public statement, the ESRB emphasizes the importance of the availability and timely use of liquidity management tools by fund managers, especially in times of stressed market conditions. In addition to being a key element of prudent liquidity risk management and protecting investors, the timely use of liquidity management tools (including those that help to ensure the appropriate allocation of redemption costs) also reduces the risk of forced sales of less liquid assets in periods of stress, helping to guard against the adverse system-wide effects of such sales across the financial system.

   https://www.esrb.europa.eu/home/coronavirus/shared/pdf/esrb.publicstatement200514_on_t he use of liquidity management tools by investment funds with exposures to less liquid _assets.en.pdf

c) In an issues note on liquidity in the corporate bond and commercial paper markets, the procyclical impact of downgrades and implications for asset managers and insurers, the ESRB examines how large-scale downgrades of corporate bonds can have an impact on the broader financial sector. The objective of the work is to assist policymakers to better evaluate the risks associated with downgrades including the negative impact they could, among other disruptive effects, have, via/through the potential sale of such assets by financial institutions on market liquidity, particularly in the high yield corporate debt segment.

   https://www.esrb.europa.eu/pub/pdf/reports/esrb.report200514_issues_note~ff7df26b93.en.pdf

In this context, the European Securities and Markets Authority (ESMA) issued a public statement where it expresses its support to the set of measures, including the Recommendation, published by the ESRB and notes that they complement the ongoing ESMA response to the COVID-19 pandemic.

https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200514_ESMA_public_statement~227bb83053.en.pdf