FINANCIAL CONDUCT AUTHORITY

Policy Statement

PS26/17

Enhancing fund liquidity risk management

August 2026

This relates to

Consultation Paper 25/38 which is available on our website at www.fca.org.uk/publications

Email:
cp25-38@fca.org.uk

Contents

Chapter 1

Summary

The wider context of this policy statement

Our consultation

1.1 Liquidity risk management is a critical tool for protecting investors in open-ended collective investment schemes ('funds'). It ensures fund managers can meet requests from investors to buy and sell units in line with the terms they have been promised, without harming remaining investors in the fund. Good liquidity risk management practices also enhance market integrity and reduce the risk of disorderly sales of assets, which may impact market integrity and financial stability.

1.2 Recently, international standard-setting bodies have updated recommendations on liquidity risk management. In May 2025, the International Organization of Securities Commissions (IOSCO) published new recommendations on liquidity risk management for funds.

1.3 IOSCO's recommendations took account of the Financial Stability Board's (FSB) 2023 revised recommendations on addressing structural vulnerabilities from liquidity mismatch in open-ended funds. We helped develop these recommendations and have reviewed our existing rules and guidance in light of them.

1.4 Existing rules in the UK already ensure that authorised fund managers (AFMs) are held to high standards of liquidity risk management. However, we identified some areas where our rules could be enhanced, or additional guidance would be beneficial.

1.5 Consultation Paper 25/38 (CP25/38) proposed targeted improvements to the liquidity risk management framework for retail-focused authorised funds, those being undertakings for collective investment in transferable securities (UCITS) schemes, and non-UCITS retail schemes (NURS).

1.6 In CP25/38, we set out proposals to:

- Promote the effective use of anti-dilution tools (ADTs), which should better protect investors in a UCITS scheme or NURS from the risk of their holdings being diluted by the costs incurred by other investors entering and exiting the fund.
- Strengthen the rules on how an AFM assesses and monitors the ongoing liquidity risk of transferable securities, such as shares and bonds, held in a UCITS scheme or NURS, such as avoiding overreliance on the fact that a security is admitted to trading on an exchange.
- Introduce new Handbook guidance on liquidity stress testing, with an updated UK version of the European Securities and Markets Authority (ESMA) liquidity stress testing guidelines, and a separate annex on good liquidity risk management practices for UCITS schemes and NURS.

1.7 The consultation closed on 23 February 2026 and, having considered all the feedback, we are now finalising the rules.

1.8 We will soon consult on wider liquidity proposals covering authorised retail funds investing in inherently illiquid assets, predominantly daily-dealt property funds. These proposals will include widening aspects of the liquidity management toolkit for AFMs of NURS, including through notice periods and deferrals, as well as some minor rule changes to the Long Term Asset Fund (LTAF) regime.

How it links to our objectives

1.9 The final rules and guidance support the Financial Conduct Authority (FCA)'s statutory objectives of:

- market integrity
- consumer protection
- competition

1.10 Our new rules and guidance should improve how AFMs assess the quality of secondary market activity when determining a security's liquidity risk. This should help strengthen market integrity by reducing the likelihood of funds that offer daily dealing accumulating positions in securities with limited secondary market trading. This in turn should reduce the risk of disorderly sales of those securities under stressed conditions.

1.11 The new rules and guidance advance our consumer protection objective by upgrading expectations of how AFMs approach liquidity risk management. Poor liquidity management can cause significant harm to retail investors and damage trust in the UK's fund management sector. Enhanced rules and guidance should better ensure that AFMs treat subscribing, remaining and redeeming investors fairly when allocating transaction costs. They should also reduce the risk of unexpected liquidity shortages, which can lead to investors being trapped in a fund for lengthy periods.

1.12 The new rules and guidance, while ensuring that AFMs remain ultimately responsible for their funds' liquidity risk management, allow them to continue investing in opportunities such as smaller companies, in the interests of investors.

1.13 There is a wide range of investment strategies within the UK asset management sector. We seek to support its continued growth by giving AFMs the flexibility to determine the most appropriate liquidity risk management model based on the nature of the funds' investors, funds' individual strategies and asset classes. We believe that a broad range of funds of varying risk profiles should be available to retail investors and our framework should be sufficiently flexible to support competition in the sector. The purpose of these changes is not to limit investment in less liquid or illiquid assets, but to ensure that where AFMs do invest in less liquid securities they must adequately account for the risks of doing so and set appropriate redemption terms.

1.14 Finally, by tailoring the FSB and IOSCO recommendations to the UK fund sector and taking a targeted approach to addressing improvements in the existing rules, we provide for consistency with international good practice while minimising the compliance burden on firms. We believe this creates a predictable regulatory environment that can support UK economic growth and the international competitiveness of the UK economy.

1.15 The enhancements to the UK's regulatory framework for liquidity risk management are based on the principle that AFMs remain responsible for an individual fund's liquidity risk management choices. The UK's investment management industry now records assets under management (AUM) of over £16.5 trillion across a very wide range of funds.

Summary of feedback and our response

1.16 We received 9 responses to the consultation. Respondents were generally satisfied with our proposals to enhance liquidity risk management. They agreed with our decision to maintain the principle that the liquidity risk management practices of funds should be the ultimate responsibility of the AFM.

1.17 In our final rules, we use the term 'anti-dilution mechanism' to refer to a single-priced fund's dilution levy, or dilution adjustment, or, in the case of a dual-priced fund, the AFM's ability to allocate portfolio transaction costs and ability to make provision for large deals. We will refer to these as ADTs throughout the Policy Statement (PS).

1.18 There was overall support for AFMs of UCITS schemes and NURS having ADTs available for use, and that these tools should be swing pricing or a dilution levy for a single-priced fund. However, some respondents challenged our assessment of how dual pricing functions as an anti-dilution mechanism. We have modified the rule accordingly.

1.19 In CP25/38, we proposed guidance on the calibration of ADTs. This included recommending that liquidity costs of transactions should be calculated on the basis of a pro-rata apportionment of scheme property across all unitholders, known as 'vertical slicing.' Some respondents wanted us to clarify that vertical slicing is not the execution method we would expect to see for every scheme transaction, which we have now made clear.

1.20 There was general consensus on our proposal to remove the listed asset presumption. While many respondents agreed with removing the derogation from the eligible market test for recently issued securities, some questioned the application to new fixed-income issuances. These respondents argued that removing the derogation would limit AFMs' ability to participate in new issues, noting transferable securities are admitted to trading quickly post-issuance. Following feedback, we will keep the derogation but are reducing it to 20 business days after issuance in which to secure admission, as opposed to 1 year.

1.21 There was general support for our guidance on good liquidity risk management practices and liquidity stress testing.

Who this affects

1.22 This PS applies to:

- AFMs of UK UCITS schemes and NURS
- The Markets in Financial Instruments Directive (MiFID) investment managers, where the AFM has delegated the portfolio management function of a UCITS scheme or NURS to them
- Depositaries of authorised funds

1.23 The PS may also be of interest to:

- Investment platforms and other fund distributors
- Investors in authorised funds
- Financial advisers and investment consultants

Outcome we are seeking

1.24 We want retail investors to continue accessing a broad range of investment opportunities with appropriate protection in place from risks that can arise where funds invest in less liquid assets.

1.25 To support this, AFMs should ensure that the redemption terms of each fund they manage are consistent with its investment strategy and liquidity profile, and that they have robust liquidity risk management systems in place.

1.26 Beyond the calibration of anti-dilution tools, our guidance makes clear that firms must embed strong governance, oversight and challenge by senior management across their liquidity risk management more broadly, including regular review of how these tools are used and calibrated in practice. In doing so, a firm should assure itself that the use of ADTs is in all unitholders' best interests. We want to ensure that AFMs remain alert to potential issues that may arise in liquidity management or transaction cost estimation.

Measuring success

1.27 Our rules should mean that where an AFM uses ADTs effectively, both subscribing and exiting investors pay or receive a more accurate price for their units, better protecting the remaining investors from dilution effects.

1.28 We have recently consulted separately on updating the fund reporting regime (in the Fund Reporting for Asset Management Entities CP), which will improve the data that we collect on funds' portfolios and risks, as well as their investor base and how they use ADTs. By using this data, we will be able to better monitor funds' liquidity positions and their use of ADTs.

1.29 This data will allow us to assess compliance with the new rules and guidance, by providing data showing ADTs are available for use. It will help us to better understand how fund managers are equipped to manage liquidity pressure and how liquidity management tools are used in practice. It should also help us assess how the use of ADTs interacts with a fund's liquidity profile, redemption terms and investor flows. We do not propose to require firms to report detailed quantitative metrics on the calibration or trigger levels of each tool, such as swing factors or dilution levy amounts.

1.30 In practice, we expect that the majority of AFMs already have ADTs available for use. A 2020 joint survey with the Bank of England, assessing liquidity management in open-ended funds in the UK, covered 51 AFMs with a total of 272 funds. Only 4 funds surveyed did not have ADTs available for use.

1.31 The 2020 survey also found that funds with different primary strategies and assets often used the same thresholds for applying swing pricing and calculation of the standardised swing factor. Only 13 of the 272 noted that market impact was considered within swing factors.

1.32 We therefore expect the majority of AFMs already have ADTs available for use, although we expect to see some improvements in how ADTs are used following these changes.

Environmental, social & governance considerations

1.33 In developing this Policy Statement, we have considered the environmental, social and governance (ESG) implications of our proposals and our duty under ss. 1B(5) and 3B(1)(c) of FSMA to have regard to contributing towards the Secretary of State achieving compliance with the net-zero emissions target under section 1 of the Climate Change Act 2008 and environmental targets under s. 5 of the Environment Act 2021. Overall, we do not consider that the proposals are relevant to contributing to those targets.

1.34 We asked:

Question 1: **Do you have any comments on the ESG implications of our proposals?**

1.35 We received no feedback that our proposals raised any ESG implications. Since we are proceeding broadly as consulted on, we do not consider that our final rules will materially change our assessment.

Equality and diversity considerations

1.36 We have considered the equality and diversity issues that may arise from the proposals in this Policy Statement. Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we said we would continue to consider the equality and diversity implications of the proposals during the consultation period and revisit them when making the final rules.

Question 2: **Do you have any comments on the equality and diversity implications of our proposals?**

1.37 No responses identified any diversity or equality issues. We do not believe our final rules introduce any new implications.

Cost Benefit Analysis (CBA)

1.38 In our CBA, we set out that we expected the proposals to deliver a net benefit through reducing the probability of individuals' financial loss, making the distribution of costs more efficient, supporting orderly markets, and improving the resilience of UK funds.

1.39 We estimated that the Net Present Value (NPV) cost of our proposals over a 10-year period would be approximately -£13.7m, with an approximate Equivalent Annual Net Direct Cost to Business (EANDCB) of £1.6 million. This comprised direct familiarisation and compliance costs to AFMs and other related market participants. We did not consider that new requirements on AFMs of UCITS schemes or NURS would produce any material costs for investors.

1.40 One respondent commented on our CBA, noting that our cost estimates appear broadly reasonable. They also noted we should ensure that smaller firms are treated proportionately, with phased timelines available should significant system enhancements be required and that reporting obligations remain focused on supervisory outcomes.

1.41 We acknowledge the feedback that smaller firms should be treated proportionately. We note that feedback received through our engagement with firms and industry associations has not indicated that the proposals would require significant systems changes. We also consider the period before the rules come into force should provide firms with sufficient time to prepare for any changes required as a result of the rules and guidance.

1.42 We are satisfied that we do not need to revise our CBA.

What you need to do next

1.43 Our rules amend some requirements on liquidity risk management for UCITS schemes and NURS. Affected firms should familiarise themselves with these changes and determine how and when they might need to implement any changes to their operations.

1.44 The new rules and guidance will come into force on **1 February 2027**. However, transitional provisions will apply to some rules until 1 August 2027. They will extend the time available for making changes to the fund prospectus and for complying with the shorter derogation period for the eligible market test for recently issued securities.

1.45 We have also provided a transitional provision for stress testing requirements that currently apply to regulated money-market funds (MMFs) but will cease to do so on the revocation of the Money Market Funds Regulation (MMFR), when we will remove any duplication between COLL and the Money Market Funds sourcebook (MMFS).

1.46 The final Handbook text can be found in Appendix 1.

Chapter 2

Promoting effective use of anti-dilution tools

2.1 This chapter summarises feedback we received relating to our proposals on targeted improvements to AFMs' use of ADTs.

Consultation proposal

2.2 ADTs are an important part of an AFM's liquidity risk management toolkit. They adjust the prices paid or received by transacting investors, so remaining investors do not bear the costs incurred by buying or selling the assets in the fund to meet dealing requests.

2.3 In the UK, most AFMs of UCITS schemes and NURS have these mechanisms available as a matter of good practice. Our consultation proposed requiring all AFMs of UCITS schemes and NURS to have these mechanisms available along with policies and procedures governing their use. We also proposed that it would remain at the AFM's discretion whether to activate these mechanisms, and that it need not do so if it assesses that there is no material risk of dilution at a particular valuation point.

2.4 We proposed requiring AFMs' policies and procedures to cover:

- How the AFM will identify actual or potential instances of dilution affecting the value of scheme property
- Where the AFM identifies an instance of dilution, how it will assess the actual or likely impact on investors at each valuation point
- Which ADT the AFM will use to protect investors from the risk of dilution

2.5 We did not propose any changes to the ADTs that schemes should make available. The ADTs available to an AFM are either dual pricing, or, in a single-priced fund, a dilution levy or dilution adjustment. We also signalled that we may consider whether AFMs should have greater flexibility to close a fund to new investors (i.e., 'soft closure') as a possible alternative to manage dilution risks in the event of high levels of subscriptions. We did not consult on rules or guidance on this matter.

2.6 We asked:

Question 3: **Do you agree that we should require all AFMs of UCITS schemes and NURS to have anti-dilution tools available for use, if they do not already do so?**

Question 4: **Do you agree that the three anti-dilution tools available to an AFM should be dual pricing, a dilution adjustment or a dilution levy? If not, what other tools do you think should be available and why?**

Question 5: **As a possible alternative, do you believe that having the ability to close a fund to new investors only ('soft close') would enhance the fund's ability to avoid dilution?**

Question 6: **Do you agree that the position for LTAFs and QIS should be considered separately as part of the 2026 AIFMD review CP?**

Feedback received

2.7 We received 7 responses to our proposals on ADTs. Respondents generally agreed that AFMs of UCITS schemes and NURS should be required to have these tools available for use.

2.8 However, one respondent said we should consider whether more frequent or pronounced use of ADTs, particularly swing pricing, could have unintended consequences for funds holding small or mid-cap equities.

2.9 This respondent commented that increased swing pricing by small and mid-cap funds could disincentivise investment in such schemes, leading to lower inflows and weaker secondary market liquidity in small-cap equities which they held. They noted that this risked exacerbating liquidity challenges in these markets. They suggested we consider how ADTs would be applied in practice, and if necessary, add guidance to ensure they did not discourage appropriate investment in small-cap, listed equities.

2.10 Another respondent suggested we explicitly state in the Handbook that the AFM remains responsible for managing the fund in the best interests of investors and thus has discretion over its choice and use of liquidity management tools.

2.11 We received 3 responses to our proposal that the ADTs available to an AFM should be dual pricing, a dilution adjustment or a dilution levy. Respondents agreed that UCITS schemes and NURS should have a dilution adjustment and dilution levy available for use in single-priced funds. However, 2 respondents disagreed that the AFM's discretion to set buying and selling prices in a dual-priced fund should be classified as an anti-dilution mechanism. A respondent argued that describing dual pricing as purely an ADT may have unintended consequences that may not have been considered. However, they noted that dual pricing has the benefit of discouraging first-mover advantage.

2.12 Four respondents responded to our question on funds' ability to 'soft close.' All respondents agreed this could be beneficial. Three said effective soft closure relied on the ability to enact it promptly, with some noting that the requirement for 60 days' notice made soft closure difficult in practice.

2.13 One respondent made the general observation that while UK AFMs generally had access to a range of liquidity management tools, funds should be able to adopt their full liquidity toolkit as appropriate for each individual fund. They noted that we should consider refining and extending deferred redemption, permitting suspension of redemptions while accepting subscriptions, and widening the situations in which funds could adopt side pockets.

2.14 This respondent sought to engage with us further on the application of notice periods for funds investing in inherently illiquid assets.

Our response

Anti-dilution tool availability

AFMs of UCITS schemes and NURS should have policies and procedures governing how and when ADTs are used. Having considered feedback, we are satisfied that the approach we consulted on is proportionate.

We expect the AFM to remain ultimately responsible for managing the liquidity risks of the fund in investors' best interests. While we will require AFMs to have ADTs available, we have opted against prescriptive requirements for when to activate these tools, and how they are calibrated. We retain the view that it is for the AFM to determine when dilution risk warrants the activation of its anti-dilution tools, so we do not foresee that the new rules will necessarily lead to a more frequent use of ADTs.

Fixed requirements for activation, such as redemption or subscription thresholds as a percentage of a fund's NAV, may not be appropriate for all funds. Such an approach could also have the unintended consequence of allowing certain investors to predict and exploit the use of ADTs. Consequently, the AFM retains discretion over when these tools should be activated, the frequency of their use and their calibration as, in its capacity as fund manager, it will be best placed to decide taking into account investment strategy, investor base and its knowledge of the fund's liquidity profile.

By having ADTs available for use and considering how to best calibrate ADT use for different asset classes and strategies, our approach seeks to support sustainable investment in small and medium-sized firms. Appropriately calibrated ADTs should enable AFMs of schemes holding such securities to recognise where abnormally large costs from the sale of these securities may unfairly dilute the value to the existing or remaining investors.

We believe this principle is already explained in COLL 6 Annex 5.25 and no further statements to this effect are required.

On widening the liquidity management toolkit, we agree it is important that a broad range of tools is available to fund managers. However, restrictions apply to the use of some quantity-based tools. We are not proposing any changes to how AFMs can use quantity-based tools in this Policy Statement. However, we have taken this feedback into account as we develop our proposals for our follow-up consultation on NURS invested in inherently illiquid assets.

Our draft rules required AFMs to use ADTs 'when necessary' to protect the interest of unitholders from dilution in the value of scheme property, providing further guidance that this meant when dilution posed a 'material risk' to unitholders. To further clarify our requirements, we have now incorporated the 'material risk' element into the rule itself, retaining the relevant example in the guidance provision regarding material risk.

In finalising our rules, we have also sought to clarify the drafting. We have made it clear that an AFM will be required to have both policies and procedures for identifying and assessing the impact of dilution on scheme property, and an anti-dilution mechanism for protecting unitholders' interests in circumstances where the AFM has assessed that such dilution poses a material risk.

Selection of anti-dilution tools
The choice of ADTs should remain as a dilution levy, dilution adjustment, or use of dual pricing. However, we accept the feedback that our description of an AFM's ability to set buying and selling prices may not have captured as accurately as it could where an AFM's discretion sits in terms of its ability to mitigate dilution in a dual-priced fund.

Further analysis of the anti-dilution mechanism for dual-priced funds can be found in our response to question 9.

Soft closure
We note the feedback received on soft closure. Our existing rules allow AFMs to introduce this mechanism, albeit as a significant change to the fund requiring adequate written notice to unitholders, therefore requiring 60 days' notice. Without having consulted on changes to soft closure, we do not propose any changes to the position at this time, but given the feedback received, we will continue to keep this under review.

Unauthorised Alternative Investment Funds (AIFs)
We are consulting in CP26/28 on the liquidity risk management framework for alternative investment fund managers (AIFMs) of unauthorised AIFs. This includes proposing baseline liquidity requirements, aligned to the FSB and IOSCO recommendations, for small AIFMs of open-ended or leveraged closed-ended AIFs. This will bring existing small AIFMs in scope of explicit liquidity risk management rules for the first time.

Chapter 3

Calibration of anti-dilution tools

3.1 ADTs should be calibrated to support the fair treatment of investors, by ensuring that the costs arising from subscriptions and redemptions are appropriately allocated to transacting investors, rather than being borne by remaining investors. Our consultation proposed guidance setting out the factors an AFM's policies and procedures on liquidity risk management should include to ensure appropriate calibration of its ADTs.

Consultation proposal

3.2 We proposed that the policies and procedures governing the calibration of ADTs should take into account:

- The explicit and implicit liquidity costs of an actual or potential transaction, calculated on the basis of a pro-rata apportionment of the scheme property across all unitholders ('vertical slicing');
- An appropriate estimate of the likely impact on the price of a transferable security where the AFM is required to sell a significant quantity of that security to meet redemption requests. This can be done by reference to previous transactions or relevant market data and models.

3.3 We proposed a new requirement for an AFM of a UCITS scheme or NURS to perform a retrospective assessment annually, to analyse how decisions on applying ADTs have led to the fair treatment of investors. We did not propose to prescribe how AFMs should do this, although we included guidance on the factors they should consider.

3.4 Given that the availability of ADTs would no longer be optional, we proposed to reflect this in the fund's prospectus by making clear that AFMs must adequately explain the policies and procedures governing their use.

3.5 We said that dilution risk exists equally in single-priced and dual-priced funds, but the mechanisms to address this risk are different. By making it explicit that the AFM's responsibility to prevent dilution also applies to a dual-priced fund, we acknowledged that the AFM would also be brought into scope of associated requirements on prospectus disclosure, record-keeping, and significant change notifications.

3.6 We asked:

Question 7: **Do you agree with the factors included in the proposed guidance regarding calibration of anti-dilution tools, for example that an AFM should take into account both explicit and implicit costs when calibrating its anti-dilution tools?**

Question 8: **Do you agree that the AFM of a UCITS scheme and a NURS should be required to annually review the effectiveness of its anti-dilution policies to ensure all unitholders have been treated fairly?**

Question 9: **Do you agree with our proposed approach for dual-priced funds? Do you anticipate there may be any other implications of our proposals beyond those explained above?**

Question 10: **Do you have any other comments on our proposals relating to anti-dilution tools?**

Feedback received

3.7 Six organisations responded to question 7. Most were broadly supportive, with some seeking clarification on how the 'vertical slicing' requirement should work in practice. One respondent fully agreed with the proposals.

3.8 Two respondents broadly agreed with the proposed guidance but stressed that AFMs should be allowed to exercise judgement over whether to execute transactions on a 'vertical slice' basis, rather than requiring this method for every transaction.

3.9 One respondent disagreed with the need for liquidity costs to be calculated on a pro-rata basis. They suggested this be replaced with a general expectation for AFMs to use professional judgement when assigning transaction costs. Two respondents agreed with AFMs taking into account the liquidity costs by calculating them on a pro-rata basis. However, they did not agree with the need to factor in the true cost to the scheme, or the price impact of selling a security.

3.10 One respondent referred to funds that invest in both liquid and illiquid assets, but do not reach the threshold to be funds investing in inherently illiquid assets (FIIAs), often referred to as 'hybrid funds.' They said that additional clarity would be helpful regarding how best to evidence the liquidity premium of the product within the implicit costs. To most effectively manage first-mover advantage, the respondent said that the fund spread should be able to capture an assumed cost of trading exposures in illiquid assets, even if the AFM does not need to sell illiquid assets to facilitate investor redemptions.

3.11 On the same topic of NURS invested in illiquid assets, another respondent agreed with the proposed guidance for appropriately calibrating anti-dilution mechanisms that requires the AFM to assume it will meet a redemption request by selling a vertical slice of the portfolio. However, they said the guidance should note that this is theoretical for real estate funds that hold a significant proportion of their portfolio in physical property. Given the nature of the portfolio, in the short term, liquidity will be managed through the liquid element, although the balance between liquid and illiquid assets will be maintained within the portfolio over time.

3.12 We received 4 responses on the need to conduct an annual effectiveness review. Two agreed without further comment. The others broadly agreed but stressed that the review should take into account the conceptual nature of anti-dilution mechanisms. One of these respondents thought the proposed language in COLL 6.3.8BR should be amended, to avoid giving the impression that an annual retrospective review could 'ensure' that unitholders had been treated fairly. Instead, a retrospective review can only assess the extent to which this has occurred.

3.13 A total of 3 respondents answered question 9. Although one respondent was supportive, two challenged our assertion that an AFM's ability to set the buying and selling prices of a dual-priced fund is the mechanism which mitigates dilution. Instead, they noted that rules about the formation of issue and cancellation prices did so.

3.14 We also received 3 responses to question 10. One had minimal comment, while 2 proposed exempting feeder funds from mandatory anti-dilution requirements, on the basis that dilution could not arise in the feeder fund which serves only as a vehicle for accessing the master fund's portfolio.

3.15 We did not receive feedback on our proposed changes to the prospectus disclosure requirements.

Our response

Explicit and implicit liquidity costs

We note the feedback received to question 7. As a general principle, we expect AFMs to maintain a fund's liquidity profile. This avoids a scenario in which, if the AFM relies on its most liquid assets to satisfy redemptions, remaining investors are left over time with an increasingly illiquid portfolio.

We accept that it may not be feasible or desirable for AFMs to meet every redemption request by selling a vertical slice of their portfolio. We do not expect AFMs to execute every transaction in this manner and recognise that some less liquid assets may take longer to sell. However, the costs of selling these less liquid assets should be factored into the calibration of ADTs.

AFMs may use their professional judgement when deciding how to execute individual transactions. However, if the fund's liquidity profile departs from its target liquidity allocations, investors may find themselves in a scheme with a materially different risk profile to that which they chose to invest in.

To prevent this, vertical slicing serves as a baseline against which liquidity costs are assessed when calibrating ADTs, rather than a requirement for executing every transaction. As such, we have removed the reference at COLL 6.3.7CG (2) for any anti-dilution mechanism to reflect the true cost to the scheme. We accept that not every transaction executed will reflect the exact true cost to the scheme and have amended our final guidance to emphasise the principle that the scheme's liquidity profile must be preserved over time. Instead, it now recommends AFMs to take into account each transaction's explicit and implicit liquidity costs, to preserve the liquidity profile of the scheme.

On NURS invested in illiquid assets, we recognise that the nature of the portfolio means short-term liquidity may be managed through the most liquid assets. However, any dilution adjustment or spread should capture an assumed cost of trading exposures in illiquid assets, even if the AFM does not immediately sell these illiquid assets to facilitate investor redemptions.

That is because the AFM of an illiquid NURS is subject to the same expectation that it maintains the scheme's liquidity profile. As such, we have not made special provision in our guidance for NURS invested in illiquid assets.

However, we believe that requiring an illiquid NURS to have redemption terms which better reflect the liquidity of the portfolio would mean that AFMs of such funds can reduce reliance on a liquidity buffer to satisfy redemption requests, as the length of the notice period should reflect the AFM's estimate of how long it would take to sell a representative sample of the portfolio.

AFMs of illiquid NURS will therefore have an interest in our follow-up CP on addressing liquidity mismatch in NURS invested in illiquid assets.

Retrospective reviews
Following feedback, we have made an amendment to COLL 6.3.8BR. We recognise that retrospective reviews cannot of themselves ensure unitholders have been treated fairly. We have therefore amended the drafting to make clear that AFMs must assess the extent to which anti-dilution mechanisms have resulted in the fair treatment of unitholders in the past.

We have also restructured the rule more generally to clarify the drafting.

Dual-priced funds
We also accept the feedback received in respect of dual-priced funds. As drafted in CP25/38, COLL 6.3.7AR (2)(b) framed the anti-dilution mechanism as being the AFM's ability to set buy and sell prices for units. We acknowledge this may not describe where a dual-priced AFM's discretion sits as accurately as it could.

Dual pricing works differently to a dilution adjustment or dilution levy in a single-priced fund, but should achieve the same outcome for investors. Dilution in a dual-priced fund is addressed in the calculation of the issue and cancellation prices, as the AFM applies a percentage levy (the notional dealing charge) on the respective valuations to reflect the AFM's best estimate of transaction costs.

For example, the cost of stamp duty on a purchase of shares increases the 'offer' valuation compared to the 'bid' valuation. The issue and cancellation prices should reflect the costs of issuing and cancelling a unit, including explicit and implicit costs. We do not agree that an AFM has no discretion at all over the determination of the percentage levy which applies to the issue and cancellation prices.

However, where fund flows can be netted off against each other, and there are few or no transactions in the underlying portfolio required, charging the full spread between issue and cancellation prices to investors has the potential to create concentration – the opposite of dilution – as transacting investors cannot benefit from the effect of transactions by other investors in the opposite direction. So, the AFM of a dual-priced fund can choose to set a narrower dealing range between sales and redemptions to reflect the actual volumes of buying and selling orders.

Although different to how an AFM approaches dilution in a single-priced fund, the dual-pricing mechanism nevertheless serves to protect against material risk from either dilution or concentration in the value of the scheme property.

The AFM's ability to make provisions for large deals in units of a dual-priced fund also serves an anti-dilution purpose. A large deal is a unit transaction of such a value that special pricing arrangements apply to it. The threshold is normally set out in the prospectus. AFMs may charge higher selling prices or pay lower redemption prices for such deals, provided that the adjusted dealing price remains within the range of the issue and cancellation prices.

As a result, we have amended our final rules to make clear that it is the AFM's procedures for allocating portfolio transaction costs when setting the prices of units, and the fact that AFMs can make special provision for large deals, which act as the anti-dilution mechanism within the AFM's control.

Feeder funds

We note the feedback received in respect of feeder funds.

There is some risk that, should a master fund execute a large redemption request for its feeder, it may impose a fee on the feeder for doing so which would be passed on to selling investors. We will therefore not be exempting feeder funds from the requirement to have ADTs available for use. However, the AFM of a feeder fund need only use these tools where it identifies the risk of actual dilution in the fund.

Prospectuses

We will proceed largely as consulted on for the prospectus disclosure requirement. However, there will now be a delay of nearly 6 months between the publication of our rules and their commencement, to allow stakeholders to make the necessary arrangements. In the consultation we proposed a transitional provision which would not require an AFM to amend its prospectus until the earlier of the date on which the prospectus is next updated for other reasons, or 12 months from near the commencement date of the instrument.

To give AFMs time to familiarise themselves with the new rules and make any necessary updates to their systems and procedures, the new rules will come into effect on 1 February 2027. The transitional provision for COLL 4.2.5R (18) will then expire six months later, on 1 August 2027.

AFMs will have nearly 12 months' notice from the making of the rules to familiarise themselves with the final rules. This comprises a 6-month period between the making of the rules and the commencement date, as well as a 6-month transitional period until the rule comes into effect.

Chapter 4

UCITS schemes and NURS liquidity risk management

4.1 Investors in UCITS schemes and most NURS normally expect to be able to redeem their investment on demand and be repaid promptly. Most of these schemes deal every business day. The liquidity of the securities and other assets that these schemes hold is key to ensuring daily dealing functions effectively.

4.2 We want to ensure that investors are appropriately protected from potential losses or delay in getting their money, should firms have difficulty managing fund liquidity.

Consultation proposal

4.3 In CP25/38, we proposed to remove the 'listed asset presumption.' An AFM could no longer presume that, because a transferable security is admitted to trading on an eligible market, its liquidity would not compromise the AFM's ability to redeem units.

4.4 However, we proposed retaining the similar presumption which applies to a money-market instrument (MMI) under COLL 5.2.7HR (3). Their relatively short maturity, and the requirements they must satisfy to be an approved MMI, mean they have a reduced liquidity risk.

4.5 UCITS schemes and NURS have always been allowed to invest in recently issued transferable securities which were not yet admitted to trading on an eligible market, as long as admission is obtained within a year of issue. We proposed that AFMs could in future only invest in such securities if they are classified as unapproved securities, and held in the unapproved securities bucket (currently 10% of the value of scheme property for a UCITS scheme and 20% for a NURS).

4.6 We also proposed to prevent a UCITS scheme or a NURS from investing in derivative instruments that reference recently issued securities not yet admitted to an eligible market.

4.7 Further proposals included:

- requiring an AFM to consider conflicts of interest between transacting investors and those remaining in the fund
- bringing a revised version of the ESMA liquidity stress testing guidelines within our Handbook
- strengthening requirements on stress testing, by requiring AFMs to carry out stress testing on a UCITS scheme's liquidity risk under both normal and exceptional cases.

4.8 We consulted on guidance on good liquidity risk management practices, containing our expectations for a well-functioning liquidity risk management system. We also stated our general expectation that AFMs should not operate on the basis that daily dealing would always be the optimal fund structure.

4.9 We said we expect AFMs to consider whether funds' redemption terms match the liquidity of their underlying assets and, if the AFM intends a fund to have significant exposure to securities with limited liquidity, this may mean choosing more restrictive redemption terms. However, we did acknowledge that the fund distribution system largely operates on the assumption of daily-dealt models and that there are challenges associated with moving away from it.

4.10 We asked:

Question 11: **Do you agree with removing the 'listed asset presumption' for transferable securities to avoid an AFM placing overreliance on the fact that a transferable security is admitted to trading when assessing its eligibility?**

Question 12: **Do you agree with the factors that an AFM should consider when assessing the liquidity risk of a transferable security?**

Question 13: **Do you agree the 'listed asset presumption' should be retained for an approved money-market instrument?**

Question 14: **Do you agree with removing the derogation from the eligible market test for recently issued securities?**

Question 15: **Do you agree with the consequential change proposed to the rules on the approved derivatives in which a UCITS scheme and a NURS can invest?**

Question 16: **Do you agree that this proposal should have a limited impact on any fund's specific investment strategies? For example, that it should not limit a fund's ability to invest in IPOs? If not, please provide any data you can to support this.**

Question 17: **Do you agree with our proposed guidance relating to eligible markets?**

Question 18: **Do you agree our proposed rule adequately captures the risks of conflicts of interest between those unitholders who want to redeem their units and those who want to remain invested?**

Question 19: **Do you agree with our proposed approach to bring the ESMA liquidity stress test guidelines into the Handbook?**

Question 20: **Are there any other areas where you consider that updates or revisions to the guidelines would be appropriate? Please explain your rationale.**

Question 21: **Do you agree that the new guidance proposed in COLL 6 Annex 4 adequately captures the key components of an effective liquidity risk management system?**

Feedback received

4.11 We received 5 responses on removing the listed asset presumption. Respondents broadly supported our proposals and three agreed with our proposal unreservedly. One respondent challenged tightening liquidity expectations further, citing the risk of AFMs reducing small-cap exposure in response to tighter supervisory expectations around liquidity. Another respondent noted the need for final rules to clarify that liquidity assessments should apply both to the underlying asset and to the market and exchange on which it is traded.

4.12 Four respondents commented on question 12 and, generally speaking, there was consensus among them. However, 2 respondents requested clarification on how firms were expected to evidence their consideration of the factors. Another suggested supplementing the guidance by referring to additional material considerations, such as the concentration of holdings and potential for correlated redemption behaviour. The final respondent agreed unreservedly.

4.13 Three respondents covered question 13. Two agreed with our proposals without further comment. One respondent believed that the presumption should not be retained, because even traditionally liquid MMIs can experience impaired liquidity under certain market conditions. The respondent said that liquidity should be assessed based on prevailing market information and not assumed by regulation. The other respondents agreed with our view that the specific characteristics of an MMI that make it eligible for a UCITS scheme or a NURS means it is appropriate to retain the presumption.

4.14 Four respondents to question 14 commented on whether to remove the derogation from the eligible market test for recently-issued transferable securities. One respondent fully agreed with the proposal.

4.15 One questioned whether it was intended to capture new debt instruments, and another raised the possibility of limited flexibility for securities subject to a binding, time-limited commitment to admission to trading. Finally, one respondent pointed out that between issuance and listing, some instruments remained actively traded without substantial deterioration of their liquidity profile.

4.16 We received 3 responses to question 15, with all 3 approving fully. Two organisations addressed question 16. One agreed the proposal should not materially impact fund investment strategies, provided funds could continue to invest in new issues in line with their mandates. Another disagreed, suggesting that removing the derogation could increase some funds' unapproved asset exposure, potentially requiring portfolio adjustments and affecting investor outcomes.

4.17 There were 3 substantive responses to question 17. Respondents broadly supported proposals. However, two requested clarification that liquidity should be assessed both at asset level and market level. One respondent also suggested the guidance at COLL 5.2.10AG should apply across all relevant markets, including UK and EEA regulated markets.

4.18 Four organisations responded to question 18, which asked whether rules sufficiently address conflicts of interest between redeeming and remaining investors. They all agreed that the proposed rule adequately captures conflicts between redeeming and remaining unitholders. Two respondents suggested further clarification on governance, documentation and how firms should show how they had considered such conflicts of interest, with one stressing that firms should be able to justify instances where they chose not to apply specific tools.

4.19 We received three responses to question 19 and 20, covering our proposals to bring ESMA guidelines into the Handbook. While there was overall support, one respondent challenged removing the 'where appropriate' qualification that applies to the guidance on reverse stress testing, noting ESMA's current approach is to recommend that reverse stress tests be carried out on an exceptional basis.

4.20 The 3 respondents to question 21 were largely in favour of the proposed guidance, although one disagreed with the recommendation that a fund invested in inherently illiquid assets, such as real estate, should have a notice period to ensure that its investment strategy, liquidity profile and redemption policy are aligned.

4.21 This respondent said fixed notice periods often provide poor outcomes for investors, compared to deferred redemptions. The same respondent made the general observation that a principles-based, rather than specific, approach to the guidance annex would be preferable.

4.22 Another respondent suggested adding guidance on investor disclosure regarding liquidity risks and the use of liquidity management tools. The same respondent also suggested that we add a guidance provision to the annex containing guidance notes on liquidity risk management regarding the monitoring of the correction of exceptions identified. Some respondents noted that it would be helpful to understand how the AFM's considerations should be evidenced or documented.

4.23 One respondent also generally welcomed our acknowledgement that daily dealing should not automatically be deemed appropriate.

4.24 However, this respondent also noted that the consultation did not mention fund distribution models, nor how alternative fund structures, beyond daily-dealt funds, could emerge. They noted this could risk AFMs responding to increased expectations on the liquidity assessment of individual securities by potentially adjusting asset allocations away from small and mid-cap equities.

Our response

Removing the 'listed asset presumption'

We acknowledge the feedback received on removing the listed asset presumption, noting the risks flagged to small-cap equities should AFMs review investment strategies in light of our changes.

However, we take the view that our proposed rule change should not, on its own, lead AFMs to widely re-evaluate particular asset classes. AFMs must already undertake rigorous assessment of a transferable security's liquidity before acquisition, with COLL 5.2.7AR setting detailed criteria for assessment before any investment in a transferable security may be made.

We also note the feedback that there needs to be adequate distinction between asset-level and market-level liquidity risk factors. However, those factors are closely interlinked. For example, the new guidance at COLL 5.2.7BG (2)(a) recommends that the AFM consider the quality of secondary market activity in the transferable security, in terms of the volume of transactions over a reasonable period of time, and the number and quality of intermediaries and market makers with respect to the trading of that transferable security.

We do not think it is right to approach the eligible asset and eligible market tests as two entirely separate tests. For a transferable security to be eligible for investment by a UCITS scheme or a NURS, not only must it be admitted to an eligible market, but the AFM must also be confident that the market is sufficiently liquid for that transferable security, so that holding it in the fund would not risk compromising the AFM's ability to redeem units.

We will not be making any changes to this guidance. We do not expect firms to make material changes to how they document factors they consider as part of a security's liquidity risk assessment, nor do we propose prescribing a specific format in which they should carry out or record this assessment. In practice, our expectation is that firms already regularly assess transferable securities as part of an ongoing liquidity bucketing exercise to determine a fund's liquidity risk profile. COLL 5.2.7BG does not seek to impose new documentation burdens on firms, but to clarify examples of good practice for firms' liquidity risk assessments.

As for the presumption of liquidity of an MMI, we do not believe that we have received sufficient representations from industry stakeholders to justify amending the existing rule, but we believe the presumption continues to be appropriate for MMIs.

Removing the derogation from the eligible market test

Given feedback that AFMs' ability to participate in new issuances could be adversely impacted by removing the derogation from the eligible market test altogether, we are amending our proposal slightly.

We accept that the time between issue and listing for transferable securities is in many cases short. Consequently, a need to classify holdings of new issues as unapproved securities, only to then reclassify them as approved securities once they have secured admission to trading soon after, may cause operational difficulties for firms that frequently subscribe to new issues.

We will therefore retain the principle of the derogation from the eligible market test in COLL 5.2.8R (3)(e) but reduce it to allow 20 business days for the transferable securities to secure admission to trading, rather than a year. This should allow AFMs to continue acquiring recently-issued securities without impairing overall portfolio liquidity. Where COLL 5.2.8R(3)(e) is cross-referenced in other provisions of COLL (i.e. COLL 5.6.5R (1)(b) and COLL 5.2.20R (2)(a)), the '20 business days' derogation will also apply for those purposes. Since we are keeping the derogation, albeit with a shorter duration, we are removing the proposed new guidance at COLL 5.2.9CG (3) as it no longer applies.

In the consultation, we proposed a transitional provision to preserve the effect of the existing rule (i.e., the 12-month period for admitting transferable securities) for recently-issued transferable securities that were held in schemes on the day before the new rule commenced. This was to avoid a 'cliff-edge' for schemes that held transferable securities that had not yet been admitted to an eligible market.

Given that we will now retain the derogation, albeit for 20 business days, and there will be a six-month delay in our rules coming into force, we have updated the transitional provision for the amendments to COLL 5.2.8R (3)(e). These also affect COLL 5.6.5R (1)(b) and COLL 5.2.20R (2)(a). The transitional period will now end on 1 August 2027.

Where an AFM has invested in a recently-issued transferable security issued before 1 August 2026, it can hold those securities under the derogation for as long as it would have lasted anyway, which is a year.

For example, if the securities were issued on 31 July 2026, then they could be held under the derogation until 30 July 2027. However, any transferable securities issued between 1 August 2026 and 31 January 2027 would need to be admitted to an eligible market by 1 August 2027, when the transitional provision expires. From 1 February 2027, any recently-issued securities which the AFM buys would be subject to the 20 day limit.

Eligible markets requirement

Some respondents noted that the supplementary guidance to the eligible market test in COLL 5.2.10R could be read as removing the requirement for a liquidity assessment of the market as a whole, with a security's liquidity being assessed solely at asset level. The same respondent noted that the rule, as amended, only applied to exchanges outside regulated UK and European Economic Area (EEA) markets, whereas there would also be assets traded on markets within the UK and EEA which could have limited liquidity.

While an AFM may continue to consider the liquidity of the market as a whole, our guidance makes clear that this assessment should be secondary to the consideration of the liquidity in that market for the transferable security in question, given that is the most relevant factor when determining whether a security is appropriate for investment by a UCITS scheme or a NURS.

We note feedback commenting that liquidity requirements should apply across all markets, not just UK and EEA regulated markets. The new guidance at COLL 5.2.10AG only requires AFMs to assess the liquidity of an exchange regulated outside the UK or EEA. The criteria in COLL 5.2.10R (2), which the new guidance supplements, only apply to a market that is not a UK or EEA market.

However, a transferable security admitted to a UK or EEA market would still need to satisfy the tests in COLL 5.2.7AR. We will be proceeding with our eligible markets guidance as consulted on.

Treating all unitholders fairly

We proposed a new rule to require an AFM to consider potential conflicts of interest between remaining and redeeming investors, as well as potential conflicts arising from the AFM's incentive to invest in less liquid or illiquid assets and its obligations to redeem units in accordance with the sale and redemption of units rules in COLL.

We are dropping the proposal for AFMs to manage and monitor conflicts between an AFM's incentive to invest in less liquid or illiquid assets, and its obligation to redeem units in accordance with the sale and redemption rules. This appeared as the new COLL 6.6.3R (5)(b) in the consultation.

The new guidance provision at COLL 6.3.7CG, and new guidance at COLL 5.2.7BG already covers the need for fund managers to consider alignment between the scheme's redemption policy and liquidity profile. We think this adequately sets out our expectation that AFMs consider their obligations to investors under their existing redemption policy, while COLL 6.2.16R sets out the AFM's duties towards subscribing or redeeming investors.

Noting feedback in favour of balancing any new rule for AFMs with their broader existing responsibilities, we think the need to balance the AFM's incentive to invest in less liquid or illiquid assets and its obligations under its redemption policy is covered sufficiently at COLL 6.6.3R (5)(a).

The rule was intended to ensure that AFMs balance their duties towards redeeming and remaining investors. Generally speaking, while AFMs may be incentivised not to meet redemption requests by selling less liquid assets with long-term potential, the new guidance on calibration of ADTs already sets out our expectation that vertical slicing be used as the calibration baseline. We now believe the supplementary rule at COLL 6.6.3R (5)(b) is not necessary to balance redeeming and remaining investors' interests, so we have removed it.

Stress testing and ESMA Guidelines
We will require stress testing to be carried out for UCITS schemes based on both normal and exceptional market conditions, as consulted on. We did not propose to amend the stress testing rules for AIFMs. We will address these rules for authorised AIFs in our forthcoming Consultation Paper. We have also brought a UK version of ESMA's stress testing guidelines into our Handbook and updated them as consulted on.

In our consultation, we proposed that certain guidance in COLL 6 Annex 6 would apply to MMFs, subject to it not conflicting with MMF regulation. We have since taken the decision that stress-testing arrangements for MMFs will be covered in future work on updating the UK MMF regulatory regime.

As part of our UK updates to the ESMA Guidelines, we removed the qualification that reverse stress testing need only be done 'where appropriate.' Proactive supervisory work on good practices in reverse stress testing in UK funds is ongoing, with a view to identifying liquidity challenges.

We remain of the view that reverse stress testing is one of the most important stress tests that can be performed, because it can identify scenarios that could lead to significant scheme liquidity risk.

So, we are retaining the reverse stress testing recommendation within our guidance, without the 'where appropriate' qualification. While we accept that implementing reverse stress testing could introduce operational costs for firms not already conducting it, retaining it as guidance in its current form reflects our expectations that it is a beneficial part of a firm's liquidity toolkit.

Guidance on good liquidity risk management practices
Given broad feedback consensus, we will proceed with our guidance on good liquidity risk management practices largely as consulted on.

We have added a guidance provision at COLL 6 Annex 5, paragraph 4.4G(5) that AFMs should consider including, as part of their controls, the ability to make corrections to the anti-dilution mechanism, such as improvements to calibration identified following the retrospective review. We have removed the guidance provision we proposed in the consultation at FUND 3.7.5ABG, which stated that the AIFM of a NURS should take into account the guidance annex when meeting its obligations under

FUND 3.7.5R. This is because COLL 6.3.7DG, which the guidance annex hangs off, already applies to NURS.

We acknowledge feedback that the guidance appears to assume that funds holding illiquid assets will have notice periods. We will take this into account in our upcoming consultation on notice periods.

Regarding investor disclosure, we chose not to propose new rules on how liquidity risks are disclosed to investors as we want UK AFMs to be able to offer a broad range of investment strategies for the benefit of investors and wider capital markets. We recently made final rules on the product summaries which will accompany Consumer Composite Investments (CCIs). These new rules have introduced a requirement for the manager of an illiquid fund (including a FIIA) to add '1' to the risk score (DISC 5.6.5R (1)).

Separately, for CCIs with low liquidity or that are not regularly priced, the manufacturer must also include a risk warning to that effect and that it may impact the retail client's ability to redeem or otherwise exit their investment (DISC 5.8.1R (10)). Taken together with the existing Handbook disclosure requirements for AFMs, we do not propose at this time to introduce any further guidance on investor disclosure.

Daily Dealing and Fund Structures

Being able to choose more restrictive redemption terms allows an AFM to mitigate the liquidity risks of following investment strategies which require significant exposure to securities with limited liquidity. However, we acknowledge that there are challenges with incorporating non daily-dealt funds into the existing fund distribution infrastructure.

Our work considering how to make a wider range of fund structures available to UK AFMs is ongoing and we will continue to work with industry to help overcome the remaining challenges. We will soon consult on proposals to address liquidity mismatch in NURS predominantly invested in inherently illiquid assets. As part of this we intend to consult on widening the availability of limited redemption arrangements so that the dealing terms of authorised funds with exposure to inherently illiquid assets better match the liquidity of the underlying assets.

In recent years we have already sought to provide AFMs with more flexibility by introducing the LTAF regime, which allows for investment into longer term illiquid assets. In COLL 15.6.7G, we say we expect the investment strategy of an LTAF to be to invest at least 50% of the value of the scheme property in unlisted securities and other long-term assets such as interests in immovables or other collective investment schemes investing in such securities or long-term assets. However, an LTAF could have a strategy of investing mainly in a mix of unlisted assets and listed but less frequently traded assets.

The changing fund and secondary market landscape

Since the introduction of MiFID II, there have been significant changes to UK equity trading, with competition and innovation widening the range of ways to trade including greater concentration around the end of the trading day.

We are aware that secondary market liquidity of securities can differ significantly. As shown in Figure 1, there is a vast differential in both the value and the volume of trading in FTSE 350 instruments in comparison with non-FTSE 350 UK equities. This remains an ongoing focus area for us, in the context of wider work on reviving equity markets in the UK.

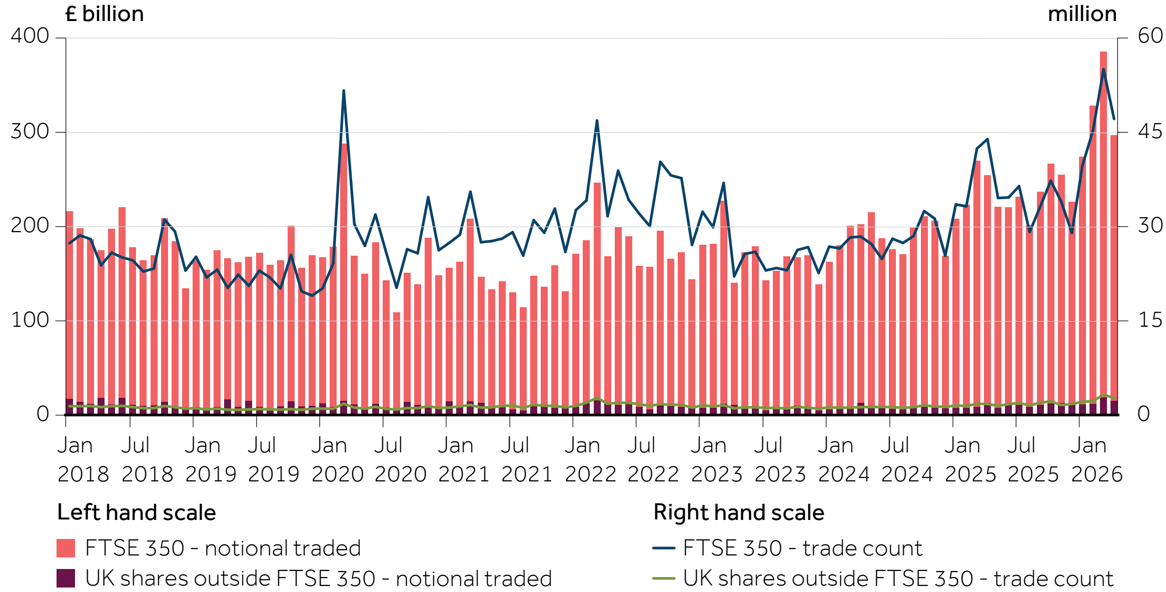
Whilst liquidity in non-FTSE 350 stocks has remained considerably lower than FTSE 350 instruments, in asset management there has been an increased focus on liquidity management, following some fund suspensions and other liquidity events. In particular, the focus has been on liquidity management for daily-dealing funds. This has been reflected in enhanced international standards on managing fund liquidity risk by the international standard-setters, IOSCO and FSB.

At the same time, due to an environment of increasing costs, and increased competition from exchange-traded funds (ETFs), we understand that open-ended funds have typically become larger to be commercially viable and to be able to compete. The combination of these factors creates a challenging dynamic for inflows into UK small-caps. We recognise that these structural issues are challenging. We want there to be an environment where capital can be allocated effectively, to a broad range of issuers, with liquidity a consideration but not an accidental primary driver for capital allocation.

Given the significant variations within secondary market liquidity and the current UK fund ecosystem, considering how to move beyond daily-dealing structures remains a key area of future work. In practice, we note that institutional investors take a variety of measures to manage their need for liquidity, where they do not necessarily require daily-dealing structures. Side letters remain a key structure for managing this dynamic. That said, we recognise that further work needs to be done to ensure that the UK fund ecosystem is equipped to allow a wide investor base to have continued access to securities which experience differing levels of secondary market liquidity.

Separately, we are aware of the challenges of incorporating non daily-dealt funds into the existing UK platform infrastructure. We are engaging with market participants to consider how to address these challenges.

Figure 1: Total trading in FTSE 350 and non-FTSE 350 UK Equities



Source: BMLL Technologies, FCA analysis.
Data for trade counts and notional traded are monthly sums of all trades minus those flagged as non-price forming trades (NPFT) or trades not contributing to price discovery (TNCP). Data covers ISINs classified as equities or closed-ended funds on the FCA's Official List and traded across European trading venues and APAs between January 2018 and April 2026.

Chapter 5

Other matters

Delegation of the portfolio management function

5.1 In CP25/38, we described our expectations where an AFM delegates portfolio management to a third party that may have significant influence over the fund's design, distribution and management.

5.2 We did not propose to make any new rules or guidance in respect of host AFM arrangements, on the basis that the existing framework and expectations for both parties are currently clear. As set out in the consultation, the Decision Notices issued to Woodford Investment Management (WIM) and Mr Neil Woodford explain the distinct but complementary responsibilities of the AFM and MiFID investment manager in ensuring that an appropriate liquidity risk management framework is established and followed.

5.3 We asked:

Question 22: **Do you agree with our decision not to propose any new rules or guidance in relation to host AFM arrangements?**

5.4 We received 4 responses to question 22. Three respondents agreed that it was not necessary to make any further rules or guidance. However, one noted that some additional supervisory guidance may reinforce practical accountability with delegation structures.

5.5 We continue to monitor host AFM arrangements and will take a targeted approach to engagement with host AFMs to ensure that liquidity risk management practices are in line with our expectations. We will keep under review whether further guidance on these arrangements would be beneficial.

Effect on other market participants

5.6 In the consultation we said that some other market participants may be affected by our proposals. For example, investment platform providers might need to make minor system updates to reflect the introduction of ADTs by a limited number of AFMs. However, we considered this impact should be small because many platform providers already accommodate the use of such tools for other AFMs and so should not need to put any new processes in place.

5.7 We noted that under COLL 6.6.4R, a depositary must take reasonable care to ensure that the AFM considers whether to use the power provided by COLL 6.3.8R (Dilution), but it has no duty in respect of the AFM using its discretion to activate these tools.

5.8 We did not propose to place any new requirement on depositaries, although we said that they may need to make small changes to update their systems when an AFM introduces ADTs for the first time.

5.9 One respondent commented on the possible impact on depositaries and said that they appreciated our clarification that the depositary's role remains limited to verification. They explained that, while depositaries are required to verify that the AFM has appropriate, documented procedures in place for liquidity stress testing, they are not required to assess the adequacy of the AFM's liquidity models, assumptions, methodologies, or outputs. Nor are they required to replicate, recalculate, or challenge the liquidity stress testing undertaken by the AFM. The respondent stressed that this delineation is important to preserve the integrity of the respective functions and avoid unnecessary duplication of responsibilities.

5.10 We agree on the distinct roles and responsibilities of an AFM and a depositary, and we do not believe that our new rules or guidance should have the effect of blurring or redefining these. Rather, we consider that COLL 6 Annex 5.3.57G to 5.3.60G makes this distinction sufficiently clear.

Wider liquidity proposals

5.11 Our consultation flagged plans to consult separately in 2026 on the liquidity management framework for alternative investment funds as part of the wider AIFMD review.

5.12 We said that we planned to reconsult on requiring some authorised AIFs invested in inherently illiquid assets, such as real estate, to have minimum notice periods, bringing them in line with the LTAF regime.

5.13 A handful of respondents commented specifically on this chapter. One stressed the need to consider proportionality and competitiveness when developing liquidity management rules for small AIFMs. Another expressed interest in working with us to develop our notice periods for funds investing in inherently illiquid assets. A final respondent stated that fixed notice periods may not be the optimal tool for managing liquidity mismatch.

5.14 We will consult separately on new proposals for retail funds invested in inherently illiquid assets.

Applicability of rules to money-market funds (MMFs)

5.15 Recently, we set out our next steps on issuing new rules and guidance on MMFs, following UK Government plans to replace the current rules.

5.16 The Government intends to lay legislation soon revoking the current UK MMFR. In December 2023, we consulted on updating the regime for MMFs in the UK. In this consultation, we proposed creating a new MMFS in the FCA Handbook which would take effect on the Government's revocation of the MMFR.

5.17 We want to ensure that our final rules on strengthening the liquidity risk management framework for authorised retail funds do not prejudice any future reforms to the UK MMF regime. We have therefore reviewed areas where any changes to current Handbook rules that cover liquidity risk management could also be applicable to MMFs.

5.18 The final rules and guidance do not propose any changes to the scope of the rules with respect to MMFs. Where new guidance has been added, this will not apply to MMFs. We anticipate that future work on UK MMF regulatory reform will consider how changes to rules and guidance made in this instrument will apply to MMFs.

5.19 As a general principle, where we have amended an existing rule in COLL that could apply to an MMF, we have not made any changes to the scope of the rule. The table below clarifies the scope of changes to rules and guidance which AFMs of MMFs should note:

Rule change	Scope
Definition of "dilution"	This definition applies to a UCITS scheme or NURS which is an MMF.
COLL 4.2.5R(18)	We have preserved the current requirements for a UCITS scheme or NURS which is an MMF.
COLL 5.1.2G (1A)	This provision applies to a UCITS scheme or NURS which is an MMF.
COLL 5.2.7AR	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 5.2.7B G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 5.2.8R	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 5.2.10 AA G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.2G	This provision applies to a UCITS scheme or NURS which is an MMF.
COLL 6.3.5BA G	This provision does not apply to a UCITS scheme or NURS which is an MMF.

Rule change	Scope
COLL 6.3.7A R	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.7B G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.7C G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.7D G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.8A G	This provision applies to a UCITS scheme or NURS which is an MMF.
COLL 6.3.8B R	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.3.8C G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6.6.3 R	This provision applies to a UCITS scheme or NURS which is an MMF.
COLL 6.12.11R	This provision applies to a UCITS scheme or NURS which is an MMF.
COLL 6.12.11A G	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6 Annex 5 (Guidance notes on liquidity risk management)	This provision does not apply to a UCITS scheme or NURS which is an MMF.
COLL 6 Annex 6 (Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes)	This provision does not apply to a UCITS scheme or NURS which is an MMF.
FUND 3.6.3A G	This provision does not apply to a UCITS scheme or NURS which is an MMF.

Annex 1

List of respondents

We are obliged to include a list of the names of respondents to our consultation who have consented to the publication of their name. That list is as follows:

Aberdeen

Amelia Lo

Association of Real Estate Funds (AREF)

Investment Company Institute (ICI)

Investment Association

Quoted Companies' Alliance (QCA)

St. James's Place

UK Depositary Association (UKDA)

UK Private Capital

Annex 2

Abbreviations used in this paper

Abbreviation	Description
ADT / ADTs	Anti-dilution tool / anti-dilution tools
AFM / AFMs	Authorised fund manager / authorised fund managers
AIF / AIFs	Alternative investment fund / alternative investment funds
AIFM / AIFMs	Alternative investment fund manager / alternative investment fund managers
AIFMD	Alternative Investment Fund Managers Directive
CBA	Cost Benefit Analysis
CCI / CCIs	Consumer Composite Investment / Consumer Composite Investments
COLL	Collective Investment Schemes sourcebook
CP	Consultation Paper
DISC	Disclosure sourcebook
EANDCB	Equivalent Annual Net Direct Cost to Business
EEA	European Economic Area
ESMA	European Securities and Markets Authority
ESG	Environmental, social and governance
FCA	Financial Conduct Authority
FIIA / FIIAs	Funds investing in inherently illiquid assets
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act
ICI	Investment Company Institute
IOSCO	International Organization of Securities Commissions
IPO / IPOs	Initial public offering / initial public offerings

Abbreviation	Description
LTAF / LTAFs	Long Term Asset Fund / Long Term Asset Funds
MiFID	Markets in Financial Instruments Directive
MMF / MMFs	Money market fund / money market funds
MMFR	Money Market Funds Regulation
MMFS	Money Market Funds sourcebook
MMI / MMIs	Money-market instrument / money-market instruments
NAV	Net Asset Value
NPV	Net Present Value
NURS	Non-UCITS retail scheme / non-UCITS retail schemes
QCA	Quoted Companies' Alliance
QIS	Qualified investor scheme
UCITS	Undertakings for Collective Investment in Transferable Securities
WIM	Woodford Investment Management

Appendix 1

Made rules (legal instrument)

COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK (LIQUIDITY MANAGEMENT) INSTRUMENT 2026

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to give guidance);
(d) section 247 (Trust scheme rules);
(e) section 248 (Scheme particulars rules);
(f) section 261I (Contractual scheme rules); and
(g) section 261J (Contractual scheme particulars rules);

(2) regulation 6(1) (FCA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228); and

(3) the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions of the FCA's Handbook.

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 February 2027.

Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below.[1]

(1)	(2)
Glossary of definitions	Annex A
Collective Investment Schemes sourcebook (COLL)	Annex B
Investment Funds sourcebook (FUND)	Annex C

[1] The material in this instrument is in part adapted from the European Institutions © European Union, 1998-2025 and re-used and adapted under the terms of the Commission Decision 2011/833/EU

Notes

E. In the annexes to this instrument, the notes (indicated by "**Note**:" and "*Editor's note*:") are included for the convenience of readers, but do not form part of the legislative text.

Citation

F. This instrument may be cited as the Collective Investment Schemes Sourcebook (Liquidity Management) Instrument 2026.

By order of the Board
30 July 2026

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

Amend the following definition as follows.

dilution	(in *COLL*) the amount of *dealing* costs incurred, or expected to be incurred, by or for the account of ~~a *single-priced authorised fund*~~ an *authorised fund* to the extent that these costs may reasonably be expected to result, or have resulted, from the acquisition or disposal of *investments* by or for the account of the ~~*single-priced authorised fund*~~ *authorised fund* as a consequence (whether or not immediate) of the increase or decrease in the cash resources of the ~~*single-priced authorised fund*~~ *authorised fund* resulting from the *issue* or *cancellation* of *units* over a period~~;~~. ~~for~~ For the purposes of this definition, *dealing* costs include both the costs of *dealing* in an *investment*, professional fees incurred, or expected to be incurred, in relation to the acquisition or disposal of an immovable and, where there is a spread between the *buying* and selling prices of the *investment*, the indirect cost resulting from the differences between those prices.

Annex B

Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

4 Investor Relations

…

4.2 Pre-sale notifications

…

Table: contents of the prospectus

4.2.5 R This table belongs to *COLL* 4.2.2R (Publishing the prospectus).

…			
Dilution			
18	~~In the case of a *single-priced authorised fund*, details~~ Details of what is meant by *dilution* including:		
	(a)	a statement explaining:	
		…	
		(ii)	~~which of the policies the *authorised fund manager* is adopting under *COLL* 6.3.8R(1) (Dilution)~~ the *authorised fund manager's* policies, procedures and mechanism under *COLL* 6.3.7AR or, with respect to a *regulated money market fund*, its policies for the purposes of *COLL* 6.3.8R(1) and *COLL* 6.3.8R(1A) (Dilution), together with an explanation of how ~~this policy~~ these policies and procedures may affect the future growth of the *authorised fund*; ~~and~~
	(b)	~~if the *authorised fund manager* may require a *dilution levy* or make a *dilution adjustment*, a statement of~~ in relation to a *single-priced authorised fund*, the statement at (a) must include the following:	
		…	
…			

…

5 Investment and borrowing powers

5.1 Introduction

…

Purpose

5.1.2 G (1) …

(1A) The *rules* relating to the spreading of risk aim to protect investors from losses that might arise if, for example, a *scheme* is overly concentrated in a small number of investments, or cannot raise enough liquidity to meet *redemption* demands on a timely basis, or has excessive exposure to a counterparty that can no longer meet its obligations to the *scheme*.

…

…

5.2 General investment powers and limits for UCITS schemes

…

Investment in transferable securities

5.2.7A R (1) A *UCITS scheme* may invest in a *transferable security* only to the extent that the *transferable security* fulfils the following criteria at the time of its acquisition and for as long as it comprises part of the *scheme property*:

…

(2) Unless there is information available to the *authorised fund manager* that would lead to a different determination, a *transferable security* which is admitted to or *dealt* in on an *eligible market* shall be presumed:

(a) ~~not to compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder*; and~~ [deleted]

…

…

5.2.7B G (1) Where information is available to the *authorised fund manager* ~~considers~~ that the liquidity or negotiability of a *transferable security* might compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder*, it should assess the *liquidity risk* of that *transferable security* in accordance with ~~*CESR's UCITS eligible assets guidelines* with respect to article 2(1) of the *UCITS eligible assets Directive*~~ the stress testing required under *COLL* 6.12.11R (Measurement and management of risk) and *COLL* 6 Annex 6 (Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes).

(2) When assessing whether the liquidity of a *transferable security* might compromise the *authorised fund manager's* ability to meet *redemption* requests for the purpose of *COLL* 5.2.7AR(1)(b), the *authorised fund* manager should consider:

(a) the quality of secondary market activity in the *transferable security*, in terms of:

(i) the volume of transactions in relation to the trading of that *transferable security* over a reasonable period of time, having regard to the nature of the *transferable security*; and

(ii) the number and quality of intermediaries and *market makers* with respect to the trading of that *transferable security*;

(b) how the *scheme's* holding of, or proposed transaction in, a *transferable security* that it might need to trade in the event of significant *redemptions* or subscriptions compares to the average daily volume of trades in that *transferable security*;

(c) the opportunities available to buy or sell the *transferable security* and the time it may take to do so; and

(d) the proportion of the value of the *scheme property* that the *transferable security* represents.

(3) An *authorised fund manager* may choose to inform its assessment of the relative liquidity and negotiability of a *transferable security* by reference to analysis of sales and purchase figures by an independent third party.

…

Transferable securities and money-market instruments generally to be admitted to or dealt in on an eligible market

5.2.8 R …

(3) Subject to (5), *transferable securities* and *approved money-market instruments* held within a *UCITS scheme* must be:

…

(e) recently issued *transferable securities*, provided that:

(i) the terms of issue include an undertaking that application will be made to be admitted to an *eligible* market; and

(ii) such admission is secured within ~~a year~~ 20 *business days* of issue.

…

[**Note**: article ~~50(1)(a)-(d)~~ 50(1)(a)-(c) and (h) and (2)(a) of the *UCITS Directive* and article 3(1) of the *UCITS eligible assets Directive*]

…

Eligible markets: requirements

5.2.10 R …

5.2.10-A G In considering whether a market is adequately liquid for the purposes of *COLL* 5.2.10R(3)(e), the *authorised fund manager* should consider how the factors set out in *COLL* 5.2.7BG(2) and (3) apply generically to the types of *scheme property* in which it intends to invest through that market.

…

6 Operating duties and responsibilities

…

6.3 Valuation and pricing

Application

6.3.1 R …

(3) The following *rules* and *guidance* do not apply to an *authorised fund manager*, a *depositary*, an *ICVC*, or any other ~~director~~ *director* of an *ICVC* where the *authorised fund* is a *regulated money market fund*:

…

(d) *COLL* 6.3.5R; ~~and~~

(e) *COLL* 6.3.5AR to *COLL* 6.3.5CG~~.~~;

(f) *COLL* 6.3.7AR;

(g) *COLL* 6.3.7BG to *COLL* 6.3.7DG;

(h) *COLL* 6.3.8BR; and

(i) *COLL* 6.3.8CG.

…

Purpose

6.3.2 G …

(2) An *authorised fund manager* is responsible for valuing the *scheme property* of the *authorised fund* it manages and for calculating the price of *units* in the *authorised fund*. This section protects *clients* by:

…

(b) ~~allowing~~ requiring the *authorised fund manager* to take steps to mitigate the effects of ~~any~~ *dilution* (reduction) in the value of the *scheme property* caused by buying and selling underlying investments as a result of the *issue* or *cancellation* of *units*; and

…

…

…

Sale and redemption price parameters for dual-priced authorised funds

6.3.5B R …

6.3.5BA G An *authorised fund manager* should apply *COLL* 6.3.5BR so as to ensure fair treatment between *unitholders* who are *dealing* in *units* and *unitholders* who were already invested or remain invested in the *scheme.*

…

Dilution

6.3.7A R (1) (a) An *authorised fund manager* must put in place policies and procedures which set out:

(i) how the *authorised fund manager* will identify instances, or potential instances, of *dilution* affecting the value of the *scheme property*; and

(ii) how, in such instances, the *authorised fund manager* will assess, at each *valuation point*, the impact, or likely impact, of such *dilution* on the *unitholders* in the *scheme.*

(b) An *authorised fund manager* must have an anti-*dilution* mechanism that the *authorised fund manager* will use to protect the interests of *unitholders* when it has assessed reasonably that *dilution* affecting, or potentially affecting, the value of *scheme property* poses a material risk to *unitholders* (see (2)).

(2) The mechanism in (1)(b) must provide for:

(a) in the case of a *single-priced authorised fund*, the payment of a *dilution levy* or the making of a *dilution adjustment*; and

(b) in the case of a *dual-priced authorised fund*, the allocation of portfolio transaction costs when setting *unit* prices, together with the ability to make provision for *large deals*.

(3) For a *single-priced authorised fund*, the policies and procedures in (1) must include:

(a) the *authorised fund manager's* policy on:

(i) when to require a *dilution levy* and its policy on *large deals* (including what is meant by *large deals*); or

(ii) when to make a *dilution adjustment*;

(b) how the *authorised fund manager* calculates the estimated rate or amount of any *dilution levy* or *dilution adjustment* based either on historical data or future projections; and

(c) when the *authorised fund manager* may require a *dilution levy* or make a *dilution adjustment* and the basis (historical or projected) on which the statement is made.

(4) An *authorised fund manager* must apply the policies and procedures and the anti-*dilution* mechanism referred to in (1) as appropriate to the circumstances and in a timely manner.

6.3.7B G (1) An *authorised fund manager* should ensure that the policies and procedures for the *authorised fund* enable it to apply the anti-*dilution* mechanism in *COLL* 6.3.7AR(1)(b) at every *valuation point*.

(2) However, as reflected in that *rule*, the mechanism need not be applied when the *authorised fund manager* has assessed reasonably that the *dilution* affecting the value of the *scheme property*, or the potential for such *dilution*, does not pose a material risk to *unitholders*. For example, cash outflows due to the *redemption* of *units* may be offset against cash inflows from the purchase of *units*.

6.3.7C	G	(1)	An *authorised fund manager's* policies and procedures should provide for the appropriate calibration of the anti-*dilution* mechanism in *COLL* 6.3.7AR(1)(b).
		(2)	For the purposes of (1), an *authorised fund manager* should take account of the explicit and implicit liquidity costs associated with a transaction, or potential transaction, in order to preserve the liquidity profile of the *scheme*.
		(3)	The liquidity costs at (2) should be calculated on the basis of a pro-rata apportionment of the *scheme property* across all *unitholders*. Such calculations should include an appropriate estimate, by reference to previous transactions or relevant market data and models, of the likely impact on the price of a *transferable security* in circumstances where the *authorised fund manager* is required to sell a significant quantity of that *transferable security* in order to meet one or more *redemption* requests.
6.3.7D	G	An *authorised fund manager* should take into account the *guidance* on liquidity risk management practices set out in *COLL* 6 Annex 5 (Guidance notes on liquidity risk management).	
6.3.8	R	…	
6.3.8A	G	An *authorised fund manager* should apply *COLL* 6.3.8R(2) so as to ensure fair treatment between *unitholders* who are *dealing* in *units* and *unitholders* who were already invested or remain invested in the *scheme*.	
6.3.8B	R	An *authorised fund manager* must conduct a retrospective assessment at least annually of:	
		(1)	the decisions it has made to apply, or refrain from applying, the anti-*dilution* mechanism in *COLL* 6.3.7AR(1)(b) to the *sale* and *redemption* of *units*; and
		(2)	the extent to which those decisions have resulted in the fair treatment of all *unitholders* in the *scheme*, including those *unitholders* who were *dealing* in the *units* of the *scheme*, and those *unitholders* who were already invested or remained invested in the *scheme*.
6.3.8C	G	An assessment under *COLL* 6.3.8BR should review:	
		(1)	the choice of anti-*dilution* mechanism that was employed, where more than one could have been used;
		(2)	the calibration of every mechanism employed; and
		(3)	whether, during the period being assessed, the frequency in employing the mechanism was appropriate, having regard to the particular characteristics of the *scheme property* and the information

available to the *authorised fund manager* with respect to the investor profile of the *scheme*.

…

6.6 Powers and duties of the scheme, the authorised fund manager, and the depositary

…

Functions of the authorised fund manager

6.6.3 R …

(4) …

(5) The *authorised fund manager* must identify, manage and monitor conflicts of interest arising, or which may foreseeably arise, between *unitholders* who wish to *redeem* their *units* and *unitholders* who wish to retain their *units*.

…

6.12 Risk management policy and risk measurement

…

Measurement and management of risk

…

6.12.11 R …

(2) ~~Where appropriate, the~~ The *authorised fund manager* must conduct stress tests to enable it to assess the *liquidity risk* of the *UCITS* under both normal and exceptional circumstances.

[**Note**: article 40(3) of the *UCITS implementing Directive*]

6.12.11A G To comply with *COLL* 6.12.11R, the *authorised fund manager* of a *UCITS scheme* which is not a *regulated money market fund* should take into account the *guidance* at *COLL* 6 Annex 6 (Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes).

…

Insert the following new Annexes, COLL 6 Annex 5 and COLL 6 Annex 6, after COLL 6 Annex 4 (Use of distributed ledger technology for the operation and maintenance of registers for authorised funds). All the text is new and is not underlined.

6 Annex 5 **Guidance notes on liquidity risk management**

6 Annex 5.1 This Annex belongs to *COLL* 6.3.7DG (Dilution).

Purpose

6 Annex 5.2 G This Annex provides *guidance* on *rules* in *COLL* relating to the management of liquidity in an *authorised fund*.

Overview

6 Annex 5.3 G When complying with the *rules* and other requirements relating to the liquidity risk management of a *UCITS scheme* or a *non-UCITS retail scheme*, an *authorised fund manager* should apply the underlying principle that it must act in the best interests of *unitholders.*

[**Note**: See *COBS* 2.1.1R (The client's best interest rule) in relation to a *non-UCITS retail scheme* managed by a *small authorised UK AIFM*; *COLL* 6.6A.2R (Duties of AFMs of UCITS schemes to act in the best interests of the scheme and its unitholder) with respect to a *UCITS scheme*; and *COBS* 2.1.4R (AIFMs' best interests rules) with respect to a *non-UCITS retail scheme* managed by a *full-scope UK AIFM*.]

6 Annex 5.4 G (1) An effective liquidity risk management system relies on the liquidity of a *scheme's* portfolio being consistent with its *redemption* policy.

(2) An *authorised fund manager* should take account of (1) and (where applicable) *COLL* 6.12.12R (Measurement and management of risk) or *FUND* 3.6.2R (Alignment of investment strategy, liquidity profile and redemption policy), both at the design stage of a *scheme* and on an ongoing basis, to allow *unitholders* to *redeem* at an accurate price that reflects the value of their investment, ensuring fairness for both *redeeming unitholders* and those remaining in the *scheme*.

[**Note**: See Article 49 of the *AIFMD level 2 regulation*]

6 Annex 5.5 G (1) An *authorised fund manager* should decide what is an appropriate *redemption* policy by considering the *scheme's* unique characteristics.

(2) A material exposure to illiquid asset classes – such as real estate, infrastructure, private equity and private debt – within a *scheme* which is daily *dealt,* without applying a notice period or similar mechanism, would be likely to mean that the investment strategy, liquidity profile and *redemption* policy are not aligned.

6 Annex 5.6	G	The following *rules* relating to investment powers are particularly important for managing the ongoing liquidity: (1) of a *UCITS scheme*: (a) *COLL* 5.2.3R(1); and (b) *COLL* 5.2.7AR(1)(b); and (2) of a *non-UCITS retail scheme*: (a) *COLL* 5.6.3R(1); and (b) *COLL* 5.6.5AR.
6 Annex 5.7	G	Once a *scheme* has been established and has raised sufficient capital to invest in a diversified asset portfolio, the portfolio management function will be responsible for investment decisions as to whether a *scheme* can meet its *redemption* obligations to *unitholders*. On that basis, the portfolio management function should act as the primary safeguard for ensuring liquidity.
6 Annex 5.8	G	(1) On the basis that the requirement to provide a prudent spread of risk applies to all risks relevant to the *scheme property*, an *authorised fund manager* should: (a) consider each investment decision in the light of how it will support risk diversification; and (b) take reasonable steps to ensure that a portfolio manager also undertakes the consideration at (a). (2) For example, with respect to (1), consideration should be given to whether *buying* or *selling* a particular asset is likely to increase the overall proportion of *scheme property* that cannot be sold in good time under normal market conditions to meet the requirements of *COLL* 6.2.16R (Sale and redemption).
6 Annex 5.9	G	(1) For the majority of *UCITS schemes* and *non-UCITS retail schemes*, the liquidity of *transferable securities* is critical since they normally comprise the greater part of *scheme property*. (2) In an actively managed *scheme*, the due diligence process applied to a prospective new investment in a *transferable security* should include careful consideration of its market liquidity and how that is likely to affect the portfolio as a whole. (3) In relation to (2), this includes consideration of the degree of exposure the *scheme* has in relation to the overall issuance of the *transferable security*, which may be significant in the case of some small-cap *transferable securities*.

6 Annex 5.10	G	(1)	All the other *rules* in *COLL* 5 (Investment and borrowing powers) not specifically referred to should, in so far as they relate to the liquidity of the *scheme*, be interpreted with regard to the principles set out in this Annex.
		(2)	For example: (a) an *authorised fund manager's* consideration of the liquidity of an *eligible market* should not override its judgement as to whether any particular asset traded on that market is adequately liquid; and (b) in applying the requirements in *COLL* 5.2.11R (Spread: general) in relation to investment spread, an *authorised fund manager* should not assume that an asset is adequately liquid simply because its value does not exceed a percentage of the value of *scheme property* specified in the *rule*.
	An authorised fund manager's liquidity risk management system		
6 Annex 5.11	G	(1)	An *authorised fund manager* should take account of all relevant factors which could affect the *scheme's* liquidity when designing an effective liquidity risk management system.
		(2)	Effective liquidity management practices should provide an *authorised fund manager* with a holistic view of the risks that may arise in different market conditions and should facilitate its ability to identify an emerging liquidity shortage before it occurs.
6 Annex 5.12	G	(1)	The key features of an effective liquidity risk management system include those relating to liquidity bucketing (see (2)) and setting thresholds between the liquidity buckets (see (3)).
		(2)	(a) An *authorised fund manager* should employ a systematic and robust liquidity bucketing system that considers, at a minimum: (i) market depth and turnover; (ii) the time it would take to sell an asset or a portion of it under different market conditions; (iii) the likely market impact of large transactions; (iv) operational features and potential frictions; and (v) valuation certainty.

(b) The *authorised fund manager* should regularly assess the liquidity of a portfolio and review its liquidity bucketing allocations, including in response to any outcomes of its stress testing.

[**Note**: See *COLL* 6 Annex 5.30G to *COLL* 6 Annex 5.32G (Stress testing)]

(c) An *authorised fund manager* should take account of the time it would take to sell *transferable securities* in the different buckets without a price discount and how the price would be affected if a sale is required within a shorter timeframe.

(d) An *authorised fund manager* should pay particular attention to the least liquid assets in its portfolio and the impact which they could have on the overall liquidity profile of the *scheme*.

(3)

(a) With respect to liquidity thresholds, an *authorised fund manager* should ensure that its liquidity risk management system is based on appropriate liquidity thresholds which are proportionate to the *redemption* obligations and other liabilities of a *scheme*. For this purpose, the other liabilities of a *scheme* include non-*redemption* pressures, such as *margin* and *collateral* calls from *derivative* counterparties.

[**Note**: See *COLL* 6 Annex 5.33G to *COLL* 6 Annex 5.37G (Non-redemption pressures)]

(b) The appropriateness of the liquidity thresholds will depend on factors such as the *scheme's* investment strategy, its investor base and its *redemption* policy.

(c) An *authorised fund manager* should set liquidity thresholds to ensure that the *scheme's redemption* terms remain aligned with its liquidity profile, both in normal and stressed market conditions, and should consider whether these are appropriate for its underlying investor base.

6 Annex 5.13 G In designing its liquidity risk management system, an *authorised fund manager* should also have regard to the *guidance* in *COLL* 6 Annex 5.14G (Governance) to *COLL* 6 Annex 5.37G (Non-redemption pressures).

Governance

6 Annex 5.14 G (1) An *authorised fund manager* should ensure that liquidity risk management forms a prominent part of its governance arrangements and is integrated into its permanent risk management function.

[**Note**: See *COLL* 6.11.4R (Duties of the permanent risk management function) and Article 39 of the *AIFMD level 2 regulation*]

(2) An *authorised fund manager* should have an internal governance framework that has appropriate representation from all areas of the *firm*, including risk and distribution, while having a robust internal conflicts management system in place to ensure that the interests of the *unitholders* are prioritised.

[**Note**: See *SYSC* 10 (Conflicts of interest)]

6 Annex 5.15 G (1) An *authorised fund manager* should put in place arrangements for detailed liquidity reporting, which should be presented to its relevant governance committees.

(2) The detailed liquidity reporting should include *redemption* trends and the evolution of liquidity buckets, particularly when *redemptions* and declining liquidity coincide.

6 Annex 5.16 G An *authorised fund manager* should establish and document protocols for escalating liquidity issues and increasing governance frequency during volatile market conditions.

6 Annex 5.17 G An *authorised fund manager's* internal governance arrangements should include, at a minimum:

(1) objective criteria for making decisions and for the application of liquidity management tools (See *COLL* 6 Annex 5.25G to *COLL* 6 Annex 5.29G (Liquidity management tools));

(2) a clear methodology, including calibration of liquidity management tools;

(3) the identification of the relevant parties involved (for example, *senior personnel*, risk management, administration), their respective functions and responsibilities, and the system in place for coordinating their respective inputs;

(4) the sources of information and data used;

(5) the controls to be carried out (including reviews on the use of liquidity management tools and any adjustments to the calibration of the anti-*dilution* mechanism) and their frequency;

(6) the documentation of recommendations and decisions made about the use of liquidity management tools and the basis for them; and

(7) the escalation processes and oversight in place to ensure governance by the *governing body*.

6 Annex 5.18	G	(1)	An *authorised fund manager* should ensure that *persons* of suitable seniority, who individually or collectively possess adequate skills and knowledge, are involved in decisions about liquidity risk management and the use of liquidity management tools.
		(2)	An *authorised fund manager* should have an informed understanding of, or reliable data about, all relevant aspects of the *scheme* to support its recommendations and decisions, for example: (a) the investor profile of the *scheme*; (b) historical and predicted inflows and outflows of cash; (c) information about the current state of the markets for the assets held, including current bid-ask spread information, executed prices and differences with quoted bid-ask prices; (d) assessments of the ability to execute transactions in underlying assets, in terms of likely market impact of transacting in average or above-average lot sizes; (e) liquidity stress testing data; and (f) operational readiness to apply or adjust liquidity management tools, both for the *authorised fund manager* and its delegates or agents, and for others in the distribution network.
6 Annex 5.19	G	(1)	An *authorised fund manager's* oversight process should result in adequate and timely management information being produced and reported to its *senior personnel* and *governing body*.
		(2)	The content and amount of management information to be produced, and the decision as to who within the *firm* is best placed to consider it, should be decided in a proportionate way, taking account of the size of the *authorised fund manager*, the characteristics of the *scheme* it manages and the levels of management within its corporate structure.
		(3)	The *authorised fund manager's governing body* should consider the information reported to it and address appropriately any weaknesses that have been identified.
6 Annex 5.20	G		The process set out at *COLL* 6 Annex 5.19G should ensure that an *authorised fund manager's* most senior level of management explicitly considers liquidity risk management processes on a periodic basis to satisfy itself that the processes are adequate and are operating in the best interests of investors in the *scheme*.

Dealing arrangements

6 Annex 5.21	G	(1)	With respect to the requirements in *COLL* 6.2.16R (Sale and redemption), an *authorised fund manager* has discretion to determine the frequency of dealing days within limits and may take the power to use certain liquidity management mechanisms for some *schemes*, such as *deferred redemption* for some kinds of *non-UCITS retail schemes*, to manage the volume of redemption requests. [**Note**: See *COLL* 6.2.21R (Deferred redemption)]
		(2)	However, the obligation to carry out a *redemption* request for an individual *unitholder* should not be refused solely for reasons relating to the *scheme's* lack of liquidity. In these circumstances, suspension of *dealing* in the *scheme* is likely to be in the best interests of all *unitholders*. [**Note**: See *COLL* 7.2 (Suspension and restart of dealings)]
		(3)	Suspension should be considered a liquidity management tool of last resort, to be employed when needed but only when no other technique for managing liquidity will adequately protect *unitholders'* interests.
6 Annex 5.22	G	An *authorised fund manager* should have a comprehensive contingency plan in place for when a suspension is required. The *authorised fund manager* should take account of the fact that the suspension not only impacts *unitholders* in the suspended *scheme*, but may lead to a loss of confidence in other *schemes* managed by the *authorised fund manager*, or *schemes* with similar investment strategies which are managed by other *authorised fund managers*.	
		Redemption processes	
6 Annex 5.23	G	(1)	An *authorised fund manager* should closely monitor levels of *redemption* requests, taking account of large *redemptions* and cumulative smaller *redemptions*.
		(2)	An *authorised fund manager* should, as part of its monitoring, have an appropriate escalation process in place for both large *redemptions* and cumulative smaller *redemptions*.
		(3)	For the purposes of (2), an *authorised fund manager* should not rely solely on third-party administrators.
6 Annex 5.24	G	(1)	An *authorised fund manager* should, when meeting *redemption* requests, consider carefully the interests of the remaining *unitholders*, especially where the *scheme* holds less liquid assets, and should avoid a scenario in which the remaining *unitholders* in the *scheme* are left with an increasingly illiquid portfolio.

		(2)	An *authorised fund manager* should therefore have a process for considering alternative solutions to meet sudden large *redemptions* in *schemes* with a concentrated portfolio or investor base, or both.
	Liquidity management tools		
6 Annex 5.25	G	(1)	An *authorised fund manager* should select the liquidity management tools which are most suited to the *scheme's* investor base, investment strategy and liquidity profile.
		(2)	An *authorised fund manager* should put in place and periodically test contingency plans, with the aim of ensuring that its liquidity management tools can be used in a prompt and orderly manner.
6 Annex 5.26	G	(1)	An *authorised fund manager* should have policies on when it will consider using its liquidity management tools.
		(2)	The policies should be documented, sufficiently detailed and accessible to the *authorised fund manager's* relevant decision makers.
6 Annex 5.27	G	(1)	An *authorised fund manager* should not rely exclusively on quantity-based liquidity management tools – for example, deferral of *redemptions* or suspension.
		(2)	An *authorised fund manager* should, in the first instance, make use of anti-*dilution* tools to mitigate material investor *dilution* and potential first-mover advantage. Such anti-*dilution* tools include: (a) swing pricing (*dilution adjustment*) or *dilution levy* for *single-priced authorised funds*; and (b) procedures for allocating portfolio transaction costs when setting *unit* prices, and the *authorised fund manager's* ability to make provision for *large deals* for *dual-priced authorised funds.*
		(3)	Anti-*dilution* tools should support good liquidity management by ensuring the fair allocation of costs to transacting *unitholders* while reducing (and ideally eliminating) any possible first-mover advantage to some *redeeming unitholders* in a stressed market environment.
6 Annex 5.28	G	*COLL* 6.3.7CG (Dilution) sets out *guidance* as to how the price-based mechanisms in *COLL* 6.3.7AR to *COLL* 6.3.8R should be calibrated.	
6 Annex 5.29	G	(1)	An *authorised fund manager* should calculate the thresholds for the application of anti-*dilution* tools and their calibration on a *scheme*-by-*scheme* basis, rather than using a one-size-fits-all approach, taking into account both explicit and implicit costs, such as market impact.

(2) An *authorised fund manager* should assess the *dilution* risk at each *valuation point*. However, in the case of a *single-priced authorised fund*, it may choose not to apply a *dilution adjustment* or *dilution levy* where it has reasonably assessed that the *dilution* risk is not material.

Stress testing

6 Annex 5.30 G (1) An *authorised fund manager* should carry out stress testing in line with *COLL* 6 Annex 6 (Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes).

(2) An *authorised fund manager* should integrate stress testing into all stages of the *scheme's* life cycle, including in the product design stage when determining the *dealing* and distribution arrangements and portfolio composition, and in carrying out investment and liquidity risk management on an ongoing basis.

6 Annex 5.31 G An *authorised fund manager* should use the results of stress testing to:

(1) determine and assess the appropriate *dealing* arrangements for each *scheme* in light of its investment strategy and underlying assets, even under stressed scenarios;

(2) consider whether any adjustments to the *scheme's dealing* arrangements, investment strategy and underlying assets (including the holdings of liquid assets) are necessary;

(3) formulate action and contingency plans to use different liquidity management tools to deal with plausible stressed market conditions; and

(4) ensure that the *scheme* holds sufficient liquid assets and eligible *collateral* to meet *margin* and *collateral* calls in a timely manner, including in extreme but plausible stressed conditions.

6 Annex 5.32 G (1) An *authorised fund manager* should ensure that the performance and oversight of stress testing is sufficiently independent from the portfolio management function.

(2) In general, stress testing should be performed by the *authorised fund manager's* risk management function, with inputs from other relevant functions, such as its portfolio management and trading functions.

(3) The results of stress testing should be reviewed by the *authorised fund manager's* governance committee responsible for liquidity risk management and reported to its *senior personnel* and *governing body*.

(4) An *authorised fund manager* should maintain appropriate information about its stress testing activities, particularly regarding whether any actions are taken in light of the stress testing results. The *authorised fund manager* should be able to provide the relevant information to the *FCA* upon request.

Non-redemption pressures

6 Annex 5.33 G (1) An *authorised fund manager* should consider risks arising from any *securities financing transaction* in *derivative*s or *transferable securities* to which it is a party.

(2) For this purpose, an *authorised fund manager* should consider:

(a) the potential for increases in variation *margin* and *collateral* calls due to adverse market price movements;

(b) the potential for counterparties to increase initial *margin* and haircuts; and

(c) the risk that counterparties to a *securities financing transaction* terminate or refrain from 'rolling over' existing financing arrangements in a stressed situation.

(3) An *authorised fund manager* should:

(a) regularly assess *collateral* quality (for example, assessing for any deterioration in the liquidity of *transferable securities* held as *collateral*); and

(b) ensure that the *scheme* holds a sufficient quantity of liquid assets and eligible *collateral* to meet *margin* or *collateral* calls in a timely manner, including in extreme but plausible stressed conditions.

6 Annex 5.34 G (1) An *authorised fund manager* should regularly assess the diversification of its eligible *collateral* and minimise its credit risk, liquidity risk and *market risk* to ensure that the amount of *collateral* remains sufficient.

(2) An *authorised fund manager* may also consider the use of credit lines and/or the expansion of the range of eligible *collateral* under its financing agreements to reduce the need to hold *cash collateral*, where appropriate.

(3) An *authorised fund manager* should be able to:

(a) identify potential intra-day *margin* and *collateral* call requirements and ensure capacity to make timely delivery;

(b) monitor the amounts of readily available *cash* and non-*cash collateral* and ensure that it can make timely delivery in the relevant market; and

(c) identify, monitor, and manage *collateral* disputes with its counterparties to *derivatives* and *securities financing transactions*.

(4) An *authorised fund manager* should have adequate *collateral* management systems and processes to ensure the timely delivery of *margin* calls, including during stressed conditions.

(5) When designing these systems and processes, an *authorised fund manager* should consider the costs and benefits of:

(a) outsourcing certain aspects to third parties;

(b) standardisation and/or automation to maximise capacity to make timely delivery during periods of heightened market activity; and

(c) holding excess *collateral* in normal market conditions to reduce the impact of increased *margin* and *collateral* calls during stressed conditions.

6 Annex 5.35 G (1) An *authorised fund manager's* cash and *collateral* management systems should be:

(a) commensurate with the size, nature and complexity of the *authorised fund manager's* transactions to ensure processes are well designed and operationally resilient; and

(b) subject to frequent review.

(2)

(a) An *authorised fund manager* should test the operational readiness of its systems and the resilience of its third-party service providers under stressed conditions.

(b) For the purposes of (a), an *authorised fund manager* should test that *collateral* is unencumbered and accessible in the required timeframe, with prudent safeguards where re-hypothecation is used.

6 Annex 5.36 G (1) An *authorised fund manager* should maintain active, transparent and regular bilateral contact with counterparties and third-party *collateral* managers to identify and manage potential liquidity risks in plausible stress events.

(2) Such contact should occur at least annually or after a stress event and consider how counterparties' risk management practices will respond to a stress.

6 Annex 5.37 G An *authorised fund manager's* liquidity risk management system should capture the operational risks of using a third party, including ensuring adequate operational resilience to manage stressed conditions.

Further information

6 Annex 5.38 G (1) The *guidance* in this Annex takes account of *IOSCO's* report on 'Revised Recommendations for Liquidity Risk Management for Collective Investment Schemes'.

(2) The *IOSCO* recommendations include further material on aspects of liquidity risk management which an *authorised fund manager* is recommended to consider.

(3) *IOSCO* has also published guidelines: 'Guidance for Open-Ended Funds for Effective Implementation of the Recommendations for Liquidity Risk Management'.

(4) The *IOSCO* guidelines contain examples of good practice in several jurisdictions that may be helpful to an *authorised fund manager* for developing procedures and processes for managing liquidity risk.

6 Annex 6 Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes

6 Annex 6.1 This Annex belongs to *COLL* 6.12.11AG (Measurement and management of risk) and *FUND* 3.6.3AG (Liquidity systems and procedures).

Definitions

6 Annex 6.2 G (1) In this Annex, the terms specified in column (1) of the table in *COLL* 6 Annex 6.3G have the definitions given in column (2).

(2) The terms defined in *COLL* 6 Annex 6.3G are not italicised in this Annex.

6 Annex 6.3 G This table belongs to *COLL* 6 Annex 6.2G:

Term (1)	**Definition (2)**
ex-post additional liquidity management tools	tools or measures applied by an *authorised fund manager* in exceptional circumstances to control or limit dealing in *units* in the interests of investors,

	including, but not limited to, suspension of *dealing* in *units* and deferral of *dealing*.
fire sale	liquidation of *scheme property* at a material discount to its fair value.
liquidation cost	the cost paid by the seller of *scheme property* for the execution of a given transaction in a timely manner for liquidity purposes.
liquidity stress testing	a risk management tool within the overall liquidity risk management framework of an *authorised fund manager* which simulates a range of conditions, including normal and stressed (ie, extreme, unlikely or unfavourable) plausible conditions, to assess their potential impact on assets and liabilities, *scheme property*, overall liquidity of a *fund* and the necessary follow-up action.
redemption coverage ratio	a measurement of the extent to which the *authorised fund's scheme property* will be sufficient to meet funding obligations arising from the liabilities side of the balance sheet, such as a high level of *redemption* requests.
reverse stress testing	a *fund*-level stress test which starts from the identification of the pre-defined outcome with regards to *fund* liquidity (eg, the point at which the *fund* would no longer be liquid enough to meet requests to *redeem units* or to meet *margin* and *collateral* calls) and then explores scenarios and circumstances that might cause this to occur.
time to liquidity	an approach, whereby an *authorised fund manager* can estimate the amount of *scheme property* which could be liquidated at an acceptable cost, for a given time horizon.

Scope: who?

6 Annex 6.4 G This *guidance* applies to the *authorised fund manager* and *depositary* of:

(1) a *UCITS scheme* which is not *regulated money market fund*; and

(2) a *non-UCITS retail scheme* which is not a *regulated money market fund*.

Scope: what?

6 Annex 6.5	G	This *guidance* relates to liquidity stress testing in *UCITS schemes* and *non-UCITS retail schemes* within *COLL* 6 Annex 6.4G.	
6 Annex 6.6	G	(1)	This *guidance* should be adapted to the nature, scale and complexity of a *scheme*.
		(2)	Liquidity stress testing naturally overlaps with other aspects of liquidity management in a *scheme*, such as managing liquid assets and less liquid assets, diversification and implementing measures such as ex-post additional liquidity management tools.
		(3)	This *guidance* is not intended to be comprehensive regarding liquidity management issues outside the scope of liquidity stress testing.
	Liquidity stress testing: the design of liquidity stress testing models		
6 Annex 6.7	G	In building liquidity stress testing models, an *authorised fund manager* should determine:	
		(1)	the risk factors that may impact a *scheme's* liquidity;
		(2)	the types of scenarios to use and their severity;
		(3)	different outputs and indicators to be monitored based on the results of the liquidity stress testing;
		(4)	the reporting of liquidity stress testing results, outputs and indicators to management; and
		(5)	how the results of liquidity stress testing are used by the risk management function, the portfolio management function and by *senior personnel*.
6 Annex 6.8	G	An *authorised fund manager* should ensure that liquidity stress testing provides information that enables follow-up action.	
	Understanding liquidity risks		
6 Annex 6.9	G	An *authorised fund manager* should have a strong understanding of the liquidity risks arising from *scheme property* and liabilities on the *scheme's* balance sheet, and its overall liquidity profile, in order to employ liquidity stress testing that is appropriate for each *scheme* it manages.	
6 Annex 6.10	G	An *authorised fund manager* should employ liquidity stress testing that:	
		(1)	is adequately focused, specific to the *scheme* and highlights the key liquidity risk factors; and

		(2)	uses a wide enough range of scenarios to adequately represent the diversity of the *scheme*'s risks.
	Governance principles for liquidity stress testing		
6 Annex 6.11	G	(1)	An *authorised fund manager* should integrate and embed liquidity stress testing into the *scheme's* risk management framework supporting liquidity management.
		(2)	A *scheme's* liquidity stress testing should be subject to appropriate governance and oversight, including appropriate reporting and escalation procedures.
6 Annex 6.12	G	(1)	An *authorised fund manager* should perform liquidity stress testing under similar conditions to other risk management operations that are subject to regulatory requirements on independence. This includes the requirement for risk management staff to act independently from other functions, such as portfolio management.
		(2)	Nevertheless, the governance structure should consider how the outcome of liquidity stress testing is taken into consideration by the portfolio management function when managing the *scheme*.
6 Annex 6.13	G	Where an *authorised fund manager* delegates portfolio management to a third party, it should pay particular attention to the independence requirement in order to avoid reliance on, or influence by, the third party's own liquidity stress testing.	
6 Annex 6.14	G	(1)	An *authorised fund manager* should, as part of its organisational arrangements, have procedures to effectively manage conflicts of interest arising from operationalising liquidity stress testing.
		(2)	An *authorised fund manager* should not allow other parties, such as portfolio management staff (including portfolio managers from separate legal entities), to exercise undue influence over the execution of liquidity stress testing, including reliance on judgements relating to asset liquidity.
		(3)	Where an *authorised fund manager* shares information regarding the results of stress tests with a *unitholder*, an investor or a *person* who offers, recommends or *sells units* in the *scheme* to investors (or arranges to do so), the *authorised fund manager* should ensure that this would not be inconsistent with its obligation to treat all investors fairly in the way it discloses information regarding the *scheme*.
	The liquidity stress testing policy		
6 Annex 6.15	G	(1)	Liquidity stress testing should be documented in a liquidity stress testing policy within the *UCITS scheme's* or *non-UCITS retail scheme's* risk management process, which should require an

authorised fund manager to review the liquidity stress testing periodically and adapt it as necessary.

(2) The liquidity stress testing policy should include at least the following:

(a) the name of the *scheme* that is subject to liquidity stress testing;

(b) its internal ownership and which management function(s) are responsible for its performance;

(c) the frequency at which liquidity stress testing is carried out and the reasons for selecting that frequency;

(d) its interaction with other liquidity risk management procedures, including portfolio management and an *authorised fund manager's* contingency plans;

(e) a requirement for regular internal reporting of liquidity stress testing results, specifying the frequency and recipients of the report;

(f) a clear definition of the role of *senior personnel* in the process, including the role of the *governing body*;

(g) the circumstances requiring escalation, including when liquidity limits or thresholds are breached;

(h) initial validation of the liquidity stress testing models and the assumptions underpinning them, which should be performed independently from portfolio management, though not necessarily by an entity or *person* external to the *authorised fund manager*;

(i) the types and severity of stress test scenarios used and the reasons for selecting those scenarios;

(j) the assumptions used, relating to data availability for the scenarios, their rationale and how frequently they are revisited;

(k) the methods for liquidating *scheme property*, including the limitations and assumptions used; and

(l) periodic review, documentation of the results and a procedure for amending the policy where required by the review.

Frequency of liquidity stress testing

6 Annex 6.16 G (1) Liquidity stress testing should be carried out at least quarterly at all stages in a *scheme's* lifecycle or more frequently as *an authorised fund manager* considers appropriate.

(2) The reasons for determining when to undertake more frequent stress testing should be recorded in the liquidity stress testing policy.

6 Annex 6.17 G When deciding on the appropriate frequency of liquidity stress testing, an *authorised fund manager* should take into account the following:

(1) the *scheme's* characteristics, including its nature, scale and complexity and liquidity profile;

(2) the liquidity of the *scheme* as determined by the *authorised fund manager* and any change in the liquidity of *scheme property*;

(3) the need to adapt the frequency according to the nature of the particular *scheme,* rather than taking a 'one-size-fits-all' approach to all *schemes* operated by the *authorised fund manager*; and

(4) the circumstances in which liquidity management tools may be used.

6 Annex 6.18 G (1) An *authorised fund manager* should take into account the factors described in the table at (2) when determining the appropriate frequency of liquidity stress testing.

(2) This table belongs to (1).

	Factor	**Practice or considerations**	
(1)	Recommended frequency of liquidity stress testing	(a)	Quarterly, unless a higher frequency is justified by the characteristics of the *scheme*.
		(b)	The justification for the frequency of liquidity stress testing should be recorded in the liquidity stress testing policy.
(2)	Factors which may may increase the frequency of regular liquidity stress testing	Factors include:	
		(a)	high frequency in *dealing* in *units*;

		(b)	increased risks emanating from liabilities, such as a concentrated investor base;
		(c)	a complex investment strategy (eg, extensive use of *derivatives*);
		(d)	a less liquid *scheme property* base; and
		(e)	a forthcoming event which could negatively affect the liquidity of the *scheme property*.
(3)	Factors which may decrease the frequency of regular liquidity stress testing	Factors include:	
		(a)	a highly liquid *scheme property* base; and
		(b)	less frequent *dealing* in *units*.
(4)	Recommended employment of ad-hoc liquidity stress testing	Ad-hoc liquidity stress testing should be undertaken as soon as practicable if a material risk to *scheme* liquidity is identified by the *authorised fund manager* and requires being addressed in a timely manner.	

The use of liquidity stress testing outcomes

6 Annex 6.19 G Liquidity stress testing should produce outputs which:

(1) help ensure the *scheme* is sufficiently liquid, as required by applicable *rules* and *redemption* terms stipulated in *scheme* documentation;

(2) strengthen an *authorised fund manager's* ability to manage *scheme* liquidity in the best interests of investors, including in planning for periods of heightened liquidity risk;

(3) help an *authorised fund manager* to identify potential liquidity weaknesses in an investment strategy and assist in investment decision-making; and

(4) assist risk management monitoring and decision-making, including setting relevant internal limits as an additional risk management tool – this may include ensuring the results of liquidity stress testing can be measured through a comparable metric, such as a key risk indicator.

6 Annex 6.20 G (1) Liquidity stress testing should assist an *authorised fund manager* in preparing a *scheme* to adapt to a crisis, and in its broader contingency planning.

(2) Such contingency planning may involve an *authorised fund manager's* plans to use any ex-post additional liquidity management tools in relation to a *scheme*.

Adapting the liquidity stress testing to each fund

6 Annex 6.21 G An *authorised fund manager* should adapt liquidity stress testing appropriately to each *scheme*, including by adapting:

(1) the frequency of liquidity stress testing;

(2) the types and severity of scenarios employed to create stressed conditions. These should be sufficiently severe but plausible and based on the liquidity risks arising from the assets and liabilities of the *scheme's* balance sheet, as well as its overall liquidity profile;

(3) the assumptions regarding investor behaviour (gross and net *redemptions*) and the liquidation of *scheme property*;

(4) the complexity of the liquidity stress testing model, which should account for the complexity of the *scheme's* investment strategy, portfolio composition, liquidity management tools and use of *efficient portfolio management* techniques; and

(5) in the case of an *ETF*, its characteristics – for example, by taking into account the role of authorised participants, *redemption* models and replication models.

Liquidity stress testing scenarios

6 Annex 6.22 G Liquidity stress testing:

(1) should employ hypothetical and historical scenarios and reverse stress testing; and

(2) should not rely overly on historical data, particularly as future stresses may differ from previous ones.

6 Annex 6.23	G	An *authorised fund manager* should choose the historical scenarios that are most appropriate to the strategy of the *scheme* such as, for example, rising interest rates, credit spread widening or political events.
6 Annex 6.24	G	(1) An *authorised fund manager* using reverse stress testing should simulate *scheme property* being liquidated in a way that reflects how the *authorised fund manager* would liquidate *scheme property* during a period of exceptional market stress. (2) Reverse stress testing should take into account the treatment of remaining, as well as *redeeming*, *unitholders* as well as the role of transaction costs and whether fire sale prices would be accepted.
6 Annex 6.25	G	An *authorised fund manager* of a *scheme* that engages in investment strategies exposing them to low-probability risks with a potentially high impact should pay particular regard to the use of reverse stress testing to assess the consequences of an extreme market event for their liquidity profile.
6 Annex 6.26	G	(1) Reverse stress testing may be used to establish whether action needs to be taken to ensure a *scheme* is adequately liquid, or whether such a circumstance would be exceptional enough to warrant suspension of dealing in compliance with applicable rules. (2) In the case of a *UCITS scheme*, the 'exceptional circumstances' are those within the meaning of *COLL* 7.2.1R (Requirement) and the *scheme's prospectus*.
6 Annex 6.27	G	An *authorised fund manager* of a *non-UCITS retail scheme* may also use reverse stress testing to simulate the level of *scheme property* that may be liquidated before implementing any ex-post additional liquidity management tools allowed by its *redemption* policy.
	Data availability	
6 Annex 6.28	G	Liquidity stress testing should demonstrate that an *authorised fund manager* is able to overcome limitations relating to the availability of data, including by: (1) avoiding optimistic assumptions; (2) justifying reliance on third parties' liquidity stress testing models, including where the model is developed by a third-party portfolio manager; and (3) exercising expert qualitative judgement.
6 Annex 6.29	G	In particular, an *authorised fund manager* should adapt its approach where data is limited and any assumptions used should be adequately reviewed.

6 Annex 6.30	G	(1)	Appropriate reductions in *scheme property* liquidity should be simulated in times of both normal and stressed market conditions, particularly where historical data does not provide sufficiently severe examples of stressed conditions.
		(2)	An *authorised fund manager* should not assume that a portfolio can be liquidated at the full average daily traded volume of an asset unless such an assumption can be justified based on empirical evidence.
	Product development		
6 Annex 6.31	G	During product development, an *authorised fund manager* should:	
		(1)	be able to demonstrate to the *FCA* that key elements of the *scheme*, including its investment strategy and dealing frequency, enable it to remain sufficiently liquid during normal and stressed circumstances; and
		(2)	where appropriate, undertake liquidity stress testing on the *scheme property* side (using a model portfolio) as well as on the liability side, incorporating the expected investor profile both from the early and late stages of the *scheme's* existence.
6 Annex 6.32	G	Liquidity stress testing can also be used on establishing a *scheme* to help identify factors material to the future risk management of the *scheme*. For example:	
		(1)	quantifying the sensitivity of the *scheme's* liquidity risk;
		(2)	identifying factors impacting liquidity risk;
		(3)	identifying metrics and key risk indicators to monitor liquidity risk going forward;
		(4)	setting the frequency for applying risk management processes; and
		(5)	assessing any potential ex-post additional liquidity management tools to be included in the *prospectus*.
	Stress testing scheme property to determine the effect on fund liquidity		
6 Annex 6.33	G	Liquidity stress testing should enable an *authorised fund manager* to assess not only the time and/or cost to liquidate *scheme property* in a portfolio, but also whether such an activity would be permissible, taking into account:	
		(1)	the investment objectives and policy of the *scheme*;
		(2)	the obligation to manage the *scheme* in the interests of investors;

(3) any applicable obligation to liquidate *scheme property* at limited cost; and

(4) the obligation to maintain the risk profile of the *scheme* following liquidation of a portion of its *scheme property*.

6 Annex 6.34 G

(1) Liquidation cost and time to liquidity are the 2 principal approaches typically employed by an *authorised fund manager* to simulate the liquidity of *scheme property* under normal and stressed conditions.

(2) An *authorised fund manager* should apply the appropriate approach for the individual *scheme*.

(3) Approaches other than those at (1) may also be adopted for the *scheme.*

6 Annex 6.35 G

An *authorised fund manager* should consider the following factors when assessing the liquidation cost of *scheme property* under normal and stressed conditions:

(1) the type of *scheme property*;

(2) the liquidation horizon; and

(3) the size of the trade or order.

6 Annex 6.36 G

An *authorised fund manager* should reflect a significant number and variety of market stresses in the estimation of the liquidation cost and time to liquidation under stressed conditions, which are typically characterised by higher volatility, lower liquidity (eg, higher bid-ask spreads) and longer time to liquidate (depending on asset class). Reference should not be made only to historical observations of stressed markets.

6 Annex 6.37 G

(1) An *authorised fund manager* should choose the method of liquidating *scheme property* in liquidity stress testing, taking into account the assets and liabilities, as well as the *redemption* terms, of a *scheme*.

(2) An *authorised fund manager* should also be aware of the limitations in the chosen method and make conservative adjustments to its broader liquidity risk management to mitigate those limitations.

6 Annex 6.38 G

The method of liquidating *scheme property* in a liquidity stress test should:

(1) reflect how an *authorised fund manager* would liquidate *scheme property* during normal and stressed conditions in accordance with regulatory requirements and any limitations specific to a *scheme* as imposed by the *prospectus*;

(2) where an *authorised fund manager* opts to reduce its exposure to *derivatives* rather than liquidate assets, reflect the time and/or cost required to do so, as well as the liquidity generated, for example through the release of initial *margin*;

(3) ensure the model used for a *scheme* stays in compliance with its investment objectives and policy;

(4) reflect the *scheme* being managed in the interests of all investors, both those *redeeming* and remaining;

(5) comply with applicable obligations for a *scheme* to maintain the risk profile envisaged by *scheme* documentation;

(6) be reflected in the liquidity stress testing policy; and

(7) take into account, where relevant, the potential negative effects on other investors or on overall market integrity.

Stress testing fund liabilities to determine the effect on fund liquidity

6 Annex 6.39 G Liquidity stress testing should incorporate scenarios relating to the liabilities of a *scheme*, including both *redemptions* and other potential sources of risk to liquidity emanating from the liability side of the *scheme's* balance sheet.

6 Annex 6.40 G Liquidity stress testing should incorporate risk factors relating to investor type and concentration according to the nature, scale and complexity of a *scheme*.

6 Annex 6.41 G An *authorised fund manager* should take into account the following when considering liquidity risk scenarios:

(1) *redemption* requests are likely to be the most common and typically most important source of liquidity risk for a *scheme*;

(2) additionally, different types of liabilities on a *scheme's* balance sheet and their potential impact on *scheme* liquidity may vary, according to the nature of the *scheme*; and

(3) ex-post additional liquidity management tools may be considered when managing liability risk.

6 Annex 6.42 G (1) For normal conditions, an *authorised fund manager* may decide to monitor the historical outflows (average and trends over time), average *redemptions* of a peer *scheme*, and information from any distribution network regarding forecast *redemptions*.

(2) An *authorised fund manager* should ensure that the time series is long enough to fairly reflect 'normal' conditions.

6 Annex 6.43 G For stressed conditions, example scenarios may include historical trends, historical events, contemporary trends in a peer *scheme*, hypothetical or event-driven scenarios and reverse stress testing.

6 Annex 6.44 G Depending on the availability of granular historical data covering *redemptions* for each investor type and other information relative to a *scheme's* specific distribution, an *authorised fund manager* may also simulate *redemption* requests for different types of investors.

6 Annex 6.45 G (1) An *authorised fund manager* should take into account the extent to which variables arising from additional factors such as investor behaviour can or should be incorporated into liquidity stress testing model scenarios.

(2) Decisions on the granularity, depth of analysis and use of data are subject to necessity and proportionality.

(3) An *authorised fund manager* should understand the potential risks associated with a *scheme's* investor base and be able to demonstrate that those risks play a material factor in the ongoing liquidity risk management of the *scheme*.

6 Annex 6.46 G (1) The table in (2) provides examples of factors regarding investor behaviour which may be incorporated into the liquidity stress testing model.

(2) This table belongs to (1):

Factor		**Examples of potential liquidity risk**	**Examples of potential incorporation into liquidity stress testing**
(1)	Investor category	*Redemption* risk may vary by type of investor. For example, the likelihood of *redeeming* during stressed conditions could be categorised according to whether investors are wealth *managers*, pension schemes, platform service providers, direct retail investors, or other *UCITS schemes* or *non-UCITS retail schemes*.	Based on an *authorised fund manager's* knowledge and experience of investors, the liquidity stress testing model may simulate, for example, a *scheme* that invests in other *schemes* posing more *redemption* risk than other types of investors, and simulate its withdrawal from the target *scheme(s)* first.
(2)	Investor concentrat ion	One or more investors may own a materially larger proportion of a *scheme* than others, leading to a	An *authorised fund manager* may model one, or a number of, the largest investors

		particular risk to *scheme* liquidity from the investor(s) *redeeming*.		redeeming simultaneously from a *scheme* over a given period of time (although this may have limited utility where all *unitholders* are institutional investors that cooperate with the *authorised fund manager* concerning their intentions to *deal* in *units*).
(3)	Investor location	(a)	Investors located in different regions or countries may pose a distinct *redemption* risk due to idiosyncratic factors linked to the political, economic or other factors relating to their location.	An *authorised fund manager* may simulate a material proportion of investors located in a specific country *redeeming* over a given time period first.
		(b)	For example, investors in a region subject to different monetary policy may pose distinct *redemption* risks during periods of changes in FX and/or interest rates.	
		(c)	Political and/or economic risks may also lead investors in other regions or countries to *redeem units*.	
(4)	Investor strategy	(a)	While many investors' strategies are long term and, in any case, challenging to unpick, some	An *authorised fund manager* may simulate *redemptions* from investors following similar strategies in

			investors follow formulaic or pre-defined strategies that may pose particular *redemption* risks in changing market conditions.	stressed and normal market conditions.
		(b)	For example, some *schemes* explicitly seek to target a level of risk, as measured by volatility, and are identifiable as such via their *scheme* names and stated investment objectives.	
		(c)	*Schemes* such as those referred to in (b) often seek to de-risk during volatile periods and may pose heightened *redemption* risk during periods of volatility in given asset classes.	
		(d)	Where *schemes* with formulaic or pre-defined strategies are investors, an *authorised fund manager* may need to pay due regard to the liquidity risk such *schemes* pose during stressed and normal market conditions.	

Liquidity stress testing on other types of liabilities

6 Annex 6.47 G (1) An *authorised fund manager* should be aware that net *redemptions* may not be the only relevant risk to liquidity coming from the liability side of a *scheme's* balance sheet which should be subject to liquidity stress testing.

(2) An *authorised fund manager* should include all other relevant types of liabilities in its liquidity stress testing in normal and stressed conditions, where appropriate.

6 Annex 6.48 G (1) In some cases, liquidity stress testing should determine the circumstances in which liquidity risk cannot be mitigated – for example, a level of *margin* calls a *scheme* would not be able to fund.

(2) An *authorised fund manager's* contingency planning should adequately reflect the circumstances identified in (1) and help to mitigate the liquidity risk in such circumstances.

6 Annex 6.49 G (1) The table in (2) provides examples of factors which may affect liquidity risk.

(2) This table belongs to (1):

Liability type		**Examples of factors which may affect liquidity risk**	**Potential events which may be simulated**
(1)	*Derivatives*	Changes in the value of the underlying may lead to *margin* calls, affecting the available liquidity of a *scheme*.	Simulation of a change in the value of the underlying of the *derivative* leading to a larger than anticipated *margin* call.
(2)	Committed capital	A *scheme* investing in real or immovable assets is often required to commit capital to service the investment, such as maintenance or refurbishment costs.	Simulation of an unexpected event causing new or higher outlay of capital to a real estate investment.
(3)	*Securities financing transactions / efficient portfolio management*	A *scheme* borrowing against or lending out assets is exposed to *margin* and *collateral* calls as well as the *counterparty risk* of its counterparty and the associated liquidity risk	Simulation of a change in the value of the *collateral* posted against a *scheme's* secured borrowing leading

		arising from potential default. While this can be mitigated by the *collateral* posted, liquidity risk is not eliminated (bearing in mind the liquidity of the *collateral*).	to a larger than anticipated *collateral* call. Simulation of default of the counterparty to a *securities financing transaction*. Simulation of *cash collateral* reinvestment risk.
(4)	Interest / credit payments	A *scheme* which incorporates leverage into its investment strategy is subject to liquidity risk arising from factors such as interest rate sensitivity.	Simulation of increased interest rates on the payment obligations of a *scheme*.

Funds investing in less liquid assets

6 Annex 6.50 G Risks arising from less liquid *scheme property* and liabilities should be reflected in the liquidity stress testing.

6 Annex 6.51 G (1) Many *schemes* invested in less liquid assets or illiquid assets have distinct risks emanating from both assets and liabilities, compared with *schemes* investing in liquid *transferable securities*.

(2) Many *schemes* investing in real estate have less frequent dealing periods and notice periods, which reduce liability risk from *redemptions*.

(3) However, such *schemes* are also exposed to distinct liability risks arising from servicing and maintaining real estate assets (including hard-to-simulate risks such as legal risks).

6 Annex 6.52 G (1) Furthermore, *schemes* investing in less liquid assets or illiquid assets have inherently less flexibility to improve overall liquidity by selling *scheme property* at a limited discount during periods of stressed market conditions.

(2) Therefore, the outputs from liquidity stress testing by an *authorised fund manager* of less liquid *scheme property* may have some distinctive features.

6 Annex 6.53 G (1) Low-probability but high-impact scenarios, including the potential difficulty of reliably pricing less liquid assets or illiquid assets during a period of market stress, will be important in respect of those assets.

		(2)	Such assets may be particularly vulnerable to an absence of liquidity in times of market stress, affecting time to liquidity, liquidation cost, and also whether or not assets would be liquidated at all when taking investors' best interests into consideration.
		(3)	Reverse stress testing may be a particularly valuable tool in this context, helping to identify scenarios which could lead to significant *scheme* liquidity risk (eg, identifying scenarios which would lead to the imposition of ex-post additional liquidity management tools or suspensions).
6 Annex 6.54	G	(1)	The nature of a less liquid *scheme property* base can place even more emphasis on the importance of an *authorised fund manager* ensuring that investors are treated impartially during stressed market conditions.
		(2)	Liquidity stress testing could therefore help an *authorised fund manager* to establish a governance framework seeking to support fair outcomes for all investors, by helping to model a fair method of liquidating *scheme property*.
6 Annex 6.55	G	(1)	One way in which an *authorised fund manager* could consider the liquidity of the *scheme* is to prioritise undertaking ad-hoc liquidity stress testing on *schemes* investing in less liquid assets or illiquid assets where a forthcoming event has been identified which could negatively impact *scheme* liquidity.
		(2)	An *authorised fund manager* should therefore pay particular regard to the appropriateness of the frequency of liquidity stress testing in *schemes* investing in less liquid assets or illiquid assets.
6 Annex 6.56	G	(1)	A *scheme* (the 'first *scheme*') which invests in one or more other *schemes* (a 'target *scheme*') and which gains indirect exposure to less liquid or illiquid assets via its target *schemes* should pay due regard to considerations relating to that exposure.
		(2)	Due regard should be paid to the assets of the target *scheme* because the underlying exposure of those target *schemes* may lead to the suspension of the target *scheme* or other measures. In turn, this may have an impact on the first *scheme*, so its liquidity stress testing model should take this risk into account.
	Combined asset and liability liquidity stress testing		
6 Annex 6.57	G	(1)	After separately stress testing the assets and the liabilities of the *scheme* balance sheet, an *authorised fund manager* should combine the results of the liquidity stress testing appropriately to determine the overall effect on *scheme* liquidity.
		(2)	Combined asset and liability liquidity stress testing can assist in the assessment of which *schemes* present the largest liquidity risk at a

given moment, considering liquidity risk on both the assets and liabilities sides.

(3) The assessment at (1) can have a material role in an *authorised fund manager's* contingency planning for a crisis, such as in the planning for the impact of crystallised liquidity risk in one or more *schemes* at firm level.

6 Annex 6.58 G An *authorised fund manager* should incorporate risk scoring into the liquidity stress testing where it enables an enhanced view of liquidity across the *scheme* range, including in contingency planning and operational preparations for a liquidity crisis.

6 Annex 6.59 G (1) An outcome of combined asset and liability liquidity stress testing may be a comparable metric or score, for example based on the redemption coverage ratio.

(2) An *authorised fund manager*'s chosen approach should be explained and documented in the liquidity stress testing policy.

(3) Where one *scheme* operated by an *authorised fund manager* can be compared with another using the metric or score, it can be a meaningful risk indicator for *senior personnel*.

6 Annex 6.60 G In cases where *scheme* scores or metrics change materially in a given timeframe, combined asset and liability liquidity stress testing can assist in the set-up of an alert system to assess whether action on a *scheme's* liquidity is required.

Aggregating liquidity stress testing across funds

6 Annex 6.61 G An *authorised fund manager* should aggregate liquidity stress testing across *schemes* under its management where it assesses such an activity to be appropriate for those *schemes*.

6 Annex 6.62 G (1) Aggregating liquidity stress testing across *schemes* involves utilising the same liquidity stress test on more than one *scheme* with similar strategies or exposures. This may be useful when considering the ability of a less liquid market to absorb asset sales, were they to occur concurrently in *schemes* operated by an *authorised fund manager*. Such an approach may be particularly pertinent when *schemes* operated by an *authorised fund manager* own a material level of assets in a given market.

(2) Aggregation of liquidity stress testing may allow an *authorised fund manager* to better ascertain the liquidation cost or time to liquidity of each *investment*, by considering the trade size, stressed market conditions and *counterparty risk*.

The role of depositaries

6 Annex 6.63	G	(1)	A *depositary* should set up appropriate verification procedures to check that an *authorised fund manager* has in place documented procedures for its liquidity stress testing programme. One way of verifying that liquidity stress testing is in place and carried out is to confirm that the risk management process for the *scheme* provides for an *authorised fund manager* to carry out liquidity stress testing on a *scheme.*
		(2)	The verification procedures do not require the *depositary* to assess the adequacy of the liquidity stress testing.
6 Annex 6.64	G	*Depositaries* of both *UCITS schemes* and *non-UCITS retail schemes* are required to implement procedures to verify that a *scheme* is acting in compliance with regulatory requirements.	
6 Annex 6.65	G	(1)	Where the *depositary* is not satisfied that liquidity stress testing is in place, it should take action as per any other evidence of a potential breach of rules by an *authorised fund manager*.
		(2)	The appropriate action at (1) may be for a *depositary* to inform (or require an *authorised fund manager* to inform) the *FCA* of the *authorised fund manager's* failure to comply with applicable rules.
6 Annex 6.66	G	The *depositary* does not need to replicate or challenge the liquidity stress testing undertaken by an *authorised fund manager*.	

Amend the following as shown.

TP 1 Transitional Provisions

TP 1.1

(1)	**(2)** Material to which the transitional provision applies	**(3)**	**(4)** Transitional provision	**(5)** Transitional provision: dates in force	**(6)** Handbook provision: coming into force
…					
69	…	…	…	…	…
	Amendments made by the Collective Investment Schemes Sourcebook (Liquidity Management) Instrument 2026				
70		R	An *authorised fund manager* is not required to comply with the	From 1 February	

<table>
<tr><td></td><td>COLL 4.2.5R(18)</td><td></td><td colspan="2">rule specified in column (2) until the earlier of:</td><td rowspan="3">2027 until 1 August 2027</td><td rowspan="3">1 February 2027</td></tr>
<tr><td></td><td></td><td></td><td>(1)</td><td>the date on which the prospectus is next updated; or</td></tr>
<tr><td></td><td></td><td></td><td>(2)</td><td>1 August 2027.</td></tr>
<tr><td rowspan="2">71</td><td rowspan="2">COLL 5.2.8R(3)(e), COLL 5.6.5R(1)(b) and COLL 5.2.20R(2)(a)</td><td rowspan="2">R</td><td>(1)</td><td>This rule applies in relation to any recently issued transferable security which, immediately before 1 February 2027, fell within the rules in column (2) and was held in the scheme property of a UCITS scheme or a non-UCITS retail scheme.</td><td rowspan="2">From 1 February 2027 until 1 August 2027</td><td rowspan="2">1 February 2027</td></tr>
<tr><td>(2)</td><td>The authorised fund manager may continue to apply the provisions in column (2) as they applied immediately before 1 February 2027, until 1 August 2027.</td></tr>
<tr><td>72</td><td>COLL 6.12.11R</td><td>R</td><td colspan="2">This rule will cease to apply to a UCITS scheme which is a regulated money market fund on the revocation of the Money Market Funds Regulation.</td><td>From 1 February 2027 until the revocation of the Money Market Funds Regulation</td><td>1 February 2027</td></tr>
</table>

Annex C

Amendments to the Investment Funds sourcebook (FUND)

In this Annex, underlining indicates new text and striking through indicates deleted text.

3 Requirements for alternative investment fund managers

…

3.6 Liquidity

…

Liquidity systems and procedures

3.6.3	R	…
3.6.3A	G	In complying with *FUND* 3.6.3R, the *AIFM* of a *non-UCITS retail scheme* which is not a *regulated money market fund* should take into account the guidance at *COLL* 6 Annex 6 (Guidance notes on liquidity stress testing in UCITS schemes and non-UCITS retail schemes).

…

FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk

Pub ref: 1-008573

All our publications are available to download from www.fca.org.uk.

Request an alternative format

Please complete this form if you require this content in an alternative format.

Or call 0207 066 1000

Sign up for our **news and publications alerts**