Press release

4 September 2023

ESRB publishes policy options to address risks in corporate debt and real estate investment funds

The European Systemic Risk Board (ESRB) has today published an issues note describing how the EU regulatory framework for investment funds, which is currently being revised, could enhance the prevention and mitigation of systemic risks.[1] The note focuses on investment funds with large exposures to corporate debt and real estate. This reflects the priority areas for enhanced scrutiny from a financial stability perspective that the ESRB identified during the COVID-19 pandemic.[2] However, the policy options presented in this note might also be applicable to other fund types with vulnerabilities similar to those present in corporate debt funds and real estate funds.

In the issues note the ESRB welcomes the provisional agreement reached between the European Parliament and the Council of the European Union on the review of the regulatory framework for investment funds. The agreement provides a basis to apply broader systemic risk considerations to investment fund regulation. In line with the ESRB's previous proposals,[3] several new provisions will enhance the regulatory and supervisory framework for investment funds from a financial stability perspective. In particular, the ESRB welcomes that the provisional agreement foresees an increased availability and consistent use of liquidity management tools (LMTs) for fund managers.

The ESRB also concludes that the resilience of investment funds with large exposures to corporate debt and real estate could be further improved by adapting some of the policy tools

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[1] See communication from the European Commission and the EU Council on the review of the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive.

[2] ESRB, "Recommendation of the European Systemic Risk Board on liquidity risks in investment funds (ESRB/2020/4)", OJ C 200/1, Frankfurt am Main, 15.6.2020.

[3] See ESRB letters to the co-legislators on this topic: Letter to the European Parliament on the AIFMD Review, 23 March 2022. and Letter to the Council Working Party on the AIFMD Review, 23 March 2022.

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already present in the regulatory framework. These include closer alignment between fund redemption terms and investment strategy, the use of anti-dilution LMTs, and better preparedness for cash needs stemming from margin and/or collateral calls in derivative and repo transactions.

In addition, the development of new tools might increase the resilience of investment funds and thus benefit the stability of the financial system. These new tools could include a liquidity bucketing approach and the development of an ex-ante policy instrument aimed at mitigating the build-up of liquidity risk. The ESRB will also reflect on the role of authorities in applying certain policy tools to address shocks triggered, transmitted or amplified by (the collective action of) investment funds.

Looking ahead, the ESRB will continue its work in two steps, which are set out below.

- First, over the coming years the ESRB will focus on adapting the tools available in the regulatory framework to better address risks in corporate debt and real estate investment funds. This will be beneficial both for the transposition of the revised directives into national law by the national authorities and for the development of the relevant Level 2 and Level 3 EU acts.
- Second, over the medium term the ESRB will assess the need for more tools to reduce systemic risk. This medium-term work would inform any future reviews of the regulatory framework for investment funds, with such reviews expected 60 months after the revised framework has entered into force.

The insights presented in the issues note will also inform the ongoing Financial Stability Board (FSB) consultation on policies to address vulnerabilities from liquidity mismatch in open-ended funds.[4]

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[4] FSB, "Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations", *Consultation Report*, Basel, 5 July 2023.

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