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	

	COLL 4.2.5R(18)		*rule* specified in column (2) until the earlier of: (1) the date on which the *prospectus* is next updated; or (2) 1 August 2027.	2027 until 1 August 2027	1 February 2027
71	*COLL* 5.2.8R(3)(e), *COLL* 5.6.5R(1)(b) and *COLL* 5.2.20R(2)(a)	R	(1) 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.* (2) 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.	From 1 February 2027 until 1 August 2027	1 February 2027
72	*COLL* 6.12.11R	R	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*.	From 1 February 2027 until the revocation of the *Money Market Funds Regulation*	1 February 2027

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).

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