

# Aligning Liquidity Risk Management with Regulatory Expectations

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## Introduction

Liquidity risk has moved to the forefront of regulatory agendas worldwide. In the wake of high-profile financial failures and market disruptions, regulators are intensifying their scrutiny of how institutions manage liquidity. For regulated financial service providers, the challenge is clear: align liquidity risk management practices with evolving regulatory expectations. According to the Central Bank of Ireland's 2025 Regulatory and Supervisory Outlook (RSO) liquidity risk remains a core supervisory concern due to its potential to undermine financial stability and consumer protection during periods of stress.

In this article we examine regulatory expectations relating to the financial services sector, and summarise recommendations for senior management and Board members regarding effective liquidity risk management.

## Liquidity Risk Management in Open-Ended Funds (OEFs)

### Regulatory Background

The Financial Stability Board (FSB) has revised its recommendations to strengthen liquidity management in OEFs, emphasising consistent use of anti-dilution Liquidity Management Tools (LMTs) i.e.

mitigating passing the cost onto investors. In 2023, International Organization of Securities Commissions (IOSCO) issued guidance on implementing these tools, followed by its May 2025 Final Report revising liquidity risk management recommendations for collective investment schemes. These measures aim to ensure funds can meet redemption requests and withstand market stress.

In Europe, these global standards are being integrated into legislation through amendments to UCITS rules, harmonising LMT selection, operation, and reporting across the European Union (EU). The European Systemic Risk Board (ESRB) supports these changes to enhance investor protection and improve responses to liquidity constraints. The Central Bank of Ireland (CBI) will introduce a dedicated UCITS section outlining operational requirements for LMTs.

## Key Liquidity Risks for OEFs

- **Liquidity mismatch** between OEFs daily redemption rights and the liquidity of their underlying investments; this has prompted global regulatory reforms.
- **Procyclicality**: A fund may be forced to sell assets to meet redemptions during a downturn, which



can further depress asset prices and negatively affect the remaining shareholders and the broader market ('doom loop').

- **Dilution of Shareholder Interests:** If a fund needs to sell assets at a discount to meet redemptions, the remaining shareholders' interests are diluted as the value of the fund's assets decreases.

### Liquidity Risk Management Recommendations (Fund Management Companies (FMCs))

1. **Governance:** Strong governance, board oversight, escalation protocols, and internal limits are required. Ongoing monitoring of liquidity metrics and enhanced reporting to regulators (e.g., CBI's Daily Investment Fund Return) is expected.
2. **Liquidity Risk Management Framework (LRMF):** FMCs must establish frameworks covering portfolio liquidity, redemption risk, stress testing, liquidity buffers, dealing terms, and LMT usage, tailored to fund characteristics. With respect to liquidity profile funds should evaluate how quickly assets can be sold under normal and stressed conditions, ensuring portfolio composition supports timely redemption.
3. **Redemption Policy & LMTs:** Clear, disclosed

redemption policies aligned with liquidity profiles are essential. FMCs should select suitable LMTs (e.g., swing pricing, gates, side-pockets, suspension, anti-dilution levies) and define activation conditions.

4. **Stress Testing & Scenario Analysis:** Regular testing under normal and extreme scenarios helps anticipate liquidity challenges.

### Liquidity Risk Management for Credit Unions

#### Regulatory Background

Section 85A of the Credit Union Act 1997 establishes the statutory obligation for credit unions to maintain adequate liquidity to meet liabilities as they fall due. This forms the foundation of liquidity governance, requiring consideration of asset composition and liability structure. The Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (as amended), operationalise these obligations by setting minimum liquidity ratios, reporting standards, and governance expectations. In addition, the CBI Credit Union Handbook consolidates legislative and regulatory requirements, offering practical guidance on liquidity management policies, asset-liability strategies, stress testing, and reporting. It clarifies what constitutes liquid assets and sets expectations

for governance and contingency planning. Together, these regulatory releases ensure credit unions maintain robust, forward-looking liquidity frameworks that protect members funds and support financial stability.

## Key Liquidity Risks for Credit Unions

Credit unions face several liquidity risks:

- **Member demand for savings products** poses challenges as these deposits are short-term compared to longer-term credit union assets. Withdrawals may spike during economic downturns or loss of confidence, forcing longer-term asset sales at a potential loss.
- **Limited market funding access** restricts credit unions from raising funds quickly in stress scenarios, as they lack direct access to capital markets or interbank facilities.
- **Investment counterparty risk** is significant because most deposits are concentrated among a few institutions—66% with the top 10 counterparties, according to the CBI’s Financial Conditions of Credit Unions 2024 report, making defaults highly impactful.

## Liquidity Risk Management Recommendations

To mitigate these risks, credit unions should adopt the below measures which collectively strengthen resilience, protect member funds, and ensure compliance with regulatory expectations:

1. **Promote strong governance and oversight**, driven by board-approved policies and committee monitoring, is essential.
2. **Adopt robust asset-liability management (ALM) practices**, including forecasting inflows/outflows, stress testing, early warning indicators, and contingency funding plans.
3. **Mitigate Counterparty risk** through continuous creditworthiness assessments.
4. **Adopt funding diversification strategies** include establishing liquidity support arrangements with other credit unions and maintaining High-Quality Liquid Assets (HQLA) to meet obligations during stress.

## Liquidity Risk Management for Insurance Companies

### Regulatory Background

Irish insurance firms are regulated under the EU Solvency II Regulations (“Solvency II”). Although Solvency II compliance has focused on capital requirements and ratios (minimum Capital Requirement), insurers are expected to maintain sufficient financial resources to meet their obligations as they fall due. In terms of liquidity risk coverage within Solvency II, there is no standard “liquidity ratio requirement”; however,

the revised Solvency II Directive, adopted in November 2024, introduced a key requirement to establish a Liquidity Risk Management Plan (LRMP), which includes cash flow projections for assets and liabilities, along with liquidity risk indicators covering short, medium, and long-term horizons.

Regulatory expectations are driven by factors such as (i) whether a firm is involved in life or non-life business, (ii) the classes of business it writes, (iii) its customer base and (iv) ownership and funding arrangements.

## Key Liquidity Risks for Insurance Companies

Insurance companies face significant liquidity challenges including:

- **Claims-Driven Liquidity Risk** due to unexpected claims events (e.g. climate events), concentration risk or seasonality.
- **Policyholder Behaviour Risk** due to cancellations, early withdrawals or surrenders e.g. policyholders exit during volatile markets.
- **Market Liquidity Risk** resulting in inability to sell assets quickly at a fair value e.g. a market crash.
- **Asset-Liability Mismatch Risk** where the timing of liability payments does not align with the liquidity of invested assets.
- **Reinsurance Liquidity Risk** as insurers rely heavily on reinsurance to cover large losses and such claims may be delayed or disputed. The CBI have highlighted reinsurance dependence as a material Irish sector vulnerability.

## Liquidity Risk Management Recommendations

1. **Allocate appropriate governance**, including Board review and approval, to ensure the LRMP is robust and will meet regulatory expectations.
2. **Maintain sufficient HQLA** in the firm’s portfolios.
3. **Align the maturity / duration profile**, currency, interest rate and credit risk exposures of assets vs liabilities.
4. **Conduct stress testing**, scenario analysis and set actions for relevant liquidity shocks, including market dislocations, mass surrender & cancellation events.
5. **Benchmark the firm’s position** in relation to other firms’ approach to liquidity risk management.

## Liquidity Risk Management for Banking Institutions

### Regulatory Background

CRD VI and CRR III embed Basel IV standards into EU law, introducing binding liquidity requirements such as the Liquidity Coverage Ratio (LCR) and Net Stable

Funding Ratio (NSFR). These ensure banks maintain sufficient high-quality liquid assets and stable funding under stress. The EBA Guidelines on ILAAP and SREP require institutions to establish robust internal liquidity adequacy assessment processes, integrate stress testing, and provide reliable data for supervisory review. A strong Internal Liquidity Adequacy Assessment Process (ILAAP) ensures banks can meet liquidity needs during recovery and resolution planning, aligning with the Banking Recovery and Resolution Directive's (BRRD's) goal of safeguarding financial stability.

## Key Liquidity Risks for Banking Institutions

Despite recent resilience challenges, banks face significant liquidity challenges:

- **Geopolitical Risks:** Armed conflicts, political instability, trade wars, and fragmentation disrupt global markets and availability of funding.
- **Macroeconomic Risks:** Elevated interest rates have boosted profitability since 2023, but future monetary easing and continued quantitative tightening will reduce excess liquidity in the financial system placing upward pressure on short term funding.
- **Competitive Risks:** Non-bank financial institutions offering higher returns are eroding banks' deposit bases.
- **Funding Concentration Risk:** Heavy reliance on limited funding sources or wholesale markets increases vulnerability to disruptions, particularly in Europe's cross-border environment.

## Liquidity Risk Management Recommendations

1. **Governance and Oversight:** On an annual basis Boards should approve liquidity risk appetite (including LCR and NSFR) annually and the bank's Internal Liquidity Adequacy Assessment Process (ILAAP) and funding plan, which should cover both ongoing activities and future planned activities of the bank. Risk committees must oversee frameworks and contingency funding plans.
2. **Diversification of Funding:** Avoid over-reliance on single channels; maintain access to retail deposits, repo markets, and central bank facilities.
3. **Stress Testing and Scenario Analysis:** Conduct regular stress tests across multiple horizons and scenarios, using behavioural models to simulate withdrawals and market shocks.
4. **Intraday Liquidity Management:** Monitor liquidity in real time to meet payment and settlement obligations. Advanced analytics should support forecasting and stress assessments.

## Liquidity Risk Management for MiFID investment firms

### Regulatory Background

The legislative framework for MiFID investment firms comes from the Markets in Financial Instruments Directive 2014/65 ("MiFID II") and the Markets in Financial Instruments Regulation 600/2014 ("MiFIR"). Firms must also comply with secondary legislation, guidance and Q&As issued, i.e. from the CBI and European Securities and Markets Authority ("ESMA").

### Key Liquidity Risks for MiFID investment firms

The liquidity risks of MiFID investment firms can vary in accordance with business activities. Generally, significant risks for these firms include:

- **Funding liquidity risk:** When engaging in client lending, potential loan defaults reduce expected inflows and can lead to liquidity shortfalls. This also occurs if a firm cannot convert assets promptly.
- **Market liquidity risk:** A firm might be unable to sell off its assets quickly enough to settle its liabilities, which may lead to a disorderly wind-down.
- **Economic factors,** such as interest rate changes, inflation, and recessions, can impact both market liquidity and the firm's ability to fund its operations.
- **Poor governance structures and inadequate risk management** can also increase a firm's vulnerability.
- **Foreign exchange risk and reputational risk** can also impact these firms.

## Liquidity Risk Management Recommendations

1. **Liquidity Risk Management Framework:** MiFID firms must maintain a liquidity risk management framework aligned with their business model and strategy, supported by strong governance for risk identification, measurement, escalation, and contingency planning. Frameworks must remain fit-for-purpose through regular analysis of internal and external risk events, integrating market, credit, operational, and liquidity risks.
2. **ILAAP:** Under the Investment Firms Directive (IFD) and CRR VI / CRD III, firms are required to implement an ILAAP in line with EBA guidelines. The ILAAP should provide a forward-looking view of liquidity risk over at least three years, incorporating adverse scenarios based on macroeconomic vulnerabilities.
3. **Scenario based liquidity management:** A contingency funding plan (CFP) is essential to address plausible and realistic liquidity



shortfalls, with clear quantitative triggers and actions. Adequate liquidity should be placed in operational accounts to meet business-as-usual and stressed outflows. Firms should document liquidity buffer calibration and ensure alignment with risk appetite and recovery plan thresholds. Intraday liquidity management should estimate next-day peak outflows and conducting two daily stress assessments—before market close and later in the evening. These are also important considerations for Recovery and Resolution Planning.

Ultimately, firms should manage intraday and multi-year liquidity needs through ILAAP and contingency planning to support growth and resilience in crisis scenarios.

### Conclusion:

Liquidity risk remains one of the most significant threats to financial stability, and regulators are increasingly demanding robust, forward-looking frameworks across all sectors.

Key to managing liquidity risk is ensuring firms have a strong governance structure in place that sets, monitors and manages this risk including:

- **Governance:** Board review, challenge and approve key liquidity risk documents e.g. ILAAP's for banks / MiFID firms.
- **Benchmarking:** Set appropriate liquidity benchmark metrics and ensure they are monitored and maintained.
- **Scenario testing:** Select robust, plausible and realistic scenarios when modelling liquidity risks and implement any lessons learned.
- **Integrated planning:** Reflect liquidity risks and risk management processes across all institutional plans including operational resilience plans and CFP.
- **Resourcing:** Ensure risk departments are well resourced and report at each board meeting.