

Division of Investment Management Issues Guidance Regarding Risk Management for Fixed Income Funds

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Monday, February 10, 2014

In January 2014, the Staff of the **Division of Investment Management of the SEC** published a Guidance Update suggesting certain risk management and disclosure practices investment advisers of fixed income funds may consider implementing given changing market conditions and the potential for future market volatility. The Guidance Update discusses the fixed income market volatility experienced in 2013 as the Federal Reserve tapered “quantitative easing” and interest rates rose, and noted that these conditions, together with the changing bond market size and structure, provide a timely reminder for the importance of sound risk management practices. The Staff highlights five particular actions investment advisers may consider given the market uncertainty.

- **Asset and Stress Test Liquidity:** Advisers may consider assessing fund liquidity needs during normal and stressed environments, including the sources of liquidity.
- **General Stress-Tests/Scenario Analyses:** Advisers may consider other potential threats, beyond liquidity, such as interest rate hikes, widening spreads and price shocks to fixed income products.
- **Risk Management Evaluation:** Given the outcomes of the assessments and analyses, advisers may consider what risk management strategies are most appropriate during periods of market volatility, including decisions involving

portfolio composition, concentration and diversification.

- Communication with Fund Boards: Advisers may consider what information should be provided to fund directors so that they are informed of fund risk exposures and liquidity positions.
- Shareholder Communications: Advisers may consider the adequacy of fund prospectus and shareholder report disclosure given the recent market volatility and potential impact of shifting market size and structure.

The Guidance Update further suggests that boards of fixed income funds discuss the actions their investment advisers are taking to address historical volatility and evolving nature of the fixed income market.

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