September 4, 2023

Mr. Damien Shanahan
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

INSTITUTE OF INTERNATIONAL FINANCE

Re: Consultation Report: Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes

Dear Mr. Shanahan:

The Institute of International Finance (IIF) [1] and its members are pleased to respond to IOSCO's Consultation Report: Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes (Consultation Report). The proposed guidance is intended to support the greater use of anti-dilution liquidity management tools (LMTs) by open-ended funds (OEFs) to mitigate investor dilution and the potential first-mover advantage arising from structural liquidity mismatches in OEFs.

We note that we are also responding to a related consultation on revisions to the 2017 Policy Recommendations of the Financial Stability Board (FSB) related to structural vulnerabilities from liquidity mismatch in OEFs.[2]

Background

Open-ended funds (OEFs) serve key roles in financial markets, contributing to market diversity and resiliency, and providing funds that finance the real economy. OEFs are well regulated and monitored on a regular basis by securities regulators. They generally are well governed internally. Fund failures are rare and largely idiosyncratic and have not to date given rise to material systemic consequences.

Fund managers have the fiduciary duty to manage the liquidity risks of their funds and to meet their obligations to investors. Fund managers also are best placed to manage the dynamic liquidity risks of their OEFs and to determine whether the use of one or more LMTs would be an optimal method of managing those risks. We agree that authorities should ensure that a broad set of LMTs and measures is available to OEF managers but the decision as to whether to deploy one or more LMTs and the timing of the use of LMTs, as well as the calibration of a particular tool, should remain with the fund manager.

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[1] The Institute of International Finance (IIF) is the global association of the financial industry, with about 400 members from more than 60 countries. The IIF provides its members with innovative research, unparalleled global advocacy, and access to leading industry events that leverage its influential network. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial, and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks, and development banks.

[2] https://www.fsb.org/wp-content/uploads/P050723.pdf

General Comments

We agree that the use of LMTs by OEF managers can address concerns about material dilution and first-mover advantage that can arise when transacting investors do not bear the costs of liquidity associated with their redemptions and subscriptions. The latter is partly driven by the different capabilities of investors, which may allow certain market participants to monitor and react more quickly to market developments compared to other shareholders in the fund, many of whom may be retail investors.

We appreciate the flexibility in the proposed guidance, which notes that responsible entities have the primary responsibility and are best placed to manage the liquidity of their OEFs. We commend IOSCO for its proportionate approach which does not prescribe a specific calibration for LMTs and does not specify the use of particular tools. We encourage IOSCO to emphasize that the examples of good practices are only illustrative and should not be interpreted as advice that would give rise to binding requirements. We favor guidance that promotes the greater inclusion of anti-dilution LMTs in OEF constitutional documents, provided that it is clear that the discretion as to whether to employ an LMT and, if so, the choice of LMT, rests solely with the fund manager. IOSCO should focus on *material* dilution and first-mover advantage in the final guidance, in the interests of a proportionate approach that balances the costs and benefits of using anti-dilution LMTs. Further comments regarding the costs and benefits of using anti-dilution LMTs are provided below.

In developing guidance, IOSCO should consider the market structure and operational challenges associated with the use of certain LMTs in some jurisdictions and reflect these challenges in flexible and non-prescriptive guidance. For example, the use of swing pricing in some countries would give rise to significant operational challenges and resistance from market participants that may impose costs that would be disproportionate to the benefits of using this tool. In other jurisdictions, swing pricing is effectively deployed as an LMT. IOSCO should acknowledge that the choice of whether and when to deploy an LMT and the choice of tool is dependent in part on these market differences.

Comments on the Proposed Guidance

Section II – Design and Use of Anti-Dilution LMTs

Proposed Guidance 3 should explicitly state that the costs of liquidity should be based on best estimates. The discussion of Proposed Guidance 3 refers to the use of best estimates with respect to the costs of liquidity to be incorporated in anti-dilution LMTs. We encourage the explicit inclusion of best estimates in Proposed Guidance 3. We also encourage IOSCO to provide for fund manager discretion as to whether to include implicit liquidity costs in anti-dilution LMTs.

The explicit inclusion of best estimates in Proposed Guidance 3 would reflect the challenges to fund managers of determining with certainty the explicit and implicit transaction costs of subscriptions or redemptions, particularly in times of market stress. Data limitations make it difficult to include with a high level of precision or confidence market impacts in the calculation. Fund managers cannot rely on past transaction data to estimate the market impact of purchases and sales needed to meet current investor subscriptions or redemptions, particularly in times of market stress. Moreover, fund managers can be expected to have a variety of methods for estimating transaction costs, with a variety of underlying assumptions.

We encourage IOSCO to provide greater flexibility to fund managers in determining whether to include implicit liquidity costs in anti-dilution LMTs, as those costs may not necessarily be material to the asset class and/or capable of reliable estimation. In some cases, the costs of estimating the implicit liquidity costs may far outweigh the benefits provided to investors.

The approach to anti-dilution LMTs should not be methodical. A 'methodical' approach to anti-dilution LMTs, which is included in the discussion of Proposed Guidance 1, would not appropriately recognize the dynamic nature of the markets, particularly in times of market stress. It may not be possible to demonstrate to authorities whether and how LMTs would be deployed on a prospective basis. Rather, fund managers should discuss with their regulators and supervisors how they manage fund liquidity and how they have employed in the past and would consider in the future employing LMTs to address concerns regarding dilution and first-mover advantage without committing in advance to a particular course of action.

Anti-dilution LMTs should be in every fund manager's toolbox and generally employed. Proposed Guidance 2 calls for responsible entities to consider *and use* at least one appropriate anti-dilution LMT for each OEF under management. We agree that LMTs should be in every fund manager's toolbox and, in general, we would expect that one or more LMTs would be employed by a fund manager. That said, we do not believe that the guidance should give rise to a rigid and automatic expectation that one or more LMTs will be used in every OEF.

An anti-dilution LMT may not be applicable to or appropriate for some fund strategies. For example, anti-dilution LMTs are not appropriate for single investor funds and other tools, such as suspensions and gates, may be appropriate for certain types of funds, such as real estate funds.

We encourage IOSCO to reword this guidance by using the phrase, '*consider and, in general, use*.'

The discussion of Proposed Guidance 2 states that IOSCO has identified five anti-dilution LMTs: (i) swing pricing; (ii) valuation at bid or ask prices; (iii) dual pricing; (iv) anti-dilution levies; and (v) subscription/redemption fees. IOSCO comments that its liquidity risk management recommendations have noted that anti-dilution levies and swing pricing may be considered particularly appropriate in addressing first-mover advantage. As noted above, IOSCO should consider the market structure and operational challenges associated with the use of certain LMTs in some jurisdictions and reflect these challenges in flexible and non-prescriptive guidance. We also encourage IOSCO to describe the five anti-dilution LMTs as non-exclusive as other effective anti-dilution tools may emerge as the market evolves.

Section III – Oversight of Anti-Dilution LMTs by Fund/Manager Board and Depositaries

We broadly agree with IOSCO's guidance on the governance surrounding the use of anti-dilution LMTs.

Section IV – Disclosure to Investors about the Use of Anti-Dilution LMTs

The IIF supports the disclosure of accurate, timely and decision-useful information on fund liquidity, liquidity risk and the availability and use of LMTs to investors and prospective investors in OEFs. Disclosure guidance and any jurisdictional disclosure requirements should be proportionate to the benefits that they bring to investors about liquidity transformation in OEFs individually and in the aggregate and should help investors clearly differentiate between different types of funds and their liquidity risks. We also support the disclosure to investors of information that allows them to understand the range of actions that fund managers may take in order to address fund liquidity needs, particularly in times of market stress. Any disclosure obligations should be on an annual basis, in order to properly balance investors' interests with the potential unanticipated consequences of disclosures.

We appreciate that IOSCO has called for an appropriate balance between transparency and the efficacy of anti-dilution LMTs. There is a careful balance that needs to be struck between investor protection and the unintentional facilitation of gaming or front-running behavior, which can have adverse effects on funds, their shareholders and broader market stability. IOSCO should consider additional avenues to receive fund managers' views and insights into how to achieve this delicate balance.

As noted in Section IV, some OEFs disclose a range of adjustment factors to facilitate investors' understanding of the potential implications of anti-dilution LMTs or to satisfy disclosure requirements in the applicable jurisdiction(s). We appreciate the statement that, where a range of adjustment factors is disclosed, fund managers should be permitted to exceed that range, if necessary, to reflect the liquidity costs in rapidly changing market environments. Additionally, funds have been allowed to disclose a range of thresholds and factors or to provide disclosure on an *ex post* basis. However, sensitive information, including thresholds and adjustment factors, should not be required in *ex post* disclosures as they may allow professional traders to circumvent anti-dilution LMTs and/or to time trades systematically, to the detriment of other investors.

IOSCO could play a role in encouraging its members to provide the needed flexibility in jurisdictional disclosure frameworks.

A proportionate and risk-based approach to disclosure guidance would facilitate the ability of OEF managers and compliance officers to balance the risks of unanticipated consequences with the need to meet the needs of investors for accurate, timely and decision-useful information by focusing disclosures on the information that investors need in order to make informed investment decisions that reflect their risk appetite and risk tolerance.

Section V – Overcoming Barriers and Disincentives to Implementation of Anti-Dilution LMTs

We broadly agree with the potential solutions to overcoming barriers and disincentives to the implementation of anti-dilution LMTs. However, it is important for the FSB and financial authorities to recognize that there may be constraints on the capacity of financial market infrastructures and market participants to fully implement anti-dilution LMTs in periods of high market volumes.

Conclusion

We thank IOSCO for its consideration of our comments, and we would welcome additional stakeholder engagement around this topic. If you have any questions or would like to discuss our comments in greater detail, please do not hesitate to contact Martin Boer at mboer@iif.com, or Mary Frances Monroe at mmonroe@iif.com.

Sincerely,

Mary Frances Monroe