

Luxembourg, 4 September 2023

## **ALFI response to FSB consultation on addressing structural vulnerabilities from liquidity mismatch in open-ended funds – revisions to the FSB’s 2017 policy recommendations**

### **Introduction**

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We thank FSB for the opportunity to participate in this consultation regarding the revisions to the FSB’s 2017 policy recommendations on addressing structural vulnerabilities from liquidity mismatch in open-ended funds.

ALFI would also like to mention the fact that we are also responding to the IOSCO consultation report in respect of Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Scheme.

## Response

### 1) Structural liquidity mismatch (Recommendation 3)

#### • Question 4

*Should the FSB consider recommending the use of a decreased redemption frequency (on a standalone basis), a longer notice period (on a standalone basis) or a longer settlement period (on a standalone basis) for OEFs investing in less liquid assets that do not meet the expectation on the implementation of antidilution LMTs? Or should these measures be used in combination, considering the risk of redemptions crowding around certain dates?*

A technical review of the described bucketing approach, proposing to directly link dealing frequency and notice period<sup>1</sup> to a prescriptive assets' liquidity classification<sup>2</sup>, highlights the existence of several fundamental factors inhibiting the effectiveness of such method in addressing liquidity mismatch.

While the implementation of the approach is technically feasible, the dynamic nature of liquidity, the inherent model risk and the assets liquidity idiosyncrasies would reduce this tool to a costly regulatory tick-the-box exercise with limited effect on liquidity mismatch and investor protection. Furthermore, the prescriptive approach taken (departing from earlier principle-based recommendations) could even set incentives with the unintended consequence of risk underestimation. The detailed rationale underlying these arguments is provided below.

Accordingly, after highlighting the shortcomings of the bucketing approach, ALFI recommends to adopt a more principle-based framework, to put more focus on other levers (such as contingency planning) to mitigate liquidity mismatch risk. Furthermore, ALFI wants to further stress that, based on previous experience and the infinite forms liquidity risk may materialize, prescribing a single liquidity management tool or even a 'one size fits all combo' cannot (and does not) work: a robust liquidity management tools approach should be designed as a toolbox with various tools included in order to provide the flexibility required to address unforeseen situations.

#### Model risk

In Section 3.3, the report proposes to categorise assets as "liquid", "less liquid" and "illiquid" on the basis of a) convertibility to cash and b) price impact. It is pivotal to acknowledge for the fact that these two elements are non-observable. Accordingly, one will only rely on point estimates to implement this strict categorisation of assets. Estimates are stemming from models that have benefited from substantial improvements over the last decade. Nevertheless, models intrinsically depend on assumptions and more often than not, incomplete data sets, leading to a wide level of uncertainty around the estimates and therefore the true level of liquidity that models intend to measure. The fact that liquidity is not an observable variable renders the use of backtesting methods less interpretable and less effective in trying to mitigate the estimation error. It is also crucial to emphasize the broad diversity of competing models in the field of liquidity measurement resulting in diverging estimates. This uncertainty around the liquidity assessment is incompatible with a strict categorical and unequivocal classification of assets that could only be done on the basis of objectively observable and precise criteria. A categorical approach with direct implication on the dealing frequency and notice period based

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<sup>1</sup> Settlement not mentioned but included in the logic

<sup>2</sup> As well as the presence of anti-dilution mechanism

on uncertain and unobservable criteria would lead to excessively diverging implementations and defy the purpose of seeking consistency in liquidity matching practices.

### Time changing liquidity dynamic

As mentioned, the bucketing approach requires an estimation of the level of liquidity of the assets held in portfolio under normal and stressed conditions. This classification would end-up being quasi-static as it will rely on long-run liquidity estimates. Accordingly, the bucketing approach is implicitly based on an assumption of constant liquidity. Empirical studies<sup>3</sup> and industry experience highlighted that assets' liquidity profile is time sensitive and fast changing. Short-term fluctuations can widely depart from the long-run asset liquidity estimate and therefore the established profile. This observation materialised recently during the fast deterioration of the liquidity for some assets previously considered safe, as a result of either market wide (e.g. Covid-19 stress) or idiosyncratic (e.g. war in Ukraine) shocks. The quasi-static approach of bucketing would fail to capture the evaporating liquidity<sup>4</sup> and miss the objective of effectively protecting the industry against the same liquidity mismatches that the tool has been designed to mitigate.

### Incentives and unintended consequences

Considering model risk, time changing liquidity and funds' specificities<sup>5</sup>, it is anticipated that non-negligible diverging classifications could be observed across comparable vehicles. In a more principle-based framework, these divergences could be reconciled in the contextualised interpretation of principles. This convergence would be less achievable in the context of the prescriptive rules proposed by the bucketing. In that respect, an adverse consequence attached to the classification could be to create a negative incentive regarding the liquidity assessment itself. Under the current principle-based framework, the assessment is incentivised to provide a fair, accurate and oftentimes even more conservative picture of the fund liquidity profile at both the asset and liability level. An internal, tailored and unbiased assessment supports effective decision making to manage the fund liquidity including asset-liability matching. On the other hand, a prescriptive rule such as bucketing could create incentives to adopt less conservative liquidity estimates allowing for a more favourable fund classification and more set-up possibilities (dealing frequency and notice period).

### Broader asset-liability liquidity matching tools

The current proposal mainly counts on dealing frequency, notice period and anti-dilution tools to manage liquidity mismatch. In practice, mismatches are managed with a much broader toolbox allowing managers to face different market conditions and adjust to various asset classes. In this respect, the report is also not distinguishing between requirements for traditional daily traded liquid funds and funds investing in less liquid asset types, like, for instance, Real Estate ("RE") funds that are usually dealing less frequently and have a predominately professional investor base. For these specific asset classes and products, other matching techniques such as commitment mechanism are possible and used.

In light of this logic, ALFI believes that although the bucketing approach can be implemented from a technical standpoint, it is likely to fall short of its objective to mitigate liquidity mismatch and induces

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<sup>3</sup> Some illustrations

Nagel, S. (2012). Evaporating liquidity. *The Review of Financial Studies*, 25(7), 2005-2039.

Jiang, G. J., Lo, I., & Verdellhan, A. (2011). Information shocks, liquidity shocks, jumps, and price discovery: Evidence from the US Treasury market. *Journal of Financial and Quantitative Analysis*, 46(2), 527-551.

<sup>4</sup> Related to the inherently unforecastable nature of liquidity shortfalls

<sup>5</sup> Such as the diversity of managers, funds, allocations, and investor bases

substantial operational costs. This prescriptive and categorical approach could even set inappropriate incentives regarding the liquidity internal assessment. Alternatively, it is believed that the liquidity management framework can build on the major progresses made over the last years and put further focus on the contingency liquidity plan leveraging on more mechanism than the dealing frequency, notice period, anti-dilution tools and asset classification alone.

- **Question 1**

*Should “normal” and “stressed” market conditions be further described to facilitate the application of the bucketing approach? If yes, how would you propose describing such conditions?*

The virtues of stress testing exercises are acknowledged. Correspondingly, in principle the clarification around the definition of stress and normal condition could be beneficial and can support convergence and reporting practices among asset managers. The effort of the European Securities and Markets Authority (‘ESMA’) to provide principle-based guidance in their [Guidelines on liquidity stress-testing on UCITS and AIFs](#) which were directly transposed in some jurisdictions as in Luxembourg<sup>6</sup> effectively promoted convergence and enhanced stress-testing practices in the industry. Nevertheless, some practical considerations need to be highlighted.

Firstly, it is essential to underline that it is the principle-based nature of the ESMA Guidelines that allowed to reach its objectives. In a principle-based framework, stress testing fosters an in-depth analysis of the scenarios by the managers as well as a tailoring of these scenarios to the most relevant risks considering the specificities of the assets, funds, investor bases, distribution networks, etc. In this context, the diversity of scenarios is supported to capture the most prevalent risks relevant to each fund. However, in a more prescriptive based approach the modelling divergences and associated wrong incentives would cause an issue of scenario relevance and market consistency with diverging asset classification and buckets for funds with similar liquidity profile. Such consistency could not be obtained with more detailed descriptions on what defines stress conditions as it would lead to a standardisation of stress scenarios making them less relevant and adapted to the funds and their idiosyncrasies in term of mismatch. ESMA, in the [Economic report – Stress simulation for investment funds](#), recalls that different types of stress exercises are for different purposes. Regarding stress tests lead by the manager, it is stated the following.

*By informing the fund manager about the risks of its investment strategy, they are part of the decision-making process and crisis management planning.*

This is in line with the view that internal stress tests support decision making including the design of dealing frequency and notice period.

Secondly, as stated in our response to Question 4, the use of stress tests to establish prescriptive rules (e.g. implication on dealing frequency) causes concerns regarding consistency. The application of stress tests requires a) the specification of scenarios, b) the calibration of shocks and c) the evaluation of the impact of the shocks (dependency modelling). In theory, it would require estimating the probabilities and impacts associated with all possible scenarios. In practice, this would translate into diverging specifications and interpretations leading to disparate estimates amongst participants.

Furthermore, recent liquidity stress events were characterised by their unprecedented and unforeseeable nature, adding to the argument of a virtually infinite number of possible scenarios. Accordingly, it is critical to acknowledge that financial market experts have a limited view on what will

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<sup>6</sup> [Circular CSSF 20/752](#)

constitute future market stresses. This consideration is particularly apropos in the context of the liquidity risk factors since many liquidity stresses are also idiosyncratic (specifically impacting a particular market at a particular time) yet material for investment funds' investors. These features make prominent the inadequacy of the reliance on stress tests for prescriptive rules such as the bucketing approach.

Based on this reasoning, ALFI recommends to a) leverage on existing principle-based stress testing guidelines for convergence purposes and b) not to embed stress testing into prescriptive rule-based approach. Hence, as detailed in Question 4, it is argued that the bucketing approach is inadequate and does not meet the objective of mitigating the asset-liability mismatch.

- **Question 3**

*Is the use of specific thresholds an appropriate way to implement the bucketing approach? If yes, are the proposed thresholds for defining funds that invest mainly (i.e. more than 50%) in liquid or less liquid assets and funds that allocate a significant proportion (i.e. 30% or more) of their assets to illiquid assets appropriate? If not, which thresholds would be more appropriate and why?*

In line with previous comments on the bucketing approach, ALFI believes that the use of prescriptive thresholds departs from a principle-based framework and is not appropriate to address liquidity mismatch. The rationale beyond this statement is provided below under three main arguments pertaining to the insufficient grounds to justify the threshold values, the need to address heterogeneity and the impact of cliff edge effect.

#### **Arbitrary nature of the thresholds**

The reliance on specific thresholds would require a calibration rationalising the use of the selected values (thresholds). Such an approach would be required to avoid depending on arbitrary thresholds. In the report, the rationale for the proposed thresholds does not appear clear to market participants. In absence of objective justification, the arbitrary nature of the thresholds remains a concern.

#### **Absence of universal thresholds**

As mentioned, thresholds should be calibrated. However, this presupposes the existence of a set of thresholds applicable at all time to all funds without considerations for other factors than the portfolio holdings. Accounting for all relevant factors, two funds with comparable holdings can be exposed to contrasting mismatch risk. This would imply that the thresholds should be tailored to the specific features of the funds (changing allocation, global distribution network model, investors behaviour and other contractual arrangements, etc). Similarly, the bucketing might yield different results at different points in time. Against this background, prescribed universal thresholds would not be sufficiently granular to effectively tackle mismatch vulnerabilities.

#### **Cliff edges effect**

By construction thresholds induce cliff edges effects. Firstly, a minor difference in the portfolio allocation could lead to a different fund classification with substantial consequences as per the prescriptive bucketing approach. Secondly, such thresholds could hinder certain active management practices built on fast changing allocations to deliver additional value to investors and alternative risk-return profiles compared to passive investing. In such a set-up, while the classification is static, the allocation is dynamic. The bucketing would become an important operational day-to-day burden for those strategies and would limit the capability of the manager to adjust to new market conditions and expected returns.

Thirdly, the use of absolute thresholds could also provide an incentive to adopt a sub-optimal portfolio allocation to fall in a given liquidity category.

II) Liquidity management tools (Recommendations 4, 5 and 8)

• **Question 6**

*Do the proposed changes to Recommendations 4 and 5, when read together with the proposed IOSCO guidance on anti-dilution LMTs, help achieve greater use and a more consistent approach to the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?*

ALFI is convinced that liquidity management tools should be extensively available to managers and that it is in the best interest of investors. The access to a full toolkit is instrumental in allowing managers to adjust their responses to a broad range of market scenarios in the most adequate manner.

The Recommendation 5 specifically requires significant market impact to be captured by the anti-dilution liquidity management tools.

*Such tools should impose on redeeming and subscribing investors the explicit and implicit costs of redemptions and subscriptions, including any significant market impact of asset sales and purchases to meet those redemptions and subscriptions.*

The virtue and economic sense of including market impact in the total cost passed to transacting investors is fully acknowledged. Nevertheless, in practice, one should recognize that significant market or price impact a) is not directly observable and b) has to be forecasted to account for different incoming transaction features (e.g. market conditions, size, timing, etc).

Therefore, significant market impact measures are only proxies and needs to be estimated. Estimates are generated by models and inherit the limitations and uncertainty from the selected model (same dynamic as introduced in Question 3 in the model risk paragraph). A broad spectrum of price impact models

exists relying on alternative sets of assumptions and data<sup>7</sup>. This ranges from sophisticated models based on high frequency data to more elementary approaches driven by (conditional) descriptive statistics. In a comprehensive review, Fong, Holden and Trzcinka (2017)<sup>8</sup> provide empirical evidence on the performances, similarities and divergences of the estimates generated by alternative liquidity models encompassing both high and low frequency data-based forecasts.

In this respect, there is a trade-off between model risk and costs. On the one hand, some standard models can generate estimates at reasonable costs but with a sizeable uncertainty around these estimates and therefore around the cost to be passed on to transacting investors. On the other hand,

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<sup>7</sup> For real assets, some considerations should be given to the fact that market data is scarce and as such liquidity assumptions are based on estimates and a large degree of subjectivity which will mean that calibration factors may vary substantially (even for comparable funds).

<sup>8</sup> Fong, K. Y., Holden, C. W., & Trzcinka, C. A. (2017). What are the best liquidity proxies for global research?. *Review of Finance*, 21(4), 1355-1401.

other more sophisticated models can generate precise estimates and forecasts<sup>9</sup> but at more substantial costs and data requirements.

The benefits of the inclusion of significant market impact into anti-dilution tools should not be outweighed by the associated downsides in term of uncertainty impacting the fund net asset value<sup>10</sup> and costs ultimately borne by investors. The decision to include price impact into anti-dilution tools should therefore result from an assessment of whether price impact can be estimated adequately and at a fair cost to investors. The conclusion of this assessment would diverge depending on the set-up and pre-existing resources of each manager<sup>11</sup>.

ALFI recommends that the decision to include price impact into anti-dilution tools would remain the ultimate responsibility of the manager on the basis of a cost-benefit analysis rather than an external regulatory prescription.

- **Question 8**

*Would additional recommendations or guidance be helpful in clarifying the expectation that OEF managers have internal systems, procedures and controls enabling them to use anti-dilution LMTs as part of the OEFs' day-to-day liquidity risk management?*

The principle-based 2017 FSB policy recommendations to address structural vulnerabilities from asset management activities together with the 2018 IOSCO recommendations for liquidity risk management for collective investment schemes have significantly strengthened liquidity and risk management practices while promoting convergence. Over the last five years, the liquidity management landscape has substantially evolved toward enhanced and more robust practices. This was allowed by the industry efforts in developing liquidity methodologies and governance frameworks and the sustained supervision activities and guidance from the authorities. Some illustrations of these authorities' initiatives are provided below:

- [ESMA – Guidelines on liquidity stress testing in UCITS and AIFs](#)<sup>12</sup>
- [Circular CSSF 19/733](#)
- [Circular CSSF 20/752](#)
- [ESMA Report - Recommendation of the European Systemic Risk Board \(ESRB\) on liquidity risk in investment funds](#)
- [ESMA Public statement on the results of the 2020 Common Supervisory Action \(CSA\) on UCITS liquidity risk management](#)
- [CSSF Feedback report on ESMA common supervisory action on UCITS liquidity risk management](#)
- [CSSF – Swing pricing mechanism - FAQ](#)

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<sup>9</sup> Note that the price impact forecasting exercise remains non-trivial especially during stress.

<sup>10</sup> As anti-dilution tools may have an impact on the net asset value it is relevant to highlight that the trading net asset value is supposed to remain largely independent from the manager's influence which calls for a particular scrutiny on the uncertainty around price impact estimates.

<sup>11</sup> For example, a manager having data driven strategies or being part of a group with trading desks might benefit from economies of scales regarding data acquisition and uses making price impact estimation more accessible. Not all managers can benefit from these resources.

<sup>12</sup> Note that the [Circular CSSF 18/698](#) already established requirements of formalised risk management procedure encompassing the liquidity risk management framework along with other relevant risk factors.

- [CSSF Working paper – Liquidity stress test for Luxembourg investment funds: the time to liquidation approach](#)
- [CSSF – Ukraine crisis: FAQs on the application of LMTs by investment funds](#)
- as well as the periodic and ongoing information and data collection exercises from National Competent Authorities.

The ongoing review of AIFMD and the new liquidity risk management related provisions (e.g. new article 18.a ([Amendments to AIFMD and UCITSD](#))) aims to ensure that a larger set of LMTs are available to UCITS and that the inclusion of any given LMT is part of a wider assessment by the management company. This further underlines the need for a flexible approach to liquidity risk management as best assessed by industry participants.

In light of this evolution and state of the industry, it is considered that the current guidance successfully promotes convergence as well as good practices while allowing for the needed flexibility to address the diversity of the industry. Principle-based regulatory guidance, as opposed to rules-based, acknowledging for the specific characteristics of managed funds are recommendable to provide market players with a flexible framework to operate.

- **Question 9**

*Do you agree with applying anti-dilution LMTs to subscribing investors as well as to redeeming investors? If not, why?*

The application of anti-dilution tools when investors are redeeming and subscribing could be differentiated and we would welcome flexibility that would allow for applying a different treatment on subscriptions and redemptions, when deemed appropriate by the investment managers in regards to the range of LMTs and other tools such as e.g. valuation adjustments available to them.

Unlike for redemptions, the dilution caused by subscriptions is spread out across time via several indirect channels (e.g. effect of larger cash holdings, changing expected return)<sup>13</sup>. Due to these inter-temporal and indirect characteristics, robust and sound assessment methodologies are even more complex to define. Indeed, the impact of subscriptions on dilution depends on an increasing number of factors to account for, such as:

- the valuation methodology of assets;

*e.g. valuation at the bid prices with a focus on anti-dilution tools for subscriptions instead of redemptions (and conversely)*

- the speed of investment made with the incoming liquidities; and

*e.g. investment in securities spread out in time aiming to strike a balance between the price impact incurred and the effect of cash on expected returns*

- the use of incoming liquidities to either replicate existing portfolio or seize contemplated investment opportunities (adjustment allocation for actively managed funds).

*e.g. subscriptions used to execute intended reallocations and not to replicate the existing portfolio*

Due to the disparities above detailed, ALFI recommends that the responsible entity be allowed for a distinct treatment between redemptions and subscriptions. On the basis of the different elements to consider, the manager should remain responsible for determining whether to apply anti-dilution to subscribing investors as well. While the underlying rationale of applying anti-dilution tools to subscriptions is understood, the decision should be left to the managers according to how they set up their valuation and liquidity risk management.

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<sup>13</sup> Beyond the technical aspects described, it is also relevant to highlight that the (dis)alignment of interest between the investors in the fund with the investor entering is not of the same nature and prevalence as it is with the investors entering.



### III) Other FSB Recommendations

- **Question 11**

*Do the proposed changes to Recommendation 2, when read together with the proposed IOSCO guidance on disclosure to investors, help enhance disclosure to investors on the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?*

Disclosure to investors and transparency are essential elements of efficient capital markets and investors protection. ALFI supports initiatives allowing investors to gain further knowledge on products and markets when it ensures better protection. More transparency can foster a higher adoption of anti-dilution tools and increase investors' confidence in those tools and the industry at large. In this context, the notion of transparency focusing on the applicable principles and governance processes framing the implementation of anti-dilution tools and aggregated statistics on the use of anti-dilution tools is welcomed. In contrast, full public transparency focusing on the detailed history of tools' activations and on selected parameters (triggers, thresholds, etc) should be avoided.

This recommendation is stemming from the possibility that some particular investors would exploit public information with detrimental effects on other investors<sup>14</sup>. The last paragraph of section 3.2 of the report is indirectly referring to this threat.

*“In determining the content and frequency of disclosure to investors, it is important to consider the potential for unanticipated consequences from public disclosure of detailed information (e.g. the potential for predatory trading and/or herding behaviour by funds and other market participants)”*

Industry observations and past experiences show that this threat is a possibility that should be mitigated through selected disclosures and the monitoring of such opportunistic transaction activities. For supervision purposes, with considerations to the proportionality between costs and benefits, as is already the case in Luxembourg with the semi-annual [UCITS Risk Reporting](#) established and used by the Commission de Surveillance du Secteur Financier ('CSSF'), more transparency on the past activations of anti-dilution tools could be provided to National Competent Authorities. For example, in term of market wide disclosure, the CSSF makes publicly available information on the aggregated past uses of liquidity management tools in their periodic [UCITS Risk Reporting dashboard](#).

In order to strike a balance, ALFI recommends public disclosure to be made at the level of applicable principles and governance arrangements but to restrict other information regarding specific parameters and past activations.

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<sup>14</sup> Sometimes referred as front running or trade breaking.

#### IV) Other FSB Recommendations

- **Question 13**

*Are there any other aspects that should be considered in the revised FSB Recommendations to ensure that they are effective from a financial stability perspective?*

The overarching objective of the proposed recommendations is a) to enhance financial stability and b) to protect fund investors.

In our opinion, the proposals might embed a conceptual misunderstanding about the principal goals of anti-dilution tools. The primary goal of anti-dilution tools is to avoid dilution and protect investors from such impact. As a second-round effect, anti-dilution tools might discourage redemptions but that is not their initial aim. Financial stability issues, as caused by spiralling redemption requests and falling asset prices with potential for negative feedback loops and herd behaviour cannot be materially mitigated by anti-dilution tools alone and are better addressed by other liquidity management tools and techniques. Although anti-dilution tools have a role to play in preventing redemptions only motivated by exploiting first mover advantages, linking asset bucketing, presence of anti-dilution tools and dealing frequency is therefore conceptually not aligned with the prime objective of the tools and fundamentally misguided.

Some of the proposals seem to reduce and potentially harm the value offered to fund investors. Notably, stability is proposed to be enhanced through a reduction of the liquidity mismatch or its impact via:

- a) more prescriptive rules on the dealing frequency and notice period;
- b) including all costs encompassing anti-dilution tools; and
- c) enhanced investors transparency.

Regarding a), it is worthwhile reminding the investors' preference for flexible and swift access to capital. From this perspective, offering frequent dealing<sup>15</sup> is also beneficial to investors and contribute to delivering value to clients as well as protect their utility. Regarding b), the report introduces the notion of 'excess redemption' especially in time of stress. The definition of 'excess redemption' and more specifically its identification is extremely challenging. Indeed, periods of stresses are associated with changing expected risk-return profile as well as changing utility of consumption motivating significant investors transactions and assets reallocation for perfectly justifiable reasons well beyond first-mover advantage considerations. Providing investors with the opportunity to execute this reallocation and match their changing preferences at fair costs is of pivotal importance. Accordingly, the burden of transacting for fund investors should not be excessively increased to the point of preventing them from transacting compared to other investors (vehicles). From a macroeconomic perspective, periods of stresses are associated with changes in risks, consumption preferences (discount factors) and expectations (cash-flows) which in turn rationally impact fundamental valuations of assets. This price equilibrium mechanism should not be affected by excessive frictions related to hindered transactions.

In conclusion, the objectives should not be met at fund investors' expenses (including retail). Accessibility to capital is beneficial and sought for by investors. Accordingly, liquidity management framework should aim at reflecting the right level of liquidity and costs and should not aim for excessively conservative constraints to investors. At the risk of repetition, principle-based frameworks are better suited to reach this objective than prescriptive rule-based framework. The access to a full toolkit of liquidity management tools including anti-dilution is instrumental in allowing managers to adjust their

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<sup>15</sup> And short notice

responses to a broad range of market scenarios in the most adequate manner and in the best interest of investors.

## **Annex 1: List of questions**

### Structural liquidity mismatch (Recommendation 3)

**Q1** - Should “normal” and “stressed” market conditions be further described to facilitate the application of the bucketing approach? If yes, how would you propose describing such conditions?

**Q2** - Are the examples of the factors that should be considered in determining whether assets are liquid, less liquid or illiquid appropriate? Are there other factors which should be considered and, if yes, which ones and why? *ALFI did not provide an answer to this question.*

**Q3** - Is the use of specific thresholds an appropriate way to implement the bucketing approach? If yes, are the proposed thresholds for defining funds that invest mainly (i.e. more than 50%) in liquid or less liquid assets and funds that allocate a significant proportion (i.e. 30% or more) of their assets to illiquid assets appropriate? If not, which thresholds would be more appropriate and why?

**Q4** - Should the FSB consider recommending the use of a decreased redemption frequency (on a standalone basis), a longer notice period (on a standalone basis) or a longer settlement period (on a standalone basis) for OEFs investing in less liquid assets that do not meet the expectation on the implementation of anti-dilution LMTs? Or should these measures be used in combination, considering the risk of redemptions crowding around certain dates?

**Q5** - Would additional guidance on factors to consider when setting the redemption frequency or notice or settlement period be helpful? If yes, in what respect? *ALFI did not provide an answer to this question.*

### Liquidity management tools (Recommendations 4, 5 and 8)

**Q6** - Do the proposed changes to Recommendations 4 and 5, when read together with the proposed IOSCO guidance on anti-dilution LMTs, help achieve greater use and a more consistent approach to the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?

**Q7** - Are there any obstacles (either universal or jurisdiction specific) to the implementation of the revised FSB Recommendations on the use of anti-dilution LMTs? If yes, what additional recommendations or guidance would help address such obstacles? *ALFI did not provide an answer to this question.*

**Q8** - Would additional recommendations or guidance be helpful in clarifying the expectation that OEF managers have internal systems, procedures and controls enabling them to use anti-dilution LMTs as part of the OEFs’ day-to-day liquidity risk management?

**Q9** - Do you agree with applying anti-dilution LMTs to subscribing investors as well as to redeeming investors? If not, why?

**Q10** - Would additional international guidance on the availability and use of quantity-based LMTs be useful? If yes, what aspects should such guidance focus on? If not, why? *ALFI did not provide an answer to this question.*

### Other FSB Recommendations

**Q11** - Do the proposed changes to Recommendation 2, when read together with the proposed IOSCO guidance on disclosure to investors, help enhance disclosure to investors on the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?

**Q12** - Should any other 2017 FSB Recommendations (Recommendations 1, 6, 7 or 9) be amended to enhance the clarity and specificity of the intended policy outcomes? If yes, which ones and why? *ALFI did not provide an answer to this question.*

Additional considerations

**Q13** - Are there any other aspects that should be considered in the revised FSB Recommendations to ensure that they are effective from a financial stability perspective?