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São Paulo, September 4, 2023

ANBIMA - Brazilian Financial and Capital Markets Association

Subject: Consultation by FSB on “Revised OEF Recommendations”
Consultation by IOSCO on “LMT Guidance – Consultation Report”
Submitted by email: fsb@fsb.org & LMTGuidanceConsultation@iosco.org

Re: ANBIMA Response to FSB and IOSCO Consultations

Dear Sir/Madam,

The Brazilian Financial and Capital Markets Association (ANBIMA) congratulates the entities for the publication of the consultations and for the successful launching event for a broad-based audience, including in Brazil.

ANBIMA is aware that the various events that impacted the financial and capital markets after the publication in 2017 of the FSB Recommendations to address vulnerabilities from asset management activities led to a review (in particular) of the recommendations on liquidity mismatch in Open-ended Funds, the object of the respective consultation. It was also noted that the IOSCO Consultation, providing guidance on anti-dilution liquidity management tools, should be read in conjunction with the FSB consultation, due to its complementary character to the proposed revision. In this respect, the Association prepared a joint response to the consultations, aiming at summarizing the main points arising from the experience of the Brazilian investment funds industry, and to contribute with specific considerations to each consultation as indicated below.

Since the beginning, ANBIMA took part of the international debate upon the suitable prudential treatment of non-bank financial institutions with systemic importance¹ and vulnerabilities presented by the collective investment management activity² regarding not only liquidity risk management but also leverage³.

¹ See: *FSB Consultative Document (2nd) on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (NBNI SIFI)* – [Comments from ANBIMA](#) – May 2015

² See: *FSB Consultative Document on Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* – [Comments from ANBIMA](#) – September 2016

³ See: *IOSCO Consultation Report on Leverage* – [ANBIMA Comments](#) – February 2019



Regarding the assessment and control of the intrinsic liquidity risk related to asset management, the Association understands that the adoption of measures from the inception of each fund, as well as a pre-established and transparent-based liquidity management on a daily basis are essential conditions for continuously mitigating risks of mismatches and facing exceptional liquidity crisis — whether or not arising from market conditions. It also understands that by having freedom of design and continuous liquidity management procedures, fund managers and administrators have greater flexibility to adequately mix and match types of funds, investors profile and liquidity risk management policies, considering the characteristics of depth and diversity of each asset trading market that will integrate the fund portfolio.

Executive Summary

The Brazilian market has several regulatory requirements applicable to investment funds that impact their composition and risk diversification. Moreover, the local Securities and Exchange Commission (CVM) establish minimum procedures regarding liquidity management. All funds are subject to mark-to-market rules for portfolio assets and (with rare exceptions) disclosure of the composition of the respective portfolio. ANBIMA⁴'s self-regulation determines the creation of liquidity risk management policies that should consider both the liquidity of the fund's assets and the investors behavior characteristics, which implies a daily monitoring dynamic — in funds with this liquidity condition — based on a redemption probability matrix and asset liquidity indicators.

These characteristics will be detailed later, but it is possible to point out certain aspects resulting from this model that are relevant to the consultations. Briefly:

- ✓ Regarding the FSB consultation, ANBIMA understands that one of the lessons from recent events in this agenda was the broad differentiation in the availability and use of liquidity tools, not always under suitable and/or previously arranged conditions. In this regard, the Association supports recommendations aimed at ensuring the wide and appropriate availability of anti-dilution LMTs, the use of quantity-based LMTs and other measures under stressed market conditions (Recommendations 3, 4 and 7, 8).

⁴ ANBIMA is a non-profit organization that gathers representatives of approximately 300 financial and capital market institutions in Brazil. The Association also acts as a self-regulatory entity for the Investment Funds segment in Brazil, following a formal agreement entered with Brazilian Securities and Exchange Commission (CVM) — the regulator of the local capital market.



- ✓ In this respect, local regulation is expanding the range of available LMTs, with the introduction of redemption gates and side pockets, within the scope of the implementation of a new regulatory framework for investment funds accompanied by a thorough discussion concerning its adoption.
- ✓ The Association also agrees that price-based LMTs can contribute to the mitigation of dilution risks as part of the daily liquidity management in certain funds that present this condition for redemption and other elements that may arise the need of these tools, provided it is under the appropriate conditions regarding design and governance, as detailed in the IOSCO consultation.
- ✓ On the other hand, in the light of local experience, it is ANBIMA's understanding that proper liquidity management occurs in three stages: (i) in the fund's establishment when the investment objectives and policies, asset liquidity, investors profile, and redemption proceeds are defined; (ii) in the fund's asset liquidity and current liabilities (investors) daily basis monitoring, e.g., based on the calculation of liquidity indices on a certain period of time, favoring the continuous management of liquidity conditions; and (iii) through the provision of appropriate liquidity risk management instruments for each type of fund and respective redemption criteria.
- ✓ Therefore, the liquidity risk management process begins when the fund is established (product design) and must be implemented proactively through preventive liquidity indices monitoring (asset liquidity forecasting and redemption scenarios); it must also have liquidity tools to deal with specific characteristics, atypical illiquidity scenarios, and/or systemic stress scenarios.
- ✓ As it is known, there is a number of structural characteristics of the markets and regulations that affect the configuration of the segment and investor behavior in different types of funds, with a different dynamic of investing/redeeming being expected by investors, depending on factors such as market conditions, macroeconomic scenario, and product performance.
- ✓ The FSB proposal (bucketing approach) contained in revised Recommendation 3, by classifying all possible types of open-ended funds into three categories — requiring an attribution of liquidity to the assets comprising the portfolios, classification according to fixed percentages, and mandatory adoption of price-based LMTs, in fact points into a different direction from what we see on the market, and does not properly reflect the diversity of products, assets and situations that impact the investor's behavior.



- ✓ The proposal privileges the ex-ante classification of asset liquidity and the availability of price-based LMTs instead of active liquidity management per se, which considers aspects such as future redemption expectations and appropriate asset pricing.
- ✓ ANBIMA understands that, in several funds with daily liquidity, the risk of “first mover advantage” can be mitigated through daily pricing of the fund assets and adequate management between asset liquidity against estimate redemption flows and terms. This process will allow the manager to foresee potential liquidity mismatches (liquidity ALM). Furthermore, we believe that, for exceptional situations (crisis), in which such practices are not enough, quantity-based tools — such as gates — provides a more equitable treatment of investors compared to price-based LMTs.
- ✓ In lesser diverse and depth markets such as Brazil, the use of price-based LMTs under conditions of greater market volatility, may require discretionary attributions of what is known as “cost of liquidity,” even if the practices and procedures recommended by IOSCO are adopted.
- ✓ Such positioning by ANBIMA does not mean that the entity is against the use of anti-dilution (or price-based) liquidity tools. In Brazil, redemption fees are already established in the regulation, and the introduction of other tools listed in the IOSCO consultation is currently being studied, *jointly with the regulator*.
- ✓ With regard to the IOSCO consultation, ANBIMA has specific considerations regarding the challenges in the implementation and use of the LMTs in focus, but believes that, in general, aspects such as design, calibration and adoption conditions, governance, and information disclosure are relevant to the proper adoption of these liquidity management instruments. It should also be borne in mind that the compulsory adoption of a price-based liquidity tool by a wide range of funds with daily liquidity may affect the competitiveness of this type of investment.
- ✓ In short, it is ANBIMA’s understanding that the general rule for open-ended funds should provide for an active, robust, daily management of liquidity, based on estimates of redemptions by investors, and that — in designing funds with daily liquidity — the availability of an anti-dilution tool should be evaluated by the asset manager, according to the characteristics of the fund, the asset trading market and investors profile.
- ✓ ANBIMA agrees with the idea that quantity-based tools are more appropriate for stress situations, while anti-dilution tools should be made available for both normal and stress situations. However, the proposal of general adoption of the latter in daily liquidity funds may lead to the understanding that the LMTs is a suitable substitute for daily liquidity management per se. We believe that LMTs are complementary instruments to



the management per se, and that the excessive and compulsory use thereof may bring incentives contrary to those that the new recommendations seek to establish.

The importance attributed by ANBIMA to the liquidity management policies used for this management in designing investment funds and in the daily management thereof is related to the regulatory, self-regulatory and monitoring framework in place in Brazil in this respect. Below, we detail the aspects related to this framework mainly for exposing the procedures for diversifying open-ended fund portfolios, asset mark to market, liquidity monitoring based on the redemption's probability matrix and asset liquidity, and information available for supervision in addition to stress testing. Based on the evolution of this framework, we will then seek to explore the general questions raised by the consultations, as well as some specific questions where we believe that the Brazilian experience can offer additional contributions.

Liquidity Management – Brazil's experience

The net worth of Investment Funds in Brazil reached R\$ 7.7 trillion (or US\$ 1.607 trillion) at the end of the first six months of 2023, distributed among 17,912 funds⁵. Regarding composition, fixed-income funds represent the largest share (37,6%), followed by multimarket funds (21.7%). In contrast to other jurisdictions, in Brazil, equity funds represent 6.9% of the industry total and ETFs only 0.5% (the same fraction of offshore funds). Other relevant segments are Pension Funds, which exceed 16.2%, and Alternative Funds, which reach 16.5%, encompassing Real Estate Funds (3.4%), Private Equity (8.5%), and Credit Receivables (4.6%).

It is important to emphasize that the share of federal government bonds is high comparing to corporate bonds and securitizations. In the case of fixed-income funds, the participation of government bonds reaches, on average, 51% of the fund's portfolio. In contrast, the share represented by securities issued by companies is small. The so-called "private credit funds" — which correspond to funds that hold more than 50% of their portfolios in bonds issued by private companies — account for only 10.8% of total open-ended funds, and this percentage drops to 8.5% if the same proportion is considered, but only between funds that offers daily liquidity.

According to IIFA data, assets under management in Brazil represent the 11th position in relation to other countries monitored in the international survey. And according to the survey published by IOSCO in January 2023, considering assets under management, the Brazilian Open-ended Funds segment ranks 8th compared to the other countries included in this specific

⁵ If Fund of Funds are considered, these totals rise to R\$ 11.520 trillion (or US\$ 2.390 trillion), distributed among 29,630 funds.



sample. Based on the industry's total equity, open-ended funds account for a 76% portion, and, out of this total, those offering daily liquidity account for 59% (or 45% of the industry).

The regime applicable to Investment Fund shares is regulated by the Law that guides the Capital Market in Brazil, which classifies these assets as securities, under the regulatory regime of the CVM. The regulations applicable to Mutual Funds are based on CVM Instruction 555 and, starting in October of this year, based on CVM Resolution 175. As for the rules referring to liquidity management in open-ended funds, although the new regulatory framework has ushered in several advances, it has also preserved the essential elements that characterize the liquidity management on the local market.

One of the first elements that contributes to the conduction of liquidity management policies for Investment Funds in Brazil refers to the more general regulatory framework of the Funds. According to the aforementioned CVM regulations:

- certain types of Funds must be set up in a closed-ended regime (such as *Private Equity* and *Real Estate* Funds),
- all funds must be registered at CVM and are subject to portfolio composition limits by issuer risk diversification, by issuer type (financial institutions, companies), and by type of asset
- each fund's net assets and share value must be calculated based on the value of marked-to-market assets
- the respective fund administrator must calculate and disclose the share value on a daily basis, for funds that offer daily liquidity to their investors — it is worth mentioning that the pricing of the Fund's assets is the responsibility of administrators, which means that funds from the same administrator have the mark-to-market assigned by them.

Regarding CVM rules aimed specifically at liquidity management: policies, procedures, and internal controls are required “to ensure that the liquidity of the asset portfolio is compatible with the time frames set forth in the regulation for redemption payment requests and the fulfillment of obligations” of the class or fund. The parameters considered should include the following: liquidity of the assets, obligations of the fund (margins, guarantees), expected redemption values “under ordinary conditions with consistent and verifiable statistical criteria,” and degree of dispersion of ownership of the shares. There are also parameters to be considered in the case of funds that invest in other funds.

The responsibility for policies and procedures is shared between managers and administrators — i.e., both must be responsible for implementing and complying with liquidity management rules. The conditions must be agreed upon between these parties and the criteria used,



including in stress scenarios, must be consistent and verifiable. Finally, the current regulation also requires stress tests to be conducted in an appropriate frequency according to the characteristics of the class or fund and “considering scenarios that take into account, at minimum, changes in liabilities, liquidity of assets, obligations and the pricing of the share”. Also, CVM receives and processes daily data on funds, equity, value of shares, and composition of the portfolios. There is continuous monitoring and questioning of participants based on the information received daily in a proprietary system that uses the ANBIMA database.

A complementary “layer” to these procedures is possible by the more granular rules of ANBIMA’s self-regulation. The document “Liquidity Risk Rules and Procedures”⁶ provides information requirements, functional structure, and for the implementation of a methodology that seeks to ensure compatibility between the demand for and supply of estimated liquidity.

It has been established in the self-regulation rules that the area or professional responsible for the liquidity risk management process must formalize and keep the documents containing explanations for the decisions made within the scope of liquidity risk management. If there is a group (forum, committee, or similar) whose purpose is to discuss matters related to liquidity risk management, the materials that support the decisions of such group must be verifiable and remain available to ANBIMA for at least five (5) years.

The asset manager must prepare a document that addresses the liquidity risk, which must be reviewed at least annually (or whenever updated). This document must be registered at ANBIMA and published on the asset manager’s website. It also must address the description of the methodology, mechanisms, procedures, and controls adopted for liquidity risk management. In broad terms, liquidity risk management, according to the Rules and Procedures for Liquidity Management in “555” Funds, covers the compilation of estimated supply and demand indicators for liquidity referring to different time horizons (“vertices”), and seek to ensure the compatibility thereof. The preventive and predictive analyses and the construction of “soft limit” and “hard limit” indicators, respectively, must be described in each institution’s own methodology, and constitute an integral part of this document.

For the construction of the estimated demand for liquidity indicators, known information is added to future redemptions estimates, as well as costs and obligations that the fund is subject to, including transaction costs, margins, guarantees, among others. The following should be considered: (i) redemption orders already known but pending settlement; (ii) expected redemption amounts under normal market conditions, calculated using specific and verifiable

⁶ See [Rules and Procedures for Liquidity Management in “555” Funds](#).



criteria; (iii) the degree of concentration of shares per investor; (iv) time limits for settling redemptions; (v) the degree of concentration by allocators, distributors and/or other asset managers, and analysis of the expected behavior of these agents; and (vi) the fund’s investor segment (e.g. retail, private, institutional, among others). To assist in this process, ANBIMA publishes, monthly, redemption’s probability matrices, by term vertices and different fund classes (equities, foreign exchange, multimarket, fixed income, fixed income credit, fixed income MMF) and according to the type of investor (e.g., retail, institutional, among others); see example below⁷.

Varejo		<i>dias úteis</i>							
Classe	1	2	3	4	5	10	21	42	
Ações	0,21%	0,39%	0,55%	0,73%	0,90%	1,75%	3,60%	7,04%	10,3
Cambial	0,27%	0,59%	0,89%	1,29%	1,59%	3,05%	5,77%	10,23%	16,1
Multimercados	0,35%	0,61%	0,84%	1,07%	1,28%	2,36%	4,75%	8,99%	12,9
Renda Fixa	0,23%	0,44%	0,66%	0,88%	1,10%	2,18%	4,73%	9,60%	14,3
Renda Fixa Crédito	0,25%	0,49%	0,75%	0,97%	1,21%	2,42%	5,09%	10,43%	15,5
RF DI	0,22%	0,43%	0,65%	0,86%	1,07%	2,14%	4,53%	9,11%	13,6

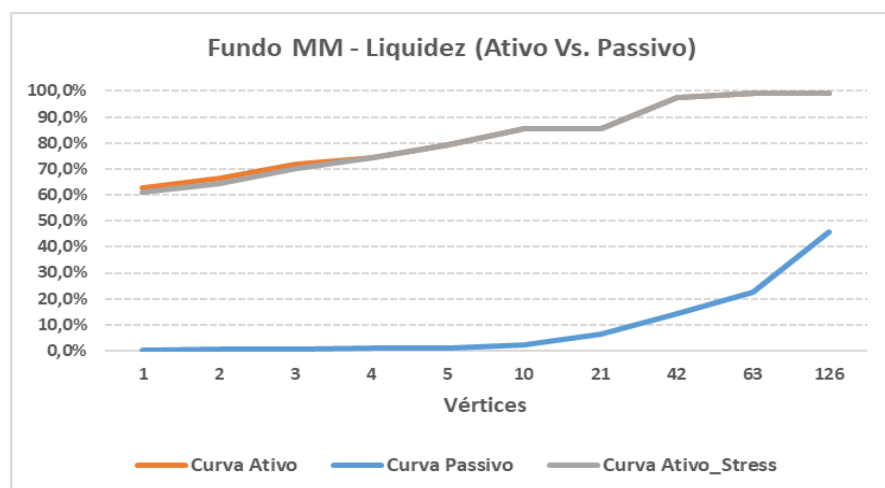
Regarding asset liquidity, at least one of the following criteria must be used: (i) cash flow of each asset that integrates the fund’s portfolio; or (ii) estimate of the volume traded in the secondary market in relation to an asset, extracted based on the historical volume discounted by a “haircut” defined in the policy. It is worth mentioning that the assets that comprise the portfolios are obligatorily registered in Brazil, which allows access to information on transactions that have taken place. Due to obligation of mark-to-market of portfolios, there is also daily availability of market prices and/or fair prices for a wide range of assets. Other criteria may be considered, provided there is proper rationale and that they are verifiable for oversight purposes. The treatment of assets used as margin, adjustments in operations or guarantees, for the purposes of management policies, must also be described.

Indicators of both liabilities (probability of redemptions) and assets must be related, at least, to the time horizons of one (1), two (2), three (3), four (4), five (5), twenty-one (21), forty-two

⁷ Sources: [ANBIMA website](#) for monthly data and [Methodology](#) for rules used in the calculation of matrices by segment.



(42) and sixty-three (63) business days⁸, according to the methodology. The example below shows the graphic tracking of estimated indicators and stress test results — predicting and monitoring potential mismatches.



The use of this liquidity management monitoring model in local funds represents innovation in relation to traditional metrics based only on the liquidity of the funds’ assets. Even when we observe the use of liability liquidity risk parameters, it is common to attempt to use metrics applicable to market risk, such as VAR and Stress, adapted to liquidity risk management (Liquidity VAR or Liquidity Stress). However, such methodologies do not capture recent changes or ongoing changes in investor behavior. In other words, there is no way to justify that any investor behavior that has occurred in the past in a particular fund will be repeated in the future, since the composition of investors (number and type) changes constantly, as well as their behavior vis-à-vis market conditions

The attempt to apply liquidity metrics based on the stress of redemptions through estimates based on parameters of the fund’s track record, without considering changes in its investors’ profile (for example), may lead to errors⁹. Likewise, redemption estimates based on historical data for a new fund, in which only positive investment flows were observed, are not appropriate. Or even assumptions that funds that have the same parameter of net inflows and

⁸ Longer time horizons should be considered if the fund has longer redemption terms than the ones considered.

⁹ In this regard, when using liquidity metrics based on redemption stress, one of the possible mistakes is to try to estimate a parameter considering the highest redemption amount, on a given day, in the fund’s history, without taking into account changes in the profile of investors; e.g., if such parameter is 10% of the fund’s equity and, currently, there is a single investor or allocator representing 20% of this total, the assumption will not be correct.



outflows have the same level of liquidity risk¹⁰. Situations such as the ones exemplified above demonstrate that appropriate liquidity management must also focus on liabilities and on the dynamics of investors' behavior, with the latter (independent) variable being a determinant or a limiting factor with respect to the liquidity of the fund's assets.

It should be noted that investment funds that have the same portfolio composition, but different liability compositions (of clients) also present different liquidity risk. In the Brazilian scenario, self-regulation has therefore sought to adopt metrics that are more predictive, in other words, metrics that seek to estimate the behavior of investor redemptions in the future, based on a snapshot of the type of investor that the fund has in a given day *multiplied* by a probability matrix of market redemptions. For example, this analysis allows one to consider the daily changes in investor concentration in the Fund so that adjustments in the composition of the portfolio can be made.

Lastly, the methodology may also consider any mitigating or aggravating factors to the liquidity estimate. In the first group, examples are the settlement periods or notice periods, the availability of tools such as redemption fees or gates, and the dispersion of shares. In the case of aggravating factors, it is worth mentioning the status of a closed to fundraising, negative subscription trends, and concentration of liabilities, among others.

These procedures are implemented on-going, supported by documented policies, registered with oversight agencies and available to investors. They are also based on the construction of liquidity metrics, indicators and estimates that generate relevant and trackable information. Actions, metrics, and procedures are monitored by CVM's and ANBIMA's Oversight in their respective spheres of action. The result also contributes toward greater transparency for investors, since the management policy must be published by each manager and is added to the information made available to investors, such as daily PL and unit, composition of the fund portfolio, and description of the tools that may be available in the Regulations.

¹⁰ For the purpose of illustration: an investment fund with equity of 100 and daily movement of 10 in subscriptions and 11 in redemptions (i.e., negative variation of 1) is different from an investment fund with the same equity and daily movement of 1 in subscriptions and 3 in redemptions (negative variation of 2). Greater liquidity risk might be attributed to the second fund, but it is clearly the first one that presents the greatest risk, considering the magnitude of changes in relation to Net assets.



RESULTS OF LIQUIDITY MANAGEMENT RULES IN BRAZILIAN FUNDS

REGULATION	INFORMATION FOR SUPERVISORS	INFORMATION FOR INVESTORS
<p>General Rules: Registration, Diversification Limits, Composition Limits, Daily Market Pricing</p>		
<p>Liquidity Management Rules: Policy for matching obligations and redemption terms, liquidity parameters for assets, obligations, expected redemptions, and the degree of dispersion of investors with accountable parameters, stress tests at a frequency compatible with liquidity conditions, available tools based on price and quantity, provided for in the regulations</p>	<p>Composition of Portfolios Liquidity Management Policies Parameters for monitoring policies Stress Test Results Redemption Probability Matrix Monitoring of estimated indicators predicting potential situations of liquidity mismatch</p>	<p>Daily PL and Unit data Regulation with tools provided</p> <p>Composition of Portfolios Liquidity management policies</p>
<p>Self-Regulation Rules: Construction of estimated liquidity demand and supply indicators. Documentation of the methodology used for indicators. Creation of alert parameters.</p>		

Comments on the FSB Consultation in light of the Brazilian Experience

The revision suggested by the FSB in its recommendations to address vulnerabilities arising from the liquidity mismatch in Open-ended funds, object of the consultation in progress, is based on lessons learned from volatility and instability events that have occurred in several markets since the publication of its original version in 2017. In particular, the FSB concluded from the evaluation carried out in this regard, that the recommendations remain appropriate in general terms, but that there is room for reinforcement and further detailing, especially due to the significant difference in the ways in which LMTs were used in these events, particularly the anti-dilution tools. Also, according to the FSB, these tools are intended to transfer the cost of liquidity to investors who redeem funds in both normal conditions and stressed market conditions.

In fact, the proposals brought by the FSB consultation can be summarized in three points:

- (i) reinforce that the relevant regulations must ensure a wide range of tools, both in normal situations and under market stress, for the proper management of liquidity in open-ended funds, and must promote the reduction of barriers to their appropriate and transparent use (Recommendations 3 and 4);



- (ii) establish rules aimed at the availability of anti-dilution tools for managers of open-ended funds who must implement them in order to mitigate dilution risks, attributing — to the respective investors — the liquidity costs owed in relation to the redemptions and investments they carry out (Recommendation 5); and
- (iii) associate — in the pertinent regulations — the use of liquidity tools based on quantity and other measures, with exceptional situations or market stress (Recommendations 7 and 8).

It was found that the use of tools such as swing pricing in moments of acute market stress encountered difficulties related both to inadequate documentation, as well as the scarcity of price references and decision-making under unusual conditions. On the other hand, such tools have been increasingly used in the setting up of funds, enabling the use of a suitable instrument for measuring transaction costs and liquidity premiums of investors contributing or redeeming resources, which can be transferred to the funds. In Brazil, the subscription and redemption fee, already provided for in local regulations, can be designed to meet an anti-dilution rate format used as an appropriate instrument for certain portfolios. The introduction of other anti-dilution mechanisms is currently under analysis, but still subject to limitations in terms of governance, not suitable for the ‘condominium’ structure that still prevails in the local market.

ANBIMA understands that the revisions proposed in the FSB recommendations are suitable while they seek to reinforce the necessary availability of a wide range of liquidity management tools to fund managers, as well as establish more suitable conditions for the use of price-based (or *anti-dilution*) tools and for quantity-based tools. Regarding the establishment of a classification for all open-ended funds, with the compulsory use of anti-dilution tools for all portfolios considered liquid or low-liquid, ANBIMA understands that the proposal goes against the idea of flexibility and proper use of tools which is intended to be strengthened.

In a summarized way, ANBIMA considers the reinforcements and adjustments promoted in the FSB recommendations to be appropriate but disagrees with the adoption of a bucketing approach that determines the mandatory availability of an anti-dilution tool to open-ended funds with daily liquidity, as proposed in the consultation document.

Based on the description of the robust procedures implemented on the local market regarding liquidity management, the Association assesses that there is a wide array of varying types of open-ended funds with diversified portfolios, and a greater proportion of liquid assets in which policies aimed at ensuring harmony between the assets and liabilities of said funds are effective even in mitigating dilution risks in the most liquid funds, among others.



One can also see that several elements suggested as relevant by IOSCO for the appropriate calibration of anti-dilution liquidity tools are already present as an integral part of the policies for the daily management of liquidity of funds in Brazil.

Stressed situations, in markets characterized by less depth and diversification, bring about challenges to the proper pricing of assets, making the use of quantity-based tools both appropriate and equitable. The IOSCO itself recognizes, in this regard, that “if responsible entities cannot (...) reasonably estimate the cost of liquidity for these assets, especially in stressed markets conditions, the use of quantitative based LMTs and other liquidity management measures (applied in accordance with local regulations), such as side pockets, suspensions, longer notice or settlements periods or reduced redemption frequencies, may be more suitable than the use of anti-dilution LMTs.¹¹”

In this respect, ANBIMA agrees with the idea that quantity-based tools are more proper for stressed situations, while anti-dilution tools should be made available for both normal and stressed situations. However, the proposal for generalized adoption of the latter in daily liquidity funds may lead to the understanding that the tool is a suitable substitute for daily liquidity management per se. We believe that liquidity management tools are complementary instruments to the management per se, and that the excessive and compulsory use thereof may bring incentives contrary to those that the new recommendations seek to establish.

Thus, ANBIMA considers the proposal to establish mandatory objective parameters for the adoption of anti-dilution tools by open-ended funds to be inadequate, and suggests prioritizing managers’ flexibility of choice, as well as adopting robust policies for daily liquidity management.

Comments on the IOSCO Consultation

The limitation seen in the prescription suggested by the FSB also extends to IOSCO Guidance n.1, since it is in line with a regulatory determination that requires the design and use of an anti-dilution tool as part of the liquidity management of open-ended funds. As for the other guidelines proposed in the IOSCO Consultation regarding the list of these tools, calibration, usage, governance, and information to investors, ANBIMA believes that they are appropriate and complete operational precepts in this regard. Some additional information in this respect can be added, still in the light of local experience.

¹¹ IOSCO Consultation, page 11.



As for the use of anti-dilution tools, it is worth mentioning the availability of subscription and redemption fees in Brazil. Within the scope of the studies already conducted, this possibility was clarified by CVM¹², which highlighted that there is no regulatory restriction on the use of this instrument as an anti-dilution tool. Local participants are authorized by current regulations to provide for the availability of this tool, even in the case of daily liquidity funds and are able to adopt parameters for use and calibration in line with IOSCO guidelines.

Therefore, the use of anti-dilution tools may advance on the local market, either from the already available instrument, which use, as previously noted, may be expanded in specific cases of open-ended funds with daily liquidity, or based on studies regarding the availability of alternatives among those mapped out by IOSCO. In fact, in the current context, the main issue regarding the appropriate availability of anti-dilution tools in Brazil refers to matters of governance. Although the regulatory framework of the funds has been recently reformulated in order to make the legal arrangement of the funds more flexible, currently their most common format is still that of a 'condominium'. Therefore, decision-making frameworks, executive boards, or Councils appropriate for the use of anti-dilution tools have not been verified, in line with the prescription proposed by IOSCO.

Currently, in Brazil, funds do not have legal personality, and the sovereign decision-making body is the investor, through the investors general meeting. As a consequence, instead of reinforcing instruments that require different decision-making instances, the path chosen on the local market for liquidity management of open-ended funds was to improve daily preventive and predictive liquidity controls, as described, with the use of stress tests and consideration of estimates for asset and liability indicators. The option for a "culture of prevention" is related to the existing governance framework, but it proved to be suitable in view of recent lessons from the international experience, with respect to the excessive responsibility of asset managers. In the case of Brazil, administrators' and asset managers' joint responsibility for liquidity management in the Funds and the strengthening of preventive and predictive practices and procedures responded suitably to this condition and is appropriate to the availability of various liquidity tools, for optional use and tailored by those responsible.

In shallower and less diversified markets, such as the local market, measuring the calibration parameters of anti-dilution tools beyond direct transactional costs, reaching (for example) liquidity premiums (spreads) or indirect impacts tends to be more complex and imprecise. At the current stage, the availability of tools such as the subscription and redemption fee,

¹² Such a possibility was even foreseen in a [Study](#) by CVM (Circular Letter 10/2018).



conservatively calibrated or admitting “thresholds,” as suggested in the IOSCO consultation, meets the needs of a management tool in normal situations in the case of specific funds, and can contribute to the proper mitigation of dilution risks if (and when) employed. The multiplication of diversified portfolios may lead to the introduction of other price-based tools, which may even contribute to this measurement, as well as new governance arrangements hereby authorized.

Lastly, it is important to emphasize — with regards to the matter of barriers and disincentives to the adoption of these tools — that some elements in this respect indicated at the end of the IOSCO consultation can be verified on the local market. There is a wide variety of open-ended funds, with daily liquidity, which represent a liquid and profitable investment for many retail investors. The compulsory introduction of an instrument such as an anti-dilution tool could be seen as a penalty for funds with greater liquidity, thus causing the perception of extra costs and loss of competitiveness. Yet, the adoption of this tool in specific funds, with differentiated composition and investor profile, and established in the respective structuring on a case-by-case basis, may be the result of an evolution of the local industry, in line with the international prescription.

Moreover, a number of unintentional negative effects may result from the broad implementation of price-based liquidity tools, such as improper use of the provision, questions about the criteria adopted by the asset manager to determine parameters of use, and inhibition of placement of orders to sell assets on the secondary market which — for less liquid markets — may imply price dynamics that do not adequately reflect the risk premiums for these assets.

We take the opportunity to round out the document with a (re)organization of the main points of ANBIMA’s positioning, based on the questions asked in the FSB (Annex I) and IOSCO (Annex II) consultations, to facilitate the use thereof by the entities.

ANBIMA appreciates the opportunity to comment on both consultations. The Association looks forward to continuing the dialogue and remain at the disposal of the FSB and of IOSCO to explain in more details some of the information presented in this answer.

Yours Sincerely,

Jose Carlos Doherty
ANBIMA Chief Executive Officer



Annex I - Answers to FSB Consultation questions

FSB Questions	ANBIMA Positioning
<p>Structural liquidity mismatch (Recommendation 3)</p> <p>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?</p> <p>2. 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?</p> <p>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?</p> <p>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 anti-dilution LMTs? Or should these measures be used in combination, considering the risk of redemptions crowding around certain dates?</p> <p>5. Would additional guidance on factors to consider when setting the redemption frequency or notice or settlement period be helpful? If yes, in what respect?</p>	<p>ANBIMA understands that the adoption of mandatory criteria to define — on a mandatory basis as well — the availability of liquidity management tools for open-ended funds is unsuitable, considering the different characteristics, stages of evolution and regulatory frameworks of the markets. This fact is applicable in relation to the concepts of normal or stressed situations, as well as liquid, illiquid, or low-liquid assets, and also the percentages (50%, 30%) that are the object of the bucketing approach proposal.</p> <p>ANBIMA considers the reinforcements and adjustments promoted in the FSB recommendations to be suitable, but disagrees with the adoption of a bucketing approach that determines the mandatory availability of an anti-dilution tool to any open-ended fund with daily liquidity, as proposed in the consultation document.</p> <p>In shallow markets, it is possible to assign classifications to liquid and illiquid assets, but there is a vast differentiation between the remaining assets between these two extremes, the classification of which is uncertain. Likewise, the measurement of calibration parameters of anti-dilution tools beyond direct transactional costs, reaching — for example — liquidity premiums (spreads) or indirect impacts is complex and imprecise in these markets.</p> <p>Time frames for redemption and notice periods should be considered as “attenuating” in relation to the daily management of liquidity, which may be an appropriate alternative to help decisions regarding the implementation or use of the tools.</p> <p>The flexibility for the manager to reconcile fund types and portfolio, as well as investors profile and liquidity management methodology used across a range of tools that can be associated, is recommended.</p>
<p>Liquidity management tools (Recommendations 4, 5 and 8)</p> <p>6. Do the proposed changes to Recommendations 4 and 5, when read together with the proposed IOSCO</p>	<p>ANBIMA agrees with the idea that quantity-based tools are more appropriate for stress situations, while anti-dilution tools should be made available for both normal</p>



<p>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?</p> <p>7. 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?</p> <p>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?</p> <p>9. Do you agree with applying anti-dilution LMTs to subscribing investors as well as to redeeming investors? If not, why?</p> <p>10. 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?</p>	<p>and stress situations. However, the proposal for generalized adoption of the latter in daily liquidity funds may lead to the understanding that the tool is a suitable substitute for daily liquidity management per se. We believe that liquidity management tools are complementary instruments to the daily liquidity management, and that the excessive and compulsory use thereof may bring incentives contrary to those that the new recommendations seek to establish.</p> <p>Regarding the application of anti-dilution tools both for investors who subscribe and redeem, we believe that there are situations in which the possibility of suspending subscriptions is simpler and easier to use (provided it is foreseen in the fund's documentation) and the condition of anti-dilution to be more specifically applicable to redemptions.</p> <p>The FSB consultation could be focused on indicating design situations or specific characteristics of portfolios that may give rise to higher potential dilution risks, and which therefore would make it advisable to implement an anti-dilution tool, in order to guide regulators and asset managers in this regard.</p>
<p>Other FSB Recommendations</p> <p>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? 12. 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? Additional considerations</p> <p>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?</p>	<p>ANBIMA agrees with the idea that anti-dilution tools must be provided for in the Fund's documentation and that the calibration and use conditions must be the object of information to investors, provided they do not result in unnecessary detail regarding the use of the tool that may bring about unintended consequences of the respective tools.</p> <p>With respect to the establishment of a classification for all open-ended funds, with the compulsory use of anti-dilution tools for all portfolios considered liquid or low-liquid, ANBIMA believes that the proposal goes against the idea of flexibility and appropriate use of the tools that are intended to be strengthened.</p>



Annex II - Answers to IOSCO Consultation – selected Questions

IOSCO Consultation Questions	ANBIMA Positioning
<p>Proposed Guidance 1 – Overall Framework</p> <ol style="list-style-type: none"> 1. To what extent does the proposed guidance 1 help responsible entities to better integrate the use of anti-dilution LMTs within their existing liquidity risk management framework? Have all the critical elements been captured? 2. Do you agree with the proposed guidance 1 regarding the inclusion of anti-dilution LMTs within the daily liquidity risk management framework that OEF managers should have in place at all times? 3. Is this proposed guidance appropriate for all types of OEFs in its scope, and proportionate for all types of responsible entities to implement? If not, please explain. 	<p>ANBIMA believes that the general rule for open-ended funds should stipulate robust daily liquidity management, and also believes that — in the design of daily liquidity funds — the provision of an anti-dilution tool should be evaluated by those responsible, according to the characteristics of the fund, the markets where the underlying assets are traded and the target investors.</p> <p>The proposal for the widespread adoption of these anti-dilution tools in daily liquidity funds may lead to the understanding that the tool is a suitable substitute for daily liquidity management per se. We believe that liquidity management tools are complementary instruments to daily liquidity management and that their excessive and mandatory use may bring about incentives contrary to those that the new recommendations seek to establish.</p> <p>As for the other guidelines proposed in the IOSCO Consultation regarding the list of these tools, calibration, usage, governance, and information to investors, ANBIMA understands that they are appropriate and complete operational precepts in this regard.</p>
<p>Proposed Guidance 2 – Types of Anti-Dilution LMTs</p> <ol style="list-style-type: none"> 1. Has the proposed guidance identified all of the anti-dilution LMTs commonly used by responsible entities? Are there any other LMTs that share the same economic objective of passing on the liquidity cost to transacting investors, that could be included in this guidance? If so, please describe them. 2. Are the identified anti-dilution LMTs described correctly? Do the features or characteristics of the different tools vary or do they generally operate as described? 3. Do you support the proposed guidance 2? If not, in which cases do you think it could be justified not to adopt at least one anti-dilution LMT in OEFs (other than ETFs and MMFs)? What elements do you take into consideration to choose a specific anti-dilution LMT for your OEFs? 	<p>ANBIMA agrees with the list of anti-dilution tools listed by IOSCO.</p> <p>Situations of stress, in markets characterized by less depth and less diversification, bring challenges to the appropriate pricing of assets, making the use of quantity-based tools possibly more suitable and equitable. IOSCO itself recognizes, in this regard, that <i>“if responsible entities cannot (...) reasonably estimate the cost of liquidity for these assets, especially in stressed markets conditions, the use of quantitative based LMTs and other liquidity management measures (applied in accordance with local regulations), such as side pockets, suspensions, longer notice or settlements periods or reduced redemption</i></p>



frequencies, may be more suitable than the use of anti-dilution LMTs.¹³

Proposed Guidance 3 – Calibration of Liquidity Costs

4. Have the components of the cost of liquidity, as described above, captured all the relevant costs that should be considered when calibrating anti-dilution LMTs?
5. How does the cost of liquidity vary across different funds? To what extent could we achieve a more consistent approach to calibrating anti-dilution LMTs for similar funds, and what is the best way to do so?
6. How can significant market impact be incorporated in the calibration of all of the proposed anti-dilution tools? Please provide examples.
7. Can all of the components of the cost of liquidity (i.e., explicit and implicit transaction costs including any significant market impact) be incorporated in all five anti-dilution LMTs as set out in the discussion of Element (i) above? If not, what are the limitations to doing so and how would you suggest improving the effectiveness of these anti-dilution LMTs?
8. To what extent can a subscription / redemption fee achieve the objective of addressing the investor dilution issue and financial stability concern of OEFs by attributing the liquidity costs to transacting investors? How could it be appropriately calibrated to achieve this objective?
9. Do you see benefits in a tiered approach to attributing the cost of liquidity by using different adjustment factors according to net fund flow, market conditions and characteristics of the

It is worth bearing in mind that in shallow and diverse markets, such as the Brazilian market, the measurement of calibration parameters of anti-dilution tools beyond direct transactional costs, reaching — for example — liquidity premiums (spreads) or indirect impacts tends to be more complex and imprecise.

In this context, the availability of tools such as the subscription and redemption fee, calibrated in a conservative way or admitting “thresholds,” as suggested in the IOSCO consultation, meets the needs of a liquidity management tool in normal situations in the case of specific funds, and can contribute toward proper mitigation of dilution risks if (and when) used. In certain stressed situations, in markets thus characterized, there are also challenges for the appropriate pricing of assets, making the use of quantity-based tools possibly more suitable and equitable.

Monitoring liquidity indicators through estimates and conducting stress tests prove to be suitable for daily liquidity management, without requiring the widespread use of a price-based tool.

The attribution of degrees of liquidity to assets is relative and differs according to markets, types of funds, and type of investor. Moreover, considering credit risks (for example), very rapid changes may occur in the assessment of the liquidity of a given asset. These and other portfolio characteristics should be prevalent in the implementation and use of anti-dilution tools as part of management policy, rather than compulsory adoption.

¹³ IOSCO Consultation, page 11.



<p>funds? Are there any operational difficulties? Any further comments thereto?</p> <p>10. How could guidance on LMT calibration achieve a fair balance between (i) ensuring investors have a clear expectation of the cost of liquidity they could be charged and (ii) ensuring responsible entities have enough flexibility to attribute the overall cost of liquidity at all times, especially under stressed market conditions?</p> <p>14. Is the proposed approach regarding ranges of liquidity cost adjustment appropriate? If not, how could it be improved?</p> <p>15. Is the proposed expectation on the level of confidence and the sophistication of liquidity cost estimations appropriate? If not, how could it be improved?</p>	
<p>Proposed Guidance 4 – Appropriate Activation Threshold</p> <p>16. What are the appropriate factors to consider in setting the activation threshold so that antidilution LMTs will be activated for any subscription / redemption activities with material dilution effect? How would you define ‘material dilution effect’? Why and how could it vary across different funds?</p> <p>17. Does the use of an activation threshold introduce the risk of trigger / cliff-edge effects? How could trigger / cliff-edge effects be avoided? Could the tiered swing pricing address the trigger / cliff-edge effect?</p>	<p>We found that, in relation to the local industry, the possibility of working with triggers for the use of instruments and “thresholds” on fees would be more consistent with an initial period of use of these tools.</p>
<p>Overcoming Barriers and Disincentives</p> <p>23. Do you agree with the list of barriers and disincentives identified? Do you consider there are others that are not covered?</p> <p>24. In your view, what are the most significant barriers or disincentives to the implementation of anti-dilution LMTs? What are your suggestions for possible solutions to mitigate or overcome the barriers and disincentives to the implementation of anti-dilution LMTs?</p>	<p>ANBIMA understands that in markets with a wide diversity of open-ended funds, with daily liquidity, which represent a liquid and profitable investment for several retail investors, the introduction of an instrument as an anti-dilution tool, on a compulsory basis, could be seen as a penalty for funds with greater liquidity, thus causing the perception of extra costs and loss of competitiveness. The adoption of this tool in specific funds, with differentiated composition and investor profile, and established since its inception on a case-by-case basis, may be</p>



25. For those OEFs facing significant barriers, what are the implications for their ability to implement this guidance? Are adjustments needed to the guidance to account for this, bearing in mind the objective to mitigate dilution for investor protection? Other questions

26. Do you have any other comments on any guidance proposed in this document?

the result of an evolution of the local industry, in line with the international prescription.

Again, adoption of the tool should not be excessive and automatic.

In the Brazilian scenario, as in other jurisdictions, the Funds industry is subject to comprehensive specific regulation, recently reformulated. On the local market, all investment funds are registered at CVM. The FSB's proposed bucketing approach may have consequences on the competitiveness of the Funds. Price-based tools can be complex and will require understanding by investors. In practice, the measure can be understood as an obstacle to daily redemption and/or as a result of poor management.

