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Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 Basel  
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Submitted via email to [fsb@fsb.org](mailto:fsb@fsb.org)

4 September 2023

Dear Madam, Sir,

Please find attached Invesco's response to the Financial Stability Board (FSB) consultation on Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-ended Funds.

Invesco welcomes the opportunity to respond to the consultation and thanks the FSB for its constructive engagement with stakeholders.

Yours sincerely,

**Michael O'Shea**  
Senior Public Policy Manager, EMEA

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## Invesco response to the Financial Stability Board (FSB) consultation on Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-ended Funds

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?

While we agree with the principle of Proposed Recommendation 3 that an OEF’s dealing profile should appropriately reflect its investment strategy and the liquidity profile of the underlying assets, we do not believe that the FSB’s proposal regarding liquidity bucketing is an appropriate means by which to achieve this objective.

First, it is not clear that a top-down approach is required given that, in 2022, both the FSB and IOSCO found in their respective assessments of the effectiveness of their recommendations on liquidity risk management in OEFs that there was a high degree of implementation thereof, including regarding recommendations on ensuring that an OEF’s dealing profile appropriately reflects its investment strategy and the liquidity profile of the underlying assets.

Second, while we acknowledge the FSB’s attempt to achieve the above objective by proposing liquidity bucketing, we believe the proposal to impose certain dealing and liquidity risk management profiles on OEFs investing to a prescribed extent in “liquid”, “less liquid”, and “illiquid” assets is insufficiently flexible, and neither accounts for the diversity of the OEF sector, as recognised by both the FSB and IOSCO, nor adequately reflects the dynamic nature of liquidity.

Indeed, in setting out its proposal, the FSB risks undermining one of the key principles on which it and IOSCO agree: that OEF managers are best placed to manage the liquidity of their OEFs. It is essential that OEF managers retain primary responsibility in this regard, and that they are not impeded in carrying out this responsibility by the Proposed Recommendation.

Third, in proposing that, under certain conditions, OEFs investing in “less liquid” assets implement “long notice periods”, the FSB risks unnecessarily reducing investment opportunities for retail investors in certain jurisdictions. As set out in our response to the IOSCO consultation report on anti-dilution liquidity management tools (LMTs), in some jurisdictions (e.g., the UK), it is the case that some third-party distributors may not be in a position to distribute daily dealing OEFs from an operational perspective (or indeed may take a commercial decision not to do so) where those OEFs include within their liquidity risk management framework the use of certain quantity-based LMTs, such as notice periods.

In addition, in some jurisdictions (e.g., the UK), rules governing certain retail investment products (e.g., tax-efficient stocks and shares savings products through which investors can invest in OEFs) may even preclude investment in daily dealing OEFs that use notice periods. As such, the FSB and IOSCO should consider undertaking a broader analysis of barriers and disincentives to the implementation of LMTs, including potential implications for retail investors’ access to certain OEFs, before imposing such requirements.

To avoid the potential unintended consequences set out above, the FSB should maintain Proposed Recommendation 3, per Annex 1, setting out the need for an OEF's dealing profile to appropriately reflect its investment strategy and the liquidity profile of the underlying assets, while retaining existing supplementary language on the need for authorities to provide guidance supporting this objective, per the FSB's 2017 Recommendations to Address Structural Vulnerabilities from Asset Management Activities.

Finally, as Proposed Recommendation 3 refers to the need for an OEF's dealing profile to appropriately reflect its investment strategy and the liquidity profile of the underlying assets "at the time of designing a fund and on an ongoing basis", it is sufficiently clear that this objective should be met under both "normal" and "stressed" market conditions. There is no need to further describe said market conditions.

Indeed, the structure and functioning of markets have changed greatly in the years following the 2007-2008 financial crisis, in particular as a result of macroprudential policies implemented globally in the intervening period. Meanwhile, the crises and periods of market volatility that have arisen since then have each taken different forms, requiring those tasked with managing invested capital to make use of the requisite flexibility afforded to them within the regulatory and supervisory frameworks in which they operate.

As set out above, imposing certain dealing and liquidity risk management profiles on OEFs investing to a prescribed extent in "liquid", "less liquid", and "illiquid" assets would, in our view, remove that requisite flexibility and thus undermine the broader objectives being sought by the FSB and IOSCO. It would also, ultimately, reduce the utility of OEFs as investment products which have been so critical to the creation of wealth for investors over the decades.

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?

As outlined in our response to Q1, we do not support the FSB's proposal regarding liquidity bucketing as an effective means to achieve the principle, with which we agree, of Proposed Recommendation 3. Nevertheless, the FSB's considerations regarding the determination of the liquidity of an asset, as set out in the draft supplementary language under Proposed Recommendation 3 in Annex 2, include relevant elements.

However, this draft supplementary language, which we have suggested in our response to Q1 the FSB removes (while retaining existing supplementary as set out in the FSB's 2017 Recommendations), highlights another potential shortcoming of the FSB's proposal regarding liquidity bucketing. Given that it would be for each member jurisdiction "to determine its overall liquidity framework and an overall approach to defining assets as liquid, illiquid or less liquid (or comparable categories)", it is conceivable that inconsistent approaches would be taken when determining the liquidity of assets, and that similar (or even the same) OEF investment strategies would be treated differently across member jurisdictions in terms of liquidity risk management requirements. This poses questions as to the practical utility of the FSB's proposal, particularly where OEF managers manage and/or distribute OEFs cross-border.

Indeed, as we set out in our response to Q1, it is not clear that a top-down approach is required given that, in 2022, both the FSB and IOSCO found in their respective assessments of the effectiveness of their recommendations on liquidity risk management in OEFs that there was a high degree of implementation thereof, including regarding recommendations on ensuring that an OEF's dealing profile appropriately reflects its investment strategy and the liquidity profile of the underlying assets.

Given the FSB and IOSCO 2022 assessments, we believe that implementing the suggested enhancements to Proposed Recommendation 3, per Annex 1, while retaining existing supplementary language on the need for authorities to provide guidance, per the FSB's 2017 Recommendations, represents a more effective way to ensure that an OEF's dealing profile appropriately reflects its investment strategy and the liquidity profile of the underlying assets.

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?

As outlined in our responses to previous questions, we do not support the FSB's proposal regarding liquidity bucketing as an effective means to achieve the principle, with which we agree, of Proposed Recommendation 3.

The proposed thresholds for implementing the liquidity bucketing approach highlight another potential shortcoming of the FSB's proposal. As has been recognised by the FSB and IOSCO (and other regulatory authorities across the globe) in the context of money market funds (MMFs), implementing thresholds linked to the use of certain LMTs introduces potential trigger/cliff-edge effects which give rise to potential first-mover advantage and act procyclically during periods of underlying market volatility.

If the FSB were to proceed in implementing this proposal, it would risk knowingly implementing regulatory requirements which could amplify, rather than mitigate, negative investor behaviour, undermine investor protection, and contribute to underlying market volatility during periods of stress.

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?

We agree with the FSB and IOSCO that there can be no "one-size-fits-all" approach to OEF liquidity risk management. Given the diversity of the OEF sector, we do not believe that specific LMTs should be prescribed on a standalone basis to a certain subset of OEFs as proposed by the FSB.

Within the context of a robust yet flexible regulatory and supervisory framework (and, where relevant, as agreed with the regulator at the point of authorisation and in compliance with local

rules), OEF managers should be afforded sufficient flexibility in structuring an OEF, including regarding their dealing profile and the liquidity risk management mechanisms that they make available for use, to ensure that an OEF's dealing profile appropriately reflects its investment strategy and the liquidity profile of the underlying assets.

Notwithstanding the above, if the FSB were to proceed in implementing this proposal, in particular regarding notice periods, it would risk knowingly implementing a dealing profile which, as we set out in our response to Q1, would unnecessarily reduce investment opportunities for retail investors in certain jurisdictions.

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?

As outlined in our responses to Q1 and Q4, we do not support the FSB's proposals to require liquidity bucketing or to prescribe specific LMTs on a standalone basis to a certain subset of OEFs. Nevertheless, the FSB's considerations regarding the setting an OEF's redemption frequency, or notice or settlement period, as set out on p15 of the consultation report, include relevant elements.

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?

Proposed Recommendations 4 and 5 support the principles of ensuring that the estimated cost of liquidity is borne by subscribing/redeeming investors, and that existing/remaining investors are protected from material dilution. The recommendations also appropriately acknowledge that OEF managers are best placed to manage the liquidity of their OEFs given they have the greatest proximity to and understanding of the OEFs that they manage, for example regarding the liquidity profile of underlying assets and the profile(s) and concentration of investors etc.

In addition, we agree with the FSB that it is critically important that authorities work to "reduce operational and other barriers that prevent the use of such tools and measures". In particular, and as set out in our response to the IOSCO consultation report, we highlight issues relating to the involvement of third-parties in OEF operations and administration, and broader order processing and distribution market structures as the two areas of greatest importance. We also acknowledge that the cost of implementing and operating on an ongoing basis certain anti-dilution LMTs may act as a disincentive to implementing such tools, or enhancing the complexity thereof, in addition to other mechanisms that form part of an OEF manager's approach to liquidity risk management.

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?

As alluded to in our response to Q6 and developed further in our response to the IOSCO consultation report, issues relating to the involvement of third-parties in OEF operations and administration, and

broader order processing and distribution market structures are two areas of greatest important, both universally (e.g., the role of fund administrators and/or service providers) and at a jurisdictional level (e.g., see our response to Q1 regarding the impact on retail investors' access to certain OEFs that use notice periods in the UK).

As an example, regarding the role of fund administrators and/or service providers, we have encouraged IOSCO, if it retains as an example of good practice the tiered approach to swing pricing, to consider the appropriateness of Guidance setting out how fund administrators and/or service providers can facilitate such an approach. Otherwise, IOSCO risks unintended consequences including potential related third-party concentration and operational resilience risks.

As another example, regarding barriers to the distribution by third-parties of OEFs implementing certain LMTs (e.g., notice periods), we have encouraged IOSCO to consider the appropriateness of Guidance setting out how third-party distributors can facilitate the distribution of such OEFs where currently there are operational, commercial, or other barriers.

Additionally, while we believe that sophisticated investors are sufficiently informed so as to understand that they are expected to bear the estimated cost of liquidity when subscribing/redeeming, we believe there is an opportunity to enhance retail investor education at the point of sale. To this end, we have encouraged IOSCO to consider the appropriateness of Guidance for intermediaries regarding the information that should be provided to retail investors at the point of sale relating to the attribution of the estimated cost of liquidity when subscribing/redeeming (including, where relevant, the operation of anti-dilution LMTs), in particular during periods of underlying market volatility.

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?

As set out in our response to the IOSCO consultation report, where an OEF manager determines that it is appropriate to make anti-dilution LMTs available for use, it will generally implement a governance framework which foresees regular/periodic review and, where required, adjustment of the calibration thereof. The review process may be undertaken on a monthly or quarterly basis (or any other regular cadence as determined appropriate by the OEF manager).

In order that the calibration of anti-dilution LMTs appropriately reflects the estimated cost of liquidity during, for example, periods of underlying market volatility, an OEF manager's anti-dilution LMT governance framework should allow for 'ad-hoc' reviews of and, where appropriate, adjustments to the calibration of the anti-dilution LMTs outside of the regular/periodic review process. We have proposed that IOSCO guidance and member jurisdictions' regulatory frameworks, where they foresee the use of anti-dilution LMTs, should allow for such flexibility.

Notwithstanding our comments in response to the FSB and IOSCO consultation reports, and the Proposed Recommendations and Proposed Guidance therein, we do not believe it is necessary to provide further recommendations or guidance regarding the expectation that OEF managers have in

place internal systems, procedures, and controls relating to anti-dilution LMTs, where they are deemed appropriate for use.

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

Where it is necessary to avoid the material dilution of existing investors' holdings, the estimated cost of liquidity should be attributed to the subscribing investor(s). This may be achieved through the deployment of an anti-dilution LMT, where an OEF manager determines that it is appropriate to make such LMTs available for use, or any other liquidity risk management mechanism that gives rise to the same regulatory outcome.

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?

Further analysis regarding the availability and use of quantity-based LMTs across member jurisdictions would be welcome. If the analysis highlights a need for additional international guidance, then work should be undertaken in this regard.

As with the FSB's Proposed Recommendations and IOSCO's Proposed Guidance relating to the availability and use of anti-dilution LMTs, any such guidance relating to quantity-based LMTs should appropriately acknowledge that OEF managers are best placed to manage the liquidity of their OEFs given they have the greatest proximity to and understanding of the OEFs that they manage, for example regarding the liquidity profile of underlying assets and the profile(s) and concentration of investors etc.

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?

As set out in our response to the IOSCO consultation report, where an OEF manager determines that it is appropriate to make anti-dilution LMTs available for use, we believe that disclosure to investors regarding such LMTs is critical. We therefore agree with the principle of Proposed Recommendation 2.

However, the 2022 FSB assessment of the effectiveness of its recommendations on liquidity risk management in OEFs states that "while all surveyed jurisdictions require disclosure of fund liquidity risk to investors, more could be done to enhance these". As such, it may be more appropriate (and relevant) for the Proposed Recommendation 2 to refer to enhancing existing disclosures, rather than requiring "additional" disclosures. This would be a more proportionate way forward as investors already receive a significant amount of documentation prior to and at the point of investing, and it may be more effective to enhance the utility of existing disclosures, rather than adding to the volume of information already received.

As such, the FSB should consider amending Proposed Recommendation 2 to introduce necessary proportionality, as follows:

*“Authorities should review existing investor disclosure requirements and determine the degree to which ~~additional~~ disclosures should be ~~provided~~ ~~enhanced~~ by open-ended funds to investors regarding fund liquidity risk and the availability and use of liquidity management tools, proportionate to the liquidity risks funds may pose from a financial stability perspective. Authorities should enhance existing investor disclosure requirements as appropriate to ensure that the required disclosures are of sufficient quality and frequency. In this regard, IOSCO should review its 2018 recommendations and, as appropriate, enhance them.”*

Additionally, as set out in our response to Q7, while we believe that sophisticated investors are sufficiently informed so as to understand that they are expected to bear the estimated cost of liquidity when subscribing/redeeming, we believe there is an opportunity to enhance retail investor education at the point of sale. To this end, we have encouraged IOSCO to consider the appropriateness of Guidance for intermediaries regarding the information that should be provided to retail investors at the point of sale relating to the attribution of the estimated cost of liquidity when subscribing/redeeming (including, where relevant, the operation of anti-dilution LMTs), in particular during periods of underlying market volatility.

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?

No response provided regarding Proposed Recommendations 1, 6, or 9.

In our response to Q10, we note that further analysis regarding the availability and use of quantity-based LMTs across member jurisdictions would be welcome and that, if the analysis highlights a need for additional international guidance, then work should be undertaken in this regard.

Subject to the above, regarding Proposed Recommendation 7, we acknowledge the ambition for member jurisdictions to set out more clearly in guidance expectations relating to the potential use of quantity-based LMTs, including for example the potential use of side pockets in OEFs marketed to retail investors. In doing so, we remind the FSB, member jurisdictions, and relevant regulatory authorities of the importance of taking a consistent approach to such guidance, as failure to do so may create barriers to use.

To illustrate this point, in 2022 following the Russian invasion of Ukraine, the Financial Conduct Authority (FCA), the Central Bank of Ireland (CBI), and the Commission de Surveillance du Secteur Financier (CSSF) each came out with similar but different regulatory approaches to the potential use of side pockets, under certain conditions, in OEFs marketed to retail investors. For firms operating across those jurisdictions, the lack of consistency from those regulators increased the complexity of the situation for OEF managers managing and/or marketing impacted OEFs, particularly regarding cross-border distribution.

We also welcome the FSB’s recommendation, as set out in the draft supplementary language under Proposed Recommendation 7 in Annex 2, to remove practical obstacles to the use of such tools and



mechanisms, such as in the distribution of OEFs by third-parties as we have highlighted elsewhere. In addition, and in the context of the potential use of side pockets in OEFs marketed to retail investors, the FSB should also consider broader issues such as the potential tax implications of segregating assets.

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?

No response provided.

– ENDS –