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Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
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Via email: fsb@fsb.org

4 September 2023

Dear Sir/Madam,

AIMA response to the Financial Stability Board ("FSB") consultation report, Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations

The Alternative Investment Management Association ("AIMA")[1] welcomes the opportunity to comment on its consultation report (the "consultation").[2] The proportionate and appropriate use of liquidity risk management tools is a core issue for asset managers. AIMA has always supported the widest availability of anti-dilution and liquidity management tools. These allow managers to operate their funds as effectively as possible, in the interests of all investors. AIMA is supportive of moves to encourage national competent authorities to enable the use of such tools. However, we have yet to be convinced that the recommendations in the existing International Organization of Securities Commission ("IOSCO") 2018 final report on Recommendations for Liquidity Risk Management for Collective Investment Schemes (the "2018 recommendations") require change.[3]

[1] The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US$2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage US$600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For more information, visit www.aima.org.

[2] FSB "Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report" (5 July 2023).

[3] IOSCO, "Recommendations for Liquidity Risk Management for Collective Investment Schemes" (Feb. 2018).

Maintaining stability in the financial system requires identifying and addressing potential risks to it. This in turn requires a complete understanding of the way in which market participants function. This includes how market participants interact, the resulting interdependencies as well as the relevant rules applying to them. AIMA is concerned that this is not always borne fully in mind.

The FSB's approach of looking at open-ended funds through the prism of banking risks, such as the requirement to protect deposits, and regulation is misconceived, inappropriate and likely to be counterproductive. The top-down imposition of tools will likely increase not reduce the risk of pro-cyclical behaviour. Further, such tools are not applied to assets that are held individually rather than collectively managed via open-ended funds and so do nothing to address the issue of direct investors engaging in the kinds of pro-cyclical behaviours the FSB is concerned about. This is not a trivial point as an increasing portion of institutional investor assets is managed individually and not through commingled vehicles. Therefore, the inappropriate application of such tools may also have the effect of pushing investors out of collective vehicles, so reducing choice and transparency.

Before addressing the specific questions in the consultation, set out in the annex, AIMA would like to make some wider points that should be used to frame this work.

The difference between retail and professional/institutional investor funds

AIMA has consistently argued that a difference should be drawn between retail and professional/ institutional open-ended funds.[4] The former are usually mandated to deal on a daily or very frequent basis and only invest a range of assets whose eligibility is often based on their immediate liquidity. The latter invest in a wide range of assets, some of which may be liquid and others illiquid. The dealing frequency of professional/institutional open-end funds could be daily, monthly, quarterly, semi-annually, annually or anything in between depending on the liquidity characteristics of those assets.

We therefore welcome the FSB's acknowledgement that its recommendations "do not imply a 'one-size-fits-all' approach across all open-end funds or all jurisdictions."[5] The current regulatory approach for retail funds is not appropriate in the context of professional investor funds. Existing principles-based requirements coupled with the observance of basic sound practices identified by the industry have proven to be robust for professional investor funds, even in the most challenging conditions.

This acknowledgement is important given that the FSB's concerns appear to be driven by specific concerns over daily or very frequently dealing funds investing in equities and bonds. The universe of open-ended funds is vastly wider than this. Despite the FSB's acknowledgement, we remain concerned that its proposals for all open-ended funds proceed from a narrow section of that fund universe.

Open-ended funds are already highly regulated

Asset management is a highly regulated activity with extensive rules and regulations. These govern, among other things, how asset managers can be structured, the investment and other services they can offer, the treatment of conflicts of interest, the use of leverage as well as extensive reporting requirements. Open-ended funds available to retail investors often have detailed portfolio-level

[4] *See* AIMA, "Liquidity Risk Management in Alternative Funds" (23 Mar. 2021), available upon request to regulatory contacts.
[5] *See* consultation, *supra* note 2, at 10.

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regulations related to eligible assets intended to ensure that the portfolios of funds offering daily liquidity can meet redemption requests. [6]

We are concerned that this objective fact is often ignored or not considered.[7] Asset management regulation addresses issues that apply to asset managers and the way they are structured and operate as agency businesses with fiduciary obligations. This is very different to the way in which balance sheet businesses such as banks and insurers are structured and operate. The extensive requirements on and tools available to asset managers are already sufficient to meet FSB's concerns.

It should also be expected that liquidity management and anti-dilution tools will vary greatly in their use. Open-ended funds with similar strategies and dealing frequencies may have very different investors with entirely different investment horizons. This will work against similarly invested funds always using such tools in a consistent or uniform way.

Unproven assumptions

The FSB is introducing novel and unproven assumptions and terms into the consultation. These do not bear up under scrutiny and should not be an element in the policymaking process. Of particular concern is the new and undefined phrase, "'excess' redemptions".[8]

We are at a loss as to how such a concept as "'excess' redemptions", even if it were proven to have some form of empirical grounding, could be monitored or measured in any meaningful way. Such theoretical constructs should have no place in evidence-based policymaking.

Banks' role as liquidity providers

The withdrawal of banks from lending and other activities because of changes to banking regulations has both led to the increase in NBFI activities and a reduction in the amount of liquidity banks provide. FSB should consider amending banking regulations to improve the availability of liquidity. Alternatively, the FSB should consider ways in which bank/dealer balance sheets no longer need to be used as the primary points of intermediation through, for example, greater use of all-to-all trading models and greater use of central clearing. Addressing this as one of the fundamental causes of the dearth of liquidity in some markets would be more fruitful than the current relentless focus on NBFIs and how they deal with that bank regulation-induced lack of liquidity.

We would be happy to elaborate further on any of the points raised in this letter. We have also responded to the associated IOSCO consultation paper on Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes which we have attached in Annex 2.[9] For further information please

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[6] *See, e.g.,* fund registered as investment companies under the U.S. Investment Company Act of 1940 and EU and UK UCITS funds.

[7] *See, e.g.*, FSB, "Enhancing the Resilience of Non-Bank Financial Intermediation: Progress Report" (10 Nov. 2022), at 29, which implies that hedge funds do not report on leverage. This is incorrect. Hedge funds in major jurisdictions have been reporting leverage since 2009. *See* the UK FSA Hedge Fund Survey, subsequently taken over by IOSCO, as well as the later adopted AIFMD Annex IV and SEC Form PF.

[8] *See also* consultation, *supra* note 2, at 10.

[9] IOSCO, "Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes Consultation Report" (5 July 2023).

contact James Hopegood, Director of Asset Management Regulation and Sound Practices at jhopegood@aima.org.

Yours faithfully,

Jiří Król
Deputy CEO, Global Head of Government Affairs

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ANNEX 1

The questions asked by the consultation are wide-ranging and interlock with each other. While we have addressed some of the individual questions relevant to AIMA members, we think it helpful to outline the issues managers of professional investor funds take into account.

When thinking about how liquidity management for professional investor funds works, it is important to recognise the main factors managers take into account. There are a minimum of four key issues:[10]

- *investor liquidity* relates to the predefined conditions under which investors can redeem some or all their investments at NAV;
- *asset liquidity* refers to how quickly and easily assets can be converted into cash;
- *strategy liquidity* relates to the overall liquidity profile of a fund as implied by the assets it holds; and
- *funding liquidity* refers to the availability and terms of credit to finance the purchase of financial assets or how easily synthetic positions can be supported through margining.

To manage these key liquidity issues, managers use a range of tools, some of which are routinely used, for example lock up periods during which investors cannot make redemptions, notice periods, in some cases swing pricing, anti-dilution levies and redemption frequencies. They also have additional tools such as side pockets or suspension of redemption, redemption gates, redemption fees and in some instances in-kind redemptions.

These and a range of other liquidity management tools are used by managers with reference to the specific circumstances of their funds. The funds will be designed to take account of the nature of the assets but also investor preferences. This means, for example, that dealing frequencies will be aligned with the underlying liquidity profile of the fund and the assets it invests in and the liquidity tools available will be appropriate for them. What is more important is that different tools might be used to address the same issues of illiquidity. For example, an open-end fund with a relatively frequent redemption schedule might use side-pockets for its illiquid investments in the normal course of business, as opposed to using side-pockets as an emergency measure. Another fund with the same liquidity profile might rely on less frequent redemptions to limit the amount any investor might redeem from a fund at any given redemption period.

Due diligence

Professional/institutional investor funds are, as the name implies, designed for professional/ institutional investors with particular risk appetites and investment horizons. These investors carry out detailed due diligence work on the funds in which they consider investing. Part of this due diligence work will be to understand the liquidity characteristics of a particular fund and a detailed understanding of the redemption terms and the circumstances under which routine and additional liquidity management tools may be used.

Greater uniformity can be counter-productive

[10] For a detailed discussion, *see* AIMA paper, *supra* note 4.

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Given these factors AIMA is concerned that the FSB's stated aim of greater uniformity in the use of liquidity management tools rests on a misunderstanding of the nature and complexity of funds and the vast range of investors using them. Creating uniformity and certainty in when liquidity management tools will be used will also be counter-productive and act against the FSB's intended aims. More sophisticated investors will be aware of when the ability to redeem may be limited and so act first. This risks giving form to the concept of the first mover advantage that the FSB is so concerned about. It will also create herd behaviour within funds and their investors as funds are forced to act in concert by unnecessarily rigid and deterministic rules.

Secondary effects

We are also concerned that the FSB has not considered the secondary issues its approach may create. For example, open-ended funds are routinely used by life assurance companies and pension providers to back the benefits, such as a retirement income or lump sum payout on death, their contracts promise to provide. The assets used to back such benefits have to be realisable to meet these benefit promises as they fall due. Insurance companies are liability-driven investors and often require custom solutions, such as long-duration corporate credit or composite products that include a variety of government or corporate securities, which are designed with a specific liability or hedging objective. Artificial regulatory barriers could have a significant negative impact on the ability of investment managers to meet their insurance client needs. If an asset cannot be realised at a contractual date stipulated by the contract, then the life assurer or pension provider may experience the exact kind of liquidity challenges that the proposal intends to resolve. Insurers would likely be forced to sell assets that they otherwise would not have, which may have negative effects on the cost of insurance products, their liquidity risk management or even their prudential reserve.[11] A mechanistic approach to the use of liquidity management tools increases this risk.

Bucketing

The proposal to use a so-called "bucketing" approach to create categories of open-ended funds based on their liquidity profiles will create rigid and arbitrary thresholds for such funds which will in practice be difficult to manage, particularly for actively managed funds. It would be helpful if there was a clear explanation of exactly what "liquid" or "illiquid" assets are supposed to be in this context. Nor does it seem to take into account the very wide universe of open-ended funds and their differing liquidity profiles and dealing frequencies. There is also a likelihood that such an approach will be applied in a variety of ways across jurisdictions and providers, creating confusion for investors and supervisory authorities.

Furthermore, the type of categorisation and the thresholds proposed appear to be inconsistent and based on little empirical evidence. The FSB does not provide any data or examples that would allow us to meaningfully comment on the bucketing approach. As we saw in March 2020, even the most liquid assets in the world became suddenly illiquid, requiring central bank intervention. Other assets remained liquid but suffered from extreme volatility.

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[11] *See, e.g.*, the UK Prudential Regulatory Authority, "Supervisory Statement ss5/19; Liquidity Risk Management for Insurers" (Sept. 2019), at paragraph 3.16 which states "3.16 "In some instances, for example where policy documentation provides for a specified time to payment, an insurer may be expected or required to provide supporting liquidity when liquidity buffers within funds are depleted. An insurer is expected to consider the possible actions it can take to meet such short term liquidity needs and to take such circumstances into account in its liquidity risk management strategy."

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Therefore, under certain assumptions, most assets could be considered illiquid in some imagined stressed condition. At the same time, we saw that certain "illiquid" assets funds continue to provide liquidity to investors simply by virtue of the non-traded" illiquid" assets being able to provide" liquidity" through the underlying cash-flows associated with them, for example, loan amortisation and interest payments.

We would therefore strongly recommend that the bucketing approach is abandoned as it will not be possible to create a regime that improves financial stability without harming the functioning of markets.

Double charging

The cost of providing liquidity will already be built into fund structures and so investors will be paying implicit costs for it. Additional liquidity management tools should not become a method of double-charging investors where they have to pay both the implicit costs built into fund charges structures and explicit costs from extra liquidity management tools.

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?

No. The bucketing approach does not take account of the differing appetites for risk disclosed by funds and accepted by investors. What a fund manager considers as "normal" will therefore vary depending on such factors. It is not clear whether FSB has considered alternative markets such as commodities and infrastructure which will have very different characteristics to equity and bond markets.

Furthermore, as we point out above, it's not just asset or market liquidity that needs to be taken into account but also the purpose of the strategy managers might be carrying out. Funds engaging in strategies relying on the need to hold assets for a defined period of time, might need to have different liquidity profiles irrespective of the underlying asset liquidity. Similarly, illiquid and/or non-traded assets might have different underlying features such as short maturities that provide a different kind of liquidity from trading liquidity, allowing funds to have more frequent redemptions.

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?

FSB should consider the well-established concepts of levels 1, 2 and 3 assets. These are routinely used by the asset management industry.

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?

No. Please see our preface on bucketing.

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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 open-end funds 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?

National competent authorities should give asset managers access to the widest range of appropriate risk management tools possible. It should then be for the manager to decide, in both the design and management of their open-ended funds and how these are configured and used.

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

No. Existing guidance from IOSCO's 2018 recommendations remains fit for purpose.

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?

FSB should not attempt to mandate more use of liquidity management tools than is necessary to ensure that all investors in an open-ended fund are treated fairly. As also noted above, greater uniformity in the use of such tools is inappropriate given that even seemingly similar funds may have very different investment portfolios, funding related obligations and/or investor bases. Moreover, greater uniformity could also create herd behaviour among funds and investors.

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?

Managers have a fiduciary duty to treat all investors fairly. The FSB's recommendations risk forcing managers to favour the interests of remaining investors to the detriment of those subscribing to and redeeming from funds. This is not an "obstacle" but a key mechanism in the proper functioning of funds and maintenance of confidence in them. The FSB should not undermine this.

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

No. The existing IOSCO 2018 recommendations, which have already been implemented in major fund jurisdictions' rules, are appropriate.

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

No. It is not clear why such an approach is necessary. As we have discussed above in the section on double charging, The cost of entering funds is built in at their design stage. Viewed in this way, LMTs are already routinely operational for all new investors subscribing to a fund and the cost of entry is factored in and charged appropriately. We see no justification for the creation of a second charge to such investors for the same costs.

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If a subscription is so large that it could be detrimental to other investors, then managers already apply anti-dilution tools to mitigate that risk. On that basis we do not see the need for a further recommendation.

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?

No. The existing IOSCO 2018 recommendations are appropriate.

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?

The information already disclosed to investors in professional investor funds already provide detailed information. This is then supplemented by extensive due diligence before professional investors decide to put their money into funds. For professional investor funds at least, we see no justification for enhancing the disclosures already made. We take the view that the 2018 recommendations remain appropriate.

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?

No. As noted before, we have not been presented with evidence to justify further FSB intervention.

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?

FSB should address one of the key issues in relation to any lack of liquidity by reviewing the rules for banks in this area. This would allow banks to resume their prior role as liquidity providers.

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Via email: LMTGuidanceConsultation@iosco.org

4 September 2023

Dear Damien,

AIMA's response to the IOSCO consultation report: Anti-Dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes

The Alternative Investment Management Association ("AIMA")[1] welcomes the opportunity to comment on IOSCO's consultation on proposed amendments to its 2018 recommendations on liquidity risk management in open-ended funds (the "consultation").[2] The proportionate and appropriate use of liquidity risk management tools is a core issue for asset managers. AIMA has always supported the widest availability of anti-dilution and liquidity management tools. These allow managers to operate their funds as effectively as possible, in the interests of all investors.

Changing global standards has serious implications for the regulators that have to amend their rules and potentially change the way they supervise firms subject to them. This is equally the case for the firms subject to those changed rules. It is of the utmost importance that proposals to change globally recognised standards are based on clear and unequivocal evidence that such changes are vital.

We have yet to be convinced that there is a clearly evidenced need to revisit IOSCO's 2018 final report on Recommendations for Liquidity Risk Management for Collective Investment Schemes (the "2018

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[2] IOSCO, "Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes Consultation Report" (5 July 2023).

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recommendations").[3] Taken in combination, we believe that the current tools and their flexibility of use are sufficient to address the issues IOSCO is concerned about. The revisions set out in the consultation appear to be minor recalibrations or re-wording of the 2018 recommendations. However, we are concerned that the detailed questions underlying the revised proposed recommendations is an inappropriate drive to far greater uniformity of use of liquidity management tools. This risks creating counterproductive behaviour and undermining asset managers' fiduciary duty to treat all investors in funds fairly.

IOSCO's consultation is being driven by what AIMA considers to be the Financial Stability Board's ("FSB") misconceived wish to impose inappropriate regulations on open-ended funds.[4] As we have explained in our response to the FSB's parallel consultation, included in Annex 2 to this letter, the top-down imposition of tools will increase, not reduce, the risk of pro-cyclical behaviour. Such tools are not applied to assets that are held individually rather than collectively managed via open-ended funds and so do nothing to address the issue of direct investors engaging in the kinds of pro-cyclical behaviours the FSB is concerned about. This may also have the effect of pushing investors out of collective vehicles, thus reducing choice, the ability to diversify risk and the ability to manage assets in a way that treats all investors fairly.

AIMA has consistently argued that a difference should be drawn between retail and professional/institutional open-ended funds. The former are usually mandated to deal on a daily or very frequent basis and can only invest a range of assets whose eligibility is often based on their immediate liquidity. The latter invest in a wide range of assets, some of which may be liquid and others illiquid. The dealing frequency of professional/institutional open-ended funds could be daily, monthly, quarterly, semi-annually, annually or anything in between depending on the liquidity characteristics of those assets. As we note in our response to question 20, professional investors carry out detailed due diligence of funds to understand whether they meet their performance, risk and liquidity requirements. This often goes beyond regulatory requirements.

We therefore welcome both IOSCO's and the accompanying FSB consultation's[5] explicit recognition that "one size does not fit all" for the very wide universe of open-ended investment funds.

However, as we note above, we are concerned that the drive towards a more uniform use of liquidity management tools may be in tension with this acknowledgement. A wish to see greater use of such tools should not translate into inflexible rules which do not recognise the diversity of open-ended funds and the wide variety of investors with differing appetites for risk and investment horizons.

We are also concerned that novel and unproven concepts are being referred to in both the IOSCO and FSB consultations. In particular, we object to the use of "excess redemptions". This is a previously unknown phrase with no empirical backing. Such theoretical constructs should have no place in evidence-based policymaking.

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[3] IOSCO, "Recommendations for Liquidity Risk Management for Collective Investment Schemes" (Feb. 2018).

[4] *See* FSB "Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report" (5 July 2023).

[5] *Id.*

AIMA

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact James Hopegood, Director of Asset Management Regulation and Sound Practices at jhopegood@aima.org.

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs

AIMA

ANNEX 1

The proposed changes appear to be small recalibrations or rewordings of the 2018 recommendations. This supports AIMA's contention that there is not sufficient evidence to justify changes to global standards.

AIMA would like to preface its answers to the consultation's detailed questions with some broader points. Managers of professional/institutional investor funds take a number of factors into account when managing liquidity. There are a minimum of four key issues:[6]

- *investor liquidity* relates to the predefined conditions under which investors can redeem some or all their investments at NAV;
- *asset liquidity* refers to how quickly and easily and at what price assets can be converted into cash;
- *strategy liquidity* relates to the overall liquidity profile of a fund as implied by the assets it holds; and
- *funding liquidity* refers to the availability and terms of credit to finance the purchase of financial assets or how easily synthetic positions can be supported through margining.

To manage these key liquidity issues, managers use a range of tools, some of which are routinely used, for example lock up periods during which investors cannot make redemptions, in some cases swing pricing, anti-dilution levies and redemption frequencies. They also have additional tools such as side pockets or suspension of redemption, redemption gates, redemption fees and in some instances in-kind redemptions. There will also be a process to manage investor concentration in a fund. This is an efficient way of managing the risk of very large outflows or inflows. There can also be notice periods for subscriptions and redemptions. These allow the manager to prepare for a large change in the fund size and let them, for example, reduce the portfolio in anticipation of a redemption. This is an effective way of managing trading costs.

These and a range of other liquidity management tools are used by managers with reference to the specific circumstances of their funds. The funds will be designed to take account of the nature of the assets. This means, for example, that dealing frequencies will be aligned with the underlying liquidity profile of the fund and the assets it invests in and the liquidity tools available will be appropriate for them.

Open-ended fund managers' ability to deploy liquidity risk management tools will often depend on the laws and regulations applying in their jurisdiction of domicile. We urge IOSCO members to facilitate the ability of open-ended fund managers to be able to use them in the widest range of appropriate circumstances. Effectively pushing asset managers towards the most liquid of the spectrum of assets will make alternative assets harder to finance and so reduce funding to the real economy.

AIMA's responses apply to more than one of the questions asked by IOSCO. Where this is the case we have grouped the answers together with a single answer underneath them. Questions for which we

[6] *See* AIMA, "Liquidity Risk Management in Alternative Funds" (23 Mar. 2021) ("AIMA's LRM Guide"), available upon request to regulatory contacts.

have not provided a response have been omitted from the list, but the original numbering has been retained for ease of reference.

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?

We do not see how this alters the effect of the existing recommendations.

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.

6. 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?

We support the widest availability of appropriate liquidity management tools for managers of open-ended funds. However, it should be for the managers to decide which tools may be needed depending on the characteristics of the open-ended funds in question and their investor profiles.

4. 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.

5. 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?

7. 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?

18. Do the proposed arrangements discussed above include all the essential elements regarding governance and oversight arrangements in relation to the use of anti-dilution LMTs? Are they proportionate to the differing size and complexity of responsible entities' fund ranges?

19. Please describe any material factors of the governance and oversight arrangements which have not been included.

We refer to AIMA's LRM Guide which describes the liquidity management tools available and the circumstances in which they might be used.[7] The LRM Guide looks in detail at the different LMT tools managers can consider using in both routine and exceptional circumstances. It also makes the very

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[7] *See id.*

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important point that the needs for such tools should be considered at the design stage of a fund, based on the assets it will hold, the investment and who will subscribe to it.

8. 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?

This question pre-supposes that greater uniformity in the use of such tools is a desirable outcome. AIMA disputes this underlying assumption. Even where open-ended funds may appear to be similar, they can have different investment objectives, risk tolerances and underlying funding structures. They may also have a wide variety of investor types, with different risk appetites and investment horizons. This can be the case within a single fund as each event reducing the liquidity of its portfolio is likely to be of different nature depending on the share of assets becoming illiquid, the type of asset, as well as, for example, a reduction in liquidity related to the issuer, counterparty, market or country risk.

9. How can significant market impact be incorporated in the calibration of all of the proposed anti-dilution tools? Please provide examples.

10. 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?

13. 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?

14. Is the proposed approach regarding ranges of liquidity cost adjustment appropriate? If not, how could it be improved?

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?

Please also see our response to question 4. Liquidity management tools will be used in ways that are appropriate to the characteristics of each specific open-ended fund and the profile of the investors in them. Market impact and trading cost are complicated statistical measures. Establishing the market impact of a trade requires data such as the number of trades over longer periods. This drive towards uniformity in their calibration does not properly recognise this and a host of other issues.

11. 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?

The cost of entering funds is built in at their design stage. If a subscription is so large that it could be detrimental to other investors, then managers already apply anti-dilution tools to mitigate that risk. Additional liquidity management tools should not become a method of double-charging investors where they have to pay both the implicit costs built into fund charges structures and explicit costs from extra liquidity management tools. It is not clear how potentially increasing the cost of investing indirectly in assets will mitigate any perceived financial stability concerns.

12. 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 funds? Are there any operational difficulties? Any further comments thereto?

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?

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?

22. Are there other risks than those described in this section attached to the disclosure of the parameters used for anti-dilution tools?

It is for managers of open-ended funds to set their thresholds for the use of liquidity management tools. This will be based on the design of the funds, the assets they hold and the expectations on liquidity communicated to their investors. Forcing managers to set more uniform terms will not only be inappropriate as they are less likely to meet the characteristics of individual funds, but also counterproductive. Greater predictability of the use of liquidity management tools will give some investors the ability to redeem before others if they are able to use such information to anticipate when those tools will be used. This could give form to the first mover advantage that central bankers are so concerned about. It may also encourage herd behaviour among both funds and investors. Please also see our reply to question 20.

20. Is the ex-ante information described above likely to be appropriate and effective in explaining the use of anti-dilution LMTs to investors? What other information about dilution, if any, might be helpful to investors before they invest in a fund?

The carrying out of full and thorough due diligence before committing money is a very strong characteristic of professional/institutional investors to ensure any investment suits their risk appetites and investment horizons. Part of this due diligence work will be to understand the liquidity characteristics of a particular fund and a detailed understanding of the redemption terms and the circumstances under which routine and additional liquidity management tools may be used. This will be done by reference to the information that must be disclosed in offering documents as well as frequent engagement with the manager.

21. What information can (and should) be disclosed ex-post to investors or the public, and at what frequency, to enhance transparency without compromising the aims of the antidilution LMTs or creating unintended consequences? Further, how soon should this information be disclosed to investors?

Other than on-going fund information that is already mandated to be published, we do not see any justification for further disclosure. The tools and the circumstances they can be used are set out in offering documents. Giving further "after the fact" detail on how and when they have been used invites the kind of behaviour we are concerned about in our response to questions 12, 16, 17 and 22.

AIMA

23. Do you agree with the list of barriers and disincentives identified? Do you consider there are others that are not covered?

Managers have a fiduciary duty to treat all investors fairly. The FSB's recommendations risk forcing managers to favour the interests of remaining investors to the detriment of those subscribing to and redeeming from funds. This is not a "barrier or disincentive" but a key mechanism in the proper functioning of funds and maintenance of confidence in them. IOSCO should strive to preserve, not undermine this.