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Irish Funds Response to the FSB Consultation - Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations

Introduction

The Irish Funds Industry Association (Irish Funds) is the representative body for the international investment funds industry in Ireland. Our members include fund managers, fund administrators, transfer agents, depositaries, professional advisory firms, and other specialist firms involved in the international fund services industry in Ireland. By enabling global investment managers to deploy capital around the world for the benefit of internationally based investors, we support saving and investing across economies. Ireland is a leading location in Europe and globally for the domiciling and administration of investment funds. The funds industry employs over 17,000 professionals across every county in Ireland, with over 34,000 of a total employment impact right across the country[1] and provide services to over 8,600 Irish regulated investment funds with assets of just under EUR 3.8 trillion[2].

Irish Funds welcomes the opportunity to respond on the Financial Stability Board's (FSB) consultation report on Addressing Structural Vulnerabilities from Liquidity mismatch in Open Ended Funds and the proposed revisions to the 2017 Policy Recommendations[3]. We wish to highlight that our response to this effort was crafted in conjunction with our feedback on the International Organization of Securities Commissions' (IOSCO) consultation report, which pertains to guidance on anti-dilution liquidity management tools (LMTs)[4] and that we extend our support to the FSB's efforts to advance the international macroprudential framework.

Irish Funds concur with the FSB's stance that **all available liquidity management tools**, including those which involve extended notice periods and settlement periods, **should remain at the disposal of responsible entities**[5] across various market scenarios. Nevertheless, we propose that **the utilisation of these tools should be determined based on the specific circumstances of each fund**, rather than adhering to a broad market definition of "normal" or "stressed" market conditions **and caution against adopting single definitions**, as the evaluation of stressed markets can differ based on factors such as asset class, managerial approach, and economic conditions. Our concern lies in the potential constraint this could impose on the use of certain tools at the fund level when they are truly needed. Alternatively, in line with existing regulatory liquidity management requirements within the European Union (as outlined by AIFMD and UCITS), we suggest that **emphasis should be placed on the fund's readiness to confront stressed market conditions through having a robust liquidity risk management framework.**

Similarly**, we harbour reservations about the categorisation of assets as liquid, less liquid, or illiquid** and **oppose the proposed bucketing approach** outlined in the consultation paper. We have outlined substantial challenges that must be considered (encompassing operational processes and transitions between these categories) which underscore the rationale for this opposition. Should the FSB proceed with the implementation of the revised recommendations pertaining to the bucketing approach we anticipate potential **challenges, particularly an escalation in operational complexity**.

Turning to the use of anti-dilution liquidity management tools, we would also highlight the recently finalised review of the Alternative Investment Fund Managers Directive (AIFMD) and

[1] Source: Economic Impact of the Funds & Asset Management Industry on the Irish Economy, Indecon, 2021

[2] Source: Central Bank of Ireland, May 2023

[3] FSB consultation report 5th July 2023 *Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report*

[4] *IOSCO consultation report 5th July 2023 CR03/2023 Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes (iosco.org)*

[5] *Per the definition in the IOSCO Guidance – "Responsible entities in this guidance generally refer to the entity / entities responsible for the overall operation of the OEF and in particular its compliance with the legal / regulatory framework in the respective jurisdiction (e.g., the fund manager or the fund board)"*

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Undertakings for the Collective Investment in Transferable Securities Directive (UCITS Directive), whereby LMTs, their use and reporting of, were key areas of focus. In addition, the European Securities and Markets Authority (ESMA) is expected to adopt regulations and guidelines relating to LMTs[6].

Further, we note the **assumption** in the consultation paper **that there is a material or demonstrable vulnerability to Open Ended Funds from first mover advantage**, *"A first-mover advantage can drive 'excess' redemptions, especially in times of stress, relative to what might have otherwise been the case.*"[7] and that this vulnerability is so extensive that **it requires the application of a transaction cost charge** to redeeming investors. We believe that it is important to **consider the potential materiality of the dilution** before mandating the use of an anti-dilution LMT, and that when dilution effects are estimated to ensure **that investors do not bear excessive costs**.

We also note that in Section 3.1 you highlight that "*exclusive reliance on quantity based LMTs can entail unintended consequences…." which "may add to excess redemptions*".[8] It is not clear that it has been concluded that such unintended consequences would not arise as a result of the application of this bucketing approach. **This action itself could exacerbate the already deteriorating liquidity of the fund** and disadvantage the remaining investors.

Among the other FSB Recommendations, we acknowledge the considerable volume of data presently reported to both national and European authorities however, we would be supportive of **the improvement of access to data for all stakeholders**. The FSB should consider market wide reform and the inclusion of a consolidated tape would be particularly beneficial from a European perspective as it would provide for **greater transparency for both regulators and the wider market.** Within this framework, it becomes **crucial to evaluate the appropriateness of disclosures and the level of specificity required.** We agree that additional reporting should be **"proportionate"** and should seek to have **"*consistent requirements*** *in order to facilitate effective monitoring across jurisdictions for financial stability purposes and* ***reduce unnecessary reporting burdens***"[9].

Finally, we would like to highlight in our response, the well-established existing framework in Europe for AIF and UCITS liquidity management and also point to ESMA's published 2020 Guidelines on liquidity stress testing[10].

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[6] As the EU co-legislators have found a political agreement in July 2023, the legislation is expected to be published towards the end of 2023. In the meantime, please refer to the Council's position and the European Parliament's Report for an overview: Council of the European Union, Position on the AIFMD/UCITS Review, June 2022; European Parliament, Report on the AIFMD/UCITS Review, May 2023.

[7] 2.1 Structural liquidity mismatch in open-ended funds pg. 6 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

[8] 3.1 Scope and Terminology pg. 11 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

[9] 3.2 Adequacy of information and transparency pg. 12 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

[10] ESMA Guidelines - On liquidity stress testing in UCITS and AIFs 16th July 2020 https://www.esma.europa.eu/sites/default/files/library/esma34-39-897_guidelines_on_liquidity_stress_testing_in_ucits_and_aifs_en.pdf

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Structural liquidity mismatch (Recommendation 3)

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

Irish Funds asserts that, in pursuit of strengthening liquidity management practices, the most impactful approach revolves around prioritising the availability of all liquidity management tools. Any use of such tools should be defined and informed by the individual circumstance of each fund rather than a general or high-level market definition of “normal” or “stressed.” Therefore, Irish Funds would not be in favour of overly prescriptive definitions of “normal” and “stressed” market conditions. The rationale for this position is that, on the basis of recent events such as the emergence of Covid-19 in March 2020, the escalation of the Russian-Ukraine war in February 2022 or the Liability Driven Investments crisis in September 2022, the definition of stressed markets may vary materially depending on asset class, investment strategy, manager, prevailing market conditions or dynamic economic circumstance. Therefore, a singular definition may un-necessarily limit the use, at an individual fund level, of certain tools where they may be required to respond to either an evolving or dynamic macro-economic situation or an exogenous market event.

In line with existing regulatory requirements and expectations in respect of the liquidity management framework under AIFMD and UCITS, our view is that the focus should be on a fund having a robust liquidity risk management framework, rather than on high level or overarching definitions of stressed and normal market conditions, which can come from a whole variety of external causes. For example, it is arguable that the most involved and considered definitions of stressed scenarios or related models would likely not have predicted the events of March 2020 (Covid-19 crisis) or indeed September 2022 (Liability Driven Investments crisis). Accordingly, it is our view that the availability of the tools referenced below, coupled with the considered discretion of the responsible entity in its application, would create an adaptive environment suitable to the management of a fund’s liquidity and the mitigation of unforeseen market shocks:

- Availability of price based and quantity-based liquidity management tools appropriate to fund type and underlying assets.
- Comprehensive stress testing.
- Operational ability to use these tools.
- Ongoing readiness to activate tools in stressed market conditions e.g., with “break glass “procedures.

The responsibility for the implementation of liquidity management tools ultimately lies with the responsible entity and should not be prescribed by regulatory bodies. The responsible entity is already required to act in the best interests of investors and ultimately has access to all available information to determine the most applicable tool, thus mitigating risks associated with information a-symmetry and decision making.

In analysing the asset level liquidity of a portfolio, we note that some jurisdictions have adopted a prescriptive method in defining liquidity parameters while others, in particular Europe, have adopted a principles-based approach. Irish Funds remains steadfast in its support of a principles-based approach which afford the responsibility entity the discretion and flexibility to manage its liquidity risk in the best interests of the fund investors.

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?

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While we value the chance to deliberate upon the concept of "bucketing" and acknowledge the merits in fostering greater consistency across funds, along with providing transparent criteria for expected liquidity levels in daily trading Open-Ended Funds, the broader consideration lies in determining whether bucketing effectively addresses these aspects and the significant challenges associated with the proposal.

Firstly, it is important to recognise that there is already significant liquidity regulation in place in Europe whereby fund managers have specific liquidity risk management requirements under both the UCITS and AIFM directives.

As mentioned in our introduction, Undertakings for Collective Investment in Transferable Securities (UCITS) managers and Alternative Investment Fund Managers (AIFMs) must also comply with the ESMA guidelines on liquidity stress testing (LST)[11]. The guidelines require an appropriate LST policy be implemented to ensure the fund is sufficiently liquid and should be conducted at each stage of the funds lifecycle. Liquidity risks must also be clearly documented in the Risk Management Policy.

Further, it should also be noted that during the Covid-19 crisis some National Competent Authorities (NCAs) including the Central Bank of Ireland, did request and receive additional liquidity management reporting from asset managers (including daily reporting for some managers). Our view is that this additional reporting of liquidity information, which provided timely and detailed insights as to how liquidity was being managed in a time of stress, provides real benefit for those regulators overseeing the funds industry.

Overall, in our view, there are also significant challenges to implementing a bucketing approach that currently outweigh the benefits.

Relevant challenges that should be considered include:

- Funds that are at the threshold will be in a difficult position if they move between categories. Investors would be at a disadvantage if their funds suddenly do not offer daily dealing. This could also lead to higher transaction costs if a responsible entity has to rebalance their portfolio on this basis.
- There will be a difficulty for fund managers managing the operational process of moving funds from daily dealing to a less frequent dealing frequency. Even if the language within the fund's constitutional documents allows for this change in dealing frequency, there will still be a significant level of reporting and communication to all fund stakeholders (e.g., investor communications, administrator process adjustment etc…) required to ensure all stakeholders are made aware of these changes. This will take significant time and resources to execute.
- Harmonisation across jurisdictions and asset managers will be difficult. It is well recognised that each jurisdiction will have their own approach to liquidity reporting. Additionally, liquidity methodologies across asset managers will vary depending on strategy, asset types, investor base etc. Creating overly prescriptive definitions of asset categories will ignore the nuances of the different liquidity management approaches taken by each asset manager. It should be noted that liquidity management needs to consider not only the assets of the fund but also the liabilities (e.g., forecasted investor behaviour).

[11] ESMA Guidelines - On liquidity stress testing in UCITS and AIFs 16th July 2020 https://www.esma.europa.eu/sites/default/files/library/esma34-39-897_guidelines_on_liquidity_stress_testing_in_ucits_and_aifs_en.pdf

- To have a harmonised approach, it will be necessary to be very prescriptive however, it is difficult to be prescriptive when there are direct consequences to an individual fund. As noted in the above response Irish Funds does not support such an approach.
- Given the fluid nature of liquidity (i.e., it depends on a number of factors for example trade sizes, market depth, market resilience etc…), introducing a static measure based on categories of assets (liquid, illiquid & less liquid) would prove counterproductive. The breadth and impact of stressed market conditions vary and therefore past levels of liquidity do not guarantee future liquidity. It is also worth noting that often exogenous shocks have asymmetric effects. For example, even within a particular asset class (e.g., equities) the Covid-19 crisis significantly impacted those sectors relating to hospitality, airlines etc… whereas other sectors e.g., technology saw improved performance, as such liquidity management cannot be viewed in a linear way. We would emphasise that fund managers are best placed to manage the liquidity of their funds (e.g., LMT selection, dealing frequency etc…). So, although we welcome the fact that "*the FSB believes that managers of OEFs have the primary responsibility and are best placed to manage the liquidity of their portfolios*" and that there is not a "*'one-size-fits-all' approach*"[12] - this principle should be better reflected in the FSB's recommendations.

Finally, having outlined the current robust liquidity management practices in place in Europe, in addition to the numerous challenges highlighted in adopting a bucketing approach, we would again reiterate that the consistent harmonised availability and use of liquidity management tools should be a key focus in ensuring robust liquidity management practices.

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 noted above, the challenges of the bucketing approach outweigh the benefits. Some of these challenges are further outlined below.

Challenges:

- The level playing field created by a uniform approach is not necessarily optimal as liquidity concerns vary by asset class, geography, sector, market cap and other factors, and a one-size-fits-all approach does not allow the fund to reflect this in its categorisation and could therefore lead to unintended adverse consequences.
- Funds that are close to the threshold between risk buckets may have to update and re-file offering documents and reduce their dealing frequency, or at minimum communicate this to all relevant stakeholders including investors. In addition to the administrative burden for the fund, this is unlikely to be in the best interests of investors who would experience a reduction in the dealing frequency of their chosen fund even though that fund may still be able to engage in liquidity transformation i.e., funds do not have to exactly match the liquidity of their assets and liabilities as the underlying investors will have different investment holding period preferences.

[12] 3.1 Scope and Terminology pg. 11 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

- Some fund strategies may target a portion of illiquid exposure close to the threshold which would put them at risk of constantly fluctuating from one bucket to the other. This would present a significant administrative challenge and would not be the preference for investors who would likely prefer some certainty/stability over the timing of their dealing.
- We note that in Section 3.1 you highlight that "*exclusive reliance on quantity based LMTs can entail unintended consequences….*" which *"may add to excess redemptions*".[13] It is not clear that it has been concluded that such unintended consequences would not arise as a result of the application of this bucketing approach i.e., investors may anticipate a fund's shift to a less liquid bucket and move to sell ahead of any reduction in the fund's dealing frequency. This action itself could exacerbate the already deteriorating liquidity of the fund and disadvantage the remaining investors.
- Liquidity of most funds will dip during stressed periods, increasing the likelihood of funds being re-categorized from one liquidity bucket to another.

Therefore, given the above, together with the challenges highlighted in question 2, we would propose that in *lieu* of strictly defined buckets, other liquidity management tools such as swing pricing or anti-dilution levies would be more suitable. Noting that ultimately setting static thresholds to determine the liquidity of a fund cannot replace the detailed understanding and assessment of asset liquidity by managers.

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?

Our response to this question is consistent with our overall view that each OEF should have the LMTs available to it that it believes are the most appropriate for the fund. Accordingly, our view is that a one-size-fits all approach i.e., without regard to the specificity of the fund type including relevant factors or indeed, if known, investor incentives or behaviour, could result in unintended consequences. Further, as noted in Section 2.2 of your paper[14], the absence of data on the deployment of non-exceptional LMTs, means that it is not possible to gauge whether longer notice or settlement periods are currently used by responsible entities as LMTs. We believe it would be useful to have some insight into existing practices in order to appropriately inform future policy changes with respect to this point.

In a more practical context, we found it valuable to offer an illustrative example that highlights how prevailing circumstances, many of which lie beyond the control and accurate prediction of an Open-Ended Fund (OEF) Manager during the initial application phase, can influence the choice between longer notice periods and extended settlement periods. If the primary goal of implementing an LMT is to minimize the adverse impact on the market due to a redemption request, opting for an extended settlement period could allow for the realisation of value within for example, a five-day timeframe, as opposed to a shorter period, for example T+3. This

[13] 3.1 Scope and Terminology pg. 11 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report
[14] 2.2 Liquidity management tools Pg 8 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

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approach is likely to allow the manager to manage market impact leading to lower implicit costs.

We emphasise that while the value of positions being sold would experience daily gains and losses, executing trades over a more extended timeframe can likely curtail overall market impact costs for investors. Moreover, within these scenarios, it can be argued that an extended settlement period would be operationally simpler. Shifting the settlement date for cash distribution to investors is ostensibly less intricate than dynamically altering a notification period. It is worth noting that fund prospectuses commonly include a provision stating that "settlement cycles will be X, but under certain circumstances, they may extend beyond." In this context, an elongated settlement period leverages an existing clause in the fund prospectus to adapt to specific situations.

However, the abovementioned scenario largely assumes the overall market is stable during the settlement period. This means the investment manager can engage in trading over several days following the Net Asset Value (NAV) date, allowing the manager to trade in potentially smaller lot sizes which reduces potential market impact and therefore transaction costs for investors.

Conversely, during periods of heightened market stress when concerns about market impact and liquidity are significantly intensified, the situation changes. In such stressed market environments, the remaining investors might encounter more substantial losses than they would in ordinary circumstances due to increased market exposure.

Accordingly, in such a scenario, it may be more optimal to consider lengthening the notice period to enable the manager to plan appropriately for the proposed redemption.

These examples are presented as potential abstract scenarios; however, we believe that highlighting these scenarios is constructive as they underscore the significance of relevant facts and specifics (in the current conditions) in determining the appropriateness of implementing a specific LMT. Therefore, akin to the preceding considerations, it remains crucial for the responsible entity to retain the discretion to employ an extended settlement or notice period.

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?

Irish Funds supports flexibility as the use of an appropriate LMTs is fund specific. While guiding principles are helpful, as above, we are not in support of rigid guidance on factors to consider when setting the redemption frequency, notice or settlement period.

The use of anti-dilution tools or quantity-based tools should be decided based on how liquid and tradeable the fund assets are, the expected investor base and any other potential liabilities, and should be incorporated at the fund design stage. For instance, consider that:

- Assets that can be traded frequently but may need more preparation, can be accommodated by longer notice periods.
- Some asset-backed securities trade daily but with a lead time to gather quotes such as ABS/MBS auctions, which notice periods would allow time for; and
- Corporate bonds which are traded continuously but with variable costs depending on market circumstances may be more suited to daily dealing with the use of anti-dilution tools.

- e.g., high yield corporate bonds have had stable trading volumes during stress events, but with significantly higher trading costs, where investor protection concerns for remaining investors can lead a fund to pass on the costs to redeeming/subscribing investors. This puts them in the same position as if they had invested directly into the underlying markets.

Simply moving to decreased redemption frequency could indeed lead to the crowding of redemptions around certain dates, so a more flexible approach that can be tailored for the funds specific needs would be helpful.

Liquidity management tools (Recommendations 4, 5 and 8)

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

Broadly, we would agree that Recommendations 4 & 5, along with the proposed IOSCO guidance, should help toward achieving greater use and a more consistent approach to the use of LMTs. But as highlighted both in this response (see Q2) and our response to the IOSCO consultation, global harmonisation, will not be easy to achieve. However, we believe that through providing a principles-based flexible approach the guiding principles of investor protection and greater financial stability can still be met.

As stated in our answer to question 2, we believe it is important to note that liquidity risk management is highly regulated in the European Union and has been assessed most recently in the context of the recently achieved political agreement on the AIFMD Reform. In assessing the impact of the proposals from both IOSCO and the FSB, it is important that the substantive regulatory requirements of the European Union on open-ended funds are recognised and considered.

Further in respect of the amendments to Recommendation 4, and as previously stated above, measures that increase the availability of LMTs to responsible entities are to be welcomed in principle. However, we believe that discretion as to application should remain with the responsible entities and welcome the assertion in the consultation that "*the FSB believes that managers of OEFs have the primary responsibility and are best placed to manage the liquidity of their portfolios*."

Regarding, Recommendation 5, we note the assumption in the consultation paper that there is a material or demonstrable vulnerability to OEFs from first mover advantage, *"A first-mover advantage can drive 'excess' redemptions, especially in times of stress, relative to what might have otherwise been the case*[15]." And that this vulnerability is so extensive that it requires the application of a transaction cost charge to redeeming investors. Per our response to the IOSCO consultation, we believe that it is important to consider the potential materiality of the dilution before mandating the use of an anti-dilution LMT, it is important that when dilution effects are estimated to ensure that investors do not bear excessive costs (both those remain, leaving or joining the fund). Noting that where transactions costs are material, Irish Funds are supportive of applying anti-dilution LMTs.

[15] 2.1 Structural liquidity mismatch in open-ended funds Pg 6 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

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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?

- Material time and cost impact to the constitutional documents of the fund.
- Investor detriment and loss of contractual certainty and consistency as a result of the imposition of the proposed liquidity bucket thresholds.
- Lack of consistency of measurement or modelling to support the need to apply transaction costs to redeeming investors for a benefit that may or may not accrue or as against an asserted dilution effect. For the imposition of any cost or charge to be contemplated, the risk or vulnerability would need to be assessed in detail.
- There is no evidence that the introduction of 'bucketing thresholds' would not incentivise sophisticated investors, with appropriate resources, to monitor and model when a fund is likely to be classed as less liquid or illiquid and therefore result in effects that could also be classified as first mover effects. However, first mover effects in such a scenario are as likely to be related to the routine liquidity management of the fund as they are to exogenous market shocks.

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 noted above, in Europe this is a substantively regulated sector today and is on the legislative agenda for future reform within existing legal frameworks for example the AIFMD Review. We would suggest that supervisory engagement on these matters may be as effective and less burdensome than other proposals to further encourage OEF Managers to be aware of the anti-dilution LMTs at their disposal in the appropriate circumstances. As such we welcome the fact that the FSB has highlighted the importance of the role of the OEF manager and the recognition that a one-size fits all approach is not intended[16]. Accordingly, it would be helpful if this principle were further reflected in the amended recommendations and the importance of the supervisory dialogue between national authority and relevant OEF manager was considered.

In addition, we would stress that it is important to ensure that the distinction, in fact and in form, between OEF Managers and the Asset Management sector as a whole, and the banking sector is made clear. Stress testing methodologies developed in the banking sector focused on solvency not liquidity, further OEF Managers are dealing as agent not as principle and investments by investment funds are valued and monitored on a much more frequent basis than bank deposits. Accordingly, in developing any further recommendations or guidance, it would be helpful if specific tailoring to the substance, form, risk profile and risk mitigants of the asset management sector were demonstrably reflected.

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

Irish Funds are supportive of the use of anti-dilution LMTs in ensuring that remaining fund investors do not bear material transaction costs as a result of those investors subscribing and

[16] 3.1 Scope and terminology Pg 10 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

redeeming in a fund. As such, we support the application of anti-dilution LMTs to both subscribing and redeeming investors where there are material levels of dilution within the fund. However, it should remain down to each individual asset manager as to whether they apply the anti-dilution LMTs to the subscriptions and redemptions individually or apply on a net basis (i.e., apply on the net value of the subscriptions and redemptions).

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?

Irish Funds has no comment in relation to Q10.

Other FSB Recommendations

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

On this point Irish Funds would highlight that it is important to strike the right balance between transparency and effectiveness.

Echoing our IOSCO response, we believe that overly prescriptive or granular disclosure requirements (particularly in relation to the calculation of adjustment factors and/or ranges of activation thresholds) may be counterproductive. This is also acknowledged within the IOSCO consultation (i.e., detailed disclosures leading to pre-emptive redemptions as certain investors seek to "game" the dilution mechanism).

Further supervisory engagement between the OEF Manager and the national authority should be assessed as possibly a more appropriate means of enhancing disclosure.

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?

We welcome recommendation 1's assertion that any additional reporting should be "*proportionate*" and should seek to have "*consistent requirements in order to facilitate effective monitoring across jurisdictions for financial stability purposes and reduce unnecessary reporting burdens*"[17]. It is important that any additional reporting requirements focus on those data points that supervisors use consistently in their macroprudential analysis. From a European perspective there is already a large amount of data provided, this data should be reviewed to remove the potential for duplicative reporting requirements. We would also point to the AIFMD/UCITS review which set regulatory expectations for reporting the availability of LMTs and the use of certain LMTs (focus on exceptional use basis). Any reporting recommendations would need to consider and align with these recent reviews.

We would also point to the fact that many NCAs require reporting of significant redemption capital flows including the Central Bank of Ireland, with some asking for detail on how these flows are managed. As referred to in Q2, there was significant additional liquidity reporting to

[17] 3.2Adequacy of information and transparency Pg 11 Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations: Consultation report

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some NCAs including the Central Bank of Ireland during the Covid-19 crisis which helped inform regulators how liquidity was being managed during a stress market period. As such, there is nothing to preclude regulators from requesting ad hoc liquidity data, noting the European Securities and Markets Authority (ESMA) performed a Common Supervisory Action (CSA) on UCITS Liquidity Risk Management in 2020.[18]

Irish Funds is supportive of improving access to data for all stakeholders and recognise in particular, as noted in our IOSCO consultation response, that the fragmented nature of the European market makes data access for certain security types, for example fixed income, more difficult. The FSB should consider market wide reform and within Europe, the development of a consolidated tape for greater transparency for both regulators and the wider market. In terms of investor data, improved access through distributors and intermediaries would provide for greater client base transparency, which will assist funds in their modelling and stress testing analysis.

In relation to Recommendation 6 on stress testing, Irish Funds would like to highlight the work already done in this area at a European level, where ESMA developed and published their Guidelines on liquidity stress testing in 2020[19].

Finally, in relation to recommendation 9 - system-wide stress testing - we would query whether it is currently possible to perform stress testing on a system-wide basis. As pointed out in Q8, the funds sector cannot be assessed in the same way as the banking sector. A system-wide test of the funds sector would need to focus on liquidity (not solvency) and would need to make some unrealistic assumptions (e.g., all investors behaving the same way), and use fragmented data (as already highlighted), all of which would call into question the usefulness of any results from such an exercise.

Additional considerations

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

While we would agree with the FSBs stated goal of strengthening liquidity management by responsible entities, we would respectfully question if the focus on dilution effects that arise as a result of first mover advantage is a slightly one-sided analysis of the relevant financial stability risks. We would consider a more holistic review of the impact on the real economy of each of the amended recommendations would be useful. Otherwise, the proposal might be considered to focus more on investor protection measures rather than financial stability/macro prudential ones. We note again that existing methodologies in this sphere have been designed and tested in the retail banking environment and as such new methodologies or heavily amended methodologies would have to be applied in any such exercise.

The provision of any further evidence charting the aforementioned amplification effect would be useful so that an empirical analysis of the actual or probable vulnerabilities of the OEF sector and its amplification effect or otherwise on the real economy could be assessed. We

[18] ESMA, Public Statement – CSA on UCITS Liquidity Risk Management, March 2021.
[19] ESMA Guidelines - On liquidity stress testing in UCITS and AIFs 16th July 2020 https://www.esma.europa.eu/sites/default/files/library/esma34-39-897_guidelines_on_liquidity_stress_testing_in_ucits_and_aifs_en.pdf

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would contend that different fund types would have differing effects and as such the 'problem statement' for each fund type should be clearly defined and an impact assessment conducted on the proposed responses to those questions.

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