sifma

sifma asset management group

August 31, 2023

Submitted via email to: fsb@fsb.org – subject line: Revised OEF Recommendations

Re: Financial Stability Board Consultation Report, July 5, 2023 "Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations"

The Securities Industry and Financial Markets Association ("SIFMA")[1] and the Asset Management Group of SIFMA ("SIFMA AMG")[2] appreciate the opportunity to provide comments to the Financial Stability Board's July 2023 Consultation Report on liquidity risk management practices of open-end funds.

FSB's Consultation raises key questions about investor behavior and decision-making for open-end mutual funds. We believe that key design elements must guide regulatory authorities intending to require more robust liquidity management programs and use of anti-dilution tools. We are pleased to provide our thoughts below and respond to the FSB's questions. Separately, we are submitting a response to the July 2023 IOSCO Consultation Report that reflects similar themes as our responses below to the FSB Consultation.

I. General Observations

SIFMA and SIFMA AMG recognize the need for open-end mutual funds to effectively manage liquidity risk and act in the interest of shareholders. With the wide breadth of funds with different managers, perspectives on strategies and investment decision-making, instruments and asset classes, and shareholder bases, it is critical to allow funds to retain the ability to make investment and product design decisions for themselves.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our members, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").

[2] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

Funds manage liquidity, transaction costs, and the risk of dilution every day. Transaction costs directly erode performance. As fund managers are primarily judged on performance by investors and boards or other oversight bodies, the natural built-in incentives influence behavior. Likewise, funds manage liquidity risk and balance the need to meet shareholder redemptions with the desire to invest in assets that produce returns for shareholders.

Funds clearly disclose their investment objectives and provide ongoing reporting to shareholders, allowing shareholders to make informed decisions regarding whether to invest, how much to invest, and when to make changes. In a competitive market with a wide variety of options, shareholders make their own investing choices or rely on the assistance of financial advisors to help guide them.

If there is reason for additional regulatory measures to address liquidity or the risk of material dilution, we encourage data-driven and incremental measures that balance actual costs and potential benefits, preserves the role of the fund manager as the party best positioned to know their specific facts and circumstances, and avoids prescriptive frameworks build on estimates and data limited by artificial precision. Our thoughts and suggestions below further amplify these themes in response to questions asked in the FSB Consultation.

As a threshold matter, we agree that the scope of the Consultation should exclude exchange traded funds and money market funds. The scope should also be focused on public collective investment schemes and exclude private fund vehicles. Private funds have very different investor profiles, use cases, distribution mechanisms, and regulatory regimes that limit public disclosure and communications.

II. Executive Summary

The following themes are woven through our responses:

- Funds and investment managers are best positioned to manage liquidity and make assessments of appropriate measures. Funds are not homogenous - "one size fits all" solutions will not effectively adapt to unique facts and circumstances.

- Any anti-dilution efforts must focus on material dilution or the risk of material dilution and should not be employed in ordinary market conditions. Anti-dilution measures must avoid becoming a penalty for those redeeming or subscribing.

- Regulatory authorities should not prohibit any credible alternatives or mandate particular measures. Funds must have latitude to assess and tailor measures considering potential benefits for shareholders and the associated costs, burdens, and challenges.

- Liquidity management tools must be operationally feasible and cost effective to implement and maintain. Simple and stable tools that use existing workflows, timelines and technology will be more feasible than complex and dynamic tools. Expensive measures will impose more costs than benefits, particularly on shareholders.

- In the absence of commonly agreed methodologies to identify and measure material dilution, any regulatory guidance or mandate must acknowledge the imprecise nature of estimates when funds seek to impose actual liquidity costs on redeeming or purchasing shareholders.

- The proposed bucketing approach is unnecessary and unwarranted. Mechanisms such as product design and ongoing stress testing are better suited for funds to make assessments of their instruments and strategies and properly align the terms of shareholder redemptions.

- There are no credible, repeatable, and objective means of precisely measuring implicit costs through "market impact" or "slippage." The number of dynamic market factors involved – particularly for fixed-income instruments – makes such estimates inappropriate inputs for assessing actual costs to shareholders.

- The "first mover" advantage rationale can benefit from further review and validation to confirm that transaction cost avoidance drives investor behavior as opposed to investment-driven goals such as capital preservation.

III. Responses to Questions

Structural Liquidity Mismatch (Recommendation 3)

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

The methodology utilized for bucketing will drive the efficacy of the entire approach. We remain skeptical that liquidity can always be accurately and credibly measured, particularly in times of changing market conditions. It is difficult to make precise determinations in normal markets given the breadth of market factors that influence liquidity, particularly in fixed income markets. It is even more challenging in stressed markets. Describing factors that may drive currents in the market or that investment professionals may subjectively assess is different than reducing the mind of the market to mechanical formulas and metrics.

Assuming worst case scenarios may be appropriate for stress testing, but not ongoing bucketing. If "stressed market conditions" is the baseline for determinations of market liquidity and determinations of market liquidity drive bucketing and thresholds in all markets, then assets that are liquid in most markets could be misclassified in most market conditions.

The exercise of measuring and bucketing based on liquidity can become more about the methodologies than the actual liquidity of the instruments. More methodology parameters and stipulations (such as assuming stressed market conditions) remove assessments from what the investment professionals are seeing in the market and using to make decisions.

The thought process of liquid, less liquid and illiquid can be helpful to investment professionals as they manage fund liquidity. We disagree that rigid frameworks should mechanically determine shareholder redemption terms with arbitrary thresholds. Thresholds could be useful as informal guidance for a fund making its own assessments but should not be mandatory.

It is also possible that, as market conditions change or methodologies change, a fund could bump against or go over a limit. Funds and shareholders need stability and a fund passively moving between buckets could trigger forced sales or changes in redemption terms.

We also note that the costs for bucketing and thresholds will be borne by shareholders through reduced returns and operational costs. Conservative bucketing methodologies and/or conservative thresholds both diminish a fund's investing ability and its ability to deliver returns to investors. These direct and indirect costs should be part of any assessment.

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?**

We are skeptical about the ability to objectively measure and quantify liquidity for regulatory purposes. Describing a variety of factors that influence market liquidity is different than being able to disaggregate, measure and predict them. A significant degree of false precision could result, depending on the sophistication or complexity of the bucketing or assessment regime. Funds should be focused on managing fund assets in the best interests of investors, not focused on updating and measuring liquidity for compliance purposes. If the priority becomes measuring and classifying assets for compliance reasons rather than managing assets for shareholder benefit, the regulatory mandate driving that priority deserves to be re-assessed.

For these reasons, funds often have their own internally designed ways of assessing and managing liquidity. Such efforts may not be precise. However, they provide reasonable and practicable data points to assist investment and risk professionals in their assessments and decision-making.

The U.S. Securities and Exchange Commission ("SEC") mandated bucketing by liquidity since 2019 for registered open-end funds. The expense and effort invested into methodology, data and technology has been substantial. Shareholders have directly borne many of those costs.

In late 2022, the SEC proposed new rules to revise the bucketing methodologies by effectively assuming worst case scenarios for day-to-day liquidity assessments. Instruments would appear much less liquid than warranted in most markets, further separating the classifications from actual market conditions and liquidity and turning classification into a compliance exercise rather than an exercise in managing liquidity risk. In addition, the SEC's proposal would change the way funds are managed and cause forced sales of securities due to bucketing methodology changes rather than changes in market liquidity. The gravity of concerns filling the public comment file in response to the SEC's proposals should give the FSB pause before proceeding with a bucketing regime.

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?**

A fund might conceptually think about its design at inception through a similar lens. However, a system of mandated thresholds is not necessary, nor does it reflect the way that funds typically approach managing liquidity. Funds might have portfolio guidelines that utilize combinations of minimums and maximums to help guide product design and inform shareholders what type of strategy to expect. However, funds do not typically utilize frameworks and thresholds in the nature suggested by the FSB Consultation. Attempting to apply a one-size-fits-all approach will inevitably lead to debates about the appropriate thresholds and the methodologies used to drive the underlying classifications.

Given the arbitrary nature of the thresholds, they will become hard and fast guidelines that govern investment decisions. Funds will execute trades with an eye on the thresholds that may not have been needed otherwise.

Methodologies and definitions used to classify assets for compliance with the thresholds are just as important as the thresholds themselves. The difficult experience in the U.S. with Rule 22e-4 should be considered before attempting to build new liquidity classification and threshold frameworks. It is easier to discuss concepts and "I-know-it-when-I-see-it" edge cases than to translate those ideas into a durable, objective, and cost-effective regulatory structure.

By way of illustration, the FSB Consultation's definition of "Less liquid" includes assets that, in stressed conditions, ***might*** not be readily convertible into cash without significant discounts and whose valuations ***might*** become more difficult to assess with certainty (emphasis added).[3] Operationally, a fund would be challenged to develop and maintain objective means of assessing classifications based on predictions of what might occur in the future. In addition, using what "might" happen in a stressed market scenario as the base case for classifications would produce liquidity classifications wholly unrelated to most market conditions.

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

Investors have a multitude of investing options. They are not limited to, nor compelled to invest only through open-end funds. They choose open-end funds for the unique features, including daily liquidity. We believe that this hallmark feature should be preserved and urge caution before

[3] FSB Consultation, July 2023 at Page 14.

imposing any measures that make it more difficult for investors to trade in and out of open-end funds. These investments are a critical part of a vibrant capital market and should be encouraged rather than impaired.

Such measures may be appropriate for a fund to consider at inception when designing its strategy, determining instruments for investment and associated guidelines/limits, and considering shareholder redemption frequency. Product design also considers fund distribution and flow behavior (including timing, velocity, and scale) and investor concentration. Funds may have facilities such as lines of credit to help manage liquidity or provide more tools in times of unexpected flow activity.

Reasonable stress testing can be a means of ongoing validation of product design decisions at fund inception. Funds working in good faith could find that facts and circumstances have changed, and stress testing is one avenue of good practice to facilitate ongoing internal awareness of liquidity risk management.

Funds are not homogenous and therefore are in the best position to know their specific fund characteristics and make decisions about fund design. Even funds with similar strategies using similar asset classes make different investment decisions, take different approaches to manage risk, and have different shareholder compositions.

However, some measures may not always be feasible given operational logistics or regulatory hurdles in a particular jurisdiction. We agree that FSB guidance can encourage regulators to take measures to reduce regulatory impediments. We do not believe that such measures are appropriate for regulatory mandate. One-size-fits-all solutions will inherently be an awkward fit for all.

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?**

See previous response. Any FSB guidance should take the form of reducing regulatory impediments rather than mandating specific redemption measures.

Liquidity Management Tools (Recommendations 4, 5 and 8)

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?**

We support the following key principles:

- Shareholders come first. Any solution needs to be in their best interests and balance costs against benefits, avoid impairing the product or their investing experience.

- Simple and stable solutions are best.
    - Solutions must be understandable to shareholders.
    - Minimize impact on existing timelines, technology, workflows, and operations.
    - Minimize impacts on distributors, intermediaries, recordkeepers and others in similar roles downstream of funds and fund decisions.
    - Solutions need to be reasonably stable over the long term. Frequent changes are difficult to administer and can cause shareholder confusion.

- Any LMT must retain a link to material dilution. A blunt tool used solely to discourage redemptions (rather than address dilution) loses credibility. Any concept to enhance dilution risk management recognizes that:
    - Funds have inherent incentives to minimize transaction costs because costs reduce performance.
    - Material dilution does not always exist.
    - LMTs should not be employed in ordinary market conditions.

- Funds rather than regulators are best positioned to assess dilution and tailor LMT tools for different dilution magnitudes, strategies, and shareholder bases. Keep board or other oversight body involvement consistent with oversight rather than operations.

- Chasing precision has diminishing returns. Practicable rather than certain is sufficient.
    - Reasonable methodologies for identifying material dilution and calculating fees/factors warrant good faith deference.
    - Stable fees/factors are more viable than constantly changing fees/factors.
    - Balance risks of undercharging and overcharging exiting shareholders.
    - Market impact estimates are incapable of reliable and credible models or measurements, especially when being used to calculate actual costs to shareholders.

- Stable but flexible
    - Periodically re-validate dilution assessment, measures and fee/factor calculations.
    - Retain agility to change fees and factors for significant market developments.

Given those principles, we believe that not all funds require active anti-dilution programs and material dilution is not aways a problem warranting an LMT solution. We believe that regulators should defer to the judgment of the fund and manager to determine whether anti-dilution measures are necessary or appropriate for their fund and, if so, what specific anti-dilution measures are appropriate for their fund.

Factors considered by a fund include, but are not limited to other regulatory implications, shareholder acceptance, assets, strategy, shareholder concentration, distribution (*i.e.,* implications for intermediaries and retirement platforms), practicality of implementation, availability of data, and potential benefit for the costs and burdens involved. These elements should not be a checklist but are illustrations of factors that a fund could incorporate into its considerations.

In addition to fund holdings/instruments or strategy, there are valid reasons why an LMT may not be available, reasonable, or warranted for a fund to implement. For example, swing pricing might not be viable because of unavailable timely fund flow information, liquidity fees may not be viable because the funds are wrapped into other insurance or contractual arrangements prohibiting added fees and dual NAV may not be viable because of the major operational and technology overhaul required. Bid-ask pricing based on direction of flows may not be viable because of the lack of timely flow information and market trading conventions that utilize bid-ask pricing only in certain asset classes. A fund with unconcentrated but highly liquid holdings and a diverse shareholder base that trades infrequently has a low risk of material dilution. We believe a fund should have the deference to assess its facts and options and make decisions it believes are in the best interest of its shareholders.

We also emphasize that market participants may not be able to accurately and credibly identify and measure "slippage" or "market impact." While we understand the concept of including implicit costs, we do not believe that a regulatory mechanism can credibly establish a credible, repeatable, and objective means of measuring implicit costs through "market impact" or "slippage."

The number of dynamic market factors involved makes such estimates inappropriate inputs for assessing actual costs to shareholders. This is particularly the case for fixed-income instruments where variances in bid-offer spread changes, differences based on size, and dislocations between and among sectors and sub-sectors are integral characteristics of liquidity at any point in time.

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?**

Further work should be done on methodologies to identify and calculate material dilution risk. At present, the lack of consensus on agreed approaches is a barrier to implementation. It is insufficient to base regulatory mandates purely on estimates and guesswork about what might or might not be happening in the market.

Operational implications also exist and vary by jurisdiction which add complexity and limit the viability of certain LMT tools. Some operational hurdles may be easier to reduce than others. We encourage regulatory bodies to continually measure the potential benefits with the costs involved in changing operational infrastructure to accomplish broader use of LMTs. If actual material dilution is limited, then the corresponding costs to address should be kept in proportion.

For example, any framework with the latitude to adjust depending on market conditions must be capable of administration by all parties involved (including funds and intermediaries) and capable of being conceptually explained to shareholders. Administration becomes difficult with greater complexity and variability. For example, a variable liquidity fee requires a fund to identify the need and calculate the revised fee and requires any intermediaries involved to update their systems to apply and collect the new and different fee. While a theoretical vision might suggest that precise and timely market data can drive tailored and dynamic anti-dilution measures when warranted, operational logistics make such an approach less feasible. A stable framework that is periodically revisited and revalidated is likely more operationally viable.

It is also worth validating the rationale for LMTs at the outset.

The companion July 2023 IOSCO Consultation assessment stated that "[i]t is difficult to quantify and determine the materiality" of a potential first mover advantage.[4] Questions remain about the rationale that LMTs solve a "first mover" advantage. The "first mover" advantage suggests that in times of market stress, investors move quickly and cause excess redemptions and corresponding transaction costs that all shareholders bear.

Investors could be very savvy and agile, driven by the desire to avoid transaction costs as opposed to moving out of a fund, strategy and/or asset class for investment reasons. Conversely, the FSB appears concerned that investors could redeem out of fear rather than rational investment decisions to preserve capital in times of stress. In both cases, the presumption is that a shareholder who bears a proportionate share of transaction costs no longer has the incentive to move quickly out of a fund.

Further work is required to validate this theory in practice and confirm that transaction cost avoidance actually drives investor behavior. Do investors make decisions in times of stress based on avoiding transaction costs? In jurisdictions using LMTs, do shareholders fully understand LMTs? If so, does the presence of LMTs influence how they make investment decisions in times of stress?

In times of stress, flights to quality to preserve capital are a major part of investor behavior and could overwhelm concern about avoiding transaction costs.

If more widespread use and acceptance of LMT tools is based on solving a "first mover" advantage, more data-driven validation work should be conducted to give that rationale additional credibility. Otherwise, it will not resonate with shareholders who think in terms of saving 500bps of capital rather than 50bps or less of transaction costs.

Costs should also be carefully considered before implementing LMTs. What are the actual costs involved to develop and maintain LMTs and do the costs outweigh the demonstrated benefits? Funds must bear costs to build out infrastructure that is ready for use when and if needed. Depending on fund design and facts and market conditions, funds and shareholders could bear substantial cost for tools that are never utilized. The significant cost further argues for keeping LMTs limited in scope because not all funds require active anti-dilution programs and material dilution is not always a problem warranting an LMT solution.

We emphasize the potential for challenges presented to distributors, intermediaries and recordkeepers. Operationalizing LMTs involves them and their workflows, technology, and infrastructure as well. The task becomes more complex as different funds elect different LMT tools with unique features. Funds do not operate in a vacuum, so the guidance or regulatory mandates need to be flexible enough to allow for consideration of such factors.

[4] IOSCO Consultation, July 2023 at Page 6.

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

Each fund should be able to design their own liquidity risk programs, how those programs are structured and operated, and how best to effectively meet investor needs and regulatory requirements. We believe that any regulatory guidance should not attempt to define or mandate prescriptive elements of fund operations. We also believe that the magnitude of resources and cost required to design, implement, and administer LMTs should be proportionate to the potential benefits. A single fund with low risk for material dilution risk should not need the same infrastructure and governance of a fund complex with much higher risks.

The breadth of business models and organizational structures makes it challenging to design, implement and administer common programs. In some cases, funds may already have structures where it makes sense to incorporate consideration of dilution risk rather than create stand-alone groups or committees. In other cases, funds retain one or more sub-advisers so there is a distinct separation between those who are responsible for fund valuation, distribution, and administration and those who make investment decisions. Sub-advisory structures often span the globe with a fund domiciled in one continent and investment decision making located multiple time zones ahead or behind. Guidance should not presume a particular business model or organizational structure.

In addition, funds may not have the internal expertise or tools to maintain a comprehensive LMT framework. Funds may find it necessary or prudent to engage third parties, particularly with the amount of data analysis and calculations that could potentially be involved. Regulatory guidance should be neutral on the use of third parties, but should recognize that involvement of third parties is a possibility which further illustrates that deference should be given to funds to organize and structure its own effort.

LMT use should be limited to relevant funds with material dilution or a high risk of material dilution and not used in normal market conditions. Accordingly, while a fund might have an LMT mechanism prepared if needed, the LMT may not play a large role in "day to day" liquidity risk management.

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

We believe that similar approaches are not always warranted for redemptions and subscriptions. While redemptions carry the weight of a calendar in terms of a fund needing to send cash to departing shareholders, subscriptions have no such timing pressure. Fund managers are incentivized to deploy the fund's assets prudently and decisions about cash utilization and timing are within their prerogative and may not cause the same types of transaction costs involved in selling assets in a stressed market to meet unexpected redemptions on a set time schedule. We believe that funds should have the option to apply to subscriptions but there should be no regulatory mandate.

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?**

As described above, such measures may be appropriate for a fund to consider at inception when designing its strategy, determining instruments for investment and associated guidelines/limits, and considering shareholder redemption frequency. Product design also considers fund distribution and flow behavior (including timing, velocity, and scale) and investor concentration. Funds may have facilities such as lines of credit to help manage liquidity or provide more tools in times of unexpected flow activity that should be taken into account.

Funds are in the best position to know their specific fund characteristics and make decisions about fund design. Funds are not homogenous. Even funds with similar strategies using similar asset classes make different investment decisions, take different approaches to manage risk, and have different shareholder compositions.

These differences prevent some measures from being viable for some funds. For example, mandating redemptions in-kind may work for institutional investors but not retail investors or omnibus accounts. Implementing suspensions and gates may accelerate outflows rather than mitigate them (such as the March 2020 experience in the U.S. when investors quickly moved out of non-government money market funds out of fear that such measures could be imposed). Side pockets are options for many private funds but may not be viable at scale and may encounter regulatory prohibitions.

However, some measures may not always be feasible given operational logistics or regulatory hurdles in a particular jurisdiction. We agree that FSB guidance can encourage regulators to take measures to reduce regulatory impediments. We do not believe that such measures are appropriate for regulatory mandate. One-size-fits-all solutions will inherently be an awkward fit for all.

Other FSB Recommendations

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?**

Investors should be given sufficient information prior to investing to enable a good understanding of the implications of anti-dilution LMTs. As a general matter, shareholders are entitled to clear disclosure regarding the material elements of funds in which they invest.

If the premise is that investors need to know that transaction costs may be allocated to their redemption or subscription orders, disclosure that a fund has such a feature is sufficient. Funds can clearly disclose the presence and use of LMTs.

Specific details about the mechanism, calculations, trigger thresholds, ranges of cost adjustments, etc. are subject to oversight by a fund's board or other oversight body, but LMTs should be treated similarly to other operational aspects of fund operations in terms of whether they are sufficiently material to warrant detailed disclosure.

We believe that funds should not be required to publicly disclose threshold triggers or swing factors. Disclosure could provide an avenue for savvy investors to attempt to "game the system" by strategically timing their purchases and redemptions based on expected swings. Although a few European funds selectively disclose their swing factors and swing pricing thresholds, many have chosen not to publicly disclose this information and only disclose the maximum factors for these same reasons.

Shareholders should have a sense of the realistic maximum that they might be charged and whether such charges are applied in the ordinary course or limited to unusual circumstances. We believe that can be accomplished without providing a granular description of methodology, calculation inputs, etc. An unlimited maximum could erode investor confidence. If an investor believes they could be subject to an unlimited cost that could attach at any unknown point in the future, they may be reluctant to assume that risk. It would be reasonable for a fund to set a maximum fee or charge with the knowledge that, in theory, there could be a circumstance where calculations could press to and beyond the maximum. This is balance that a fund should be able to set.

Shareholder disclosure should be sufficiently evergreen such that a fund can change logistics and details of the LMTs without waiting to update prospectus disclosure for all shareholders or send update notices to all shareholders. LMT mechanics should be viewed similar to valuation methodologies – the relevant fund actors and committees are charged with maintaining the program and making changes but not every aspect of the program or change requires disclosure. This principle suggests that general disclosure about the presence of an LMT is preferred over more specific disclosure about the operation of an LMT.

Disclosure may be warranted for larger changes that directly impact operational logistics such as moving from swing pricing to liquidity fees or bid-ask pricing. Transparency would be prudent because shareholders would see differences in their trade order confirmations and need disclosure to understand the economics of their trade. In part, this is for the benefit of shareholders, but implementation logistics may also require notice to other impacted parties (such as intermediaries and recordkeepers). Increased disclosure and additional preparation time required for implementation means that funds will not be able to quickly change LMTs being utilized.

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?**

<u>Recommendation 1</u> suggests that regulators should collect more information on the liquidity profile of open-end funds in their jurisdiction and proposes a pilot program to expand data coverage and reporting to give regulators and central banks more data to monitor liquidity mismatch.

Regulators should continually evaluate the intended uses, benefits and costs associated with imposing greater reporting requirements. More data is not always better if it fails to accomplish policy goals. There needs to be a compelling reason to gather data beyond the convenience of having it on hand should it become of interest.

We also encourage regulators to consider recent and ongoing moves to shorten settlement cycles such as the move to T+1 in some jurisdictions. The ability to convert holdings to cash more quickly ought to mitigate liquidity concerns and the ability to meet shareholder redemptions.

Recommendation 6 states that authorities should require/provide guidance on stress testing for individual funds to mitigate systemic financial stability risk and this consultation proposes no changes.

Reasonable stress testing can be helpful and many asset managers currently design and utilize their own protocols. Regulatory guidance can help encourage good practices but should not stray into attempts of prescriptive mandates. Funds are closest to their facts and circumstances and different funds with different personnel and different tools may have different ways of viewing liquidity risk. These differences ought to be encouraged to enable funds to distinguish themselves. If FSB is concerned about herd behavior, regulators should not create herding by forcing all funds to operate in the same way. In addition, frameworks that require liquidity risk management elements for compliance purposes become separated from liquidity risk management elements derived from the actual market. This separation makes them less useful and adds unnecessary cost.

We also believe that reasonable stress testing can be a means of ongoing validation of product design decisions at fund inception. Funds working in good faith could find that facts and circumstances have changed and stress testing is one avenue of good practice to facilitate ongoing internal awareness of liquidity risk management.

Recommendation 7 encourages more quantity-based liquidity management tools such as suspensions, gates, in-kind redemptions, and side pockets and encourages regulators to provide greater clarity to reduce stigma of use.

As discussed more fully above, some mechanisms may not be viable for all funds and all cases. We agree that FSB guidance can encourage regulators to take measures to reduce regulatory impediments. We do not believe that such measures are appropriate for regulatory mandate. One-size-fits-all solutions will inherently be an awkward fit for all.

Recommendation 9 suggests that regulators should consider system-wide testing that could capture the effect of collective selling and the consultation makes no changes.

We continue to believe that asset managers and funds should not be viewed as homogenous actors. Even funds with similar strategies using similar asset classes make different investment decisions, take different approaches to manage risk, and have different shareholder compositions. We also believe that regulators should be cautious about implying that rational investor decisions in times of market stress are attributable to the design of open-end funds or that open-end funds inherently cause systemic risk. Investing options are much broader than open-end funds and markets encompass an extremely wide range of investors across the globe.

Investors have a multitude of investing options. They are not limited to open-end funds or compelled to invest only through open-end funds. They choose open-end funds for the unique features, including daily liquidity. We believe that the hallmark feature of open-end funds should be preserved and urge caution before imposing any measures that make it more difficult for investors to trade in and out of open-end funds. Open-end funds are a critical part of a vibrant capital market and should be encouraged rather than impaired.

Additional Considerations

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?**

Liquidity does not exist in a vacuum and should not be taken for granted. Open-end funds around the world operate as part of the broader capital markets. Accordingly, we encourage FSB to consider the impacts of bank regulation on liquidity, such as Basel III endgame concepts currently under consideration in the U.S.

We are concerned that the U.S. Basel III "Endgame" will overhaul the current risk-based capital framework and dramatically increase capital requirements for the largest U.S. and internationally headquartered banks' trading activities. We struggle to see adequate justification for such an increase in capital requirements for the trading book, particularly given how resilient U.S. markets have been since the Global Financial Crisis. We are also concerned about adverse impacts that bank regulation might have on the ability for banks to offer affordable lines of credit which can be useful tools for investment funds to manage liquidity.

The U.S. funds 75% of commercial activity through its capital markets. Imposing dramatic increases in capital on the trading book will likely result in increased costs and/or reduced capital and credit to end users.

While considering liquidity risk management practices at open-end funds is appropriate, we strongly believe that liquidity is a much broader issue and the sources and drivers of market liquidity need to be part of the discussion. Reducing the ability of market participants to remain actively involved in the capital markets frustrates rather than facilitates liquidity.

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We look forward to continuing to participate in future discussions regarding liquidity risk for open-end funds. We stand ready should you have any questions about our response or the subject more broadly. Please contact Kevin Ehrlich at 202.962.7336 or kehrlich@sifma.org or Thomas Price 212.313.1260 or tprice@sifma.org if you have questions.

Respectfully submitted,

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