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Submitted via email to:
fsb@fsb.org
LMTGuidanceConsultations@iosco.org

John Schindler
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Damien Shanahan
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Dear Messrs. Schindler and Shanahan:

Re: *Revised OEF Recommendations; Public Comment on LMT Guidance—Consultation Reports*

The Vanguard Group, Inc. (Vanguard)[1] appreciates the opportunity to comment on the Financial Stability Board's (FSB) and International Organization of Securities Commissions' (IOSCO) consultations regarding liquidity management tools in open-end funds.[2] Vanguard has a long history of supporting reforms by US and global policymakers and standard-setting bodies designed to strengthen financial markets and protect investors.[3] Indeed, our unique investor-

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[1] Vanguard is a leading global investment management organization that offers a large selection of low-cost mutual funds, exchange-traded funds,investment advice, and related services to individual investors, financial professionals, and institutional investors. Together with its wholly owned affiliated investment advisers, Vanguard operates in the United States, Europe, Australia, Canada, and Mexico, where it acts as investment adviser to more than 400 funds.

[2] FSB Consultation Report: Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds—Revisions to the FSB's 2017 Policy Recommendations (5 July 2023), *available at* https://www.fsb.org/wp-content/uploads/P050723.pdf ("FSB Consultation"); Anti-dilution Liquidity Management Tools—Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes (July 2023), *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD739.pdf ("IOSCO Consultation" and, together with the FSB Consultation, "Consultations").

[3] *See* Letter from Gregory Davis, Chief Investment Officer, Vanguard, to Vanessa A. Countryman, Secretary, SEC, dated Feb. 14, 2023, *available at* https://www.sec.gov/comments/s7-26-22/s72622-20157324-325667.pdf ("2023 Vanguard Letter") and Letter from Tim Buckley, Managing Director and Chief Investment Officer & John Hollyer,

owned structure means the interests of our over fifty million individual investors are at the center of everything we do, which is why we continue to support the highest quality liquidity risk management approaches to prepare funds for stressed conditions, protect fund investors, and enhance investor understanding of investment risks.

Concerning the current Consultations, we appreciate the FSB's and IOSCO's intention to provide a principles-based and flexible approach to open-end fund liquidity risk management, and their acknowledgement that open-end funds are a diverse class of products and not suited for "one-size-fits-all" policies. To their credit, the FSB and IOSCO recognize that fund liquidity practices should vary based on a variety of factors, including the liquidity of underlying assets.[4] Further, the Consultations acknowledge that fund managers are "best placed to manage the liquidity of their portfolios" and that managers should exercise that responsibility within a flexible regulatory framework. We agree and believe that a well-designed framework supports high quality liquidity risk management practices tailored to the needs and behaviors of each fund.[5]

The FSB and IOSCO also appropriately recognize that dilution can be mitigated in multiple ways. Rather than favoring a single tool, the Consultations, through their various recommendations and guidance, seek to ensure that funds have access to a broad set of anti-dilution liquidity management tools (LMTs) that may vary by jurisdiction and fund type. We commend the FSB and IOSCO for this work and believe it provides a thoughtful foundation for further reforms. We offer several suggestions for improving this effort with that in mind.

As an asset manager offering high-quality, low-cost funds in multiple jurisdictions worldwide, Vanguard has experience with many anti-dilution LMTs. These include swing pricing, "dual pricing," purchase and redemption fees, and "bid pricing," which Vanguard and many other fund managers use to "pre-swing" open-end bond funds during both normal and stressed market conditions. In our experience, these tools can protect investors, particularly when they are aligned to the specific market ecosystem and are tailored to meet the specific needs of particular funds and their investors.

Each Consultation begins with a foundation that seems to recognize differences among open-end funds. The Consultations, however, go on to apply a banking perspective to funds by assuming that *all or even a meaningful subset of open-end funds*, regardless of size, investor base, or fund strategy, experience material dilution sufficient to create a so-called "*first-mover advantage*" that gives rise to "excess" redemptions in stressed market conditions. This unsupported assumption is

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Principal and Head of Risk Management Group, Vanguard, to Secretariat of the Financial Stability Board, dated Sept. 21, 2016, *available at* https://www.fsb.org/wp-content/uploads/Vanguard1.pdf.

[4] We also agree with the FSB and IOSCO that money market funds and exchange-traded funds should be out of scope of the Consultations since these structures warrant different assessments.

[5] By contrast, a one-size-fits-all approach to liquidity risk management does not take into account a host of other elements that affect fund flows and investor interests. *See* 2023 Vanguard Letter, *supra* note 3.

inconsistent with our experience[6] and industry data (particularly, the Investment Company Institute (ICI)),[7] and ignores a host of other factors that affect investor behavior, including leverage, investor type, and concentration, *in addition to* asset liquidity.[8]

The Consultations provide no evidence that even the small subset of open-end funds with identified weaknesses experienced excessive outflows in March 2020. Nor do the Consultations include any methodology for identifying or measuring so-called "excess" flows. This makes it impossible to (1) know if "excess" exists, (2) assess whether the proposed reforms address concerns regarding "excess," or (3) provide confidence that even if these reforms are implemented, similar arguments will not resurface following the next bout of market instability.

The overwhelming majority of open-end funds have demonstrated resiliency through numerous crises (particularly in March 2020),[9] and empirical evidence has not shown a "first-mover advantage" that gives rise to "excess" procyclical behavior. Indeed, the available data appears to go in the other direction.[10]

That being said, Vanguard supports efforts by global policymakers and international standard setters to address potential risks and believes regulators should follow the data and prioritize financial products with potential weaknesses, such as products with high amounts of leverage, concentrated investor bases, and large quantities of illiquid securities. Unfortunately, the Consultations go well beyond such products, lack the necessary analysis or data, and paint with a broad brush a host of new requirements on *all* open-end funds. These include the vast majority of

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[6] Vanguard has reviewed the largest net redemptions from our US bond funds during 2020 and 2021 and analyzed whether trade price obtained in the market differed from the valuation of holdings used to calculate NAV on the trade date, thereby creating dilution. We concluded that dilution to existing shareholders was minimal. Of the six days with the largest net redemptions (as a percentage of a fund's assets) during that timeframe, only two had a negative impact on the NAV, and that impact on a per share basis amounted to $0.0006 and $0.0033, respectively.

[7] Traditional long-term open-end funds performed well during the market turmoil of March 2020. Outflows for US equity and bond mutual funds during March 2020 were approximately 0.4% and 5%, respectively. *See* ICI data based on February 2020 month-end total net assets. *See also* ICI Viewpoints, Policymakers Need to Focus on Economic Fundamentals and Not Blame Bond Mutual Funds: Examining the Evidence of Investment Grade Corporate Bond Yield Spreads in March 2020, (July 6, 2022), *available at* https://www.ici.org/viewpoints/22-viewbondfund-survey-4; Policymakers Say Bond Mutual Funds Contributed Significantly to Treasury Market Stress but. . . (March 24, 2022), *available at* https://www.ici.org/viewpoints/22-view-bondfund-survey-3; Bond Mutual Fund Outflows: A Measured Investor Response to a Massive Shock (March 4, 2021), *available at* https://www.ici.org/viewpoints/21 view covid1 (noting that investors redeemed only 5.2% of their bond fund assets).

[8] Indeed, the concept of first-mover advantage is a phenomenon more associated with other financial products and client types including those that employ book value accounting, leverage, and less frequent repricing. These features are not applicable to unleveraged open-end funds that value assets mark-to-market on a daily basis and serve as agents for millions of investors, all with their own time horizons, risk preferences, and investment goals.

[9] *See supra* note 7.

[10] During March 2020, Vanguard saw aggregate *inflows* of 0.27% for equity funds and outflows of only 2.26% for bond funds.

equity and bond funds that have operated safely and successfully for investors and markets for decades.

Liquidity Risk Management, Including the Use of Anti-Dilution LMTs, Should Be Carefully Crafted, Supported, and Tailored To Meet Investor Needs

Vanguard supports efforts to protect fund investors and minimize dilution in those funds that are at risk of experiencing it, especially during periods of market stress. Indeed, all funds must identify and manage liquidity risk as appropriate, taking into consideration a fund's asset types and other factors, such as its investment objective, historical fund flows in actual stress scenarios, and investor base (*i.e*., retail and institutional mix). Vanguard's liquidity risk management program (a holistic approach which incorporates specific jurisdictional requirements) simulates each fund's liquidity needs using current market conditions and historical statistical analysis of that fund's daily cash flows and has been very successful at responsibly meeting our investors' needs. Additionally, and as a best practice, Vanguard utilizes a large transaction notification policy that alerts a fund's traders/portfolio managers to large transactions so they can better manage cash flows. This policy also allows traders/portfolio managers to reject certain large purchase trades that can harm the existing fund shareholders. The benefits of a large transaction notification policy include helping funds stay fully invested, enhancing performance, monitoring cash flow, and managing risk.

Specific to the needs of our funds, Vanguard also uses several anti-dilution LMTs in various jurisdictions in which we operate, including swing pricing in Europe and the practice of calculating two net asset values (NAVs) per valuation point (referred to as "dual pricing" in the IOSCO Consultation) in Australia. These tools can provide value to shareholders because they are tailored to the needs of the funds and the jurisdictions in which they operate. Features of European funds, such as their operating and distribution models, make swing pricing an attractive tool that can provide fund shareholders benefits that outweigh their costs. Likewise, fund shareholders in Australia are well served by "dual pricing," and the Australian fund distribution infrastructure is built to accommodate multiple NAVs.[11]

For our bond funds in the United States and Ireland, we use bid pricing at all times, which in effect is a "pre-swung" NAV that improves, in a simple yet effective away, fund pricing, especially in a crisis.[12] For these funds, we rely on the bid price to allocate transaction costs to transacting investors during times of net redemptions.

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[11] In contrast, implementing such tools in the United States would require significant enhancements and rebuilds across all aspects of the mutual fund industry that are not warranted for the vast majority of open-end funds that do not experience material dilution. *See* Vanguard Letter, *supra* note 3.

[12] Swing pricing is more applicable in the United Kingdom because bonds price at the midpoint of the bid.

For certain new and smaller funds, we use purchase fees (for both equity and bond funds) and redemption fees (for equity only given our use of bid pricing for bond funds) to cover transaction costs and protect buy-and-hold shareholders from short-term, speculative trading practices.

For most of our other funds, their diverse and very liquid holdings, combined with the absence of riskier features like leverage, generally makes the application of an anti-dilution LMT unnecessary. Broad-based equity index funds track indices that comprise large segments of the equity market (*e.g*., Standard & Poor's 500 Index), and as such, hold the *most liquid* exchange traded securities in the most well-functioning markets in the world. In these markets, prices—both bid and ask—change almost instantly to reflect the cost of selling. Participants can readily source liquidity, even for large trades, and open-end funds can readily sell positions to meet redemptions without diluting the investment outcomes of long-term investors, let alone giving rise to any "first-mover advantage" or excess trading.

On the other hand, during periods of market volatility, it is conceivable that funds with certain attributes, such as those that are highly levered, illiquid, or concentrated, may be more likely to experience redemption pressure and material dilution. We hope policymakers, however, would analyze high-quality data to assess and confirm before imposing a host of new requirements on these funds. Accordingly, any guidance regarding anti-dilution LMTs should be tailored to address the types of funds and circumstances where dilution concerns are salient. Reframing the guidance this way would help protect long-term, buy-and-hold investors in those funds from material dilution while minimizing the impact on funds that don't share that risk profile.

We also recommend that IOSCO expand its list of anti-dilution LMTs to include other tools and variations that funds currently use to mitigate dilution, such as "pricing at the bid," without switching to ask depending on the direction of flows.[13] Any guidance should avoid mandating particular anti-dilution LMTs or requiring rigid application of such LMTs that deprives managers the necessary flexibility to manage funds to meet their investors' needs.

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[13] The IOSCO Consultation includes "valuation at the bid or ask prices" as one of the five identified anti-dilution LMTs. The Consultation describes this tool as a process that can switch from bid to ask price depending on the direction of net flows. This approach, however, requires knowledge of net flows, which has implications in the United States where most fund investors transact through intermediaries and retirement plan recordkeepers. Imposing a "hard close" that requires a fund to receive all orders before it calculates its NAV would require significant enhancements and rebuilds across all aspects of the open-end fund industry, including intermediaries, retirement plan recordkeepers, custodians, and transfer agents—costs of which we fear would be passed along to investors in the form of higher fees and expenses. Pricing at the bid consistently is a simple and effective way to pre-swing and mitigates dilution risks associated with fund outflows, particularly during a crisis when spreads widen.

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Vanguard appreciates the opportunity to comment on the Consultations. If you have any questions or would like to discuss our views further, please contact me at ricardo_delfin@vanguard.com or Jane Heinrichs, Senior Policy Advisor, at jane_heinrichs@vanguard.com.

Sincerely,

/s/ Ricardo R. Delfin

Ricardo R. Delfin
Principal, Global Head of Regulatory and Public Policy
The Vanguard Group, Inc.