Frankfurt am Main,
4 September 2023

BVI[1] position on IOSCO Consultation Report on Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes

We take the opportunity to present our views on the IOSCO's consultation report on guidance for effective implementation of the recommendations for liquidity risk management for collective investment schemes with the aim of outlining guidance for the use of anti-dilution liquidity management tools.

In the EU, a total of €12.8 trillion is invested in investment funds by private and institutional investors. With assets of €3.5 trillion in undertakings for the collective investment in transferable securities (UCITS) and alternative investment funds (AIFs), Germany is the largest market with a share of 28 percent. In terms of funds launched in the EU, the German AIF market accounts for EUR 2,187 billion out of EUR 6,544 billion in the EU, which corresponds to a share of 33.4 percent. Most German AIFs are so-called special funds, which are exclusively open to professional and semi-professional investors. These are primarily regulated companies such as insurance companies, banks or pension schemes that invest in low-leverage investment funds.

Overall, we welcome the IOSCO's efforts to establish guidance for effective implementation of anti-dilution tools (ADTs) in opened-ended funds (OEF). **However, we have strong concerns about the proposed guidance to consider and use at least one anti-dilution liquidity management tool (LMT) in each OEF and to tighten up the guidance to such an extent and to lay down new approaches at such a high level of detail, for example, regarding the calibration of liquidity costs**. This also applies in conjunction with the FSB's recommendation in its consultation that supervisors should ensure that such tools are available to managers of open-ended funds and these managers consider and use such tools. In particular, we miss the principle-based and proportionality approach that is otherwise usual at IOSCO, which also considers already existing well-functioning country-specific regulations and practices. IOSCO, for example, has elaborated a holistic approach very well in its paper on leverage and recognises that some countries/regions already have well-functioning rules, while others do not. The European legislator has already done its homework. Legislators in other jurisdictions need to close the gap and make available all liquidity tools to OEFs. It is therefore not acceptable that the well-functioning and strict European regulatory system will be overloaded with new and different rules just because other jurisdictions are maybe not able to implement adequate rules or to check compliance with these rules and therefore individual cases arise that may have an impact on the financial market in certain countries.

Any guidance should therefore embed proportionality, by acknowledging that not all funds need to be captured for financial stability monitoring purposes given the immense diversity in funds' structures, types, and strategies as well as domestic legal and regulatory frameworks governing these investment vehicles.

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[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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Moreover, we reject the approach of replacing the existing IOSCO's recommendations for liquidity risk management for collective investment schemes with general guidance on the use of all LMTs with these new guidelines - limited to ADTs. In particular, we criticize the fact that IOSCO does not deal more closely with the use and application of quantity based LMTs. We find that this is not in line with the mandate that the FSB gave to IOSCO. Unfortunately, the short paragraph on page 9 of the consultation paper does not do justice to this claim. It is therefore necessary to carry out further analyses of how the other LMTs work before at least one ADT has to be introduced in all OEFs. The FSB highlights itself that its analysis based on available data was subject to a number of limitations and assumptions and therefore the results should be interpreted cautiously. **As a first step, therefore, careful analyses based on valid data are needed that are actually capable of assessing any systemic risks of funds with an impact on financial stability. To this end, supervisory authorities and legislators must first do their homework to adequately collect such data and develop an appropriate macro-prudential toolkit before considering further measures for asset managers.**

Since we basically agree with the preparation of guidelines for the general use of ADTs based on the discretion of the fund manager, we limit our detailed comments to the aspects that are critical from our point of view as follows:

Proposed Guidance 1 – Overall Framework

Question 1: To what extent does the proposed guidance 1 help responsible entities to better integrate the use of anti-dilution LMTs within their existing liquidity risk management framework? Have all the critical elements been captured?
Question 2: Do you agree with the proposed guidance 1 regarding the inclusion of anti-dilution LMTs within the daily liquidity risk management framework that OEF managers should have in place at all times?
Question 3: Is this proposed guidance appropriate for all types of OEFs in its scope, and proportionate for all types of responsible entities to implement? If not, please explain.

Managers need a wide range of principle based LMTs. If regulators introduce too detailed and restrictive additional rules for investment funds, asset managers would be forced to act in a similar way during a possible crisis. This could lead to an amplification of the crisis rather than mitigation and is exactly the opposite of what is intended to avoid systemic risks. **It is much more important that LMTs are available to all jurisdictions and the managers have a wide range of degree of freedom in using such LMTs.** That involves a need for a common understanding based on general principles on EU or global level on how to use such tools. However, any guidelines should be principle-based and only explain how the tool works, without giving specific guidance on the individual measures. Therefore, it could be helpful to list all possible LMTs (ADTs and quantity based LMTs) with a broad definition. However, we do not consider a ranking of which LMTs are used first to be appropriate.

In any case, it must be at the discretion of the manager of the funds which tools they want to use because of very different fund types and structures. **For these purposes the manager shall also consider the profile of the investor base, including the type of investors, the relative size of investments and the redemption terms to which these investments are subject.** Therefore, it cannot be ignored that an OEF with a limited number of investors who cooperate with the manager concerning intentions to subscribe and redeem units or shares of the OEF must be treated differently from those where the investor structure is more comprehensive and not known down to the last link (such as OEFs offered to a wide range of retail investors). We therefore see the need to distinguish between OEFs distributed to retail or institutional investors. The same applies, for example, to funds with a restricted group of investors and a long-term investment horizon, in which an early exit has an economically disadvantageous effect on the investor and thus a sudden increased return demand, which the manager is confronted with, is not to be expected.

Deployed appropriately, the use of LMTs or possible use can create a sense of constructive ambiguity amongst individual market participants which can help to encourage better market discipline in stressed situations. As a last resort, redemption should be suspended under the precondition that no alternative is available under the fund rules or other potential liquidity management tools are considered inappropriate. In any case, the management company should establish written policies and procedures for the OEF which enable it to monitor the liquidity risks of the OEF and to ensure that the liquidity profile of the fund's investments is consistent with the underlying liabilities of the OEF taking into account the investment strategy and the OEF's liquidity profile.

Proposed Guidance 2 – Types of Anti-Dilution LMTs

Question 4: Has the proposed guidance identified all of the anti-dilution LMTs commonly used by responsible entities? Are there any other LMTs that share the same economic objective of passing on the liquidity cost to transacting investors, that could be included in this guidance? If so, please describe them.
Question 5: Are the identified anti-dilution LMTs described correctly? Do the features or characteristics of the different tools vary or do they generally operate as described?
Question 6: Do you support the proposed guidance 2? If not, in which cases do you think it could be justified not to adopt at least one anti-dilution LMT in OEFs (other than ETFs and MMFs)? What elements do you take into consideration to choose a specific anti-dilution LMT for your OEFs?

We strongly disagree with the proposed guidance 2 that responsible entities should consider and use at least one appropriate anti-dilution LMT for each OEF under management to mitigate investor dilution and potential first-mover advantage arising from structural liquidity mismatch in the OEFs they manage.

First of all, the European legislator has recently decided in the current review of the AIFM and UCITS Directives that managers can only use three ADTs, namely swing pricing, anti-dilution levy and redemption fees, in addition to other quantity based LMTs. As already stated at the beginning, it therefore makes no sense to prescribe a list of ADTs worldwide that are not (cannot) be used at all in individual jurisdictions. We therefore have no practical experience at all with the other two proposed ADTs (such as ‘valuation at bid or ask prices’ or ‘dual pricing’) and cannot make any assessment of them. **This also shortens the selection of European managers to only three ADTs, which are, however, not suitable to protect investors from the fund's redemption suspension in times of crisis.**

We see **anti-dilution levy** as a complicated variant of swing pricing, so that the other variants of swing pricing (such as full or partial) would be preferable in practise. Due to the complexity of the procedure for anti-dilution levy, it does not make sense to use only anti-dilution levy, but not the other (more common) variants of swing pricing. However, **redemption fees** could be used as a supporting tool for quantity based LMTs such as gating. Therefore, to the extent that FSB and IOSCO recommend the use of redemption fees only under certain conditions, the recommendation amounts to an obligation to use swing pricing in each OEF in Europe. We expressly reject this. Please also note the existence of funds with a limited number of investors which are well known by the management company. For these any ADT does not make any sense.

ADTs are not intended to offer investor protection in liquidity crises. We expressly disagree with the FSB's and IOSCO's finding that exclusive reliance on 'quantity' LMTs targeting the impact of 'excessive' redemptions and 'excessive' sales of assets could result in unintended consequences (e.g., 'excessive' investor redemptions in times of stress). It is a quantity LMT (**redemption gates**) that can effectively reduce such effects. This is because this LMT can offer effective investor protection in liquidity crises. Compared to other LMTs in terms of market acceptance and cost/benefit ratio, redemption gating is 'relatively easy' to implement for all stakeholders. It is suitable to both stabilise the individual OEF in extraordinary situations and to make a significant contribution to financial market stability.

ADTs, on the other hand, will not prevent the investor from redeeming the units/shares, so that the entire fund would still have to be closed in the worst case. And that can then lead to further undesirable effect. In this context, the fundamental question arises: What are ADTs intended to achieve? ADTs only make sense if individual investors hold large shares in the fund and investors are not willing to liaise with the fund manager. But that does not have to be the case. This requirement would punish those funds that have a balanced investor structure and thus would have to set up extensive processes to hedge a non-existent risk. For this reason alone, it makes no sense to make at least one ADT mandatory. In times of crisis, investors who want to redeem their units/shares will leave the fund anyway, and even higher costs will not deter them. Hence, the manager should decide which of the LMTs is the most appropriate given the investment/risk strategy and investor structure.

Moreover, the implementation of **swing pricing and anti-dilution levies** is very complex and will not only lead to an administrative burden with very limited benefits during financial crises. The practical challenges vary depending on the number of funds for which swing pricing is to be introduced, how often unit prices are published, how order acceptance deadlines are regulated, which accounting software is used, which form of swing pricing is chosen and through which channels the manager obtains knowledge about buy and sell orders (flow of information about movements of funds). In general, swing pricing would have to be built into the valuation routines as a regular, automatic process. The implementation effort is therefore evident, in particular, in the technical or accounting area. The more often unit prices are calculated and the closer the order processing is to the order acceptance deadline (e.g., daily issue and redemption with order processing t+1), the narrower the time window in which the new and additional procedural steps have to be completed. For this purpose, corresponding resources must be made available at the management company.

Moreover, using these ADTs will cause disproportionately high costs. For example, one of our members has just taken a year and a half to implement swing pricing for a fund as a pilot project in the company for the first time. In particular, this also involves extensive cost controlling. For this purpose, the company needs an overview of the development of market prices in the respective asset classes in order to be able to derive comparisons (e.g. bid-ask spreads). This data must largely be purchased externally from the expensive market data providers, which will lead to a large cost factor in view of the current licensing and price structure. It is therefore likely that smaller companies will no longer be able to afford the implementation of such tools.

FSB and IOSCO should also be aware that the mandatory implementation of such instruments will lead to a further thinning out of asset managers which would also increase concentration risk among asset managers thereby also increasing systemic risks instead of reducing them. **Moreover, competition will then no longer be possible in the long run.** Undesirable side effects can then occur here: The investor is overprotected against risks that he knows and takes himself but has to pay a lot of money for it and no longer has a choice between products and managers.

Furthermore, IOSCO's and FSB's proposals ignore that **ADTs make no sense at all for certain OEF (such as real-estate or private equity OEFs)**. While we welcome the clarification in footnote 25 of the consultation paper that other LMTs such as a long notice period could be envisaged to protect remaining investors and reduce the risk of fire sales and first mover advantage, nevertheless, such an approach should be explicitly included in the guidance.

For example, swing pricing is not permissible for open-ended real estate funds in Germany, since due to the special features of real estate funds and in particular its assets (real estate and participations in real estate companies), a causation-based distribution of the transaction costs caused by unit redemptions and unit issues would in principle not be possible when calculating the NAV. If a property has to be sold due to a surplus of redemptions and insufficient liquidity in the fund, then this sale is usually intended to cover the redemption requests of a certain longer period. In addition, a real estate transaction is a costly procedure that can extend over a long period of time. However, the transaction costs would actually be incurred on certain days and, in the case of a daily calculation of the net asset value, would only affect individual and not all originators of the transaction arbitrarily and disproportionately.

Regardless, we believe that an approach of establishing detailed exceptions for each individual use case is too far-reaching and therefore explicitly call for a principle-based approach guided by the proportionality principle and the investment/redemption strategy as well as the investor structure. In particular, it cannot be ignored that an OEF with a limited number of investors who cooperate with the manager concerning intentions to subscribe and redeem units or shares of the OEF must be treated differently from those where the investor structure is more comprehensive and not known down to the last link (such as OEFs offered to a wide range of retail investors). We therefore see the need to distinguish between OEFs distributed to retail or institutional investors. The same applies, for example, to funds with a restricted group of investors and a long-term investment horizon, in which an early exit has an economically disadvantageous effect on the investor and thus a sudden increased return demand, which the manager is confronted with, is not to be expected. However, fragmentation by fund type and asset categorisation should be avoided. Therefore, it must be the task and decision of an asset manager to examine whether there are special circumstances in the individual case that could make the possibility of certain LMTs useful. Otherwise, we need a broader range of exemptions where the use of certain LMTs can regularly have no added value for liquidity management. However, such a case-by-case exemption list and bucketing approach will lead to a very static set of rules that does not allow for flexibility in times of crisis.

Proposed Guidance 3 – Calibration of Liquidity Costs

Question 7: Have the components of the cost of liquidity, as described above, captured all the relevant costs that should be considered when calibrating anti-dilution LMTs?
Question 8: How does the cost of liquidity vary across different funds? To what extent could we achieve a more consistent approach to calibrating anti-dilution LMTs for similar funds, and what is the best way to do so?
Question 9: How can significant market impact be incorporated in the calibration of all of the proposed anti-dilution tools? Please provide examples.
Question 10: Can all of the components of the cost of liquidity (i.e., explicit and implicit transaction costs including any significant market impact) be incorporated in all five anti-dilution LMTs as set out in the discussion of Element (i) above? If not, what are the limitations to doing so and how would you suggest improving the effectiveness of these anti-dilution LMTs?
Question 11: To what extent can a subscription / redemption fee achieve the objective of addressing the investor dilution issue and financial stability concern of OEFs by attributing the liquidity costs to transacting investors? How could it be appropriately calibrated to achieve this objective?
Question 12: Do you see benefits in a tiered approach to attributing the cost of liquidity by using different adjustment factors according to net fund flow, market conditions and characteristics of the funds? Are there any operational difficulties? Any further comments thereto?
Question 13: How could guidance on LMT calibration achieve a fair balance between (i) ensuring investors have a clear expectation of the cost of liquidity they could be charged and (ii) ensuring responsible entities have enough flexibility to attribute the overall cost of liquidity at all times, especially under stressed market conditions?
Question 14: Is the proposed approach regarding ranges of liquidity cost adjustment appropriate? If not, how could it be improved?
Question 15: Is the proposed expectation on the level of confidence and the sophistication of liquidity cost estimations appropriate? If not, how could it be improved?

We disagree with the detailed guidance on the calibration of liquidity costs. In particular, the detailed approach including also the significant market impact as part of the implicit costs is far too broad. At present, we do not have any information on the effort that such significant market impact entail in practical implementation. In any case, IOSCO's proposals do not appear practicable, firstly with regard to the procurement of (external) data and the associated costs, and secondly with regard to the effect on the amount of the liquidity costs. In general, a rather general approach should be used here without any claim to 100 per cent accuracy.

In Germany, for instance, we have implemented a more general approach: the swing factor takes into account the transaction costs caused by an excess of redemption or issue requests. The swing factor is determined by the management company depending on various parameters (e.g. taking into account transaction costs, bid/offer spreads, market price impact).

Proposed Guidance 4 – Appropriate Activation Threshold

Question 16: What are the appropriate factors to consider in setting the activation threshold so that anti-dilution LMTs will be activated for any subscription / redemption activities with material dilution effect? How would you define 'material dilution effect'? Why and how could it vary across different funds?
Question 17: Does the use of an activation threshold introduce the risk of trigger / cliff-edge effects? How could trigger / cliff-edge effects be avoided? Could the tiered swing pricing address the trigger / cliff-edge effect?

Activating of LMTs is firstly a question of the individual risk situation of each investment fund. The activating mechanism of an LMT depends on the type of the LMT. Therefore, there is a need to distinguish between LMTs which need to be activated or not. For instance, (full and partial) **swing pricing** applies by agreement in the fund rules or prospectus with investors on an ongoing basis without additional activating mechanism during periods of market stressed situations. In Germany, however, a higher swing factor may be set in exceptional market conditions (such as when assets of the OEF cannot be valued or when, due to political, economic, or other events, trading of financial instruments in the markets is significantly impaired or of other circumstances). In our assessment, therefore, the activation of swing pricing as such is not a question of whether exceptional circumstances exist. Rather, once swing pricing is agreed with investors, thresholds for the swing factor, thresholds for applying partial swing pricing (if the excess of redemptions and issues of units/shares on the relevant valuation day exceeds a threshold determined by the management company) based on several criteria (such as market conditions, market liquidity, risk analyses), and procedures and must also be established for this purpose. We therefore do not agree with the explanation, such LMTs are not necessarily expected to be activated at all times.

The same applies to **notice periods**. Should the manager make use of this LMT, the notice period must apply to each redemption request by the investor. This means, the notice period must be integrated into the manager's liquidity management system as a permanent measure. The notice period must be specified in the investment conditions so that investors are aware of the period. The determination of the period is at the discretion of the manger. In exercising its discretion, particular account must be taken of investor interests and investment strategy as well as the liquidity of the assets of the investment fund. However, in order to exclude unreasonably long periods, a statutory maximum period of one month is introduced in Germany for OEFs which invest in securities such as UCITS, whereas real estate investment funds, for example, are subject to a one-year time limit. Moreover, the maximum period does not apply to special AIFs for institutional investors, as such a stipulation is not necessary for them because professional and semi-professional investors can decide for themselves whether they also want to enter into longer redemption periods.

In contrast, other LMTs like **redemption gates** or **suspension of redemption** need to be activated in stressed market situations. In Germany it is required by law that the manager must inform the NCA about an activation of an LMT (where it is needed), or as part of the fund rules it is already subject to approval by the NCA (for retail funds). Because such an information can be provided in a not standardised way (for instance by email), no expenses are incurred. Such information would allow NCAs to better understand the use of LMTs.

Proposed Guidance 5 – Governance

Question 18: Do the proposed arrangements discussed above include all the essential elements regarding governance and oversight arrangements in relation to the use of anti-dilution LMTs? Are they proportionate to the differing size and complexity of responsible entities' fund ranges?
Question 19: Please describe any material factors of the governance and oversight arrangements which have not been included.

We have no further comments on this.

Proposed Guidance 6 – Disclosure to Investors

Question 20: Is the ex-ante information described above likely to be appropriate and effective in explaining the use of anti-dilution LMTs to investors? What other information about dilution, if any, might be helpful to investors before they invest in a fund?
Question 21: What information can (and should) be disclosed ex-post to investors or the public, and at what frequency, to enhance transparency without compromising the aims of the anti-dilution LMTs or creating unintended consequences? Further, how soon should this information be disclosed to investors?
Question 22: Are there other risks than those described in this section attached to the disclosure of the parameters used for anti-dilution tools?

Any guidelines on disclosure should be principle-based and only explain how the tool works, without giving specific guidance on the individual measures. In particular, a distinction must be made between the information that should be available to investors in advance (e.g., in the investment terms and conditions or the prospectus) and the information that should be available afterwards (e.g., in the annual report). In the first case, the information should contain which LMTs are already implemented in the fund, how they work and what impact they have on the investors. The annual report could then inform the investors, whether and to what extent the LMTs were activated or used.

On partial swing pricing, we agreed with the German competent authority (BaFin) the following explanation in the prospectus (excerpt):

'For the purpose of calculating the issue price and the redemption price of the units, the Depositary, with the assistance of the Company [alternatively: the Company under the control of the Depositary], shall determine a net asset value on each valuation day. In doing so, it applies partial swing pricing for all unit issues and unit redemptions of the valuation day.
Swing pricing is a method of calculating the unit price in which the transaction costs caused by the redemption or issue of units are distributed according to their origin. For this purpose, the net asset value is first determined by the value of the assets belonging to the fund less the liabilities. Dividing the net asset value determined in this way by the number of units issued results in the unit value, which is additionally modified by a premium or discount (swing factor). In the case of partial swing pricing, this mechanism is only applied if the surpluses of unit redemptions and unit issues on the respective valuation day exceed a threshold value determined by the Company. The Company determines the threshold as a percentage [absolute] amount based on several criteria such as market conditions, market liquidity, risk analyses.
The Company determines the threshold as a percentage [absolute] amount based on several criteria such as market conditions, market liquidity, risk analyses.
The swing factor takes into account the transaction costs caused by an excess of redemption or issue requests. The swing factor is determined by the Company depending on various parameters (e.g. taking into account

transaction costs, bid/offer spreads, market price impact). The swing factor will not exceed [X] per cent of the Net Asset Value. [optional: the Company will publish the current swing factor on its website].
In an exceptional market environment, a higher swing factor [but not exceeding [X] per cent of the Net Asset Value] may be set. [The Company shall publish on its website a notice of any such increase in such case].'

Overcoming Barriers and Disincentives

Question 23: Do you agree with the list of barriers and disincentives identified? Do you consider there are others that are not covered?
Question 24: In your view, what are the most significant barriers or disincentives to the implementation of anti-dilution LMTs? What are your suggestions for possible solutions to mitigate or overcome the barriers and disincentives to the implementation of anti-dilution LMTs?
Question 25: For those OEFs facing significant barriers, what are the implications for their ability to implement this guidance? Are adjustments needed to the guidance to account for this, bearing in mind the objective to mitigate dilution for investor protection?

We have no further comments on this.

Other questions

Question 26: Do you have any other comments on any guidance proposed in this document?

We refer to our position paper on addressing structural vulnerabilities from liquidity mismatch in open-ended funds (revision to the FSB's 2017 Policy Recommendations) to the FSB (cf. **Annex**) and refrain from repeating the aspects mentioned there in this statement.

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Frankfurt am Main,
4 September 2023

BVI[1] position on FSB consultation report on addressing structural vulnerabilities from liquidity mismatch in open-ended funds – revision to the FSB's 2017 Policy Recommendations

We take the opportunity to present our views on the consultation of FSBs report on addressing structural vulnerabilities from liquidity mismatch in open-ended funds (OEF), which sets out proposed revisions to the FSB's 2017 Policy Recommendations.

In the EU, a total of €12.8 trillion is invested in investment funds by private and institutional investors. With assets of €3.5 trillion in undertakings for the collective investment in transferable securities (UCITS) and alternative investment funds (AIFs), Germany is the largest market with a share of 28 percent. In terms of funds launched in the EU, the German AIF market accounts for EUR 2,187 billion out of EUR 6,544 billion in the EU, which corresponds to a share of 33.4 percent. Most German AIFs are so-called special funds, which are exclusively open to professional and semi-professional investors. These are primarily regulated companies such as insurance companies, banks or pension schemes that invest in low-leverage investment funds.

Overall, we welcome the FSB's efforts to review and - where necessary - also revise its 2017 recommendations in light of further developments in open-end fund liquidity management. Ensuring that investors can redeem their units/shares at any time is one of the outstanding regulatory features for OEFs and at the same time one of the most important challenges for management companies. **However, we do not see the need to tighten up the existing FSB recommendations to such an extent and to lay down new requirements at such a high level of detail. In particular, we have strong concerns about the new bucketing approach and the proposed obligation to consider and use at least one anti-dilution liquidity management tool (LMT) in each OEF**. This also applies in conjunction with the International Organisation of Securities Commissions' (IOSCO) consultation report on guidance on anti-dilution liquidity management tools. It is important to highlight that there is no need for a global and common guidance related to the degree of liquidity of assets in which an OEF invests such as which measures should be taken and which LMTs may not be suitable for an OEF structure as well as an abstract classification of the liquidity of asset categories. **The European legislator has already done its homework. It is therefore not acceptable that the well-functioning European regulatory system will be overloaded with new and different rules just because other jurisdictions are maybe not able to establish adequate rules or monitor compliance with these rules and therefore individual cases arise that may have an impact on the financial market in certain countries. It is also important to consider the particularities of the individual countries in the distribution of funds and their investor structure. This can vary from country to country and therefore require different measures.** Therefore, FSB and IOSCO should avoid setting too detailed recommendations on liquidity analysis of assets and using specific LMTs. Otherwise, we see the danger that the management company might not be able to react properly to changes in the market.

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Since we reject the bucketing approach and the handling of anti-dilution tools (ADTs) as a whole, we refrain from answering the specific questions. Rather, we request the FSB to consider explicitly the following general remarks:

Structural liquidity mismatch (Recommendation 3)

- **The proposed new definition of 'liquid assets' as part of the new bucketing approach leads to undesirable effects and does not reflect any vulnerabilities from liquidity mismatch in open-ended funds.** We strongly disagree to introduce a completely new definition of 'liquid asset'. According to the proposed revised Recommendation 3 and its explanations made by the FSB, liquid assets should be defined as assets that are readily convertible into cash without significant market impact in both normal and stressed market conditions. Such an approach mixes the question of whether an asset could be qualified as 'liquid' with the question of how high the '**liquidity risk**' can be under normal and stressed market conditions which must be part of an appropriate liquidity risk management process for each OEF. To the extent that the FSB includes 'stressed market conditions' in the definition of 'liquid assets', there will no longer be a fund that can be qualified as investing in liquid assets. This is because liquidity of assets can also be volatile, especially in stressed times, and can lead to an asset that is basically classified as liquid now having to be qualified as illiquid - this was historically even the case for US Treasuries or German Bunds. Therefore, the European UCITS brand would no longer be able to be classified as a liquid fund under this definition because the eligible assets could no longer (theoretically) be defined as assets that are readily convertible into cash without significant market impact in stressed market conditions. Instead, the UCITS Directive refrains from defining what is liquid, but rather defines the '**liquidity risk**' as the risk that a position in the fund portfolio cannot be sold, liquidated or closed at limited cost in an adequately short time frame and that the ability of the fund to comply at any time with the redemptions at the request of any unitholder. This definition of liquidity risk is then supplemented by measures, techniques, tools and arrangements that enable liquidity risk of the fund to be assessed and monitored under normal and stressed market conditions including through the use of regularly conducted stress tests. In this context, it is of utmost importance that any guidance on liquidity management of OEF consider that managing liquidity risks needs to be observed in the overall context of the individual fund's portfolio including the investment objective, the investment instrument, redemption terms and investor base. All of these issues have a different effect on the liquidity. In particular, investment funds can compensate outflows with inflows and vice versa. We therefore see no need to adjust FSB's Recommendation 3.

  Moreover, there is no need for additional requirements related to OEF which hold a large proportion of their investments in inherently less liquid assets. The European legislation already requires a strict and efficient liquidity management process. Hence, common requirements in managing liquidity risks of investment funds and in using liquidity management tools (as a general rule) are much more important. As an example, the German legislator has responded to the crisis by implementing new legal liquidity management tools for open-ended property investment funds. We also see no need for an abstract classification of the liquidity of inherently less liquid assets or asset categories. In particular, it should be avoided that a new bucketing list sets too strict binding requirements on liquidity analysis of assets. Otherwise, we see the danger that the management company might not be able to react to changes in the market and they could make decisions with some of evidence of 'herd behaviour' with further impact to new (systemic) risk. Such requirements would also pose administrative burdens for the management companies and fundamentally change their already established and well-functioning systems. Therefore, it is important that liquidity management should be based on a case-by-case assessment.

- **Investment funds are financial products which inherently involve financial risks**. We also disagree with the narrative – which is unfortunately permanently repeated – that supposedly (too) many opened-ended funds are exposed to liquidity mismatch which would pose a risk to financial stability. Hence, we have the impression that there is an increasing assumption that investors should be able to make a risk-free investment in funds. However, liquidity risks are not avoidable, they can only be minimised under certain assumptions. Liquidity management under stressed market conditions is also assumption dependent. The overall liquidity of the fund therefore depends not only on how liquid the assets are, but also on the extent to which investors redeem their units. Fund's redemptions typically contain only a (minimum) portion of the fund volume. Therefore, a 100% (or at least 50%) liquidity match is not necessary and consequently not in the interest of investors. Our research based on historical data of OEF for retail investors shows that a **liquidity ratio of 20 per cent** can be considered as a robust prerequisite to fulfil redemption requests of OEF for retail investors. Analysis of the German open-ended retail investment fund market shows that investment management companies for the most part can manage liquidity risks to fulfil daily redemptions of fund units. When looking back to the post-crisis scenario after 2008, significant outflows first increased and later decreased slightly in open-ended retail investment funds, but not to the pre-crisis level. However, the average levels of significant net outflows did not change over time. However, while asset managers are obliged to inform their investors about investment strategies and risk profiles of investment funds according to strict transparency requirements including fees, redemption terms and suspension, the decision of the investor to invest in the fund is taken according to his own assessment of risk. In order to minimise the risk of underperformance of the managed funds, the management of inherent financial risks (including liquidity risk) is an integral part of the internal risk control system.

- **Lack of data.** The FSB highlights itself that its analysis based on available data was subject to a number of limitations and assumptions and therefore the results should be interpreted cautiously. As a first step, therefore, careful analyses based on valid data are needed that are actually capable of assessing any systemic risks of funds with an impact on financial stability. To this end, supervisory authorities and legislators must first do their homework to adequately collect such data and develop an appropriate macroprudential toolkit before considering further measures for asset managers. For a common understanding of financial stability risks and in order to avoid excessive burdens for cross border activities of asset managers, the main challenge is to agree at least on harmonised data reporting and exchange standards with the industry and supervisory bodies to enable better understanding and supervision.

- **Existing European sector-specific rules and additional national rules for asset managers already provide a robust framework to address investor protection and structural vulnerabilities**. It is essential to highlight that very strict legal requirements in the asset management sector have already been implemented in the European Union, in particular, in the field of liquidity management and leverage as potential structural vulnerabilities of investment funds. Both the UCITS Directive and the AIFMD fully cover the activities of asset managers and provide strict rules in that manner. In addition, restrictive rules apply to products such as UCITS, money market funds (MMFs), European venture capital funds (EuVECAs), European social entrepreneurship funds (EuSEFs) and European long-term investment funds (ELTIFs). Therefore, it is of great importance considering the existent experience and knowledge of the European industry in the development of global views. Moreover, on the occasion of a regular review of the specifications, the entire

European fund regulatory framework (AIFMD and UCITS Directive) is currently being revised.[2] The EU Commission has already confirmed that the regulations are effective overall and only require specific improvements in order to further strengthen investor protection and to reduce any inefficiencies and resulting inconsistent supervisory practices.[3] We expect some new amendments regarding the use of liquidity management tools (LMTs) and reporting to authorities. Under the provisional agreement, negotiators decided, for instance, to enhance the availability of LMTs, with new requirements for managers to provide for the activation of these instruments. These requirements are intended to enhance the prudential resilience of asset managers and their funds under management, thereby materially excluding or reducing the possibility of any of them posing risks to financial stability, as well as protecting investors of funds and to deal with significant outflows in times of financial turbulence.

- **The (European) fund industry is resilient and already able to absorb economic shocks.** This also applies in light of recent market developments due to the COVID 19 pandemic and the Russia-Ukraine crisis. ESMA has published a report[4] analysing how funds investing in real estate and corporate bonds could react to future liquidity and valuation shocks. Most important findings from the COVID-19 crisis: **The funds exposed to corporate debt and real estate funds under review overall managed to adequately maintain their activities when facing redemption pressures and/or episodes of valuation uncertainty**. ESMA confirms this finding in its press release[5] as the result of a further evaluation of a supervisory engagement with investment funds together with National Competent Authorities (NCAs). **The 2022 results show that the funds included in the scope of the analysis do not pose any substantial risk for financial stability.** Moreover, the recent turmoil seen on financial markets didn't stem from funds. Hence, we consider investment funds to diminish systemic risks in general as they balance between investors who want to divest and those who want to invest in a financial market. In the absence of investment funds these investors would have to access the markets directly.

- **German Spezialfonds' investors' behaviour mostly independent from situation in financial markets.** The German fund market is characterised by AIFs. With net assets of almost EUR 2.2 trillion, these AIFs are predominantly 'Spezialfonds' for institutional investors. 'Spezialfonds' are well-established investment vehicles for many regulated institutional investor groups, such as insurance companies, and follow an overall risk-averse investment strategy with no use of leverage on a substantial basis. Our research shows that in- and outflows of a particular investor group of 'Spezialfonds' are mostly independent from other groups' behaviour and the current level of financial stress in financial markets, thus effectively limiting contagion risk. The largest investor group, retirement benefit schemes even invest more when market turmoil in-creases, and the correlation coefficient for insurance companies and non-profit organizations is close to zero. 'Spezialfonds' also did not propagate market stress through their investment decisions during the COVID-19 crisis. The available data on investment decisions of 'Spezialfonds' managers indicate pro-cyclical, but less pronounced changes in the asset mix compared to retail funds.

- **Unfortunately, the FSB's and IOSCO's proposals only focus on the asset side of the funds, i.e., how liquid are the assets, without also adequately including the investor base and their**

[2] https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2021)721&lang=en.
[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0232&rid=7.
[4] ESMA, Report, Recommendation of the European Systemic Risk Board (ESRB) on liquidity risk in investment funds, 12 November 2020, Ref. ESMA34-39-1119, available under the following link: https://www.esma.europa.eu/sites/default/files/library/esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf.
[5] ESMA, press release, published on 30 March 2022, available under the following link: https://www.esma.europa.eu/press-news/esma-news/esma-and-ncas-find-room-improvement-in-funds%E2%80%99-liquidity-stress-testing.

request for return. However, liquidity management of OEF involves both. It is common standard and required in the EU that the manager has to monitor the liquidity profile of the fund's portfolio of assets, having regard to the marginal contribution of individual assets which may have a material impact on liquidity, and the material liabilities and commitments, contingent or otherwise, which the OEF may have in relation to its underlying obligations. For these purposes the manager shall also take into account the profile of the investor base, including the type of investors, the relative size of investments and the redemption terms to which these investments are subject. Therefore, it cannot be ignored that an OEF with a limited number of investors who cooperate with the manager concerning intentions to subscribe and redeem units or shares of the OEF must be treated differently from those where the investor structure is more comprehensive and not known down to the last link (such as OEFs offered to a wide range of retail investors). **We therefore see the need to distinguish between OEFs distributed to retail or institutional investors.** The same applies, for example, to funds with a restricted group of investors and a long-term investment horizon, in which an early exit has an economically disadvantageous effect on the investor and thus a sudden increased return demand, which the manager is confronted with, is not to be expected.

Liquidity management tools (Recommendations 4, 5 and 8)

- **Managers need a wide range of principle based LMTs.** If regulators introduce too detailed and restrictive additional rules for investment funds, asset managers would be forced to act in a similar way during a possible crisis. This could lead to an amplification of the crisis rather than mitigation and is exactly the opposite of what is intended to avoid systemic risks. It is much more important that LMTs are available to all jurisdictions and the managers have a wide range of degree of freedom in using such LMTs. That involves a need for a common understanding based on general principles on EU level on how to use such tools. However, any guidelines should be principle-based and only explain how the tool works, without giving specific guidance on the individual measures. Therefore, it could be helpful to list all possible LMTs (ADTs and quantity based LMTs) with a broad definition. In any case, it must be at the discretion of the manager of the funds which tools they want to use because of very different fund types and structures. Deployed appropriately, their use or possible use can create a sense of constructive ambiguity amongst individual market participants which can help to encourage better market discipline in stressed situations. As a last resort, redemption should be suspended under the precondition that no alternative is available under the fund rules or other potential liquidity management tools are considered inappropriate.

- **German fund industry sets standards in using liquidity management tools in open-ended investment funds for retail investors.** Germany had already introduced holding and notice periods for open-ended real estate funds for retail investors years ago. Investors of open-ended retail real estate funds are not allowed to redeem their units on short notice: a minimum holding period of 24 months and a notice period of twelve months apply. In addition to the strict risk and liquidity management requirements of the AIFMD, these rules have proven to be tools for liquidity management not only during the COVID-19 crisis. Therefore, they are suitable to be used as a model for possible new regulation. Alongside swing pricing and notice periods, redemption restrictions complement the existing toolbox for German open-ended funds investing in securities such as UCITS since March 2020. Redemption fees and in-kind redemptions have also long been permissible instruments. In particular, funds that invest in securities and have a small number of institutional investors use the instrument of in-kind distribution. All these LMTs serve to reduce systemic risks and protect investors, even though their rights may exceptionally be restricted in difficult market situations and help to avoid the use of the sharpest tool of all, fund closure. Institutional investors and fund-of-funds managers can also benefit from this.

- **ADTs are not intended to offer investor protection in liquidity crises.** We expressly disagree with the FSB's finding that exclusive reliance on 'quantity' LMTs targeting the impact of 'excessive' redemptions and 'excessive' sales of assets could result in unintended consequences (e.g. 'excessive' investor redemptions in times of stress). It is a quantity LMT (**redemption gates**) that can effectively reduce such effects. This is because this LMT can offer effective investor protection in liquidity crises. Compared to other LMTs in terms of market acceptance and cost/benefit ratio, redemption gating is 'relatively easy' to implement for all stakeholders. It is suitable to both stabilise the individual OEF in extraordinary situations and to make a significant contribution to financial market stability. Moreover, in the German fund market, large institutional investors in OEF are often known to the management companies and coordinate the market-friendly execution of their intended unit redemptions with the portfolio managers in advance.

> Since 2021, the German supervisory authority BaFin expects that German UCITS agree on the introduction of redemption gates (please see our guidance). After weighing up all the advantages and disadvantages of the various solutions, the German investment fund industry, together with the German Banking Industry Committee (DK) and BaFin, agreed on the pro rata approach with expiry of the residual order as a target-oriented solution for the German market which is also permissible in France. According to this approach, the investment fund rules must provide that if a threshold value is exceeded, the management company is entitled to redeem the units at the redemption price applicable on the settlement date only on a pro rata basis; beyond that amount, the management company must under its rules reject the redemption orders and the redemption obligation does not apply. This means that each redemption order is only executed on a pro rata basis dependent on a quota to be determined by the management company. The not executed part of the order (the residual order) will not be executed by the management company at a later point in time but will lapse in accordance with the provision in the fund's investment rules.

ADTs, on the other hand, will not prevent the investor from redeeming the units/shares, so that the entire fund would still have to be closed in the worst case. And that can then lead to further undesirable effect. In this context, the fundamental question arises: What are ADTs intended to achieve? ADTs only make sense if individual investors hold large shares in the fund. But that does not have to be the case. This requirement would punish those funds that have a balanced investor structure and thus would have to set up extensive processes to hedge a non-existent risk. For this reason alone, it makes no sense to make at least one ADT mandatory. In times of crisis, investors who want to redeem their units/shares will leave the fund anyway, and even higher costs will not deter them. Hence, the manager should decide which of the LMTs is the most appropriate given the investment/risk strategy and investor structure. However, ADTs such as redemption fees could be used in extraordinary situations as a supporting tool for gating.

Moreover, the implementation of ADTs such as swing pricing and anti-dilution levies are very complex to implement and will not only lead to an administrative burden with very limited benefits during financial crises. Using these tools will cause disproportionately high costs. For example, one of our members has just taken a year and a half to implement swing pricing for a fund as a pilot project in the company for the first time. In particular, this also involves extensive transaction cost controlling. For this purpose, the company needs an overview of the development of market prices in the respective asset classes in order to be able to derive comparisons (e.g., bid-ask spreads). This data must largely be purchased externally from the expensive market data providers, which will lead to a large cost factor in view of the current licensing and price structure. It is therefore likely that smaller companies will no longer be able to afford the implementation of such tools. FSB and IOSCO should also be aware that the mandatory implementation of such instruments will lead to a further thinning out of asset managers which would also increase concentration risk among asset managers thereby also increasing systemic risks instead of reducing them. Moreover, competition will then be limited in the long run. Undesirable side effects can then occur here: The investor is overprotected against risks that he knows and takes himself but has to pay a lot of money for it and no longer has a choice between products and managers.

Other FSB Recommendations

- **Avoiding fragmentation by fund type and asset categorisation.** We understand that the FSB also consider liquidity transformation in ETFs involving less liquid underlying assets. However, the FSB mentioned that the revised FSB Recommendations should not be applicable to ETFs because the structural features and liquidity management of ETFs distinguish them from other OEFs. As actively managed funds typically make more use of LMTs it is surprising that these are then considered (more) problematic although having (by definition) more possibilities to dampen redemptions causing less possible systemically relevant pressure in the financial markets (please note that IOSCO explicitly has seen no necessity for modifications for ETFs.[6]). Therefore, it must be the task and decision of an asset manager to examine whether there are special circumstances in the individual case that could make the possibility of certain LMTs useful in exceptional cases. Otherwise, we need a broader range of exemptions where the use of certain LMTs can regularly have no added value for liquidity management. However, such a case-by-case exemption list and bucketing approach will lead to a very static set of rules that does not allow for flexibility in times of crisis.

Additional considerations

- As mentioned above, we suggest focussing the new recommendations on developing **harmonised data reporting standards and macro-policy tools** with the industry and supervisory bodies to enable better understanding of any potential systemic risk and supervision. Such tools can be used by supervisors such as national competent authorities (NCA), ESMA, the European Systemic Risk Bord (ESRB) or IOSCO for their own analysis to identify potential systemic risk. The German NCA (BaFin)[7], for instance, has started a new central Data Intelligence Unit (DIU) and a digital supervisor cockpit to form the backbone of IT-driven supervision of the financial sector. ESMA introduced the STRESI solution (stress simulation for investment funds)[8]. In this regard, these analyses should be based on data reported by the supervised entities. Moreover, it is important to set up or improve the information sharing process between all supervisors. Such a single regulatory reporting mechanism would reduce operational effort and burden for asset managers as well as supervisory authorities. This important task should not be left solely to national authorities.

- Moreover, we share the FSB's assessment that **liquidity buffers should not be specified** (cf. footnote 26 of the consultation paper). These tend to be counterproductive and are detrimental to performance of investment funds and thus to investors. This applies even more if they must be

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[6] *"IOSCO has concluded that the ETF Principles **remain relevant and appropriate**. No major gaps have been identified, and no major regulatory issues were reported by IOSCO members or industry participants. The ETF structure has generally remained resilient during historical stress events. Historical stresses related to ETFs have been idiosyncratic events or were precipitated by exogenous shocks to the sector. As of the date of this report, no structural issues related to ETFs have been identified that have had a bearing on financial stability.*"; Link: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD733.pdf

[7] More 'bite' for the Financial Supervisory Authority, https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Financial_markets/Articles/2021-02-03-more-bite-for-the-financial-supervisory-authority.html.

[8] Available under the following link: https://www.esma.europa.eu/sites/default/files/library/esma50-164-2458_stresi_report.pdf.

invested in fixed-term deposits for which negative interest rates might still have to be paid in a low-interest phase.

- We refer to our position paper on IOSCO Consultation Report on Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes (cf. **Annex**) and refrain from repeating the aspects mentioned there in this statement.

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