

MEMO# 30780

July 14, 2017

IOSCO Issues Two Consultations on Fund Liquidity Risk Management

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July 14, 2017 TO: ICI Members
Investment Company Directors
ICI Global Members SUBJECTS: Compliance
Disclosure
Exchange-Traded Funds (ETFs)
Fund Governance
International/Global
Investment Advisers
Portfolio Oversight
Risk Oversight
Systemic Risk RE: IOSCO Issues Two Consultations on Fund Liquidity Risk Management

The International Organization of Securities Commissions (IOSCO) published two consultation papers on fund liquidity risk management last week, the first titled *Consultation on CIS Liquidity Risk Management Recommendations* (the “Recommendations Consultation”)[[1](#)] and the second titled *Open-ended Fund Liquidity and Risk Management—Good Practices and Issues for Consideration* (the “Good Practices Consultation”)[[2](#)] This memorandum briefly summarizes the two Consultations and the context in which they are arising.

Comments are due to IOSCO by September 18. ICI Global intends to file a comment letter responding to the two consultations. Members wishing to suggest issues for possible inclusion in the letter should contact the undersigned, preferably on or before August 15.

Background

IOSCO published *Principles of Liquidity Risk Management for Collective Investment Schemes* in 2013 (the “2013 Liquidity Report”)[[3](#)] The 2013 Liquidity Report was intended to be a practical guide on liquidity risk management of open-end funds (“funds”) for authorities and industry practitioners. Since then, regulatory bodies worldwide have continued focusing on fund liquidity, and earlier this year the Financial Stability Board (FSB) issued *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*[[4](#)] Nine of the FSB’s final recommendations related to what the FSB termed “liquidity mismatch” of funds. Eight of those recommendations call upon IOSCO to

take further action, with most instructing IOSCO to “review its existing guidance and, as appropriate, enhance it.”

Summary of the Recommendations Consultation

The Recommendations Consultation is IOSCO’s “first step” in response to the FSB’s liquidity recommendations, and in it IOSCO seeks to build upon its 2013 Liquidity Report. Broadly speaking, IOSCO’s Recommendations, as it proposes to amend them, cover disclosure to investors, alignment between portfolio assets and redemption terms, availability and effectiveness of liquidity risk management tools, and fund-level stress testing. More specifically, the Recommendations Consultation includes:

- Additional guidance under Recommendation 3, which relates to determining a suitable dealing (*i.e.*, subscription and redemption) frequency for a fund, and the importance of this as a design decision;
- A substantial rewording of Recommendation 4, which relates to the appropriateness of a fund’s dealing arrangements for its investment strategy and portfolio assets, throughout the fund’s lifecycle;
- Additional guidance under Recommendation 7, which concerns liquidity-related disclosure to investors;
- Additional guidance under Recommendation 12, which relates to identifying emerging liquidity shortages and maintaining the fund’s investment strategy during stressed conditions;
- Additional guidance under Recommendation 13, which relates to incorporating relevant data and factors into the fund’s liquidity risk management process and understanding the fund’s investor base;
- A substantial rewording of Recommendation 14, which relates to fund-level stress testing;
- New Recommendation 16, which relates to periodic operational testing of liquidity management tools to ensure readiness when necessary; and
- New Recommendation 17, which relates to the availability and use of additional liquidity management tools to protect investors from unfair treatment.

The Recommendations Consultation solicits feedback on these proposed changes. It also discusses the unique liquidity characteristics of ETFs, and asks whether they should be subject to different liquidity requirements.

Summary of the Good Practices Consultation

IOSCO’s Good Practices Consultation is meant to supplement its Recommendations Consultation. It is aimed at regulators (“as a reference guide that illustrates how various jurisdictions regulate liquidity risk practices”), the industry (providing examples that “describe where, when and how certain tools have been used in the past and how they can be used in the future” and describing “good practice for liquidity risk management throughout the entire life cycle of a fund”), and investors (outlining scenarios in which an asset manager could use liquidity management tools). It does not represent standards or recommendations from IOSCO, nor does it provide concrete standardized proposals for regulators or the industry.

The Good Practices Consultation emphasizes the need for funds to ensure consistency between their redemption terms and their investment strategies. It provides guidance about what funds could consider at the design phase, and after they commence operations. It then covers the liquidity risk management tools available to funds, depending on the

jurisdiction.^[5] Specifically, it discusses swing pricing, anti-dilution levies, valuation practices, redemption gates, side pockets, notice periods, suspensions of redemptions, and in-kind redemptions. In each case, the Consultation describes the tool, setting forth advantages and disadvantages to its use, providing examples and/or short case studies, and highlighting how certain jurisdictions regulate its use. The Good Practices Consultation concludes by discussing fund-level stress testing, providing background and highlighting current industry and regulatory approaches to its use as a component of the liquidity risk management process.

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endnotes

[1] Available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD573.pdf.

[2] Available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD574.pdf.

[3] Available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD405.pdf.

[4] Available at: www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf. See Institute [Memorandum No. 30531](#), dated January 23, 2017, for a summary of the FSB's final recommendations.

[5] IOSCO previously addressed this topic in 2015. See *Liquidity Management Tools in Collective Investment Schemes: Results from an IOSCO Committee 5 survey to members*, available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD517.pdf.