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IOSCO Final Report on Liquidity Management Tools in Collective Investment Schemes

[29657]

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TO: ICI GLOBAL REGULATED FUNDS COMMITTEE No. 6-16
INTERNATIONAL COMMITTEE No. 6-16
INTERNATIONAL INVESTING SUBCOMMITTEE No. 3-16 RE: IOSCO FINAL REPORT ON LIQUIDITY MANAGEMENT TOOLS IN COLLECTIVE INVESTMENT SCHEMES

On December 17, 2015, the International Organization of Securities Commissions (IOSCO) published a Final Report on Liquidity Management Tools in Collective Investment Schemes: Results from an IOSCO Committee 5 survey to members (Report). [1] The Report summarizes responses from 26 jurisdictions to a survey on liquidity management frameworks and tools. The survey questions focused on four areas:

- What type of liquidity management tools are available in your jurisdiction?
- Does your regulatory framework define liquidity and/or liquid instrument, if so how?
- Does your regulatory framework contain provisions on how to manage liquidity beyond the overarching principle that managers should ensure investors can redeem at the frequency set in the fund's documents?
- For each tool, describe certain specific features, e.g., prior supervisory authorization, any mandatory or other specified features, requirements for tools for certain fund types, ability to use during normal circumstances, disclosure for investors, who can activate the tool, past experiences with tools.

Generally, the tools available in the reporting jurisdictions "are as varied as the jurisdictions responding;" however, there are similar tools available in multiple jurisdictions. For example, the majority reported the following tools were available: redemption fees, gates, redemption in kind, side pockets and suspensions. The ability to suspend redemptions was the one common tool in all jurisdictions. Other tools include: short-term trading restrictions, limits on illiquid investments, limits on asset concentration, limits on derivatives and leverage, liquidity buffers, valuation at bid, rolling withdrawals and short-term borrowings. [2]

On regulatory definitions for liquidity or liquid instruments, there were a range of responses. Some reported no formal definition and some had very granular specifications, including lists of liquid instruments. The majority indicated that there was no formal definition of liquidity in their countries. Where liquidity is defined, the definition tends to be principle-based and not prescriptive. [3]

Generally, many jurisdictions indicated funds have a fiduciary duty to investors to ensure assets are able to meet redemptions, i.e., that the liquidity profile of investments and redemption policies are consistent. Some countries specifically limit the amount of illiquid assets that can be held by a fund or limit leverage. [4] In many jurisdictions, the ability to use liquidity tools is in within the discretion of the fund, but guided under the principle of acting in the best interest of the fund's investors. Regulatory approval is generally not needed, but in many countries the possibility of using the tools must be highlighted in the prospectus or constituting documents of the fund. Since the prospectus or fund document information is approved by regulators, the Report noted that there is quasi-approval by regulators in some countries. [5]

The Report includes tables with additional information by jurisdiction on tools for certain types of funds (Table 7), whether jurisdictions have time limits for the resolution of issues that are requiring funds to use a liquidity tool (Table 8) and whether tools can be used during normal times (Table 9). Table 10 summarizes the responses for how investors are informed of liquidity tools and Table 11 covers whether the tool can be activated by the manager or the regulator.

The later part of the Report provides brief details on some past experiences in various jurisdictions with liquidity management tools, particularly suspensions. Examples of fund suspensions are described including related to (1) open-end real estate funds, (2) a situation involving a bank insolvency, (3) suspensions due to market closures, (4) suspensions related to September 11, (5) the 2007/2008 financial turmoil, and (6) challenges posed by concentrated portfolio holdings, i.e., 20% of fund assets. There also are some descriptions of circumstances when funds used redemptions in kind, gates and side pockets. [6]

In conclusion, the Report stated that the following common themes had emerged from the survey responses:

- First, regardless of the liquidity tool and the reason for its use, fund and asset managers generally disclose the "rules of the game" upfront.
- Second, funds generally have shown to be responsible in their liquidity management through the types of assets in which they invest. Consequently much of the responsibility for invoking tools begins with funds.
- Third, managers generally have a fiduciary duty to investors and have invoked liquidity management tools only when they are in the best interests of investors.

The Report also noted that liquidity management tools are reinforced in many jurisdictions by funds' internal risk management and quality control systems. In summary, the Report found that although the use of liquidity management tools is rare, there have been times when these tools have been needed to protect investors. Further, although the impact of the tools has been "acutely felt by fund investors, the broader, system wide consequences of invoking such tools has been limited." [7]

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endnotes

[1] IOSCO, FR 28/2015, Final Report, Liquidity Management Tools in Collective Investment Schemes: Results from an IOSCO Committee 5 survey to members (December 2015), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD517.pdf (Report).

[2] Report at 3.

[3] Report at 6-8 (Table 3 provides definitions by jurisdiction).

[4] Report at 9-12 (Table 4 describes extra regulatory provisions on managing liquidity by country).

[5] Report at 4; Table 5 (regulatory authorization for use of tools), Table 6 (regulatory guidance on tools) and Table 11 (tools activated by regulator).

[6] The Report also explains that, in India, during 2008 and 2013, the regulator considered case by case requests to increase mutual fund borrowing limits and the central bank of India provided a special refinance window to mutual funds to allow them to borrow from the central bank to meet short-term liquidity needs. Report at 23-25.

[7] Report at 26.