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Submitted via email to: j.wennstrom@iosco.org
Submitted via survey link to: Recommendations Survey, Guidance Survey

John Wennstrom, Senior Policy Advisor
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: *Public Comment on Revised Liquidity Risk Management Recommendations for OEFs*

Dear Sir or Madam:

The Vanguard Group, Inc. ("Vanguard")[1] appreciates the opportunity to comment on the International Organization of Securities Commissions' ("IOSCO") consultations on its revised recommendations for open-end fund liquidity risk management (the "Consultations").[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] Our unique investor-owned structure means the interests of more than 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 better prepare funds for stressed conditions, protect fund investors from potential dilution, and enhance investor understanding of investment risks.

We support IOSCO's efforts to operationalize the Financial Stability Board's ("FSB") revised recommendations to address liquidity mismatch in open-end funds (the "Revised FSB

[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] Revised Recommendations for Liquidity Risk Management for Collective Investment Schemes (Nov. 2024), *available at* *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD770.pdf*; Guidance for Open-ended Funds for Effective Implementation of the Recommendations for Liquidity Risk Management (Nov. 2024), *available at* *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD771.pdf*.

[3] *See* Letter from Ricardo Delfin, Global Head of Regulatory and Public Policy, Vanguard, to Secretary General of FSB and Coordinator of Standards Development of IOSCO, dated Sept. 1, 2023, *available at* *https://www.iosco.org/library/pubdocs/739/pdf/Vanguard%20Group,%20Inc.%20(Vanguard).pdf;* 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*.

Recommendations")[4] and appreciate IOSCO's intent to provide a flexible and principled approach to open-end fund liquidity risk management. Importantly, IOSCO recognizes that open-end funds are a diverse class of products and not suited for a one-size-fits-all approach to liquidity risk management. We agree and believe that an effective framework for open-end fund liquidity risk management should support high quality liquidity risk management practices tailored to the behaviors and needs of each fund. With that in mind, we believe that certain recommendations would benefit from further clarification.

Our comments and recommendations include the following:

- ***Every fund has a different liquidity profile.*** Vanguard offers a wide-range of funds, including broad market funds, targeted sector funds, target-date funds, and index and actively managed funds, to a diverse investor base. Each fund experiences inflows and outflows differently, and different market conditions lead different types of investors to purchase and redeem at different times. Vanguard's funds consider a host of factors to ensure adequate liquidity in all market conditions. These factors include the fund's holdings and the market liquidity of those holdings, past levels of peak redemption, composition of the fund's investors, as well as other factors that may be relevant for a particular fund. Based on these factors, each fund adopts a liquidity risk management program that is designed to ensure each fund can readily meet redemptions without diluting the investment outcomes of long-term investors. Vanguard's holistic approach to liquidity risk management has been successful at responsibly meeting our investors' needs. Even during the volatile markets of March 2020, our funds performed exceptionally well.[5] That being said, Vanguard supports efforts by policymakers to follow the data and prioritize oversight of financial products with riskier features, like high amounts of leverage, concentrated investor bases, and large quantities of illiquid securities.

- ***Governance and disclosure are critical components of an effective liquidity risk management program.*** We commend IOSCO for developing recommendations regarding liquidity risk management governance arrangements and disclosure of liquidity management tools ("LMTs"). We encourage IOSCO to clarify that disclosure regarding LMTs should be proportionate to the fund's level of liquidity risk, including identification of the material benefits and risks posed by the LMTs that are most likely to be employed. This approach will enable investors to better incorporate their potential use and the cost of liquidity into their investment decisions.

- ***Liquidity management tools should be tailored to meet investor needs.*** Effective liquidity management programs provide funds with the flexibility to tailor their use of

[4] Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds (Dec. 20, 2023), *available at* https://www.fsb.org/uploads/P201223-1.pdf.

[5] Vanguard saw aggregate *inflows* of 0.27% for equity funds and outflows of only 2.26% for bond funds. These flows, especially during an unprecedented global crisis, are fully in keeping with a healthy and successful investment product, let alone one that allows investors to make near real-time decisions involving diversified products at a low cost.

LMTs depending on the fund's unique characteristics. Liquidity risk management programs that are too prescriptive can harm investors by forcing funds to maintain higher cash balances than necessary or change fund mandates, reducing investors' likely returns and exposure to their desired investment style or asset class. Given this, we suggest that IOSCO highlight the significant downsides associated with a one-size-fits-all liquidity categorization regime, in favor of a more tailored, fund-specific, approach to liquidity risk management that addresses the unique risks of particular funds. We also suggest the proposed recommendations make clear that the implementation of LMTs should be tailored to the characteristics and risks associated with particular funds.

Governance and Disclosure are Critical Components of Effective Liquidity Management Programs

We commend IOSCO for developing a recommendation regarding liquidity risk management governance arrangements. IOSCO appropriately recognizes that governance is a critical component of an effective liquidity risk management program. We support a governance framework that is commensurate with the liquidity profile of a fund and agree that fund managers should have clear decision-making processes for the use of LMTs in normal and stressed market conditions.

We also commend IOSCO for developing a recommendation regarding disclosure of LMTs. Vanguard has long supported reforms that enhance investor understanding of investment risks. Properly designed disclosure empowers investors to determine whether their liquidity risk appetite matches the liquidity risk profile of a fund. Furthermore, we appreciate IOSCO's efforts to strike an appropriate balance between transparency and efficacy of LMTs.

With this in mind, we suggest that IOSCO make clear that disclosure regarding LMTs should be proportionate to the fund's level of liquidity risk, including identification of the material benefits and risks posed by the LMTs that are most likely to be employed. IOSCO recognizes elsewhere in the Consultations that "disclosures should be proportionate to their risks." We agree and we encourage IOSCO to adopt this principle in this recommendation. Disclosures that are overly lengthy and technical can make it difficult for investors to identify and understand the material risks of an investment. Clear and concise disclosure can enable investors to better incorporate the potential use of relevant LMTs and the cost of liquidity into their investment decisions.

Liquidity Management Tools Should Be Tailored to Meet Investor Needs

Investors are best served when funds can tailor their use of liquidity management measures depending on the fund's unique characteristics, including the nature of the fund's assets and the market in which the fund operates. Liquidity risk management programs that are too prescriptive can harm investors by forcing funds to adopt liquidity management measures designed for the last crisis that may be counterproductive in the next one. They may also force funds to implement measures that reduce investor returns by, among other things, maintaining higher cash balances than necessary or change fund mandates. With this in mind, we believe that the proposed recommendation regarding liquidity categorization would benefit from clarification.

Proposed Recommendation 3 introduces a categorization approach where open-end funds are grouped in categories depending on the liquidity of their assets. The redemption terms that open-end funds offer would then be based on such categorization. As noted above, we suggest that IOSCO clarify that it is not prescribing a one-size-fits-all liquidity categorization approach. We are concerned that such an approach is counterproductive.

Although open-end funds in the US are required to classify the liquidity of their portfolio investments in one of four prescribed categories, funds are provided with flexibility and discretion regarding how to classify investments. Critically, the liquidity classification framework does not prescribe how funds manage their liquidity risks. Rather, the liquidity classification framework is intended to help funds monitor their liquidity and to provide liquidity information to regulators. Funds are allowed to tailor their liquidity risk management programs to their unique characteristics. For instance, redemption terms are not prescribed based on liquidity classifications.[6] In fact, the Investment Company Act establishes a shareholder right of prompt redemption in open-end funds.[7] A liquidity categorization framework that prescribes the adoption of certain redemption terms or liquidity management measures, which may be infeasible or inappropriate for funds to implement, would be contrary to current practice in the US.

Vanguard also operates in jurisdictions that do not require liquidity categorization, but these funds are subject to various rules to ensure high levels of liquidity risk management. For instance, Vanguard's UK and Irish domiciled funds operate under the UCITS regime, which requires fund managers to adopt a liquidity risk management framework appropriate and proportionate to the nature of liquidity risk of the funds they manage. The framework must be adaptable and forward looking to account for any changes to the funds' activities or liquidity profile. Fund managers are also required to employ stress testing to manage asset and portfolio liquidity, disclose to clients on the use of LMTs and provide information to supervisors to help them assess funds' liquidity profile. Vanguard also operates funds in Australia. Similar to the UCITS regime, under Australia's principles-based risk management framework, fund managers are expected to design and implement an effective liquidity risk management process commensurate with the assessment of liquidity risk at a fund level. This would include stress testing and consideration of which available LMTs are appropriate to use in different scenarios. Given that fund managers in these jurisdictions are already required to implement risk management programs proportionate to their funds' liquidity risk, it is unclear how a rigid liquidity categorization regime would address investor harm or improve investor outcomes.

To ensure IOSCO's framework is applicable across funds and jurisdictions and appropriately considers the fund-specific nature of liquidity risk management, we recommend that IOSCO make clear that it is not mandating a one-size-fits-all liquidity categorization regime. Every fund is different, and fund complexes should continue to be empowered to tailor redemption terms based on a funds' actual redemption history and fund-specific liquidity risk management needs.

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[6] *See* Rule 22e-4(b)(1)(ii).

[7] Section 22(e) of the Investment Company Act provides that no registered investment company shall suspend the right of redemption or postpone the date of payment upon redemption of any redeemable security in accordance with its terms for more than seven days after tender of the security absent specified unusual circumstances.

A flexible approach to liquidity categorization would help ensure that funds are best positioned to meet their investors' needs while still ensuring that funds appropriately monitor their liquidity and provide useful liquidity information to regulators.

A Tailored Approach Also Would Ensure Broad Availability of Appropriate Tools

We believe that a broad set of LMTs, including anti-dilution LMTs, should be available for use by fund managers as part of a robust liquidity management program. To maximize the utility and impact of these tools, funds should be provided with the flexibility to tailor their use of LMTs to the fund's unique characteristics. With this in mind, we offer a few suggestions to clarify the proposed recommendations regarding the implementation of anti-dilution LMTs.

Proposed Recommendation 6 of the Consultations provides that fund managers "should consider and *implement* a broad set of liquidity management tools and measures," including anti-dilution LMTs. In contrast, Recommendation 4 of the Revised FSB Recommendations provides that "authorities should ensure that a broad set of liquidity management tools and measures is *available* for use by managers of open-ended funds in normal and stressed market conditions as part of robust liquidity management practices." In its attempt to operationalize this recommendation, IOSCO appears to have proposed a more prescriptive recommendation than the FSB. We are concerned that this recommendation could be interpreted to require funds to adopt anti-dilution LMTs that are not appropriate or feasible to implement in particular scenarios.

As an asset manager offering high-quality, low-cost funds in multiple jurisdictions worldwide, Vanguard has experience with many anti-dilution LMTs. These tools can protect investors, particularly when they are aligned to specific markets and are tailored to meet the specific needs of particular funds and their investors. For example, the Australian fund distribution infrastructure is built to accommodate multiple net asset values ("NAVs"), so fund shareholders in Australia can benefit from "dual pricing." Similarly, the operating and distribution models of European funds can make swing pricing an effective LMT in those markets and can provide fund shareholders benefits that outweigh their costs.

However, implementing such tools in jurisdictions like the United States would require significant rebuilds across all aspects of the mutual fund industry. Furthermore, for many of the funds we offer, their diverse and liquid holdings, combined with the absence of riskier features like leverage, typically makes the application of anti-dilution LMTs unnecessary and costly to fund shareholders. For example, broad-based equity index funds hold the world's most liquid exchange traded securities. In these markets, prices change almost instantly to reflect the cost of selling. Participants can readily source liquidity and open-end funds can sell positions to meet redemptions without diluting the investment outcomes of long-term investors or giving rise to any "first-mover advantage."

In contrast, during periods of market volatility, funds with riskier features like high amounts of leverage, concentrated investor bases, or large quantities of illiquid securities may be more likely to experience redemption pressure and material dilution. Accordingly, the implementation of anti-dilution LMTs should be tailored to the types of funds and circumstances where dilution concerns are salient and anti-dilution LMTs can help protect long-term, buy-and-hold investors

from material dilution. Modifying Proposed Recommendation 6 to reflect this approach would address certain products and markets with riskier features while minimizing the impact on funds that do not share that risk profile.

We are also concerned that Proposed Recommendation 7, which provides that fund managers should use anti-dilution LMTs to mitigate material investor dilution and potential "first-mover advantage," could be interpreted to require funds to adopt anti-dilution LMTs that are not appropriate or feasible to implement. Proposed Recommendation 7 assumes that that *all* open-end funds, regardless of size, investor base, or fund strategy, experience material dilution sufficient to create a "first-mover advantage"[8] that gives rise to excess redemptions in stressed markets. This assumption is inconsistent with our experience[9] and industry data[10] and it does not recognize a host of factors that affect investor behavior, including leverage, investor type, and concentration. In contrast, Recommendation 5 of the Revised FSB Recommendations begins with the principle that anti-dilution LMTs should be *available* to fund managers. The FSB also appropriately recognizes that differences between open-end funds may impact the necessity of anti-dilution LMTs.[11] We suggest that IOSCO revise its proposed recommendation to make clear that LMTs should be broadly available and that it is not requiring rigid implementation of anti-dilution LMTs. Such a revision would ensure that managers will continue to have the necessary flexibility to manage funds to meet their investors' needs. It would also encourage the implementation of appropriate anti-dilution tools for funds that exhibit risky qualities.

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[8] 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 mutual 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] Vanguard 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.

[10] 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-view-bondfund-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).

[11] Recommendation 5 of the Revised FSB Recommendations notes that authorities may seek to distinguish the application of measures to achieve greater use and greater consistency of anti-dilution LMTs based on funds' liquidity mismatch portfolios.

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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.

Sincerely,

/s/ Ricardo R. Delfin

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