Appendix I: Feedback Statement on the Public Comments received by the Technical Committee on the *Consultation Report – Suspension of Redemptions in Collective Investment Schemes*

Fifteen responses were received in relation to the Consultation Report - Principles on Suspensions of Redemptions in Collective Investment Schemes (suspension principles) as developed by the IOSCO Technical Committee (TC) and put out to public consultation from 8 March 2011 until 30 May 2011.

Non-confidential comments were submitted by the following organizations:

Association Française de la Gestion Financière (AFG)

Christoph Barnard

BlackRock

Bundesverband Investment und Asset Management e.V. (BVI)

Depositary And Trustee Association (DATA)

Dubai Financial Services Authority (DFSA)

European Fund and Asset Management Association (EFAMA)

Financial Services Board (FSB)

Hedge Fund Standards Board (HFSB)

INVERCO - Spanish Association of Collective Investment Schemes and Pension Funds

Investment Management Association (IMA)

International Investment Funds Association (IIFA)

Investment Company Institute (ICI)

National Futures Association (NFA)

Zentraler Kreditausschuss (ZKA)

IOSCO took these comments, and those submitted on a confidential basis, into account in preparing the final report. This feedback statement summarizes the main issues raised in the responses received and notes where any changes have been made to the report.

These responses can be viewed in Appendix III of this document.

By way of introduction, the vast majority of the respondents to the consultation welcomed and strongly supported the IOSCO work in relation to the suspension principles. A few respondents also described the IOSCO work as being important and valuable.

General Comments:

1. Most respondents agreed with the suspension principles. Several respondents specifically pointed out the fundamental feature of redemptions in open-ended CIS and the possibility of confidence damage by suspensions (ZKA, BVI, IIFA). One respondent highlighted the value of the suspension principles for both, regulators and industry (IIFA).

2. Several respondents specifically appreciated the policy impetus to standardise procedures and achieve convergence surrounding suspension of redemptions. It was reported that the recent events have highlighted the need for international standardization and respondents stressed that the IOSCO work was particularly timely notably in the context of the financial crisis where several suspensions occurred (BlackRock, AFG, FSB).

3. One respondent, however, mentioned the necessity for manager flexibility with regard to unique and dynamic markets in crises environments, hence highlighting potential conflicts of manager duties towards investors with too detailed regulatory frameworks reducing flexibility (BlackRock). To the contrary, two respondents supported a more binding character for the principles by removing words "generally" and replacing "should" by "shall" (AFG, FSB). Again in contradiction, one respondent (IMA) suggest using "could" instead of "should" to highlight the guiding character.

4. Some respondents especially highlighted the importance of the disclosure and communication requirements in the suspension principles since communication as much as possible and robust processes are important during extreme circumstances.

5. Few respondents (EFAMA, IMA, BVI) criticized in general the creep in the language used in IOSCO documents, from statements aimed at regulators to command to firms. They recommended clarifying that it is a matter for regulators to consider the report and transpose the guidance in each jurisdiction.

Specific Comments:

Chapter 1 Introduction

(i) Three respondents (EFAMA, IMA, BVI) pointed out that the principles are written in a way that suggests direct application to CIS operators and that this may be misleading to market participants. Particularly the last paragraph in the introduction, which defines the responsible entity and its last sentence leads to this implication. However, the paragraph before highlights the aim of the report as to outline principles against which both, the industry and regulators can assess the quality of regulation and industry practices concerning suspensions of redemptions.

Respondents highlighted that IOSCO principles can influence industry best practice but cannot supersede binding legal national rules.

Hence, the respondents suggested that the language of the report should reflect that it is a matter for regulators in each jurisdiction to consider the report and where appropriate take action (e.g. transposition or amendments to regulation). For clarification, the respondents suggested using the wording as in the IOSCO report on Examination of Governance for CIS – Part II, page 5[1].

- IOSCO added a clarification to the end of the introduction section similar to the wording used in the Technical Committee report on *Examination of governance for CIS – Part II*:

  "Although addressing the responsible entities, the principles do not provide direct applicable standards to firms. As stated above, the principles need to be implemented and respected by the jurisdictions. They obviously have to be transposed within the context of the specific legal structures prevailing in each jurisdiction. Hence, the implementation of the principles may vary from jurisdiction to jurisdiction, depending on local conditions and circumstances."

(i) Two respondents (FSB, AFG) pointed out that the term "entity responsible for the operation" may be too vague, although they acknowledged that it might be difficult to find a more precise definition at global level. They suggested to use "the entity responsible for the financial management of the CIS" complemented by a non-exhaustive list of such entities including management companies.

- IOSCO is of the view that the definition of the responsible entity is sufficiently clear having in mind the differences in jurisdictions.

Chapter 2, the Risk of Suspensions:

(i) One respondent (Christoph Barnard) stated with regard to the second sentence of Chapter 2 that investor expectations for redemption on a regular basis are the result of poor expectations management. As later principles require that the possibility of a suspension must be disclosed ex ante, it could be more appropriate to state that "Investors in open-ended CIS expect to be able to redeem…in normal market conditions".

- IOSCO did not change the sentence, as also several other respondents point out that investors indeed expect regular redemptions in general.

(ii) One respondent (Christoph Barnard) highlighted with regard to the second paragraph of Chapter 2 that the information of several investors before others would be similar to front running and must be banned.

- IOSCO added a footnote to clarify that such practices are prohibited.

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[1] *Examination of Governance for Collective Investment Schemes - Part II*, Report of the Technical Committee of IOSCO, June 2006, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD220.pdf.

(iii) Two respondents suggested balancing the fundamental right to redeem with the recognition that suspensions are a fundamental investor protection tool (IMA, EFAMA).

- IOSCO did not change the wording, since it becomes clear from the report in which circumstances suspensions may be used (i.e., interest of investors).

(iv) One respondent (HFSB) referred to the subsection "market impact" in Chapter 2 and specifically the "danger of vicious circle". This respondent pointed out that this is a sensible issue and questioned whether the decision to suspend should be based on the fair treatment of investors as well as on market impacts (vicious circles). The inclusion of the consideration of market impacts justifying the suspension would cause additional clarifications. The respondent recommended clarifying that where a fund is invested in liquid assets, redemptions should be honoured as long as fair treatment of investors can be ensured. Market wide assessments (i.e. "vicious circles") should not explicitly be incorporated in the criteria for suspensions on redemptions.

- Chapter 2 deals with a discussion on potential risks of suspension and does not aim to anticipate the criteria for the suspension decision. IOSCO considers this comment in Principle 4.

(v) One respondent (DFSA) suggested expanding the discussion on risks in Chapter 2 to risks for the financial stability. The respondent believed that this aspect is of significant importance and should be addressed expressly. Specifically the respondent suggested extending the wording on the impact on counterparties to cover systemic risks that may arise if a CIS, in which significant financial institutions have invested, were to suspend redemptions in unexpected circumstances.

- IOSCO did not change the Chapter as potential wider impacts of suspensions are already described.

Chapter 3, Principles:

(i) One respondent (IMA) proposed to change the second sentence of Chapter 3 from "*…to avoid suspension*" to "*…to mitigate the risk of suspension owing to a lack of liquidity*" in order to make clear that the goal is to mitigate risk and not to avoid risk.

- IOSCO changed the wording according to the respondents proposal.

A: Management of liquidity risk:

(i) Three respondents (IMA, BVI, EFAMA) stressed that the liquidity management policy and process is usually incorporated in the overall risk management policy and process which identifies all relevant risks (including liquidity risk) and hence IOSCO should not require liquidity management as separate arrangements.

- IOSCO added a sub sentence at the end of the explanatory text of this principle clarifying that liquidity risk management could be part of the overall risk management arrangements.

(ii) One respondent (HFSB) agreed on the principles and on further details on the liquidity management process to be developed by IOSCO. This respondent highlighted the work done in this context by HFSB which could be considered by IOSCO.

B: Ex-ante disclosure to investors:

(i) Several respondents (IMA, EFAMA) criticized the last two sentences of the explanatory text of Principle 3 which state that "*where… national law does not contain a definition of exceptional circumstances, it is recommended not to define in the CIS documentation the terms "exceptional circumstances" … Instead, it is recommended to use examples of what might constitute "exceptional circumstances*".

Instead one respondent proposed that it is sufficient that disclosure includes that suspensions may occur in exceptional circumstances when justified in the interest of unit-holders (IMA).

Another proposal relates to the clarification in the text that the examples or explanation is not exhaustive, so as not to preclude any decision by CIS operators (EFAMA).

- IOSCO clarifies in the text that the examples or explanation does not imply an exhaustive list.

C: Criteria/Reasons for the suspension:

(i) Two respondents (IMA, EFAMA) proposed to add an additional category to the list of exceptional circumstances:

"Other events
There may be other events such as natural disasters or catastrophes, which make it impossible to value, or dispose of and obtain payment for all or some of the CIS's property".

- IOSCO followed the suggestion and added a sentence to the criteria.

(ii) Few respondents (AFG, EFAMA, FSB) argued that the requirements that suspensions are justified *"in the best interest of* ***all*** *unit-holders"* is too absolute. In practice redemption may be in the interest of a few unit-holders while suspension is in the interest of the majority. One respondent (AFG) suggested stating that suspension should be done "*exclusively in the best interest of unit-holders*".

- IOSCO followed the suggestion to delete "*all*" and add "*exclusively.*

Nevertheless, the decision to suspend must be in the best interest of the collective.

(iii) Two respondents (ICI, DFSA) mentioned that in some jurisdictions, the possibility to suspend is permitted by law only in limited circumstances. Hence, the manager has less discretion. One respondent (ICI) proposed to add *"…or permitted by law*" to principle 4. The other respondent (DFSA) proposed to expand the principle to cover "*where responsible entities are* ***permitted*** *to suspend redemptions under applicable laws*".

- IOSCO clarifies that suspensions are only possible if permitted by law. However, IOSCO wants to avoid the impression that suspensions are always justified if permitted by law as this would change the meaning of the principles.

(iv) One respondent (HFSB) referred to the first paragraph of the explanatory text stating that *"Besides valuation, suspensions may also be justified if it is not possible to sell assets at prices other than at 'fire sale' prices in order to meet the redemption requests."* The respondent pointed out that this is a sensible issue and questioned whether the decision to suspend should be based on the "fire sale prices". The inclusion of the consideration of market impacts justifying the suspension would cause additional clarifications. The respondent recommended leaving the fair valuation as criteria but not refer to fire sale prices. The criteria "fair and robust valuation is not possible" (e.g. because of lacking liquidity in the market place) is likely to include certain fire sale scenarios. However, this should not be generalised.

- IOSCO deleted the last sentence of the paragraph, but explained that fire sale scenarios may be included in order to take the respondents proposal into account.

(v) One respondent (HFSB) mentioned potential conflicts of interest which could arise from a governance perspective as the responsible entity in charge of determining when suspending may be the fund governing body or the managing entity. For example, the manager has an incentive to suspend redemptions in order to avoid loss of management fees as a result of redemptions. The respondent suggested identifying potential mechanisms, such as independent boards (where investors delegate decision making authority). They give a strong preference for independent governance models to manage such situations.

- IOSCO took this comment and added in the explanatory text of principle 5 that independent oversight on the decision should be implemented to deal with conflicts of interest.

D: Decision to suspend:

Principle 5:

(i) Two respondents (IMA, BVI) mentioned that purely objective criteria (e.g. Principle 5, third paragraph and Principle 6a, second paragraph) are difficult to

set out as in practice often subjective inputs are involved and given that exceptional circumstances are not capable of full specification.

- IOSCO regards the text as sufficient. Defining objective criteria does not exclude subjective inputs in the decision making process.

Principle 6a:

(i) One respondent (IMA) proposed to replace the wording "*should*" by "*could*".

- IOSCO decided to keep the wording unchanged as the documentation and communication is important.

Principle 6b:

(i) One respondent (IMA) pointed out, that national rules do not require notification/communication of the planned actions with regard to the suspension to competent authorities. The respondent suggested referring to providing any information the authority may require.

- IOSCO took the respondents proposal into account and deleted "planned action" while adding "*any information the competent authority requires*."

E: During the suspension:

Principle 7:

(i) While the current wording of principle 7 "*should generally not accept new subscriptions*" allows for discretion and flexibility, many respondents (AFG, EFAMA, DFSA, FSB) were of the opinion that the responsible entity should be prohibited entirely from accepting new subscriptions as it is unclear at which price the new subscriptions would take place, if allowed. The respondents mentioned the potential danger to allow for that flexibility.

One of those respondents (DFSA) additionally pointed out the current inconsistency between "*should generally not*" and "*cannot*", in the second sentence of the principle as this may be misleading. Hence, suggesting simply using "*should not*".

However, DFSA additionally stated that it could be mentioned in the explanatory text that there may be an exceptional situation "*where the calculation to the unit price based on NAV could be achieved through objective and reliable means during a suspension*".

To the contrary, one respondent (Inverco) was of the view that IOSCO should be more flexible, as in most cases a reliable valuation is not possible and hence subscriptions will not be allowed in most cases. The respondent suggested to state that "*subscriptions might be accepted whether this is in the best interest of*

the unit-holders".

- IOSCO took the proposals into account by deleting the term "*generally*" and adding a possible exemption in the explanatory text.

(ii) Two respondents (IMA, EFAMA) proposed to add the wording "*before the order is accepted*" at the end of the sentence *"..., and given the chance to cancel the subscription order"*, in the explanatory text, in order to make clear that the matter is to cancel orders rather than contracts.

- IOSCO took the proposals into account by adding the proposed sentence.

Principle 8:

(i) One respondent (BVI) proposed to change the wording in the first sentence of the explanatory text. It is proposed to delete the word "*formally*" and replace the wording "*an ongoing basis*" by "*a regular basis"*.

- IOSCO decided to only partially change the wording as the monitoring on an ongoing basis would be necessary.

(ii) One respondent (IMA) proposed to recommend in the explanatory text that in case of long lasting suspensions, regulators should give consideration to regulatory tools available or to increase regulatory tools (e.g. ability to set up side pockets).

- As the consideration of alternatives (including side pockets) is already recommended in the explanatory text (last paragraph), IOSCO decided not to change the wording.

(iii) One respondent (ICI) indicated that in some jurisdictions the possibility to suspend is permitted by law only in limited circumstances. Also, the length of the suspension may be specified or the regulator authorizes the suspension only for a limited period of time (e.g., the closure of the stock exchange). Hence, the manager has less discretion and the review of the decision to suspend on an ongoing basis is not fully applicable.

- IOSCO decided to add for clarification the sentence "*However, those provisions may not be fully applicable in cases where competent authorities have authorized the suspension only for a limited period of time (e.g., only for the time the stock market is closed in response to an exceptional event)."* to the explanatory text.

Principle 9:

(i) Some respondents (IMA, EFAMA, FSB) proposed to add the information of unit-holders can be done by website or other durable means as individual information may be too burdensome.

- IOSCO decided not to follow the proposal to specify the medium for information.

F: Examples of alternative measures to deal with illiquidity in certain jurisdictions:

(i) Two respondents (IMA, EFAMA) did not agree with the recommendation that *"a good management practice for the responsible entity would be not to charge any form of management fee or performance fee on side pockets."* The respondent argued that if the suspension is not due to poor liquidity/operational management, fees are still reasonable. The important point should be to ensure investors are informed whether management or performance fees are continued to be charged.

(ii) One respondent (EFAMA) suggested mentioning redemptions in kind as another way to alleviate liquidity pressure.

(iii) One respondent (EFAMA) mentioned that gates may not only address extreme amounts of redemptions but could be installed as a general tool to discourage excessive redemption requests.

(iv) Two respondents (AFG, FSB) suggested to replace the word "*Discount*" by "*Liquidity cost impact on redemption price*" as "Discount" may be ambiguous.

- IOSCO decided not to follow the proposals. A specific workstream of IOSCO TCTCSC5 is dealing in more detail with liquidity measures.