Proposed Guidance 1 – Determining asset and portfolio liquidity

Responsible entities should holistically consider quantitative and qualitative factors to determine the liquidity of an OEF's assets and of the OEF's overall portfolio, both at the time of designing an OEF and on an ongoing basis.

Q1. To what extent does Proposed Guidance 1 help responsible entities to better integrate quantitative and qualitative factors to determine the liquidity of the portfolio? Have all the critical elements been captured?

AFG response

AFG finds helpful the Proposed Guidance and have published similar guidance on measuring the liquidity on the asset side of the CIS (https://www.afg.asso.fr/en/publication/guide-pratique-de-mise-en-conformite-du-dispositif-dencadrement-du-risque-de-liquidite/)

AFG fully agrees with IOSCO and acknowledges that there is no 'one size fits-all' approach and responsible entities are expected to exercise their sound professional judgement in the assessment of the asset and portfolio liquidity.

AFG would like also to emphasize that the liquidity level on the assets side of the fund should be considered at the portfolio level. The assets of a fund may include securities or instruments which are less liquid, provided this does not compromise at global level its capacity to comply with its regulatory obligations, regarding unit redemptions and other financial commitments.

Proposed Guidance 2 – Consistency between portfolio liquidity and redemption terms

Responsible entities should ensure that an OEF's redemption terms are consistent with its portfolio liquidity on an ongoing basis to reduce potential structural liquidity mismatches and consequently mitigate material investor dilution and any potential first mover advantage. Responsible entities should ensure the OEF is able to maintain the initial promise of liquidity disclosed to investors in normal and stressed conditions, taking into account the liquidity of underlying assets and overall portfolio, the investor base, and the effectiveness of liquidity management tools implemented by the OEFs.

Q2. Are there any additional considerations or examples that should be added in the Proposed Guidance 2 regarding consistency between portfolio liquidity and redemption terms?

AFG response

AFG fully supports the fact that IOSCO is not recommending a minimum level of liquid asset holdings across the OEF sector.

AFG would like to remind some fundamental principles:
A fund is not a deposit, it is an investment vehicle where investors expose themselves to a risk-return profil. Accordingly, no guarantee of liquidity can be given to a fund. But funds are managed in the best interest of investors with the constant objective to ensure their fair treatment.
An underlying asset is not liquid per se. one should take into account the other parameters such as the redemption policy (including the NAV frequency and the liquidity measures), the nature of the liabilities (including the investor concentration). Consequently the consistency described in the Proposed Guidance 2 should adopt a relative approach : setting absolute fixed threshold does not make sense and could potentially lead to unintended consequences.

Besides LTAF, the recent European regulation on ELTIF can be seen as a good example of consistency between assets, liabilities and specific redemption terms as defined in the recently published Regulatory Technical Standards (https://eur-lex.europa.eu/oj/daily-view/L-series/default.html?&ojDate=25102024)

Proposed Guidance 3 – Overall framework for the design and use of LMTs and other liquidity management measures

Responsible entities should have appropriate internal systems, procedures and controls in place at all times in compliance with applicable regulatory requirements for the design and use of anti-dilution LMTs, quantity-based LMTs and other liquidity risk management measures, as part of the everyday liquidity risk management of their OEFs to mitigate material investor dilution and potential first-mover advantage arising from structural liquidity mismatch in OEFs.

Q3. Do you agree with Proposed Guidance 3 regarding the inclusion of quantitative LMTs and/or other liquidity management measures within the overall liquidity risk management framework that OEF managers should have in place at all times?

AFG response

AFG acknowledges the merits of anti-dilution LMTs, but these tools must be cautiously selected in the situation where they are well suited because their implementation is heavy and expensive. It usually results in a raise of the operational risks due to the liquidity costs assessment. A wrong assessment can lead to a NAV error. And a significant NAV calculation error can potentially lead to a loss remediation.

AFG believes that the link between the LMT category (anti-dilution and quantity-based LMTs) and the market conditions (normal vs stressed) is not as obvious. anti-dilution LMTs, can be well suited even during stressed market like swing pricing for instance in high yield or convertible bond markets. Conversely activation of gates is needed during normal market conditions when a fund has to cope with unexpected massive redemption.

Q4. Is Proposed Guidance 3 appropriate for all types of OEFs in its scope, and proportionate for all types of responsible entities to implement? If not, please explain.

AFG response

In many cases, anti-dilution tools are not well suited. Typically, most of the ADT (swing pricing, dual pricing, ADL) can be calibrated by estimating liquidity cost with the bid-ask spreads. These ADT are less adapted to Real Estate (RE) funds and/or Private Equity (PE) funds where no bis-ask spreads are available. Furthermore, ADT may not be considered useful when the fund is invested in very liquid asset classes such as large cap equity.

They also may be difficult to implement in the case of funds of funds.

Proposed Guidance 7 – Types of Quantity-based LMTs and Other Liquidity Management Measures

As part of their liquidity risk management framework, responsible entities should consider and implement a broad range of quantity-based LMTs or other liquidity management measures for OEFs under management as part of their liquidity risk management.

Q5. Has the proposed guidance identified all of the quantity-based LMTs and other liquidity management measures commonly used by responsible entities? Are there any other LMTs that share the same objectives and that could be included in this guidance? If so, please describe them.

AFG response proposal

AFG understands and supports the distinction made between LMT and redemption terms such as redemption gates and redemption cap (as applied for instance on the Loan originated funds in the EU.)

Regarding the proposed guidance 7, AFG would like to mention another tool (or measure): the “soft closure”, where the fund is closed to new subscriptions as decided by the fund manager or after a pre-determined commercialization period, while still allowing investors to redeem. This example of liquidity measure (or element of the redemption policy) is used in many different cases in France.

Besides this, all the quantity-based LMTs and measures currently available in France have been identified in the proposed guidance. However, the liquidity risk management is a never-ending process and newly designed tool, or measure could be adopted in the future. The list in the proposed Guidance 7 should stay open.
Hence, AFG sees merits to consider the example of other liquidity management measures described in Box 6 (credit facilities and interfund lending) as these measures are already used, to some extent, in the EU.

Q6. Are the identified quantity-based LMTs and other liquidity management measures described correctly? Do the features or characteristics of the different tools and measures vary or do they generally operate as described?

AFG response proposal

AFG is globally agree with the description provided by the Proposed Guidance 7 but would like to add the following comments.

AFG is agnostic regarding the two types of LMTs. Fund managers are best placed to select the most appropriate LMTs regardless it is an anti-dilution or a quantity- based tool.

AFG members do not believe that the extension of the notice period should necessarily be proportionate to the initial notice period. As a matter of fact, the extension of notice period results from a change in the liquidity market conditions. The fund manager believes that he/she needs more time to sell asset in order to avoid having a price impact. It is difficult to forecast the length of a liquidity crisis. Consequently, the proportionality to the initial period notice cannot be guaranteed.

AFG would like to bring a nuance on the proposed guidance saying that “the same redemption gate shall apply to all redeeming investors, and no differentiation should be done by type of investor or share class”. AFG members see merit to deeper consider these principles in order to avoid some unintended consequences which could lead in some cases to an unfair treatment of the investors.

Regarding redemptions in kind In France, there is an additional regulatory requirement to involve an independent third party (auditor) to perform additional valuation of the assets to be redeemed. AFG is of the view that this is an unjustified requirement with an administrative and costly burden. The fund manager is responsible of the assessment of the potential liquidity discount applied to the valuation.

Regarding the suspensions of redemptions and subscriptions, the exceptional circumstances may also be linked specifically to the fund or the responsible entity and not only linked to external events.

The Proposed Guidance claims that “When activating suspension, responsible entities should close the OEF to both redemptions and subscriptions”.
AFG believes that under specific circumstances, the suspensions of redemptions only is a feature to consider. Liquidity stress comes usually from an unbalanced situation between sellers and buyers on the underlying market. The possibility of allowing the subscription only can help to bring back balance and reduce the liquidity stress, to the ultimate benefit of the existing investors. This option could be suitable for AIFMs managing AIFs whose assets might be structurally illiquid/hard to liquidate (e.g.: Real Estate (RE) funds and/or Private Equity (PE) funds). Naturally some preliminary conditions must be filled if subscriptions are still allowed.
The manager should continue to value the assets in the fund and publish a NAV to ensure a proper information to investors. The potential new investors must be fully informed of the situation of the fund and more generally the fund manager must take all the measures to ensure that an equal treatment between investors is respected.

Q7. What additional key elements should Proposed Guidance [7] take into consideration regarding the use of each quantity-based LMT and liquidity management measures identified? Are there any particular types of OEFs that are not suitable to use some of these tools and measures?

AFG response proposal

All type of OEFs are suitable to quantity-based LMT unlike the anti-dilution tool which are less adapted to Real Estate (RE) funds and/or Private Equity (PE) funds because of the absence of bid-ask spreads.

Q8. Do you have any practical examples on the use of these quantity-based LMTs and other liquidity management measures that could be included in the implementation guidance?

AFG response

In France, different extensions of notice period per share class are allowed and AFG see merits preserving this flexibility.
Typically, for real estate funds, multiple lengths of notice period are proposed. Each extension of period of time is associated with a level or redemptions fee. Here is an example for one single share class :

Extended notice period	Redemption fees
1 week	9%
3 months	6%
6 months	3%
12 months	0%

Another example is the possibility to adapt the extension of notice period to the size of the redemption order. For example, an extension is applied for orders amount that exceed a level expressed in euro (100 000 € for example). These examples of extension are automatically applied when the corresponding criteria is filled and are fully disclosed in the prospectus of the fund. The rationale is to incentive the investors to place its redemption order sufficiently in advance. We call them "incentive notice period" as opposed to "mandatory notice period". Usually, incentive notice period is reserved to the share classes dedicated to institutional investors.
In contrast with retail investors, institutional clients generally invest larger amounts and tend to redeem in significant amounts. They are also generally long term investors and are able to support notice periods. Incentive notice period proved to be an efficient tool, in normal market conditions. It allows the fund manager to cope with significant redemption orders because he/she has enough time to deal with the market participants and sell asset in an orderly and timely manner. It follows that retail investors are less impacted and more protected.

Proposed Guidance 8 – Appropriate Activation and deactivation of Quantity-based LMTs and Other Liquidity Management Measures

Responsible entities should have a clear decision-making process for the use of quantity-based LMTs and other liquidity management measures in the best interests of investors. In particular, the thresholds or criteria set (if any) for the activation of such tools and measures should be appropriate, objective and sufficiently prudent. Responsible entities should also regularly review the tools and measures currently in use and take all necessary steps to resume normal operations as soon as practicable.

Q9. Do you agree with Proposed Guidance 8 regarding the considerations on activating and deactivating quantitative LMTs and/or other liquidity management measures? Are there any additional key elements that responsible entities should consider in this regard?

AFG response proposal

AFG agrees with the proposed guidance, but fund managers could benefit from more flexibility.
Asymmetric suspension (applied only on redemption) should be considered as previously mentioned. Customized redemption gates activation according to the type of share classes or investors should also be considered
A great diversity of investors (e.g. retail vs. institute) leads to a need for flexibility and adaptability in terms of repurchase policy, in order to best meet the different needs of the holders.

Proposed Guidance 9 – Stress Testing

Q10. Do you agree with the stress testing elements identified in Proposed Guidance [9]? Are there any additional considerations or good practices that should be covered by this section?

AFG response proposal

Stress tests are key components of the liquidity risk management framework. This is a useful tool for the ongoing liquidity risks assessment. They also participate to the processus of escalation in the frame of risk management governance (for LMT activation for instance)
From the European perspective, ESMA guidelines on liquidity stress tests are already applied and provide a common and sound approach regarding the goal and the implementation of liquidity stress tests for European OEFs. These guidelines make the European asset managers compliant with the Proposed Guidance, to a great extent.
AFG would like to highlight that back testing is not a stress test exercise per se and should not be seen as a proven validation process of any assessment exercise (market impacts, swing factor, …)

Other

Q11. Do you have any practical examples regarding governance arrangement and disclosure about the use of LMTs and/or other liquidity management measures that could be included in the implementation guidance?

AFG response proposal

AFG believes that liquidity risk management details must remain non-public but made available to regulators. Some confidentiality should be kept so as not to undermine the efficiency of the risk measure. For instance, AFG backed by AMF has issued Guidance regarding the swing pricing mechanism where the manager is encouraged to give "only general principles of the chosen methodology. Furthermore, it should not disclose parameters that are too detailed and recent so that to enable an investor to amend his/her subscription or redemption strategy so as to take advantage of more advantageous conditions and thus reduce the Swing Pricing mechanism's efficiency. To this end, it notably ensures that the internal circuits of information are restricted to favour the conservation of the confidential character of this piece of information."