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Response by email to fsb@fsb.org

4 September 2023

Response to FSB Consultation Report - Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations

Executive Summary

AREF[1] welcome the opportunity to comment on this consultation on proposed changes to the FSB's 2017 Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (the "2017 FSB Recommendations") in relation to liquidity mismatch in open-ended funds (OEFs).

As recommended, we have read the FSB proposals in conjunction with the proposed IOSCO guidance on anti-dilution Liquidity Management Tools. We have responded to the IOSCO consultation too (a copy of the response is in Annex 1 below). In the response to the IOSCO consultation, we have made it clear that we do not see benefits in IOSCO making general changes to the 2018 recommendations at this stage. However, we have much more profound concerns regarding the FSB proposals which appear ill-thought through, cannot be implemented in practice and dramatically at variance with the broad message of the existing IOSCO Guidelines from 2018 and the proposed update from IOSCO. It is not clear to us whether the intention is investor protection or to address systemic risk. The IOSCO consultation implies the former, the FSB consultation the latter. If the concern is systemic risk, then the focus should be on the types of funds and underlying asset types where the risk is felt to lie, rather than attempting to apply blanket rules to all OEFs. The FSB consultation notes that a key source of evidence was the FSB's own report, "Enhancing the Resilience of Non-Bank Financial Intermediation", from November 2022. This addresses non-bank financial intermediations (NBFI), i.e. funds investing in financial assets. The UK Financial Conduct Authority (FCA), along with the French Autorité des Marchés Financiers (AMF), chaired the IOSCO group which developed the NBFI policy proposals in which the FSB regards NBFI as synonymous with "shadow banking". We would strongly question evidence-free application of the same rules to funds investing in non-financial assets such as direct real estate and infrastructure. We would also note that the chair of the FCA in his speech on the subject in May 2023[2] commented that the primary focus should be data-gathering to identify and understand the areas of risk. This seems dramatically at odds with the FSB desire to rush out policy proposals. It is not clear to us from the FSB consultation that extending what are ostensibly rules for "financial intermediations" to investment in tangible assets is intentional.

We agree with the FSB that there shouldn't be a "one-size-fits-all" approach across all OEFs. The liquidity management of OEF depends upon the assets the fund is investing in and also, the type of investors, retail, or institutional, investing in the fund. In the case of real estate funds, there shouldn't be a "one-size-fits-all" approach for all types of real estate funds. The liquidity of real estate assets various considerably according to the underlying assets. The creation of categories of OEF based on their liquidity profiles will create rigid and arbitrary thresholds for such funds which however will in practice be difficult to manage, particularly for actively managed funds. There is a wide universe of open-ended funds with differing liquidity profiles and dealing frequencies which would be difficult to shoehorn into three liquidity

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

[2] Speech by Ashley Alder - The drive for data in Non-Bank Financial Intermediation (NBFI)

categories. Also, we have concern that such an approach will be applied differently across jurisdictions creating confusion for investors and supervisory authorities. It also creates a significant risk of regulatory cliff-edges.

There is a confusing statement from the FSB, in relation to "illiquid" funds (Category 2 funds):

"The relevant authorities could also consider requiring that such funds be structured as closed-ended funds"

This is a bizarre suggestion to drop into a consultation with such a short response period, with no evidence to support the assertion. The evidence from analysis of the 2008 global financial crisis ("Unlisted funds – Lessons from the crisis"[3] published in 2012) suggests that closed-ended funds were, in practice, a greater systemic risk than open-ended funds given the evidence then that they operated at higher levels of leverage and because of the limits of their investment periods, could not raise additional capital to remedy breaches. Lessons learnt from the global financial crisis have resulted in significant changes to both open and closed-ended real estate funds.

The references in the consultation to "daily dealing" are a gross oversimplification and highly misleading. A fund may offer investors the opportunity to subscribe daily even if they are not allowed to redeem daily. A fund may allow investors to redeem daily if their redemption is being matched with an incoming investor, but provide for a longer redemption period if there are net outflows and a sale of an underlying investment is required.

We strongly agree with the FSB that that managers of OEFs have the primary responsibility and are best placed to manage the liquidity of their portfolios. They should be given the discretion, within a liquidity management framework, of implementing appropriate liquidity management measures and tools.

Further engagement

If you would like to engage with us further regarding any aspect of our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat, AREF. In addition, members of our Public Policy Committee and Tax Committee are always willing to assist the FCA by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

Managing Director, The Association of Real Estate Funds

[3] Unlisted funds - Lessons from the crisis

The Association of Real Estate Funds

Responses to Questions

Structural liquidity mismatch (Recommendation 3)

1. ***Should "normal" and "stressed" market conditions be further described to facilitate the application of the bucketing approach? If yes, how would you propose describing such conditions?***

   We believe that the concept of defining "normal" and "stressed" markets is even more misguided than the bucketing proposal. Market conditions only very rarely move from "normal" to "stressed" at a clearly defined point. More usually it is a trajectory. Very occasionally, there is an event that does trigger a substantial market move. In the UK, we do have the example of the UK EU referendum result in 2016, which triggered significant market stress impacting open-ended real estate funds for retail investors. There is a comprehensive case study of this as the Association of Real Estate Funds (AREF) undertook a review of member fund behaviour in the aftermath of the EU referendum[4].

2. ***Are the examples of the factors that should be considered in determining whether assets are liquid, less liquid or illiquid appropriate? Are there other factors which should be considered and, if yes, which ones and why?***

   We disagree with the concept of applying rigid rules and definitions through a bucketing approach.

3. ***Is the use of specific thresholds an appropriate way to implement the bucketing approach? If yes, are the proposed thresholds for defining funds that invest mainly (i.e. more than 50%) in liquid or less liquid assets and funds that allocate a significant proportion (i.e. 30% or more) of their assets to illiquid assets appropriate? If not, which thresholds would be more appropriate and why?***

   The consultation questions in the FSB assume that the "bucketing" approach is decided and the FSB is only considering the thresholds and definitions. We believe that "bucketing" is misguided and will increase rather than reduce systemic risk by creating rigid and artificial boundaries. We understand that the SEC is moving away from a "bucketing" approach. The UK has sought to implement a similar approach (to "bucketing") for open-ended real estate funds for retail investors, by applying rigid definitions for funds investing in inherently illiquid assets and a proposal to introduce fixed notice periods for such funds. This inflexible, "one-size-fits-all" approach has been a failure even for a sector that has only a limited number of funds in one asset class in one jurisdiction. It has simply resulted in the reduction in the number of funds and reduced consumer choice. We have concerns about the appropriateness, value and cost of the "bucketing" approach compared with continuing with established methods of liquidity management.

4. ***Should the FSB consider recommending the use of a decreased redemption frequency (on a standalone basis), a longer notice period (on a standalone basis) or a longer settlement period (on a standalone basis) for OEFs investing in less liquid assets that do not meet the expectation on the implementation of anti-dilution LMTs? Or should these measures be used in combination, considering the risk of redemptions crowding around certain dates?***

   The FSB's assumption about how deferrals (delayed settlement) works is incorrect, at least as far as real estate is concerned. Although prior to the global financial crisis some funds paid deferred redemptions out at the NAV prevailing on the dealing day immediately after notice was given, the majority paid at the NAV prevailing on the dealing day that redemption was paid out. We are not aware of any real estate funds that still use the NAV prevailing on the dealing day immediately after notice was given. The FSB believe that this is the difference between a notice period and a deferred redemption. This is not the case, at least in real estate funds. The difference, at least in real estate funds, is that a notice period is fixed, whereas a deferral is flexible. With a deferral mechanism, the redeeming investor can be paid out immediately if there is an incoming investor against which they can be matched, but the redemption is deferred if an underlying asset needs to be sold. With fixed notice periods, cash would be paid in by the incoming investor and held as cash by the fund until the end of the notice period. This reduces investor returns for no obvious benefit.

   Using deferred settlement with the NAV prevailing on the dealing day immediately after notice was given, as envisaged by the FSB, increases rather than reduces first mover advantage and remaining investor dilution in a falling

[4] A review of real estate fund behaviour following the EU referendum

market. We do not understand why this would be regarded as a good idea. It does illustrate a broader issue of trying to set rigid rules for all asset classes.

We would like clarification of the meaning of “excess redemptions” and “excess asset sales”. How would a fund measure and monitor whether it had “excess redemptions” or “excess asset sales”? These terms seem meaningless to us.

5. ***Would additional guidance on factors to consider when setting the redemption frequency or notice or settlement period be helpful? If yes, in what respect?***

As set out in our response to IOSCO, we believe that the existing 2018 guidance is entirely suitable. We believe that more detailed guidance should be specific to the fund type, investor type and underlying assets. Industry organisations are best able to provide this. For real estate, we have provided more detailed commentary and links to relevant guidance in our response to IOSCO.

Liquidity management tools (Recommendations 4, 5 and 8)

6. ***Do the proposed changes to Recommendations 4 and 5, when read together with the proposed IOSCO guidance on anti-dilution LMTs, help achieve greater use and a more consistent approach to the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?***

There is mention in the consultation of authorities aiming to achieve a balance between anti-dilution and quantity-based LMTs. We agree that the purpose of anti-dilution pricing is to ensure redeeming and subscribing investors pay the explicit and implicit costs of redemptions and subscriptions, including any significant market impact of asset sales and purchases to meet those redemptions and subscriptions. However, as mentioned above we are particular concerned with use of “liquidity management tools” to cover both redemption management and unit pricing. Anti-dilutive unit pricing is a way of passing the consequence and cost of liquidity to redeeming investors and very specifically should NOT be used as a liquidity management tool.

As mentioned in our response to IOSCO’s consultation, AREF undertook a review of member fund behaviour in the aftermath of the EU referendum in 2016 . This found that although dilution pricing to reflect forced sales of underlying assets to meet redemptions is possible, the overwhelming majority of funds preferred to delay sales and redemptions rather than take a discount for a rapid sale.

7. ***Are there any obstacles (either universal or jurisdiction specific) to the implementation of the revised FSB Recommendations on the use of anti-dilution LMTs? If yes, what additional recommendations or guidance would help address such obstacles?***

For real estate, generally we do not believe that there are obstacles. For UK real estate funds for retail investors, the main obstacle has been the one-size-fits-all approach of the regulator.

8. ***Would additional recommendations or guidance be helpful in clarifying the expectation that OEF managers have internal systems, procedures and controls enabling them to use anti-dilution LMTs as part of the OEFs’ day-to-day liquidity risk management?***

We strongly agree with the FSB that that managers of OEFs have the primary responsibility and are best placed to manage the liquidity of their portfolios. Guidance in their use, particularly in stressed market conditions, would be useful from the relevant authorities. Although, we would ask the relevant authorities to involve fund managers in drawing up that guidance to ensure they understand the nuances of managing the liquidity of certain assets, such as real estate assets.

We would have concern with the relevant authorities having the ability to impose measures such as suspension of redemptions. We believe in all cases, the fund manager is best placed to know the best action to take for their fund.

9. ***Do you agree with applying anti-dilution LMTs to subscribing investors as well as to redeeming investors? If not, why?***

This is specifically required by AREF in its guidelines for investors, although the approach and detail is not as assumed by the FSB.

10. ***Would additional international guidance on the availability and use of quantity-based LMTs be useful? If yes, what aspects should such guidance focus on? If not, why?***

See our response to question 5.

Other FSB Recommendations

11. ***Do the proposed changes to Recommendation 2, when read together with the proposed IOSCO guidance on disclosure to investors, help enhance disclosure to investors on the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?***

The FSB raises concerns as to whether investors understand the liquidity of the funds in which they invest. Institutional and professional investors would be expected to undertake their own due diligence, and for real estate as an asset class the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) has provided its members with detailed guidance, due diligence checklists, best practice examples and training courses. For this asset class, there is a high degree of sophistication amongst institutional investors. In the UK, the retail investor market is highly intermediated and very few retail investors invest directly in underlying real estate funds on an execution only basis. The vast majority invest through model portfolios or discretionary products where investment allocation and fund selection is undertaken by a professional intermediary. Furthermore, we would note that in the EU, and the UK which has adopted the EU regulation, there is protection for retail investors in funds where the liquidity may in practice be different from the theoretical level of liquidity by treating the fund as a “not non-complex product” under MiFID II, limiting its direct marketing to retail investors.

12. ***Should any other 2017 FSB Recommendations (Recommendations 1, 6, 7 or 9) be amended to enhance the clarity and specificity of the intended policy outcomes? If yes, which ones and why?***

We think that the Recommendations do not need further change.

Additional considerations

13. ***Are there any other aspects that should be considered in the revised FSB Recommendations to ensure that they are effective from a financial stability perspective?***

We think that the Recommendations do not need further change.

AREF
The Association of Real Estate Funds

Annex 1

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Response by email to LMTGuidanceConsultation@iosco.org

4 September 2023

Response to IOSCO Anti-Dilution Liquidity Management Tools Consultation Report (CR03/2023)

Introduction

AREF[5] welcomes the opportunity to comment on this consultation on proposed amendments to its 2018 recommendations on liquidity risk management in open-ended funds (the "consultation"). We agree with the general sentiment expressed by IOSCO that liquidity risk management is critical to the orderly functioning of open-ended funds (OEF)s and to safeguarding the interests of and protecting investors. This has been long recognised by the real estate investment management industry as real estate is an illiquid and granular asset, although, we would note that just because the assets are relatively illiquid they should not necessarily be considered as high risk.

We are responding to the consultation as well as the Financial Stability Board (FSB) consultation[6]. We are not sure whether the intention of the consultations is investor protection or to address systemic risk. The IOSCO consultation implies the focus is more on the former, the FSB consultation very much the latter. In respect of the former, for real estate, we see no evidence of investor sentiment that they need additional regulatory protection. If the concern is systemic risk, then the focus should be on the types of funds and underlying asset types where the risk is felt to lie, rather than attempting to apply blanket rules to all OEFs. As outlined in our response to the FSB, it is not clear to us from its consultation that extending what are ostensibly rules for "financial intermediations" to investment in tangible assets is intentional.

The consultation seems to be motivated by two broad areas of concern:

- OEFs providing a high degree of redemption liquidity, typically daily;
- OEFs that invest in underlying investments that are significantly less liquid than might be assumed by investors.

Neither of these would appear to be generally relevant for real estate OEFs. IOSCO should make it clear that for funds where the potential for liquidity mismatch is addressed through other liquidity management tools (LMTs), such as less frequent redemptions, deferral of redemptions or notice periods, much of this guidance may not be relevant. This consultation only addresses pricing and not other LMTs.

The IOSCO thematic review that has prompted this guidance was a response to redemption pressure in OEFs in March 2020. This was in the early stages of the global Coronavirus pandemic. For real estate funds in the UK, there were three main LMTs adopted to address the challenges that arose at that time:

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[5] The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

[6] Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations

- Suspension of subscriptions and redemptions in funds eligible for retail investors as a regulatory requirement.
- Suspension of subscriptions and redemptions in funds other than for retail investors in accordance with their own fund requirements.
- In funds that did not suspend, deferral of redemptions.

It is important to note that this was not primarily in response to redemption pressure but due to valuation uncertainty and a major practical obstacle to selling real estate at a point at which agents and fund managers were not allowed to visit properties due to lockdown rules. The position may have been different for other asset classes, and we note that the FSB's Assessment of the Effectiveness of the FSB's 2017 Recommendations on Liquidity Mismatch in Open-Ended Funds published in December 2022, which both IOSCO and the FSB consider in their current consultations, specifically refer to funds investing in corporate bonds.

According to the consultation, the thematic review in 2021 and 2022, published in a final Thematic Review on Liquidity Risk Management Recommendations in November 2022 (IOSCO LRM Review), identified differences in application of LMTs, although we note that the IOSCO LRM Review itself concludes that all the most significant jurisdictions including the UK are fully compliant with the recommendations. It would seem to us that a better approach by IOSCO would be to concentrate on adoption of the 2018 guidelines to identify areas where application has fallen short, rather than rush through new guidelines during the summer holiday period with insufficient time for consideration, risk of unintended consequences and wild interpretation by the FSB. These points are discussed later in this response.

We have concerns regarding the terminology used historically and currently by IOSCO which comes more into focus with the current proposals, and this is the use of "liquidity management tools" to cover both redemption management and unit pricing. Following the detailed work[7] on unit pricing by Association of Real Estate Funds (AREF) and the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) its guidance to members is that anti-dilutive unit pricing is a way of passing the consequence and cost of liquidity to redeeming investors and very specifically should NOT be used as a liquidity management tool. In our comments, we have addressed separately liquidity management and pricing.

Liquidity management

As mentioned above, in its background to the consultation, IOSCO states that "OEFs generally offer short-term (often daily) liquidity to their investors ". This is generally and intentionally not the case for real estate funds. In the aftermath of the global financial crisis, a large amount of work was undertaken to determine best practice for both liquidity management and non-dilutive pricing. In the UK, against the backcloth of the turbulence of the global financial crisis, AREF commissioned PwC to undertake research into the behaviour and practices of its member funds to provide an objective account of manager behaviour and to determine whether there were lessons to be learned from the experience. This was published as "Unlisted funds – Lessons from the crisis"[8] in 2012. Funds for institutional investors have introduced more sophisticated liquidity management tools as a result. Both AREF and INREV have provided guidance for their members.

The position for funds for retail investors has been more challenging as the regulatory environment and investment architecture in the UK has hindered rather than facilitated improvement in liquidity management. Funds for retail investors typically have to provide higher levels of liquidity on account of market demand. AREF undertook a review of member fund behaviour in the aftermath of the EU referendum[9]. Following suspensions of redemptions by funds for retail investors after the result of the EU referendum in 2016, the FCA has sought to introduce a "one-size-fits-all" solution of fixed notice periods. This has been extraordinarily painful and has highlighted the limitations and inappropriateness of this approach, even within the relatively narrow pool of UK retail investor real estate funds. Attempting to apply a similar approach to all types of open-ended fund for all types of investor and all types of underlying investment would seem to be a recipe for disaster. We would note that in the EU, and in the UK which has adopted the EU regulation, there is protection for retail investors in funds where the liquidity may in practice be different from the theoretical level of liquidity by treating the fund as a "not non-complex product" under MiFID II, limiting its direct marketing to retail investors.

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[7] Open End Fund Pricing Conclusion Paper 2021

[8] Unlisted funds – Lessons from the crisis

[9] A review of real estate fund behaviour following the EU referendum

Even in real estate funds that do provide daily liquidity in many circumstances, we are not aware of any examples without LMTs to limit this if redemptions are higher than anticipated.

This highlights another assumption in the consultation that is somewhat misleading. This is the focus on subscriptions and redemptions without addressing the matching of subscribing and redeeming investors, although this is alluded to in the comments on swing pricing.

Pricing

As IOSCO notes, the starting point for the calculation of net asset value for the pricing of units is the valuation of the underlying assets. We agree with IOSCO's stress on the importance of ensuring that the valuations are accurate and timely. For the valuation of real estate there are detailed and long-established professional standards, in particular the RICS "Red Book"[10] . The real estate assets of open-ended funds will be valued by an independent, external professional valuer. For funds for institutional investors, the investors demand this. For funds for retail investors, this is a regulatory requirement – in the UK authorised funds are required to have their assets valued at least monthly by a "standing independent valuer" as defined in the UK regulatory sourcebook for collective investment schemes. The RICS has been undertaking a comprehensive review of its standards, including specific changes for the valuation of assets held by funds. This has involved consultations with the industry and is drawing towards its completion.

To address the challenges regarding pricing, a considerable amount of work has been undertaken by AREF and INREV in respect of anti-dilution pricing for real estate funds. The two bodies launched an industry-wide project in 2017 to investigate pricing models used by open end real estate investment vehicles. The first phase was completed in July 2018 and undertook quantitative research on the effectiveness of the two most common pricing policies – Capitalisation & Amortisation and Classic Dual Price, and the principal factors influencing pricing outcomes. In the second phase, an expert group, appointed by INREV and AREF, researched areas where operation and governance over pricing can be enhanced. In May 2020, the two organisations published a consultation paper that set out these detailed recommendations. Following consultation with members, AREF published its updated guidelines in May 2021. A further update addressing the governance of pricing mechanisms was published in September 2022[11].

This pricing guidance has focussed very strongly on the key area identified by IOSCO, being the full reflection of transaction costs in the pricing mechanisms. Transaction costs are typically higher for real estate than other asset classes because of the granular nature of the underlying assets and the widespread application of real estate transfer taxes. It is also very important to note that the pricing considerations are relevant for OEFs where there is no liquidity mismatch as the period to meet redemptions matches the expected time to dispose of assets to meet redemptions. The direct cost of buying and selling underlying assets is still important to protect investors from dilution even when there is no liquidity mismatch.

The AREF review of member fund behaviour in the aftermath of the EU referendum looked at pricing of more liquid funds investing in illiquid assets in normal and stressed circumstances. Although dilution pricing to reflect forced sales of underlying assets to meet redemptions is possible, the overwhelming majority of funds preferred to delay sales and redemptions rather than take a discount for a rapid sale. It is also important to note that the commercial reasons for a discount in an underlying real estate asset transaction in this case is different to a disposal of securities at volume as set out in the IOSCO consultation paper.

Overall assessment

In general, our concern is not so much the proposals set out in the IOSCO consultation, but the massive overreach in their interpretation by the FSB in its consultation.

However, we do not see the benefit in IOSCO making general changes to the 2018 recommendations at this stage. Real estate fund managers and industry bodies are best placed to determine which liquidity and pricing tools are most appropriate for the particular fund, in the context of the particular investors, treating the investors fairly and underlying assets held by the fund. In the case of real estate funds, we believe that industry bodies can continue to play a key role in helping fund managers establish best practice within the regulatory framework and that already established by

[10] RICS Valuation – Global Standards ('Red Book')

[11] AREF Open End Fund Pricing Guidance September 2022

the 2018 recommendations. Although IOSCO recommendations are for regulators rather than the industry itself, the real estate investment management industry has found them to be a useful framework to consider directly.

Overall, we do not believe that the guidance is particularly useful, at least for real estate as an asset class. Funds that provide daily liquidity in real estate are unusual. In cases where funds are daily traded, deferral or suspension of redemptions is generally the preferred liquidity mechanism rather than dilution pricing. In the aftermath of the EU referendum in the UK and the liquidity stress that it placed on nine daily traded real estate funds, only one fund chose to apply dilution pricing rather than suspension. As indicated above, the commercial rationale and thus the methodology was different from that envisaged in these guidelines.

We are particularly concerned that the FSB is using this to support far-reaching, unsupported and frankly dangerous changes to its own guidelines. We have enclosed our response to the FSB (See Annex 1). The FSB appears to have a fundamental misconception as to how some aspects of liquidity management and fund unit pricing actually work.

We would strongly recommend that these guidelines are delayed to give further time for reflection. If IOSCO and the FSB believe that there are particular types of open-ended funds or underlying asset classes that do necessitate urgent action, they should focus on these rather than attempting to apply a "one-size-fits-all" approach.

Although we do not believe that the matters covered in the consultation are generally relevant for the majority of funds investing in real estate as an asset class, we have attempted to answer the questions below.

Further engagement

If you would like to engage with us further regarding any aspect of our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat, AREF. In addition, members of our Public Policy Committee and Tax Committee are always willing to assist the FCA by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

Managing Director, The Association of Real Estate Funds

Responses to Questions

Proposed Guidance 1 – Overall Framework

1. ***To what extent does the proposed guidance 1 help responsible entities to better integrate the use of anti-dilution LMTs within their existing liquidity risk management framework? Have all the critical elements been captured?***

   We are not sure that this adds anything to existing guidance. We would note, again, that most real estate OEFs do not provide daily redemptions so do not need to manage liquidity risk on a daily basis.

2. ***Do you agree with the proposed guidance 1 regarding the inclusion of anti-dilution LMTs within the daily liquidity risk management framework that OEF managers should have in place at all times?***

   We are not sure that this adds anything to existing guidance.

3. ***Is this proposed guidance appropriate for all types of OEFs in its scope, and proportionate for all types of responsible entities to implement? If not, please explain.***

   We are not sure that this adds anything to existing guidance.

Proposed Guidance 2 – Types of Anti-Dilution LMTs

4. ***Has the proposed guidance identified all of the anti-dilution LMTs commonly used by responsible entities? Are there any other LMTs that share the same economic objective of passing on the liquidity cost to transacting investors, that could be included in this guidance? If so, please describe them.***

   As outlined above, AREF has already established guidance for its member funds for reflecting explicit transaction costs in subscription and redemption pricing. This is relevant for real estate OEFs even if there is no liquidity mismatch. Additional adjustments for implicit transaction costs should be reflected where relevant, but these are generally not relevant for the vast majority of real estate OEFs as there is no forced disposal of assets as a result of liquidity mismatch.

5. ***Are the identified anti-dilution LMTs described correctly? Do the features or characteristics of the different tools vary or do they generally operate as described?***

   The description of LMTs as described is extremely superficial and not wholly accurate for real estate as an asset class. As outlined above, detailed guidance on the calculation of subscription and redemption pricing funds for AREF and INREV members has been developed by the respective organisations.

   We are not convinced that it is useful for IOSCO to be producing guidance that will be relevant in all cases.

6. ***Do you support the proposed guidance 2? If not, in which cases do you think it could be justified not to adopt at least one anti-dilution LMT in OEFs (other than ETFs and MMFs)? What elements do you take into consideration to choose a specific anti-dilution LMT for your OEFs?***

   We believe that real estate OEFs already do this.

Proposed Guidance 3 – Calibration of Liquidity Costs

7. ***Have the components of the cost of liquidity, as described above, captured all the relevant costs that should be considered when calibrating anti-dilution LMTs?***

   We do not believe that this is the relevant approach for funds investing in real estate as an asset class.

8. ***How does the cost of liquidity vary across different funds? To what extent could we achieve a more consistent approach to calibrating anti-dilution LMTs for similar funds, and what is the best way to do so?***

   The cost of liquidity will vary hugely across different funds, even within a single underlying type of asset such as real estate. Attempting to standardise this would appear to us to be impossible.

9. ***How can significant market impact be incorporated in the calibration of all of the proposed anti-dilution tools? Please provide examples.***

   We do not believe that this is the relevant approach for funds investing in real estate as an asset class.

10. ***Can all of the components of the cost of liquidity (i.e., explicit and implicit transaction costs including any significant market impact) be incorporated in all five anti-dilution LMTs as set out in the discussion of Element (i) above? If not, what are the limitations to doing so and how would you suggest improving the effectiveness of these anti-dilution LMTs?***

    See our response to question 9.

11. ***To what extent can a subscription / redemption fee achieve the objective of addressing the investor dilution issue and financial stability concern of OEFs by attributing the liquidity costs to transacting investors? How could it be appropriately calibrated to achieve this objective?***

    Although dual pricing is widely used for funds investing in real estate, this is to reflect transaction costs rather than a market bid/offer spread for the underlying assets.

12. ***Do you see benefits in a tiered approach to attributing the cost of liquidity by using different adjustment factors according to net fund flow, market conditions and characteristics of the funds? Are there any operational difficulties? Any further comments thereto?***

    We do not believe that this is the relevant approach for funds investing in real estate as an asset class.

13. ***How could guidance on LMT calibration achieve a fair balance between (i) ensuring investors have a clear expectation of the cost of liquidity they could be charged and (ii) ensuring responsible entities have enough flexibility to attribute the overall cost of liquidity at all times, especially under stressed market conditions?***

    Although the use of a dilution charge to reflect the additional liquidity cost of a forced disposal of an asset to meet redemptions is possible, this is not the usual approach for funds investing in real estate as an asset class. We are only aware of one example in the last decade.

14. ***Is the proposed approach regarding ranges of liquidity cost adjustment appropriate? If not, how could it be improved?***

    We do not believe that this is the relevant approach for funds investing in real estate as an asset class.

15. ***Is the proposed expectation on the level of confidence and the sophistication of liquidity cost estimations appropriate? If not, how could it be improved?***

    See our response to question 14.

Proposed Guidance 4 – Appropriate Activation Threshold

16. ***What are the appropriate factors to consider in setting the activation threshold so that antidilution LMTs will be activated for any subscription / redemption activities with material dilution effect? How would you define 'material dilution effect'? Why and how could it vary across different funds?***

    We do not believe that this is the relevant approach for funds investing in real estate as an asset class.

17. ***Does the use of an activation threshold introduce the risk of trigger / cliff-edge effects? How could trigger / cliff-edge effects be avoided? Could the tiered swing pricing address the trigger / cliff-edge effect?***

See our response to question 16.

Proposed Guidance 5 – Governance

18. ***Do the proposed arrangements discussed above include all the essential elements regarding governance and oversight arrangements in relation to the use of anti-dilution LMTs? Are they proportionate to the differing size and complexity of responsible entities' fund ranges?***

We agree with the general guidance that responsible entities should have adequate and appropriate governance arrangements in place for their liquidity risk management processes, including clear decision-making processes for the use of anti-dilution LMTs. The detailed commentary sets out very specific requirements for governance committees and other aspects that may be relevant for some funds but not for others. For real estate as an asset class, there are funds with very limited liquidity, for example liquidity events every five years with a further two years to meet redemptions.

19. ***Please describe any material factors of the governance and oversight arrangements which have not been included.***

See our response to question 18.

Proposed Guidance 6 – Disclosure to Investors

20. ***Is the ex-ante information described above likely to be appropriate and effective in explaining the use of anti-dilution LMTs to investors? What other information about dilution, if any, might be helpful to investors before they invest in a fund?***

As outlined above, AREF and INREV have developed pricing guidance for members. This includes disclosure requirements. This is specific to real estate as an asset class.

21. ***What information can (and should) be disclosed ex-post to investors or the public, and at what frequency, to enhance transparency without compromising the aims of the antidilution LMTs or creating unintended consequences? Further, how soon should this information be disclosed to investors?***

See our response to question 20.

22. ***Are there other risks than those described in this section attached to the disclosure of the parameters used for anti-dilution tools?***

See our response to question 20.

Overcoming Barriers and Disincentives

23. ***Do you agree with the list of barriers and disincentives identified? Do you consider there are others that are not covered?***

We believe that real estate funds already have LMTs. We are not able to comment on funds investing in other asset classes.

24. ***In your view, what are the most significant barriers or disincentives to the implementation of anti-dilution LMTs? What are your suggestions for possible solutions to mitigate or overcome the barriers and disincentives to the implementation of anti-dilution LMTs?***

See our response to question 23.

25. ***For those OEFs facing significant barriers, what are the implications for their ability to implement this guidance? Are adjustments needed to the guidance to account for this, bearing in mind the objective to mitigate dilution for investor protection?***

See our response to question 23.

Other questions

26. ***Do you have any other comments on any guidance proposed in this document?***

We have no other comments.