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ASPIM ASSOCIATION FRANÇAISE DES SOCIÉTÉS DE PLACEMENT IMMOBILIER

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ESMA

Consultation Paper

Guidelines on liquidity stress testing in UCITS and AIFs

ASPIM's answer

The **Association française des Sociétés de Placement Immobilier** (ASPIM), the French association for real estate investment funds, promotes, represents and defends the interests of its members, managers of alternative investment real estate funds (closed ended fund – "SCPI", open ended funds – "OPCI" and other AIFs invested in real estate). Created in 1975, ASPIM is a non-profit association which brings together the actors of unlisted real estate fund management.

Its members are Portfolio Management Companies of SCPI, OPCI, OPPCI (professional open ended funds) and other real estate AIFs accredited by the French Financial Market Authority (Autorité des Marchés Financiers (AMF)), whether they are affiliations of bank, insurance, foreign or entrepreneurial real estate management groups.

The following answers were drafted in collaboration with the French Asset Management Association (AFG).

Q1) What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholders you represent? Please provide quantitative figures, where available.

It is unclear which benefits the guidelines would bring to liquidity management for real estate funds. The variety of real estate funds' policies and structures is such that guidelines would either be very generic ("one size fits all") or excessively complex. Real estate funds may be closed or open-ended, have shares dealt on a primary or a secondary market, have share redemption notice periods or not, provide for settlement periods long or short, etc. Additional costs would necessarily be incurred, though for a magnitude that may not be assessed at this stage.

Q2) Do you agree with the scope of these Guidelines? Should certain types of funds be explicitly excluded from these Guidelines? Should MMFs remain in-scope of these Guidelines?

We do not agree on including levered closed-ended funds. It is our opinion that leverage in a closed-ended fund reflects the risk appetite of investors; i.e. a risk of the fund's performance rather than a liquidity issue. Besides, depending on the level of debt, a liquidity stress may or not be pertinent.

Q3) Is additional clarity required regarding the scope of these Guidelines? Is additional clarity required regarding the meaning of 'nature, scale and complexity' of a fund? Are there circumstances in which it would, in your view, be inappropriate for a UCITS to undertake LST?

No. It is essential that appreciation for the "nature, scale and complexity" be left to the AIFM, given the diversity of real estate funds' policies and structures. Each AIFM should decide the rules to apply considering the nature, scale and complexity of the funds under management for its LST Policy.

Q4) What are your views on when the Guidelines should become applicable? How much time would managers require to operationalise the requirements of these Guidelines?

We expect a minimum period of 2 - 3 years to be necessary, in order to set-out national regulatory implementation particulars, define guidelines at industry level, revise LST policies at AIFM level, adapt methodologies and systems as well as reporting to investors.

Q5) Do you agree with the proposed approach of setting out a list of Guidelines all funds should follow, and the provision of explanatory considerations to help managers comply with those overarching Guidelines? Do you see merit in including some of the explanatory considerations in the final Guidelines?

We do not agree with Guideline 4, 7, and 8. We recommend that the reverse stress tests should not mandatory at present, a transition period is necessary.

Whilst we agree on the general principle that any AIFM ought to pay particular attention to liquidity risk management, we find that the goal of consistent supervisory practices in the European Union may not be furthered by the proposed guidelines. It is our view that the inconsistency of real estate funds' polices and structures between Union member countries is a major obstacle to a consistent implementation of guidelines. For example, we find there is little common ground in terms of liquidity management between a French retail closed-ended fund ("SCPI") and a German retail open-ended fund.

As a consequence, explanatory considerations should be left out of the guidelines and to be trusted the responsibility of national regulators.

Q6) Do you agree with the proposed Guidelines? What amendments, if any, should ESMA make to its proposed Guidelines?

We agree with the proposed Guidelines, with the exceptions of guidelines:

- 4 / Frequency: we find annual stress tests to be consistent with the majority of funds. quarterly stresses seem to increase costs, without bringing value in most cases.

- 8 / Reverse testing, which we believe should not be made mandatory for real estate funds, owing to the methodological difficulty to model the behaviour of real estate funds (e.g.: lack of pertinent econometric models).

Q7) Do you agree with the proposed explanatory considerations regarding LST of fund assets?

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- 8 / Reverse testing, which we believe should not be made mandatory for real estate funds, owing to the methodological difficulty to model the behaviour of real estate funds (e.g.: lack of pertinent econometric models).

Q8) What are your views on the requirement to undertake reverse stress testing, and the use of this tool?

Reverse stress testing is an interesting tool but should not be a requirement for real estate funds. Real estate funds do not require to apply reverse stress testing to identify the circumstances that might cause a stress situation to occur as those ones are limited by the specification of the funds (at least 60% is invested in real estate assets).

Q9) Do you see merit in providing further considerations for managers on the use of data relevant to asset liquidity, particularly in circumstances when data is scarce?

If the data is scarce, managers should use benchmark as external data or historic data on other funds they managed as benchmark to adapt their approach. And asset liquidity assumptions should be reviewed at least annually especially when the data is limited by discussing with the different entities of the structure or other managers in the same market. It is up to the manager to adapt itself once again and we do not see merit in providing further considerations on this subject.

Q10) Do you agree with ESMA's wording regarding the asset liquidation method used in the LST model? How would you describe the asset liquidation method used by you or the managers you represent?

The general approach described is consistent with practice. However, we find that the examples used in the guidelines to illustrate the case of real estate assets evidence a narrow vision of real estate funds. In particular, that real estate funds may use most liquid assets for 60 business days before they use the proceeds from real estate sales is not representative of practice in many European countries: much longer periods of time would typically be necessary.

The liquidation process should be in line with each funds' profile in terms of type of assets, assets size, legal/tax/financial structuring,"

Q11) Do you agree with ESMA's wording regarding 'second round effects'? What is your current practice regarding modelling 'second round effects'?

We do not agree with the ESMA's wording because the AIFMd already requires to apply stress tests under normal operating conditions and under stressed market conditions,

Q12) What are your views on the considerations on difficult to model parameters, such as price uncertainty? What is your current practice concerning this issue?

We consider that the pricing of real estate assets in times of crisis may be particularly difficult to model. For example, the price of the same building may widely differ according to the level of rental vacancy at the time of sale. The methodology used includes historical data, benchmark, analysis of market behaviour in times of crisis in other countries, etc.

Q13) Do you agree with ESMA's considerations on LST in funds investing in less liquid assets? What amendments should be made to the proposed wording? Do you think that ESMA should outline additional and/or specific Guidelines to be made in any other fund or asset types, such as ETFs?

We agree with the ESMA's considerations, except regarding frequency and reverse stress testing.

We consider that no additional guidelines to be provided, so that the AIFM may adequately take into consideration "nature, scale and complexity".

Q14) Do you agree with the considerations regarding LST on items on the liabilities side of a fund's balance sheet?

We agree with the considerations, except reverse testing.

We consider that:

- interest/credit payments rules specified are not relevant; and

- real estate funds should focus on committed capital rules.

Q15) Do you agree with the considerations specifying the LST of redemptions and other types of liabilities may need to be considered distinctly, given a fund could potentially limit redemptions but not other sources of liquidity drain?

We agree with the considerations, if appropriate.

Q16) Do you agree with the requirement to reverse stress test items on the liabilities side of the fund balance sheet?

We do not agree with the requirement, because we consider that reverse testing should not be made mandatory for real estate funds, owing to the methodological difficulty to model the behaviour of real estate funds (e.g.: lack of pertinent econometric models).

Q17) Do you agree with the requirement to incorporate investor behaviour considerations into the LST model 'where appropriate'? Are there cases which you believe it would not be appropriate, and should these be detailed in these Guidelines?

We agree with the requirement on inclusion of behavioural considerations. But, we consider that no specific guidelines should be applied: we prefer to leave the liberty to the company to decide the approach it will use.

Q18) What do you think about ESMA's Guideline stating that managers should combine LST results on both sides of the balance sheet?

We think that it is an interesting methodology to combine both sides of the fund balance sheet. But once again, it should not be a requirement. The AIFM should be free to choose or not, when it's appropriate, to do it considering the scale, nature and complexity of the funds.

Q19) What are your views on ESMA's Guideline that aggregated LST should be undertaken where deemed appropriate by the manager?

Aggregated LST are particularly appropriate when the funds are similar. For real estate funds, with different type of investment strategies, redemptions mechanisms and net asset value frequency it doesn't seem appropriate to conduct such LST.

Q20) What is your experience of performing aggregated LST and how useful are the results?

In real estate, our experience is more that similar funds may have similar difficulties at the same time, rather than have -in aggregate- a strong impact on the market.

Q21) What are your views on ESMA's considerations concerning the use of LST during a fund's lifecycle?

About the ESMA considerations concerning the use of LST during a fund's lifecycle it seems very appropriate for the fund launch and on an-going basis for an annual review to assess the liquidity risk depending on the investment strategy of the funds. During a period of stress, the LST can be used to determine when the funds will respect again its investment policy and objectives and evaluate the correct level of assets to liquidate.

Q22) What is your experience of the use of LST in determining appropriate investments of a fund?

The use of LST to determinate appropriate investment in funds are useful for fund of funds but not so much for real estate funds. It is useful for funds which have a redemption policy very liquid (with weekly or bi weekly net asset value for example).

Q23) In your view, has ESMA omitted any key uses of LST?

We do not think that ESMA omitted any key uses of LST.

Q24) Do you agree with ESMA's Guideline that LST should be undertaken in all cases annually, but that it is recommended to undertake it at least quarterly, unless a different frequency can be justified? What is the range of frequency of LST applied on funds managed by stakeholder(s) you represent?

We consider that annually is enough for us.

Q25) Should ESMA provide more prescriptive Guidelines on the circumstances which can justify a more/less frequent employment of LST?

We consider that ESMA should not provide more prescriptive guidelines, We prefer to leave the liberty to the company to decide the approach it will use.

Q26) Do you agree that LST should be employed outside its scheduled frequency (adhoc) where justified by an emerging/imminent risk to fund liquidity?

We agree, but we prefer to leave the liberty to the AIFM to decide the approach it will use.

Q27) What are your views on the governance requirements regarding LST?

We agree with the governance requirements regarding LST.

Q28) Should more information be included in the UCITS RMP and AIF RMP?

No more information should be included.

Q29) Do you have any views on how managers which delegate portfolio management can undertake robust LST, independently of the portfolio manager, particularly when the manager does not face the market?

The delegating AIFM should set constraints in the mandate, such that the fund's overall liquidity should meet its targets.

Q30) Do you agree with the proposed Guideline for depositaries on carrying out their duties regarding LST?

We agree with the proposed guidelines. However, depositories should not review the methodologies used by the AIFM (for which we find they would not be qualified).

Q31) In your experience do depositaries review the UCITS RMP and AIF RMP as a matter of course?

In our experience depositories do not review the AIF RMP.

Q32) Do you see merit in ESMA publishing further guidance on the reporting of results of liquidity stress tests? If so, in your view how should ESMA require that results be reported?

We do not see merit in ESMA publishing further guidance on the reporting of results of LST. The results depend on the model and the scenarios used by the manager. It is hard to compare results of LST undertaken by different managers. Furthermore, we do not see it relevant to publish results of LST as it is a very sensitive data.

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