**ESMA**

Vienna, 29th March 2019

**ESMA Consultation – Guidelines on liquidity stress testing in UCITS and AIFs**

Dear Sirs,

VÖIG[[1]](#footnote-1) welcomes the opportunity to provide some comments on ESMA’s Consultation Paper.

At first we would like to make a general statement from the view of the Austrian fund management industry concerning the application of liquidity stress testing (LST) for UCITS funds and AIFs managed by Austrian investment management companies.

We want to confirm that regular LST already is an essential part of the risk management process of all Austrian UCITS funds and all Austrian AIFs, including open end real estate investment funds. LST has to be properly integrated and embedded in the individual funds risk management framework and plays an important role in the whole risk management process of the management company. The principle of proportionality regarding implementation of LST is accepted by law.

Guideline 1-6 to our mind seem to be properly drafted.

We want to point out that liquidity assumptions regarding investor behavior are not suitable (especially if you think of broadly held CIVs) as the risk manager of the investment funds generally do not have this information available. The only assumption that can be made is to distinguish between certain classes of investors (retail, commercial or institutional investors) but only for funds where the investors are known by the management company or where client information is passed by the sales force to the ManCos.

Guideline 7 subparagraph b) therefore has to be streamlined with the explanations to point 7 (reference 45 and 46) insofar as assumptions can only be done if the specific information is available.

We do see the scenarios mentioned in guideline 8 as examples of LST. There should be freedom of choice to apply one ot these scenarios or a mix of these scenarios. The decision of the appropriate LST scenario/model has to be taken by the risk management function of the ManCo. Management companies should not be obliged to apply RST.

Guideline 8 should be streamlined in order to fit to the explanatory note in the explanations to point 6 and 7 (reference 27, 28 and 43 and 44), ie it should be made clear that the scenarios mentioned in guideline 8 are examples of LST.

We do see problems when applying the guidelines to open ended real estate investment funds. Real estate investment funds are a specific type of an AIF which are characterized by

* less liquidity of real estate investments (typical liquidity period for the sale of real estate is 6-9 months without taking care of a stress situation),
* less price data availability of the real estate assets of the funds (price assessment of real estate which is held by funds, is only done once a year by qualified third party personell).

Commonly used corporate finance models do not suit the requirements of real estate investment funds due to lack of price data availability. Therefore we also think that “backtesting” which is based on pure historic data models does not suit the needs of LST of real estate investment funds where price data availability is very much restricted.

LST of real estate investment funds therefore should be built on scenario analysis, in normal and stressed situations, as well as on an ex-post review of the real outcome of the estimates.

Mit freundlichen Grüßen

VEREINIGUNG ÖSTERREICHISCHER

INVESTMENTGESELLSCHAFTEN



Mag. Dietmar Rupar Mag. Thomas Zibuschka

 **5 Summary of questions**

**Q1**

**What additional costs and benefits would compliance with the proposed**

**Guidelines bring to the stakeholder(s) you represent? Please provide**

**quantitative figures, where available.**

Additional costs and benefits can hardly be quantified; but we expect considerable additional costs and implementation effort if these Guidelines will become applicable in the proposed form.

**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?**

In Austria UCITS/OGAW as well as AIFs are already subject to LST by law.

**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

**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?**

If the Guidelines become applicable in the proposed form we expect a considerable time span (6 to 12 months) for implementation.

**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?**

No. This would counteract the recommendations set out in the Consultation Paper, that LST should be used for each fund depending on its individual properties. In our view it does not make sense to curtail the possibility to set up individual stress tests for funds according to its individual properties.

**Q6**

**Do you agree with the proposed Guidelines? What amendments, if any, should**

**ESMA make to its proposed Guidelines?**

Amendments: freedom of choice between historical and hypothetical scenarios; no obligation to reverse stress testing

Investment decisions just as choosing the appropriate LST for a fund must be subject to the management. An obligation to carry out all three LST (historical, hypothetical and reverse stress testing) is in our view not justified because of capacity, as well as lack of data availability reasons.

**Q7**

**Do you agree with the proposed explanatory considerations regarding LST of**

**fund assets?**

No. Portfolio managers should have the flexibility to use professional judgement to decide which approach is considered most appropriate in the market at the time of trading, meaning it is not always feasible to reflect the asset liquidation method a priori. Therefore, what is necessary is a flexible and time-appropriate approach relying upon the expertise of individual fund managers and avoiding processes or assumptions not reflecting the real practical conditions. Asset managers should have access to a full kit of liquidity management tools and a defined process setting out the considerations that should be taken into account when deciding to use any of these tools. The LST needs to reflect the approach the manager takes in a stressed scenario.

**Q8**

**What are your views on the requirement to undertake reverse stress testing, and**

**the use of this tool?**

Reverse stress testing should not be mandatory as it causes unjustifiable additional work and expense when exercised accurately.

These tests can hardly be automatized because different funds have individual properties which must be analysed individually and thoroughly.

Even the ESRB does not make reverse stress testing mandatory: “Reverse stress testing could complete the total stress-testing exercise.”

**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?**

Yes.

**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?**

No. See answer to Q2.

**Q11**

**Do you agree with ESMA’s wording regarding ‘second round effects’? What is**

**your current practice regarding modelling ‘second round effects’?**

It is a very difficult task to quantify/estimate second round effects.. Beyond that the validity and the results of second round effects are questionable.

Currently we are not modelling second round effects.

**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?**

Currently such investments are subject to an important liquidity discount.

But generally it can be very difficult to anticipate whether an investment will be exposed to price uncertainty.

**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?**

See introduction of our position paper regarding open ended real estate funds.

**Q14**

**Do you agree with the considerations regarding LST on items on the liabilities**

**side of a fund’s balance sheet?**

We consider investor behavioral analysis critical. The availability of valid data is not given for exercising reliable and wide behavioral analysis. Exercising this analysis would cause disproportional effort.

**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?**

**Q16**

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

No. It causes unjustifiable additional work and expense. We do not see any merit. (See Q8)

**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?**

Please see Q14.

**Q18**

**What do you think about ESMA’s Guideline stating that managers should**

**combine LST results on both sides of the balance sheet?**

The important points are

- Which conclusions are being drawn from potential mismatches between assets and liabilities?

- To what extent should LST influence investment decisions/strategies?

**Q19**

**What are your views on ESMA’s Guideline that aggregated LST should be**

**undertaken where deemed appropriate by the manager?**

From our point of view it only makes sense for funds acting on narrow markets (e.g. Austrian stock market). For all other funds we do not see any merits. As mentioned before we think that LST should be used for each fund depending on its individual properties.

**Q20**

**What is your experience of performing aggregated LST and how useful are the**

**results?**

Up to now not in use. Please see also Q.19.

**Q21**

**What are your views on ESMA’s considerations concerning the use of LST during**

**a fund’s lifecycle?**

We do think that LST at product development stage is excessive and hard to realise due to lack of valid data and the final set up of the fund.

We strongly oppose the idea of the NCAs to request LST in the course of fund authorization procedure.

**Q22**

**What is your experience of the use of LST in determining appropriate**

**investments of a fund?**

The basis for investment decisions is a set of rules (legal, contractual, stated in various fund documents etc.). Portfolio management usually has a strong understanding of liquidity risks arising from their investment decisions. Because of these facts and the required independence between portfolio management and risk management there should not be any undue influence on the investment decisions unless any limits are breached.

**Q23**

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

No.

**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?**

In Austria monthly LST are required by the NCA for UCITS/OGAWs.

**Q25**

**Should ESMA provide more prescriptive Guidelines on the circumstances which**

**can justify a more/less frequent employment of LST?**

No.

**Q26**

**Do you agree that LST should be employed outside its scheduled frequency (adhoc)**

**where justified by an emerging/imminent risk to fund liquidity?**

Exclusively if it remains a free management decision.

**Q27**

**What are your views on the governance requirements regarding LST?**

**Q28**

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

No

**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?**

**Q30**

**Do you agree with the proposed Guideline for depositaries on carrying out their**

**duties regarding LST?**

**Q31**

**In your experience do depositaries review the UCITS RMP and AIF RMP as a**

**matter of course?**

**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?**

1. The Association of Austrian Investment Fund Management Companies (Vereinigung Österreichischer Investmentgesellschaften, VÖIG) is an umbrella organisation for all Austrian investment fund management companies and all Austrian real estate investment fund management companies. VÖIG represents 100% of the fund assets managed by the Austrian investment fund management companies and real estate investment fund management companies, in total it represents assets under management of € 170 bn. [www.voeig.at](http://www.voeig.at). [↑](#footnote-ref-1)