

4 September 2023

The European Association for Investors in Non-Listed Real Estate Vehicles (INREV)¹ welcomes the opportunity to respond to IOSCO's proposed amendments to its 2018 recommendations on liquidity risk management in open-ended funds.

We hope the comments contained below make a constructive contribution to the consideration of these important policy issues.

Introduction

We welcome the opportunity to comment on IOSCO's 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 (OEFs) and to safeguarding the interests of and protecting investors. This has been long recognised by the real estate investment management industry given that 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) consultation². It is not clear to us 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.

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

¹ INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe, including the UK.

INREV has more than 500 members, comprised of institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in the UK and the rest of Europe. Our fund manager members manage hundreds of non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

² <https://www.fsb.org/wp-content/uploads/P050723.pdf>

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 Covid-19 pandemic. For real estate funds in the UK, there were three main LMTs adopted to the challenges that arose at that time:

- 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 work³ on unit pricing by the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) and the Association of Real Estate Funds (AREF) and 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

³ [Open End Fund Pricing Conclusion Paper 2021](#)

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. Funds for institutional investors have introduced more sophisticated liquidity management tools as a result. Both INREV and AREF have provided guidance for their members. For instance, INREV offers market participants a full set of liquidity guidelines and best practices on liquidity mechanics and the options available to them⁴.

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. 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 very unwise. 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.

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”⁵ and the INREV Property Valuation guidelines⁶ for the governance and oversight of the valuation process. 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.

To address the challenges regarding pricing, a considerable amount of work has been undertaken by INREV and AREF 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

⁴ <https://www.inrev.org/guidelines/module/liquidity#inrev-guidelines>

⁵ <https://www.rics.org/profession-standards/rics-standards-and-guidance/sector-standards/valuation-standards/red-book>

⁶ <https://www.inrev.org/guidelines/module/property-valuation#inrev-guidelines>

out these detailed recommendations. Following consultation with members, INREV included these recommendations into its updated Governance guidelines in January 2022⁷.

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.

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 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.

We are 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. The FSB appears to have a clear understanding of 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.

⁷ <https://www.inrev.org/guidelines/module/governance#inrev-guidelines>

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.

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. In case of institutional funds, the investment manager should be transparent with investors regarding the liquidity mechanisms and options available. INREV offers specific liquidity guidelines for institutional real estate investment vehicles along with transparency disclosures⁸.

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. Institutional open end investment funds should select a pricing mechanism that is likely to provide the fairest pricing outcomes for investors and has regard for the requirements of the target investor market.

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, INREV has already issued best practices on the pricing governance of institutional real estate OEFs.

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

⁸ <https://www.inrev.org/guidelines/module/liquidity#inrev-guidelines>

redemption pricing funds for INREV and AREF 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 believe that only explicit transaction costs are relevant for direct institutional real estate OEFs.

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 impractical.

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?

As stated above, INREV issued best practices for the effective design, operation and governance of pricing to shelter investors from the impact of dilution. Costs of trading European real estate vary significantly from country to country.

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. As stated above, INREV provides a set of transparency best practices and recommended disclosures around pricing⁹.

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. As stated above, INREV provides a set of transparency best practices and recommended disclosures around pricing¹⁰.

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.

⁹ <https://www.inrev.org/library/open-end-fund-pricing>

¹⁰ <https://www.inrev.org/library/open-end-fund-pricing>

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 stated above, INREV provides a set of transparency best practices and recommended disclosures around pricing¹¹.

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.

¹¹ <https://www.inrev.org/library/open-end-fund-pricing>

3 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 further comments.