Position Paper on IOSCO Consultation on Revised Recommendations for Liquidity Risk Management for CIS

11 February 2025

Introduction

INREV supports IOSCO's objective to improve liquidity management in open-ended funds (OEFs). In our response to the consultation, we recognise that effective liquidity risk management is essential to protect investors' interests, ensure market stability and maintain the resilience of collective investment schemes (CIS), particularly OEFs. However, we emphasise the specific characteristics of real estate funds which differ from other types of OEFs and need to be properly considered.

Recommendation 3: Consistency of OEF asset liquidity and redemption terms

We believe the definition of illiquid assets in the recommendation is misleading for real estate and other comparable assets such as infrastructure. Real estate transactions take time due to due diligence and legal processes, not a lack of a market for the assets. Real estate funds use liquidity management tools as part of "business as usual" operations much more frequently than as safety valves.

Furthermore, the assumption that open-ended real estate funds are highly liquid offering daily redemptions is almost never the case for real estate funds for institutional investors and is relatively unusual in real estate funds available to retail investors. Nevertheless, daily redemptions can still be managed effectively.

Institutional investors, such as pension funds and insurers, invest in real estate for long-term, stable income flows rather than liquidity. They prefer "evergreen" open end funds with indefinite investment periods, where redemptions typically occur quarterly or even less frequently.

- **Lock-up periods:** We agree that lock-up periods prevent investors from redeeming shares directly from the fund, but trades may still occur if an investor finds another party to buy its shares or units in the fund. Some funds have soft lock-ups allowing redemptions at a discount to protect remaining investors.
- **Matching subscriptions:** Matching subscriptions differentiate redemptions requiring asset sales from those offset by new subscriptions. Only net redemptions represent liquidity risks, making this distinction crucial for deferral policies.
- **Deferrals:** The liquidity tools described in the recommendation overlook deferrals, which are the most commonly used tool for open-ended real estate funds. These funds allow time to meet redemptions rather than requiring notice before the redemption date. This approach functions like delayed settlement but uses the NAV just before settlement rather than at the redemption request date. Delayed settlement at the NAV at the original redemption price is risky in falling markets, creates a first-mover advantage, and harms remaining investors.
- **Queuing change:** Queuing methodology may shift during market stress, moving to partial redemptions across all investors rather than chronological order, reducing first-mover advantage.

Recommendation 6: Liquidity Management Tools and Measures

We highlighted three further key considerations related to the availability and use of liquidity management measures under normal and stressed conditions. Firstly, in real estate, anti-dilution is more a reflection of the tax friction of buying assets than selling a market-moving stake. Secondly, we emphasised that deferred redemptions help mitigate the first mover advantage, while deferred settlements increase it. Finally, we noted that this advantage can be further minimised by the choice of queuing rules.

Recommendation 9: Integrating liquidity management in investment decisions

We do not agree that responsible entities should only carry out transactions if the investment or technique/strategy employed does not compromise the ability of the CIS to comply with its liabilities, and its redemption obligations in the case of OEFs provided investors are aware that the fund is investing in less liquid assets with consequences for redemptions. We do not believe that funds should be forced to sell a large asset to meet small redemptions. The fund manager would prefer to let redemptions build up before selling an asset or find a subscription against which to match the redemption, which is in the best interest of the remaining investors.

It is also possible for real estate funds to consciously acquire much more liquid assets in active markets, which results in a significantly more liquid profile of the fund as the assets are very attractive from an investment perspective and can typically be sold quickly.

Recommendations 16-17: Disclosures to Investors and Authorities

We support that *“the responsible entity should ensure that liquidity risk of CIS it manages and its liquidity risk management process, including the availability and use of liquidity management tools and liquidity management measures, are effectively disclosed to investors and prospective investors”.* However, this Recommendation is very securities focussed. LMTs are already part of regular real estate fund operations, and are not just for exceptional cases. As such, they should be disclosed in the fund prospectus like other governance policies.

While we agree that funds should prepare for exceptional circumstances and inform investors about potential LMT use, notification timeframes and methods vary across the market. A “one-size-fits-all” regulatory approach is not suitable, especially for institutional funds, where communication terms are agreed upon with investors in advance.

Other Proposed Revised Liquidity Recommendations: Open-ended funds – redemption rights

We do not agree with the general assumption prevailing in the Recommendations that OEFs deal daily. This is almost never the case for real estate funds for institutional investors and is even relatively unusual for real estate funds for retail investors. Even if redemptions are allowed daily, there will typically be significant notice or deferral periods.