AGA / Div 4778-09 bis

IOSCO

Paris, 18 September 2017

Open-ended Fund Liquidity and Risk Management – Good practices and Issues for consideration

AFG's preliminary comments

The Association Française de la Gestion financière (AFG)[1] welcomes the occasion given to comment on the IOSCO's consultation report on Open-ended Fund Liquidity and Risk Management – Good practices and Issues for consideration.

Our members are highly concerned by liquidity risk management. Liquidity risk management is an integral part of risk management and should be viewed and understood within this wider context.

IOSCO papers mention different regulatory works on this matter. It should be added that the asset management industry too had led works in the matter and issued guidance. Indeed, AFG has already issued several papers that are of interest to liquidity risk management issues:

- AFG Liquidity risk management tools in open-ended funds – May 2017

http://www.afg.asso.fr/wp-content/uploads/2017/05/2017_05_Liquidity_risk_management_tools_open-ended_funds-1.pdf

- AFG Code of Practice on liquidity risk management in Collective Investment Schemes (CIS) – January 2016

http://www.afg.asso.fr/wp-content/uploads/2016/02/Guide%20Professionnel_Liquidite_2016_ENG.pdf

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 3,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments (with 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds). In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

- (already mentioned by IOSCO) AFG Code of conduct for asset managers using Swing Pricing and variable anti-dilution levies (ADL) - 2014 / Modified January 2016

http://www.afg.asso.fr/wp-content/uploads/2014/06/GuidePro_SwingPricing_actualise_2016_ENG.pdf

Please see hereafter AFG's comments on this IOSCO "Good Practices" document

- First, such a document should be available in all IOSCO members' languages because actors need to be able to understand it and refer to it if they need so. It is therefore frustrating that native English speaking companies and global companies be advantaged in this IOSCO process.

- Second, AFG thinks this paper is well written with useful examples of good practices and that it gives interesting views on different countries' practices.

More specifically, please see our remarks:

- We appreciate the in depth and useful work done by IOSCO in the "Good practices document" but insist on this document being understood as a reference point and not as a recommendation or requirement. Every fund is different and it can evolve in an infinite type of market liquidity contexts. Flexibility is therefore key. We would also like to recall that liquidity is not a stable concept and there should be flexibility in the manner firms handle with the matter so as to be efficient relative to the market stance. AFG considers that it is not possible to know with certainty what impact future events might have on portfolio holdings and that over (ante) reacting may also prove to be harmful by advancing or exacerbating a market situation.

- If we agree that some transformation is consubstantial in a collective scheme, we do not think that it is of magnitude. On the contrary, excess transformation bears too high risks and this subject has already been analysed by the FSB within systemic risk discussions. Therefore, we continue to advocate that there is no transformation risk with mutual funds.

- Our members are highly concerned by liquidity risk management. Liquidity risk management is an integral part of risk management and should be viewed and understood within this wider context.

- Regarding the continuous monitoring of liquidity, AFG totally disagrees with the bucketing method and with the idea of maintaining "sterilised" liquidity in all funds. Envisaging that there is merit in setting up immediate liquidity "buckets" in all types of funds is a false good idea. This cushion represents one technique that may be adapted in some situations, such as for instance for funds where the expectation in terms of liquidity is high as this is identified as the promise of the fund to its investors (money market funds for instance). Sterilising all that money globally is also totally counterproductive in terms of investment for the financing of the economy. We propose to avoid any confusion and delete the second bullet point on the middle of page 5.

- Regarding the definition of "liquid assets", we would like to recall that in Europe UCITS fund invest in assets which are considered liquid by nature. The frontier of the actual more or less liquidity in the market may fluctuate and we prefer in Europe to speak in terms of eligible or non-eligible assets. Setting an arbitrary limit when investing on a certain market related definition of "illiquid" assets is an uneasy concept. Regarding the "limits on time allowed to correct unintended limit breaches", we prefer the UCITS concept which does not define any timeframe, but subjects it to the manager acting in the best interest of unitholders. We suggest to delete the two parenthesis on the last two bullet points on top pf page 8.

- AFG would like to recall that knowledge on the investors base is still at work, at a very early stage. We need to have the time to gain in maturity and also for the ecosystem to accept to give us this information on end clients and not invoke confidentiality reasons. One should not make too much emphasis on the usefulness and achievements on the liability analysis. This is not an exact science and when a serious crisis arises, no profiling or other means employed might prove helpful. We have also to insist on the fact that "getting the big picture" on the major holdings by clients will certainly be effective and there is no need to go identify and aggregate each retail holding. Cost efficiency is key so as to be able to have the big picture early enough…

- This being said, in order to provide sustainable finance to sustainable economic growth, there is a need to match long term savings with long term investment. In such a context, liquidity should not be the unavoidable requirement for any type of fund. It is a requirement for UCITs but the market needs long term AIFs shaped for retail investors that could invest in long term assets. For these funds, liquidity requirements should be very different and this would be to the benefit of investors who could get better returns and be less exposed to short term fluctuations of markets.

- We agree with IOSCO regarding the highly relevant link between liquidity and valuation.

- AFG insists on the distinction to be made between redemptions and runs. Funds may encounter situations of high redemptions and be perfectly able to deal with them (IOSCO cites by the way some examples). Runs are very particular events, highly rare and extreme in nature. They are linked to an "embedded" first mover advantage, like it was the case with the implicit guarantee on CNAV funds sold in the US. AFG disagrees with IOSCO regularly mentioning in these two consultation papers of the "first mover advantage" associated with funds in general.

- Regarding gates, we agree with IOSCO that they may be used in certain normal conditions for certain types of funds. It may be added as an *Advantage* in the table for Gates that it is a step before suspension, it may help in intermediary situation instead of using the last recourse arm which is the suspension.

- AFG believes that liquidity risk management details must remain non-public, but made available to regulators. Some confidentiality should be kept so as not to undermine the efficiency of the risk measure. For instance, AFG backed by AMF has issued Guidance regarding the swing pricing mechanism where the manager is encouraged to give "*only general principles of the chosen methodology. Furthermore, it should not disclose parameters that are too detailed and recent so that to enable an investor to amend his/her subscription or redemption strategy so as to take advantage of more advantageous conditions and thus reduce the Swing Pricing mechanism's efficiency. In particular, the management company does not communicate (in writing or orally) the current levels of the trigger thresholds. To this end, it notably ensures that the internal circuits of information are restricted to favour the conservation of the confidential character of this piece of information.*"

- Regarding the Side Pockets, AFG would like that be added as an *Advantage* in the table that the Side Pocket ensures fair treatment among investors as they get an equal share on the illiquid/distressed portion of the portfolio. We do not agree that Side Pockets be mandatorily mentioned in the Prospectus in order to be allowed to use them. It is preferable in an extreme case such as a fraud to be able to segregate the distressed part than to suspend / liquidate the entire fund.

- Regarding the notice period, we only partially agree with the disadvantage related to the perception of investors. It is not the same thing to be able to invest/get out only on Mondays than to be able to do it every day, but think to notice it to the fund manager one week before. Once explained, investors can understand very well the difference. It should be clearly mentioned that the notice has a fixed term so as to give certainty to the investor on the date of the flows, but this does not mean that the manager will systematically use the notice period.

- Regarding the in kind redemption table, some advantages disadvantages are unclear and we would remark that the argument saying the *"equal treatment of investors comes into question as there will always be some losers"* is not specific to in kind redemptions…

- Regarding stress tests, it should be reminded that they **are not a management tool**. They may give useful information that is brought to knowledge to the manager who has at his disposal an extensive set of elements to take into account when making investment decisions. Stress tests represent a check tool which should not be set so as to trigger investment decisions. If not, this tool risks to generate herding behaviours that ultimately may bring systemic risk. We disagree when IOSCO says that stress tests can be used to "tailor the CIS's composition", to "inform investment decisions", etc. We agree that aggregated stress tests are a rare exception, for instance relevant only when the manager has several S/C funds that taken together make a highly significant proportion of the free float. Fund stress tests guidance should be kept at individual level. There should be no mandatory design of scenarios. Collateral stress testing should be envisaged only when it is material in the fund strategy. AFG wonders what IOSCO means when citing the algorithmic trading as an event to be taken into account in stress tests. Regarding the "Use of stress testing section" **we would like to correct that AMF has not issued any "explicit requirements" on stress tests.** AMF's document on stress tests is a non-binding Guide, it is a collection of examples. AFG continues to totally disagree with any binding requirements in the matter; it would be counterproductive. In addition, the use of stress test results is like any other risk management tool, at the disposal of the fund management, but does not trigger any automatic investment decision.

- Last but not least, even if we totally agree to the importance of the liquidity risk management as a general rule, we would like to caution against a certain "dictatorship" of liquidity. Indeed, the tendency to privilege liquidity over longer term assets and investment vehicles impedes more stable financing of the economy. In addition, disclosures on the liquidity risks should not isolate and overemphasize this risk in particular compared with the general risk and return profile of the fund.

If you need any further information, please don't hesitate to contact me at +33.1.44.94.94.31 (a.gurau.audibert@afg.asso.fr).

Sincerely Yours,

Adina Gurau Audibert

AFG, Head of Investment Management Techniques