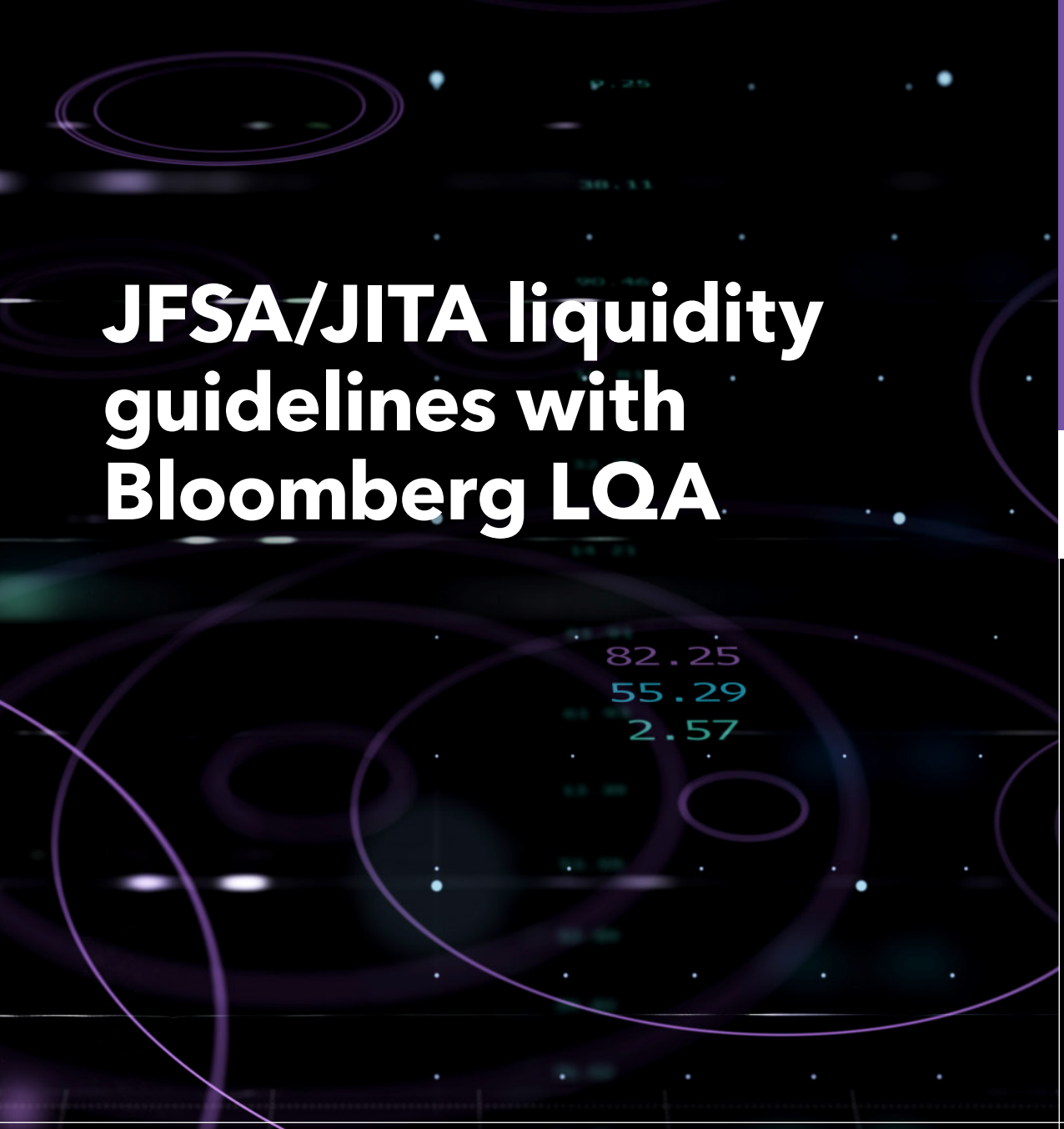
JFSA/JITA liquidity guidelines with Bloomberg LQA

Content & Data Solutions

Liquidity



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New regulatory requirements for Japanese Investment Trusts (Toshi Shintaku) come into effect on January 1, 2022, in line with IOSCO's recommendations for liquidity risk management for open-ended collective investment schemes. The guidelines are intended to promote more effective liquidity risk management and governance for open-ended funds, and introduce a liquidity classification scheme along with thresholds for the percentage of Assets under Management (AUM) held in each classification. Fund liquidity should be evaluated on a regular basis, considering both normal and stressed conditions over the entire fund lifecycle.

Bloomberg's award-winning Liquidity Assessment (LQA) solution enables quantitative evaluation of execution measures for in-scope firms. Examples include liquidation cost or liquidation horizon for a fund's holdings under custom stress scenarios. This provides the foundation for a comprehensive Liquidity Risk Management framework supporting JFSA guidelines.

Overview.

From an implementation perspective, the guidelines fall into discrete categories:

Governance framework

As liquidity risk measurement and management evolves, legacy frameworks often lack sufficient flexibility to build an appropriate governance framework. Bloomberg's fully-customizable LQA solution enables firms to create a fund-specific framework, providing the analytics to support custom liquidity stress scenarios, metrics and reporting.

LQA can assess the impact of multiple fund-specific scenarios, based on the key liquidity risk factors applicable to fund holdings, and seamlessly incorporate the results into Enterprise risk-management workflows. Front office workflow is supported through a Programmatic API, Excel Add-In, Data Feed, and/or the Bloomberg Terminal. This allows firms to consider their fund liquidity profiles through the entire product lifecycle, from initial product design and risk management through to managing the subscription and redemption process.

Liquidity classification

Under the guidelines, fund managers must allocate each position in a fund into one of four classifications. This requires a quantitative approach, as both the expected liquidation horizon to sell the entire position and consideration of whether the sale is likely to have an impact upon the market determine the classification. Both normal and stressed market conditions should be considered during the classification process.

Classification	Definition
Highly liquid	Liquidation horizon less than 3 business days (considering market impact)
Medium liquidity	Liquidation horizon between 4-7 business days (considering market impact)
Low liquidity	Liquidation horizon exceeding 8 business days (considering market impact)
Non-liquid	Liquidation horizon exceeding 8 business days (with **significant** market impact)

Figure 1 – JFSA liquidity classification bucket criteria.

Classification logic

1. Assess liquidation horizon

- Based upon position size
- Default liquidation cost target applied as half bid-ask spread (where Liquidation Cost is measured from mid market)

2. Determine "Significant market impact"

- Define "significant"
- Default baseline – ½ bid-ask spread

3. Consider position specific liquidation cost for an 8 day liquidation horizon

- Required to split "Low Liquidity" from "Non-Liquid" assets

4. Apply logic

- Consider Liquidation Horizon
- Consider Market Impact (client can either use default or customized value)*

Figure 2 – Logic used to determine JFSA liquidity classification

While Bloomberg LQA provides a default value for the significant market impact for each security based upon prevailing bid-ask spread, this can be fully customized to reflect the fund manager's determination of a "significant" market impact.

Are the JFSA guidelines the same as the U.S. SEC rule 22e4?

Although initially appearing similar, the SEC 22e4 and JFSA liquidity classification approaches differ in a number of key areas illustrated in the table below. Where firms have funds falling into both regulatory jurisdictions, the methodology used for liquidity classification must be appropriate for each regulator.

Regulator	Position size	Day count convention	Settlement period	Prescriptive	Consideration of market impact	Threshold levels specified?
JFSA	100% (full position)	Business days	Not included	Guideline based	Some buckets	No
SEC (rule 22e4)	'RATS'*	Business days & calendar days	Included	Yes	All buckets	Yes

* The SEC prescribes the liquidity classification of a position based upon a "reasonably anticipated trade size": https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq

Figure 3 – Comparing liquidity classification approaches between U.S. SEC 22e4 and JFSA guidelines.

Threshold monitoring

Governance principles in the guidelines specify implementing a lower limit for the highly liquid category and an upper limit for the non-liquid category. Prescriptive levels for the thresholds are not given; however, LQA provides a flexible framework allowing thresholds to be customized for each fund.

	Normal conditions		
JFSA classification	**Market value (JPY, in billion)**	**Normal % AUM**	**Normal cumulative % AUM**
Highly liquid	30.41	54.3%	54.3%
Medium liquidity	17.90	32.0%	86.3%
Low liquidity	–	0.0%	86.3%
Non-liquid	7.67	13.7%	100.0%
Not Covered	–	0.00%	–
Total	55.99	100.00%	

	Stressed conditions (LEHMAN08 scenario)		
JFSA classification	**Market value (JPY, in billion)**	**Normal % AUM**	**Normal cumulative % AUM**
Highly liquid	31.76	56.7%	56.7%
Medium liquidity	6.80	12.2%	68.9%
Low liquidity	–	0.0%	68.9%
Non-liquid	17.41	31.1%	100.0%
Not Covered	–	0.00%	–
Total	55.99	100.00%	

Minimum highly liquid threshold – 20%
Maximum non-liquid threshold – 15%

Pass Fail

Figure 4 – JITA classifications for a sample fund under both normal and stressed (Lehman 2008) market conditions. Includes limit monitoring indicator.

Stress testing

Defining appropriate stress scenarios can present a major challenge due to a lack of observable data points to calibrate such events. Bloomberg LQA provides a straightforward approach to scenario definition based on four market parameters:

- Redemption amount
- Price volatility
- Daily available volume
- Bid-ask spread

Firms can calibrate multiple scenarios using data from historical events and/or hypothetical (forward-looking) events to simulate a variety of stresses, including those with low probability but high impact. Stress factors can be defined either as a multiplier of current market conditions or as absolute values. Applied at the portfolio level, asset class level or even security level, this provides customisation options to complement other fund investment metrics. A parameter-based approach enhances the ability to explain outcomes to senior management.

Bloomberg has configured pre-defined stress calibrations for most significant historical stresses and built a range of forward-looking stress events. These include the Financial Crisis in 2008 and the COVID-19 pandemic in Q1 2020, calibrated at a sector level.

While LQA does not have oversight of a fund's liabilities or investor profile, firms can evaluate the liquidity sensitivity of a fund under any foreseeable redemption scenario. This can be done at the portfolio or individual position level, allowing for non-pro rata liquidation strategies to be included.

		Normal	Mild scenario	Moderate scenario	Severe scenario	Extreme scenario
Portfolio	Redemption %	1%	3%	5%	7%	10%
	Confidence level	50%	50%	50%	50%	50%
Fixed income	Multiply 1D available volume	1.00	0.90	0.75	0.50	0.25
	Multiply price volatility	1.00	1.25	1.50	1.75	3.00
	Multiply bid-ask spread	1.00	1.10	1.25	1.50	2.00
Equity	Multiply 1D available volume	1.00	1.00	0.90	0.90	0.75
	Multiply price volatility	1.00	1.50	2.00	3.00	3.50
	Multiply bid-ask spread	1.00	1.25	1.50	2.00	2.50

Figure 5 – Sample redemption scenario definitions with asset class and sector-specific stresses.

The ability to consider hypothetical scenarios, both on the asset and liability side of the balance sheet, means LQA has the flexibility to provide independent market liquidity governance metrics over the entire fund lifecycle. Current industry trends include monitoring liquidity over time, construction of early warnings to alert which scenarios have adverse outcomes in meeting fund redemptions and the use of reverse stress testing where firms consider which liquidity events lead to pre-defined adverse outcomes. Firms can also measure the cost of liquidating each position within customisable time periods to determine the total liquidation cost of each scenario.

Reporting and disclosure

Generation of fund-specific actionable liquidity metrics is possible following the application of discrete scenarios. LQA leverages a vast amount of global transactions and executable quotes data to model the time it takes to liquidate each position conditional upon liquidation cost preferences (i.e., market impact). Aggregating liquidity metrics facilitates measurement of the cumulative liquidation horizon for each scenario.

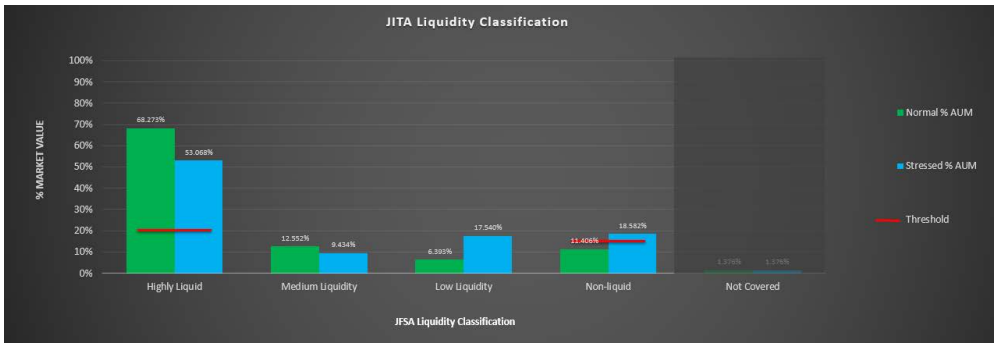

Figure 6 – Liquidity classification under both normal and stressed scenario (COVID-19, 2020). Shown with thresholds applied.

Workflow.

LQA can be seamlessly integrated into your current workflow, whether that is based in a third-party application, internal systems, Excel or the Bloomberg Terminal.

LQA liquidity analytics are available through:

- BLP API for programmatic connectivity via Python, R, C++, Java, etc.
- Excel API
- Enterprise Data Feed
- Bloomberg Terminal:
  – **LQA <GO>** for single security and sector comparison
  – **LQAP <GO>** for portfolio liquidity profiling

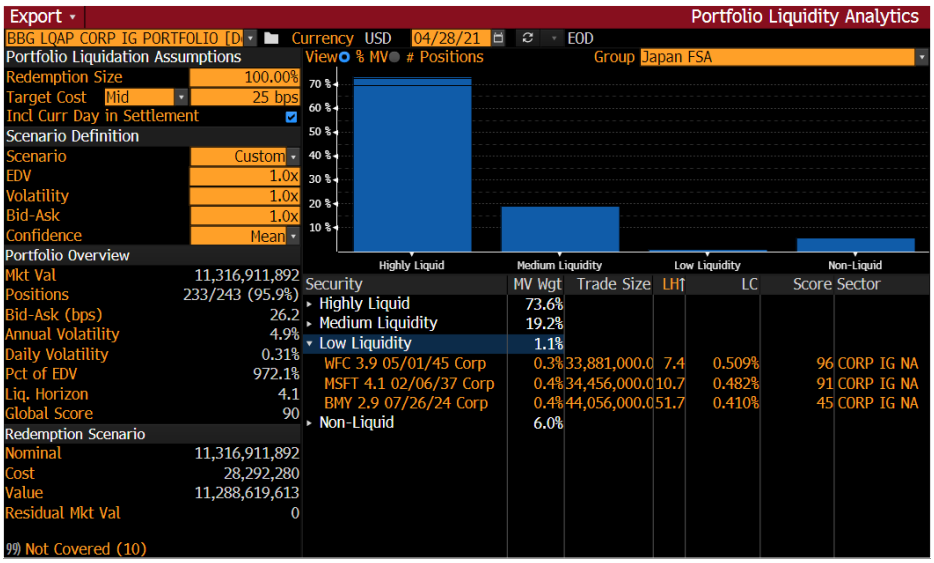

Figure 7 – Bloomberg LQAP illustrating JFSA classifications.

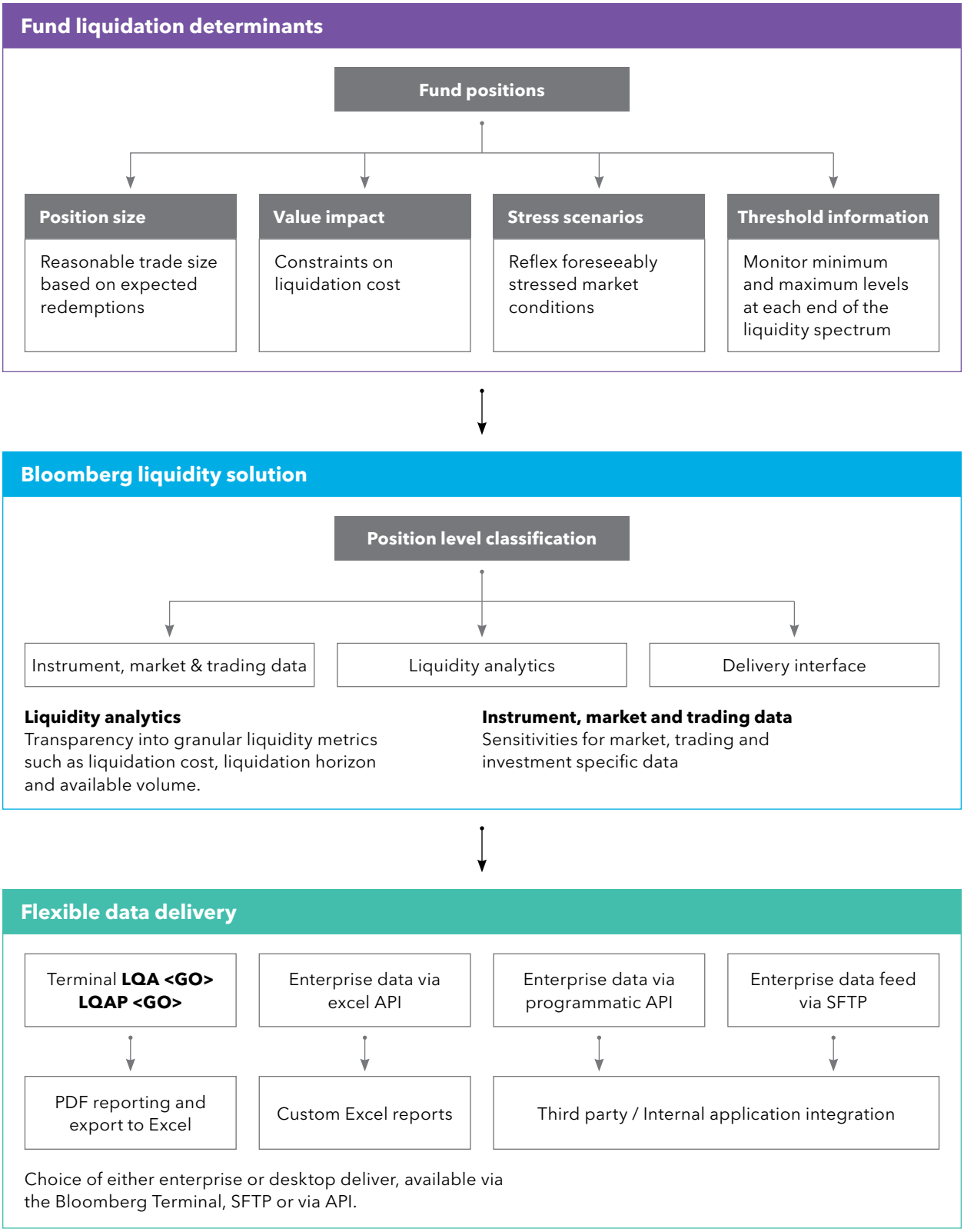

Figure 8 – Flow of Bloomberg and client inputs and corresponding outputs.

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