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CONSULTATION RESPONSE

Brussels, 8 October 2024

EFAMA's response to ESMA Consultation paper on Draft RTS on Liquidity Management Tools under the AIFMD and UCITS Directive[1]

General remarks

As stated in recital 29 of the Amending Directive 2024/927[2], the new rules on liquidity management tools (LMTs), included both in AIFMD[3] and UCITSD[4], aimed to "*ensure a more effective response to liquidity pressures in times of market stress and to better protect investors*". It also echoed the Recommendation of ESRB[5] which highlighted that "*The availability of a diverse set of liquidity management tools in all Member States would increase the capacity of fund managers to deal with redemption pressures when market liquidity becomes stressed*". These goals have been also long supported by EFAMA and the industry welcomed the opportunity to use a broader range of LMTs. The harmonisation of a list of available LMTs at EU level is expected to contribute to the creation of a level playing field and showing that EU has deployed international standards.

Therefore we also appreciate the launch by ESMA of these important consultations and the quality of drafted regulatory technical standards specifying the characteristics of LMTs (RTSs) and guidelines on selection and calibration thereof (Guidelines), as this is an area of many complexities and subtleties.

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[1] ESMA, Consultation Paper. Draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive, 8 July 2024 (Consultation Paper).
[2] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds (Text with EEA relevance) (Amending Directive 2024/927).
[3] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (AIFMD).
[4] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITSD).
[5] European Systemic Risk Board, Recommendation of the European Systemic Risk Board of 7 December 2017 on liquidity and leverage risks in investment funds, ESRB/2017/6.

EFAMA is also of the opinion that these harmonised rules should not disregard solutions that have been previously developed in Member States (e.g. borrowing, credit lines or extension of settlement period) and should view LMTs as an element of the fund's overall liquidity management framework. Therefore we strongly agree with the general consideration from ESMA in paragraph 21 and 22 of the draft RTSs and paragraph 18 of the draft Guidelines, that "*managers may also decide to use other tools than the ones referred to in the AIFMD and UCITS Directive to manage the liquidity of the fund they manage*".

Even more importantly rules established by ESMA should not constrain the manager in his ability to choose the most suitable set of LMTs for a particular fund. Ensuring sufficient flexibility for managers is essential to provide them with appropriate solutions that would allow to address any future issues with the fund's liquidity, both in normal and market stressed conditions. For that reason mandates given to ESMA in Art. 16(2h) of AIFMD and Art. 18a(4) of UCITSD clearly highlight the primary responsibility of the manager for liquidity risk management.

A too prescriptive approach, on the contrary, could hamper the deployment of a full range of available LMTs. Therefore, in our key recommendations we aim to enhance the effective use of LMTs and we call for:

i. Even stronger and more comprehensive recognition of the manager's discretion in the draft RTSs and guidelines and for that purpose:
   a. Managers should not be obliged to consider at least one anti-dilution tool and at least one quantitative LMT;
   b. There should be no definition or list of "exceptional circumstances" that justify activation of suspensions and side pockets;
   c. There should be no fixed minimum activation thresholds established by ESMA;
   d. Once thresholds set by the manager are exceeded, they should not lead to obligatory automatic activation;
   e. There should be no obligation to simultaneously suspend subscriptions, redemptions and repurchases.

ii. While managers should consider whether funds under their management are exposed to implicit transaction costs, including material market impact, they should only incorporate these costs into their anti-dilution frameworks when appropriate and only on a best effort basis.

iii. Disclosures to investors should be limited and help them understand these mechanisms and their implications. They should not include activation thresholds (as well as other conditions for activation/deactivation), as this information could be abused by sophisticated investors.

As on previous occasions, we would also like to highlight that the timing of summer holidays does not work in favour of the outcome of the consultations. It is very challenging when it comes to gathering detailed feedback and analysis, in particular on topics as technical as these. Despite what is being highlighted as most helpful feedback for ESMA, such arrangements for the consultation process impede due consideration being given to all the details. Therefore, we might be providing ESMA with additional analysis and input on the issues raised in the Consultation Paper and we would welcome the possibility to remain in an ongoing dialogue with the authority.

Suspension of subscriptions, repurchases and redemptions

Q1. Do you agree with the proposed characteristics of suspension of subscriptions, repurchases and redemptions? If not, please justify your position.

We would question the assumption that in all cases a suspension should apply simultaneously to subscriptions, repurchases and redemptions.

There are circumstances under which a fund has to suspend redemptions but should remain open for subscriptions. This would be the case for funds that invest in assets that are structurally illiquid or hard to liquidate, like for example real estate funds or private equity. An obligation to simultaneously suspend both redemptions and subscriptions would harm the possibility to create necessary liquidity in funds that are suffering temporary liquidity problems. Allowing for subscriptions to continue would help balance net redemptions and reduce the liquidity stress to the benefit of the existing investors. In fact, it is quite common in practice that also existing investors would be interested in additional subscriptions, as another possible remedy aimed at providing resources to funds that are in liquidity distress (especially in case of some AIFs). This would happen subject to the following conditions: (i) proper valuation of the fund is guaranteed and NAV is being published, (ii) new investors need to be fully informed on the situation of the fund, and (iii) the manager should take into account all possible measures to ensure an equal treatment of investors.

There are also circumstances when it would be appropriate for subscriptions to be suspended, but redemption to remain permitted. For example, where the size of the strategy is capped, subscriptions may be suspended but redemptions and repurchases should continue to be available. Alternatively, a suspension of subscriptions and redemptions may be imposed as a way to make a controlled wind down of a class or a fund, but repurchase should be available to allow the return of assets to investors.

Therefore we believe that fund managers should benefit from the flexibility to choose whether in a particular case suspensions should apply simultaneously or only to subscriptions, repurchases or redemptions.

Q2. Do you agree that orders that have been placed but not executed before the fund manager suspends shall not be executed until the suspension is lifted? If not, please explain why these orders shall be executed.

In principle we would agree.

There can be, however, circumstances when such approach may present a number of operational issues and therefore certain level of discretion and flexibility should be secured also in these regards. These circumstances revolve mainly around funds that are distributed cross-border with the use of straight through processing (STP). In cases of a difference in time zones such orders can be placed outside of the working hours in the EU. Having them suspended afterwards could be (i) seen as an argument against investing in EU funds rather than e.g. Asian ones, and (ii) challenging to carry out if these orders were already executed automatically. Any attempt to reverse them would be operationally difficult and would have an even stronger reputational impact on the industry.

Fund managers should also have the possibility to envisage a “cut-off date” of suspensions i.e. a date prior to the effective date of the suspension. It allows for all orders that have been placed before the “cut-off date” not to be affected by the suspension and be executed even before the suspension is lifted. The managers should also have the flexibility to use this solution.

Q3. Once the fund is reopened for subscriptions, repurchases and redemptions, what would be your approach to redemption orders that have not been executed before the fund was suspended?

Our understanding is that there are divergent approaches to treatment of residual orders in different Member States, with possible options being i.a.: (i) automatic cancellation, (ii) pro rata, (iii) simultaneous, or (iv) chronological execution. Therefore, we believe that it should be for the manager to determine which approach would be most suitable in case of a particular fund. This should be considered a priori and before this LMT is activated. Investors should be clearly informed and ensured to be treated equally.

There could also be cases in which investors would want to cancel the part of their redemption order that was not executed before the suspension was activated. In these circumstances we believe that the consent of the manager should be sought, depending also on the conditions specific to the market and redemption process. This should also be clearly explained in the fund's documentation. If the consent is given, such orders would be cancelled and investors would have to place new orders should they later want to redeem or suspend. Should the manager believe that it is not in the interest of the fund and remaining investors to give his consent, such orders would be executed once the suspension is lifted according to the approach chosen for particular fund.

Q4. Do you think there are circumstances where subscriptions, repurchases and redemptions may not be reopened simultaneously? If yes, what are these circumstances?

We believe that there are circumstances under which it could be justified to reopen subscriptions while keeping the redemptions suspended.

This could help solve the issues with liquidity of the fund to the benefit of all investors, as the capital gathered through subscriptions could be used to improve the liquidity of the fund by purchasing liquid assets. This would also help reduce any dilution and would allow the manager to avoid actions that would be more far-reaching, as the liquidation of the fund or the creation of side pockets. As mentioned in our response to question no. 1 it is quite common in practice for existing investors. It should also be noted that for new investors willing to subscribe to the fund in such circumstances they should be made aware of the situation of the fund before placing their order, as suspensions are publicly disclosed.

We would also like to echo other examples mentioned under our response to question no. 1.

Q5. Can you think of any further characteristics of suspension of subscriptions, repurchases and redemptions?

Apart from elements mentioned in our responses to questions no. 1-4 above, we do not see any further characteristics that could be included in the RTSs.

Q6. Do you think there is merit for the characteristics of suspension of subscriptions, repurchases and redemptions gates to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not see merit in the RTSs providing different characteristics of suspensions, between different investment strategies and between AIFs and UCITS. Ultimately it is the manager who will have to consider the investment strategy of the fund, its portfolio, type of the fund and its investors' base in order to act in the best interest of the investors.

What matters most is that managers should benefit from sufficient flexibility as they would need to react to very different circumstances. This LMT in particular requires very careful consideration due to its far-reaching consequences which can damage the relationship with investors and possibly threaten the long term survival of the fund. Therefore, managers should always treat the possible activation of this LMT with utmost consideration to choose the best solution for the unit- or shareholders.

We would like to take this question as an opportunity to highlight a more general issue regarding the scope of the RTS. As Art. 16(2c) of AIFMD refers to AIFs that are open-ended, it should be acknowledged that there are still differences among Member States on how the definition of open-ended AIFs is being interpreted. Also in this case sufficient flexibility should be given to managers to analyse redemption policy of a particular fund to conclude whether it complies with the definition of open-ended AIFs established in

the Delegated Regulation 694/2014[6], and as a consequence whether these rules on LMTs would be applicable to them.

Also in the case of AIFs that are not publicly offered (certain AIFs with restricted number of investors), they should not be covered by this RTS as in this case the redemption procedure is agreed directly between the investor and the fund manager.

In case of redemption gates, please see our response to question no. 13.

Redemption gates

Q7. Do you agree with the description of redemption gates and their characteristics? If not, please justify your position.

As a preliminary remark, we would like to highlight here that gates or "soft closures" can be used not only in circumstances when a fund is under pressure coming from redemptions, but also from subscriptions. This will become useful in cases when a fund is experiencing issues while purchasing assets.

EFAMA strongly supports full flexibility being given to managers to determine an appropriate activation threshold for each, particular fund. As we explain in more details in our response to question no. 14 under ESMA consultation paper on the Guidelines, we believe that any fixed minimum activation thresholds would clearly go against the principle of manager's discretion.

For further comments, please see answers provided in our responses to questions below.

Q8. The draft RTS provides that the redemption gate threshold shall be expressed as a percentage of the NAV of the fund considering the net redemption orders for a given dealing day. Are you aware of any other method that ESMA should consider in the RTS? If yes, please explain.

Firstly we would like to question the method provided in both draft RTSs for the calculation of the activation threshold for redemption gates.

Under Art. 2(1) included in both draft RTSs, it is specified that it will be "*predefined as net redemption orders an AIF receives for a given dealing date, in proportion to the NAV of the AIF*" (for UCITS respectively). There can be circumstances under which such calculation might not be the best approach. In some Member States redemption gates are commonly calculated as the total amount of redemption orders on a certain date and the calculation method of such amount should not be net of the subscriptions' amount. Moreover, in case of funds where subscriptions are managed through a queuing system, with capital calls made on demand, subscription orders might already be partially or fully allocated to upcoming investments and binding commitments made by the AIF. These can therefore not be used to meet redemption requests (e.g. the case of real estate funds). To address this issue, we are of the opinion that the calculation method for the activation threshold should focus solely on "redemption orders" rather than "*net* redemption orders", or at least define the net redemptions as excluding any subscription orders that have been allocated to binding commitments. This would allow for a better reflection of the fund's real ability to meet redemption requests without relying on subscription orders that may not be available.

Therefore we would suggest that the word "*net*" to be deleted from Art. 2(1) in both RTSs or they should be given the following wording : "*A redemption gate shall include an activation threshold predefined as the net redemption orders an AIF receives for a given dealing date, **excluding any subscription orders that have***

[6] Commission Delegated Regulation (EU) No 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers Text with EEA relevance (Delegated Regulation 694/2014).

been previously allocated to binding commitments made by the fund as part of its investments, *in proportion of the NAV of the AIF*" (for UCITS respectively).

Secondly, we would like to highlight that there can be alternative approaches and/or methodologies for defining of the activation threshold for redemption gates.

For example, while the draft RTSs suggest setting the redemption gate threshold based on net redemption orders for a single dealing day, a rolling period approach might be more suitable for some funds. This method provides a more comprehensive view of redemptions trend over time, allowing for a less reactive and more stable approach. It could be useful in circumstances when redemptions received over some period of time cumulatively exceed a level which could, according to the manager, be absorbed by the market without a significant impact. For example, a fund with a bi-weekly dealing frequency could use a rolling three-month period to determine the activation threshold, rather than relying on a single dealing day. Additionally, under this approach, reimbursements would be made up to a minimum percentage specified by the manager and disclosed in the fund rules, which may differ from the activation threshold level. This would also ensure an equal treatment of investors, as the gate would be applied uniformly once activated.

We would also like to highlight that having the threshold expressed as percentage of the NAV is not the only option. In cases of some asset classes, it may be more appropriate to link the threshold to the size of the market and not the size of the fund. For example, it is possible to calculate the size of a particular real estate market and deduct an absolute transaction size that the market will be able to absorb. In that case the threshold would be expressed as an absolute monetary threshold.

Q9. Do you agree that redemption gates may be either activated automatically when the activation threshold is exceeded or that the fund manager/ fund Boards may decide whether or not to activate the redemption gate? Do you believe that automatic activation of redemption gates could create a first mover advantage?

As a preliminary remark, we would like to clarify that managers should not be obliged by the automatic activation of redemption gates once the activation threshold is exceeded. It should be up to the decision of the manager on how the activation process is designed.

In general we are of the opinion that the activation of the LMT should be in the hands of the manager and such decision is discretionary and based on the analysis of particular case. Managers should not be forced to activate a gate when a threshold is exceeded but the overall analysis of the liquidity of the fund, market conditions and best interests of investors speak against it. Rather than that a threshold should be treated as an indicative guide above which manager should consider whether to activate the LMT.

We can not rule out that there could be circumstances where choosing an option of automatic activation could be useful. However, this would have to be carefully analysed and the possibility of creating a risk of this being used by sophisticated investors to obtain unfair advantage should be considered and avoided. We also believe that in cases where manager would decide at his own choice to include automatic activation into the process, he should retain the discretion not to activate the gate once the threshold is exceeded and overall circumstances speak against it.

Q10. Do you think that the automatic activation of redemption gates shall not be permitted for some types of funds? If yes, please explain your position.

Please see our response to question no. 9 above. We are of the opinion that should the automatic activation of redemption gates be permitted, there should be no differentiation as to the type of fund.

Q11. Do you agree that the activation threshold shall not be expressed at the level of the single redemption order? If not, please justify your position.

We agree in general that the activation threshold shall not be expressed at the level of the single redemption order.

We would however note that managers should be allowed to use a proportionate approach in these regards and in cases when it can be justified by the interest of smaller unitholders. There can be circumstances where there is a huge disproportion in the size of redemption orders place by different investors. For example, a fund where the activation threshold is set at the level of 10% receives total redemption of 15%, however among orders placed there is one that accounts for 12% and other orders that account for the remaining 3%. In such case it would be in line with the overall interest of the investors to partially postpone the order of 12% and allow for the smaller orders to be redeemed. It would definitely be contrary to the interest of all investors to redeem the order of 12% (up to the level of the threshold) and postpone smaller orders entirely. The advantage of this proportionality approach is also that it will reduce the operational issues that a gating could trigger for the underlying investors (e.g. in case of significant redemptions from distributors, platform, nominees).

Please also see our response to question no. 14 as regards the differentiation of the threshold between different share classes.

Q12. In the case of activation of redemption gates, do you agree that investors should have the right to cancel the non-executed part of their redemption orders? In particular, should there be a different approach between UCITS and AIFs?

The issue of non-executed parts of redemption orders is addressed very differently, according to the common practice of a Member State or manager and according to the specificities of a particular fund. Therefore, characteristics of redemption gates (paragraph 35 of the Consultation Paper) that allow for the non-executed parts of redemption orders only to (i) be carried forward to the next dealing date, or (ii) cancelled at the request of the investor, are insufficient and do not provide the necessary flexibility.

Further options should be allowed, such as:

a. Automatic expiration of the orders that were not executed, which is widely used e.g. on the German market and was also foreseen by the French supervisor as one of the possible options[7]. It allows for a reduction of administrative burdens. In particular in the case of less liquid funds (e.g. real estate or private equity funds), they may not be able to sell underlying assets within the given time. In such case the remaining orders could not be fully satisfied also on the next redemption date and would need to be further postponed.
b. Cancellation at the request of the investor which is subject to the approval of the manager on a case-by-case basis. Availability of this option is important in particular for funds with less liquid assets, which require more time to execute the sale of underlying assets. It would be contrary to the interest of remaining investors and overall liquidity risk management if such fund would first engage to sell assets and then cancel it;
c. Execution of remaining orders on the next redemption date, however without priority over redemption requests made on that day. This allows to avoid the risk of queuing of unmet redemption orders.

EFAMA is of the opinion that all above mentioned options should be available to the manger, who is best placed to determine which approach would be most suitable in case of a particular fund. The approach taken should be clearly and in advance communicated to investors (e.g. in the prospectus) and applied

[7] Autorité des Marchés Financiers, AMF Instruction. Conditions for setting up redemption gate mechanisms, DOC-2017-05, p. 4.

uniformly without possibility of amendments being made to the favour of some investors, at the expense of the others.

We do not see circumstances which would justify a different approach being taken towards UCITS and AIFs.

Q13. Do you think there is merit in having different characteristics of redemption gates for different investment strategies and between AIFs and UCITS? If yes, how?

The activation of redemption gates will always have to be consistent with different investment strategies of the fund. We believe that the broad characteristics of the redemption gates specified in the RTSs, including our remarks presented above, are sufficient, being mindful of the fact that they will be applied consistent with the different investment strategies. We also believe that there should not be differences between AIFs and UCITS in these regards.

Q14. In the case of funds with multiple share classes, do you agree that the same redemption gate shall apply to all share classes? If not, please justify your position.

We would disagree with the statement that the same redemption gate should always apply to all share classes. It is in general observed that in some cases it could be useful to have some differences in how LMTs are being applied, for example, to share classes that are distributed to retail investors in comparison to the share classes that are distributed to institutional investors. The example that was included in our response to question no. 11 above could be mitigated also by the use of different redemption gates for different share classes (where bigger orders are usually experienced from institutional investors, rather than retail) or by the calculation of the threshold separately for each share class.

Differences in the application of redemption gates among share classes should be compliant with the principles stated by ESMA in its opinion Share classes of UCITS[8] and in particular with the "Non-contagion" principle whereby "*UCITS management companies should implement appropriate procedures to minimise the risk that features that are specific to one share class could have a potentially adverse impact on other share classes of the same fund*".

Q15. Can you think of any further characteristics of redemption gates?

We would like to take this question as a opportunity to highlight specificities of European Long Term Investment Funds (ELTIF). Article 2 of the draft RTS under AIFMD states that paragraph 1 does not apply to ELTIFs, since their "gate" is calibrated by reference to the UCITS-eligible asset pocket as opposed to the overall NAV. We note some overlap with, for example, paragraph 4 which refers to the same level of redemption gate applying to all redeeming shareholders or unit-holders in proportion to their redemption orders, while Article 18(2)(d) of the ELTIF Regulation[9] provides that "r*edemptions are granted on a pro rata basis if the requests for redemptions exceed the percentage referred to in point (d) of this subparagraph*."

Extension of notice periods

Q16. Do you agree with the description of extensions of notice period and their characteristics? If not, please justify your position.

[8] ESMA, Opinion. Share classes of UCITS, 30 January 2017, ESMA34-43-296, p. 3.
[9] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (Text with EEA relevance) (ELTIF Regulation).

As a preliminary remark, we would like to add that the extension of notice periods is not only used as a remedy for the sudden deterioration of liquidity in the market at large. It is also a useful tool to properly mitigate the impact on remaining investors in the presence of large redemptions. The market impact of such redemptions is difficult to calculate in advance and can only be ascertained once all trades have been executed. Therefore the extension of notice periods allows redemptions to be properly accounted for and attributed to the redeeming investor, rather than borne by the remaining ones.

We would also suggest for Art. 3(4) of both draft RTSs to be removed, as this approach can not be implemented as regards retail funds with wide investors base.

Q17. Do you agree that the same extension of notice period shall apply to all investors or different extensions of notice periods per share class/unit shall be allowed? Please justify your position.

There could be merit in a separate treatment of individual retail investors as opposed to institutional ones. Redemption orders submitted by the former are usually less likely to cause a significant market impact and they should not necessary be delayed by the fact that they are coinciding with a significant redemption order from an institutional investor. Therefore, there could be circumstances where these orders should be treated separately to protect individual investors. Especially that there may be different notice periods applicable to different share classes to reflect different investor profiles (e.g., an institutional share class may agree to a 12 month notice period in exchange for a lower redemption fee/management fee, while a retail share class could have a much lower notice period). Requiring the same extension for each of these would lead to illogical and unfair results.

Therefore the fund manager should have flexibility to provide in the fund rules either the same extension of notice period for all share classes or differentiated extensions of notice periods across the different share classes.

Q18. Do you agree that extensions of notice period may be applied for a pre-defined period of time (for a pre-defined number of dealing dates)? If not, please justify your position.

We are in favour of sufficient flexibility being given to the manager when applying this LMT as in most cases he might not be in the position to predict upfront when the circumstances that caused the need to extend the notice period will cease to exist. There may be cases when he will be able to extend the notice period for a pre-defined period of time, however he should not be obliged to do so in each particular case.

Q19. Do you think there is merit for the characteristics of extensions of notice period to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not see merit in the RTSs providing different characteristics of extension of notice period based on different investment strategies and between different types of funds. The RTSs should give managers sufficient flexibility to structure the extensions of notice period based on the characteristics of the funds managed.

Q20. How would you execute redemption orders that have been placed but not executed before the notice period is extended? Would you execute them under the original notice period, or would you execute them at the following dealing day?

In general redemption orders that have been placed but not executed before the notice period was extended, would be executed under the original notice period. However, there may be circumstances where they would have to be executed at the following dealing day, e.g. when there are issues with market liquidity. Managers should have the flexibility to decide on the solution that will be most appropriate taking into account the functioning and operating rules of the fund and ensuring equal treatment of investors.

Q21. How would you ensure fair treatment of investors when deactivating the extension of notice period?

The fair treatment of investors and between investors would be guaranteed by (i) making sure that they all benefit from the deactivation of the extension of notice periods, and (ii) keeping a chronological sequence while executing the orders, which means that the first orders to be executed after the LMT is deactivated would be the ones that were placed the earliest before the extension of notice periods was decided. However, this chronological sequencing would not be necessary if enough liquidity is available to meet all redemption requests. Apart from that clear information to investors is necessary, both prior to the activation of this LMT as a well as during the process. We are of the opinion that this approach derives and is in line with the overarching principle of equal treatment of investors, and as such there is no need for further guidance here.

Redemption fees

Q22.Do you agree with the description of redemption fees and the corresponding characteristics? If not, please justify your position.

We would not agree entirely with the description of redemption fees provided.

First of all, we would like to highlight that redemption fees are not only used as an LMT and to reflect the immediate cost of liquidity. They can be also used for example as a way to encourage investors to hold the investment in line with the recommended holding period. In this case fees would usually decrease gradually in line with the progression of the period that the investor is in fact keeping his investments in the fund. This is helpful for the manager to reduce the impact that premature redemptions would have on its ability to fully execute the envisaged investment strategy in the interest of remaining investors. Moreover, redemption fees can be also used as a way to penalise breaches of previously agreed lock-up periods.

We would also like to point out that a redemption fee should not be considered as predetermined and more flexibility is required. Managers should be allowed to determine the actual percentage that will be applied. In fact the expectation to predetermine the fee is contradictory to what is also said in Art. 4(2) of the draft RTSs where it is expected that redemption fees shall impose also the implicit estimated costs, including estimated significant market impact. Therefore, we would suggest that the word "predefined" should be removed from Art. 4(1) in both draft RTSs.

Moreover, in some Member States limits were established in national legislation for the maximum amount of redemption fee. This goes against EU provisions and therefore harmonisation should be pursued to safeguard the same, high level of manager's discretion across the EU.

When it comes to what is mentioned in Art. 4(2) of the draft RTSs, we would like to highlight that also predetermined discount of the NAV unit price received by redeeming investors should be recognised as a possible redemption fee, as it was mentioned by the International Organisation of Securities Commissions (IOSCO) in its Guidelines on ADTs[10]. This solution could be useful in circumstances where using a pro-rata approach to estimate the transaction cost is not possible, which would be the case for funds with significant part of their portfolio allocated in inherently illiquid assets (e.g. real estate or private equity). This solution would also protect remaining investors. Therefore, we would suggest that this possibility should also be recognised in the Art. 4(2) of the draft RTSs.

[10] Guidelines on ADTs, p. 12, footnote 29.

Moreover, we would like to point out that contradictory to what is said in the Art. 4(2) of the draft RTS, the rate of the redemption fee is usually calculated by reference to typical estimated costs of liquidity and not the costs caused by particular redemptions.

We would also like to point out that Art. 4(7) of the draft RTSs would not always be true and may create practical issues. Costs can be calculated on a sub-fund level, taking into account the overall level of redemptions and not particular orders. Therefore it might not be possible to differentiate the level of the fee based on the level of the redemption.

Q23.Can you think of any other redemption fee mechanism than the ones described above? If yes, please provide examples.

Please see our response to question no. 22.

Q24. Do you think there is merit for the characteristics of redemption fees to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not believe there is merit to differentiate in the RTSs characteristics of redemption fees based on different strategies or between AIFs and UCITS.

Swing pricing

Q25. Do you agree with the description of swing pricing and the corresponding characteristics? If not, please justify your position.

Yes, we agree with the description of swing pricing and the corresponding characteristics. In particular we are of the opinion that it is important that the draft RTSs recognise, the possibility to use a partial swing only, which avoids unnecessary volatility. The same applies for a so-called "tiered" approach, where the swing factor is scaled as a function of the market situation. These elements are important to provide flexibility in the application of this LMT, which is one of the most operationally complex and expensive ADT. As regards the "tiered" approach, although we see it mentioned in the Consultation Paper and in the recitals of both draft RTSs, we are of the opinion that this option should be also clearly envisaged in the provisions of Art. 5 of both RTSs.

We would also like to highlight that swing pricing can be used not only in market stressed conditions. Its use also in the normal market conditions, where there are significant net capital flows, would also allow for better understanding of this mechanism among investors. It would help to release the stigma on swing pricing activated in market stressed conditions.

Please also see our response to question no. 27 from the consultation paper on draft Guidelines in regards to the calculation of implicit transaction costs, including significant market impact. Consequently we would ask for it to be consistently included both in the draft RTSs and in the Guidelines that managers should consider whether funds under their management are exposed to a implicit transaction costs, including material market impact, however they should only incorporate these costs when appropriate and only on a best efforts basis. Any reference to liquidity costs should only mention their estimates, as this is what the manager is able to provide at best.

Q26. Can you think of any characteristics of swing pricing that the ones described above?

We do not see further characteristics of swing pricing that could be provided here.

Q27. Do you think there is merit for the characteristics of swing pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not believe there is merit to differentiate in the RTSs characteristics of swing pricing based on different strategies or between AIFs and UCITS. It should be the manager who will consider investment strategy of the fund along with other factors and decide on the best approach.

Q28. Do you agree that in the case of funds with multiple share classes, the same swing factor shall be applied to all share classes? If not, please justify your position.

We would disagree as in our opinion it should be permitted to apply different swing pricing methods to different share classes of the same fund, as long as it is in line with the overarching principle of fair treatment of all investors.

This would, for example, be the case if different share classes are envisaged for different types of investors. If a share class that is designed for institutional investors is hedged it would result in higher costs, than an unhedged share class designed for retail investors. In such a scenario, a swing factor for unhedged retail share class should not include costs of the hedged share class.

Dual pricing

Q29. Do you agree with the description of the dual pricing and the corresponding characteristics? If not, please justify your position.

As highlighted by ESMA in question 36 of the consultation paper on the draft Guidelines, dual pricing is not particularly used in Member States. Therefore we are of the opinion that characteristics of this LMT should in particular not limit the managers discretion. If needed they could be amended further along the way, once sufficient number of practical examples could be observed on the market.

Therefore Art. 6 of both draft RTSs should first of all support the definition established in Annex V to AIFMD and Annex IIA to UCITSD and be limited to the following characteristics of dual pricing:

i. it is a mechanism allowing to charge transaction costs of buying/selling a pro-rata slice of the portfolio to subscribers/redeemers as if the were buying/selling underlying assets directly, and

ii. it creates different prices for subscriptions/redemptions at the same dealing point: The subscription price reflects the net asset value of the UCITS/AIF determined by reference to the ask prices and explicit transaction costs of the portfolio holdings. The redemption price reflects the net asset value of the UCITS/AIF determined by reference to the bid prices and explicit transaction costs of the portfolio holdings.

Q30. Are there any other calculation methods for dual pricing that should be considered? If yes, please give example.

As already raised in our response to question no. 29, due to a lack of sufficient practice with the use of dual pricing we would warn against any provisions of the draft RTSs that would limit managers discretion to develop other calculation methods than currently included in Art. 6 of the draft RTSs.

Where investors deal directly with the fund it is prone to concentration (the opposite of dilution) which artificially improves the performance of the fund. One way to reduce this issue of concentration is to reduce the difference (“spread”) between the subscription and redemption prices to align more closely with the impact of net flows. The redemption price would be increased in the case of net subscriptions and the subscription price reduced in the case of net redemptions in order to help share the benefit of dual pricing fairly between existing or remaining investors and investors trading their shares or units in the opposite

direction to the net flow. Ultimately, if the spread is reduced to nil, the mechanism performs the same as full swing pricing.

Q31. Do you think there is merit for the characteristics of dual pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not believe there is merit to differentiate in the RTSs characteristics of swing pricing based on different strategies or between AIFs and UCITS. It should be the manager who will consider investment strategy of the fund along with other factors and decide on the best approach.

Anti-dilution levy

Q32. Do you agree with the description of the anti-dilution levy and the corresponding characteristics? If not, please justify your position.

We would like to refer to our response to question no. 27 from the consultation paper on draft Guidelines where we highlight issues with estimations of implicit transaction costs, as well as significant market impact and the need for these calculations to be performed only where relevant and only on a best effort basis.

We would also like to highlight an important difference in Art. 7(1) included in both draft RTSs. In the RTS regarding UCITS funds it is clearly said that the significant market impact has to be "estimated". This is however missing in the RTS regarding AIFs. We believe this difference is unjustified and Art. 7(1) of the draft RTS for AIFs should have following wording: "*1. Anti-dilution levies shall impose on redeeming and subscribing shareholders or unitholders the explicit and implicit estimated costs of portfolio transactions caused by subscriptions or redemptions, including any* ***estimated*** *significant market impact of assets purchases or sales to meet those subscriptions or redemptions*."

We would also suggest removing phrase "in advance" in Art. 7(4) of both draft RTSs and giving it, on the example of the RTS for AIFs, the following wording: "*4. Anti-dilution levies may include a trigger threshold determined ~~in advance~~ by the AIFM or the fund Board as applicable. In the case of an anti-dilution levy with a trigger threshold, the anti-dilution levy shall be applied only if the net difference between the redemption orders and the subscription orders, for a given dealing date, exceeds the trigger threshold*."

Q33. Are there any other calculation methods for anti-dilution levy that ESMA shall consider? If yes, please give example.

Anti-dilution levies are also used where the exposure to underlying assets is obtained in a synthetic manner. In such case built-in, fixed rebalancing costs or "swap fees" need to be taken into account. The "swap fees" are charged by the counterparty that is providing the manager with exposure to a particular asset class or basket of securities via a total return swap. In such case the fund will not buy these assets but will get the performance of these assets from a counterparty. The "swap fees" can include costs of hedging for the counterparty, rebalancing costs, if the underlying basket is not static etc.

Therefore, managers should be enabled to take into account also these factors when setting the level of anti-dilution levy.

Q34. In the case of funds with multiple share classes, would you see the possibility for different anti-dilution levies depending on share classes? Please justify your position.

We would like to refer to our response to question no. 28 and the example of hedged and non-hedged asset classes which could also justify different ADL being applied.

Q35. Do you think there is merit for the characteristics of anti-dilution levy to differ between different investment strategies and between AIFs and UCITS? If yes, how?

We do not believe there is merit to differentiate in the RTSs characteristics of an anti-dilution levy based on different strategies or between AIFs and UCITS. It should be the manager who will consider investment strategy of the fund along with other factors and decide on the best approach.

Redemptions in kind

Q36. Do you agree with the description of redemptions in kind and the corresponding characteristics? If not, please justify your position.

We broadly agree with the criteria guiding the opportunity of in kind redemptions for certain types of funds.

However, one important consideration in this regard relates to Exchange Traded Funds (ETFs), given the specific wording of the exemption provided under the new Art. 18a (2) of UCITSD. Accordingly, this article introduces a derogation for an in kind redemption to be processed pro rata only if (i) the UCITS is marketed solely to professional investors, or (ii) where the UCITS is structured as an ETF. While the rationale for the latter exemption remains unclear, we stress that:

i. ETF investors – whether professional or retail – transact their shares on a secondary market where liquidity is guaranteed by several specialised market-making firms. Investors have therefore no direct recourse to the ETF issuer (i.e. the management company sponsoring a given ETF) and therefore cannot buy or sell their shares vis-à-vis the latter. Exceptionally, ESMA's 2014 Guidelines on ETFs and other UCITS issues do offer investors an opportunity to redeem directly with the ETF, but the related operational complexities would de facto make such process extremely costly and complicated, if not prohibitive for retail investors in particular; and

ii. Regarding the "in kind" exchange of an ETF's portfolio components versus blocks of ETF shares underpinning an ETF's structural create/redeem mechanism – involving the ETF issuer on the one hand and a specialised dealer (commonly known as the "Authorised Participant") on the other – this feature should be exempted from the broader "redemption in kind" notion proper of the present ESMA consultations. As create/redeem transactions lie at the heart of an ETF's constitution, are crucial to the underlying arbitrage mechanism[11] and only involve two very specific professional actors, none of which can been considered as an "investor" in the directive's sense, it would be sensible to exclude such transactions from the scope of the above Art. 18a provision entirely. Moreover, such transactions would also not meet the definition and rationale of a liquidity management tool under recital (53) of the amended UCITS directive, i.e. "*To enable UCITS established in any Member State to deal with redemption pressures under stressed market conditions (...)*". Being an intimate part of an ETF's ordinary operation, create/redeem transactions in fact occur regardless of market conditions.

As noted by both the Financial Stability Board (FSB) and IOSCO in their respective guidance and recommendations of December 2023, ETFs have an operational structure which is distinct from other UCITS. Consequently, both standard setters explicitly state that their respective guidance/recommendations on the application of LMTs are not applicable to ETFs[12].

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[11] The arbitrage mechanism is a defining feature of the ETF's operational set-up and provides the mean for the ETF's market price and its NAV per share to remain aligned.
[12] Please refer to IOSCO's Anti-Dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes) and to the FSB's Revised Policy

We would also like to highlight further specificities of ELTIF. Article 8(3) of the draft RTS under AIFMD provides that for professional-only AIFs or for ETFs, the manager/board can decide whether to transfer the assets on a pro rata basis. This reflects Article 18a of the AIFMD, that redemption in kind can be activated only to meet redemptions of professional investors and if the redemption in kind corresponds to a pro rata share of the assets held by the UCITS. However, it should be clarified that the more specific rules in the ELTIF Regulation on when redemption in kind may be used should take precedence over this text. In addition to clarifying that the ELTIF takes precedence, it could be clarified that investors always have the option to be repaid in cash, and receive redemption in kind where they request this in writing (per Article 18(4) and (5) of the ELTIF Regulation).

Q37. Can you think of any characteristics of redemptions in kind?

Redemptions in kind can be very useful in allowing the seed investor or other sophisticated, institutional investors to directly take charge of less liquid assets. This way the overall liquidity of the remaining portfolio may improve for the remaining, often retail, investors. Therefore it is also important that it is not always mandatory to transfer the vertical slice of the portfolio to the professional investor. Allowing for a transfer of particular, illiquid assets decreases also the need for the use of side pockets.

We see benefit in clarifying that in cases where redemptions in kind are applied to one of the redeeming, professional investors, these are not automatically applied to the rest of redeeming investors in the same way. Therefore, we would suggest that in recital 17 of both draft RTSs the wording is changed in the following way: "*(17) When management companies decide to execute redemption orders from professional investors in kind, they ~~should~~* ***may*** *apply the same method to all redeeming professional investors*." We would also suggest for it to be clarified in provisions of Art. 8 of both draft RTSs by adding a following sentence: "***If a redemption in kind is initiated by a professional investor it should not be understood as an obligation to apply it, and in the same way, to all other redeeming and professional investors.***" This will allow for redemptions to take place in accordance with different modalities between one professional investor and another. Additional and necessary flexibility should also be included in Art. 8(3) of both draft RTSs by including a following change explained on the example of the RTS for UCITS: "*3. If the UCITS is solely marketed to professional investors or if the investment policy of the UCITS is to replicate the composition of a certain stock or debt securities index and that UCITS is an ETF fund, management companies may decide whether they transfer assets to professional investors on a pro rata basis of the assets held by the UCITS. Management companies ~~shall~~* ***may*** *apply the same type of transfer of assets (i.e., pro rata share of each asset or not) to all redeeming professional investors for a given UCITS. However, that provision regarding the rest of redeeming professional investors should not apply if the redemption in kind is initiated by a professional investor itself.*"

Q38. Do you think there is merit for the characteristics of redemption in kinds to differ between different investment strategies between AIFs and UCITS? If yes, how?

Besides our considerations above pertaining to ETFs and ELTIF, we do not believe there is merit to differentiate in the RTSs characteristics of redemptions in kind based on different strategies or between AIFs and UCITS.

Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-ended Funds, as published on 20 December 2023.

Side pockets

Q39. Do you agree with the description of side pockets and the corresponding characteristics? If not, please justify your position.

As regards paragraph 90 of the Consultation Paper and Art. 9(2) of both RTSs, we are of the opinion that phrase "*assets for which there are valuation issues or legal uncertainty*" is to narrow also in line with the Annex V to AIFMD and Annex IIA to UCITSD. Definition of side pockets included therein refer to assets "*whose economic or legal features have changed significantly or become uncertain*". Therefore we would suggest to allow for more manager's discretion in this regard and to allow him to move assets to side pockets "*if he deems so necessary*".

Q40. Do you agree that in the case of UCITS, side pockets created by physical separation should only be done with the creation of a new UCITS where the assets for which there are no problems are placed? If not, please explain your position.

Under paragraph 91 of the Consultation Paper ESMA says that, in case of UCITS funds, physical separation of assets which became illiquid leads to a transformation of the fund into a non-UCITS fund, which is against provisions of Art. 1(5) of UCITSD. We strongly disagree with this statement.

We are of the opinion that the prohibition in Art. 1(5) of UCITSD is related to the legal nature of a fund which in case of UCITS includes (i) a public offer, (ii) a portfolio managed in line with legal and contractual investment limits, guidelines and strategy, and (iii) one which is working towards an investment objective.

We do not agree that the nature of the fund changes when physical segregation of assets is executed in order to create a side pocket. It is not a transformation of a UCITS fund into a non-UCITS one, as it is only a process where a part of the assets is separated into a second (temporary) fund, which due to special circumstances (e.g. EU sanctions on Russian capital market) is no longer liquid. The separated part of the UCITS fund remains part of its original portfolio and only differs because it has to be temporarily closed as the valuation/liquidity of the assets cannot be guaranteed. It is the manager's duty to wait until the external circumstances change and the assets become once again tradable. It is also important to note that nobody can subscribe or redeem units of this separated fund and the investment limits no longer apply.

It should also be highlighted that the same, but reversed, would be the case of physical separation where problematic assets would remain in the original UCITS, and remaining ones transferred to a new one.

We are also of the opinion that such approach as presented by ESMA was not intended by the EU legislators. If otherwise, they would not have included provision of Art. 84(2)(a) of UCITSD which allows for separated assets to be excluded from the calculation of limits laid down in Chapter VII on investment policies of UCITS.

The approach proposed by ESMA would create a significant change to the current practice which will also have further consequences such as (i) additional operational complications, (ii) additional transaction costs that would be borne by the fund and as a result by investors, (iii) potential tax implications.

Therefore, we do not agree with the different treatment of side pockets between UCITSD and AIFMD.

We would also like to suggest a change that would add more flexibility to the Art. 9(2) of the draft RTS for UCITS by giving it the following wording: "*1. For side pockets referred to in paragraph 1 b) of this Article, management companies ~~shall~~* ***may*** *suspend the subscriptions and redemptions of the UCITS and transfer the assets for which there are no valuation issues or legal uncertainty in a new UCITS created specifically for the purpose of this operation (or via a merger into an existing UCITS in so far as the merger complies with the requirements set out in Chapter VI of Directive 2009/65/EC).*"

Q41. Can you think of any other characteristics of side pockets that ESMA should consider? In particular, do you think that the characteristics of side pockets shall differ between UCITS and AIFs (in addition to the creation of side pockets via physical separation of the assets)? If, yes please elaborate.

We do not think there are further characteristics to be considered by ESMA and we do not believe that there should be different characteristics provided in the RTSs for AIFs and UCITS.

Q42. Do you see merit in specifying further the characteristics that side pocket created by means of accounting segregation should have? If yes, can you please explain how you have created side pocket via accounting segregation? Have you encountered any legal constraints or are you aware of any legal constraints in your jurisdiction that may limit the use of side pockets via asset segregation?

We do not think there are further characteristics to be considered by ESMA.

Q43: Do you agree that the assets in the side pocket should always be managed with the view to liquidate them? Or could there be circumstances, where a reintegration with the normal assets could be contemplated? Please explain.

We do not agree with the assumption that assets in the side pocket should always be managed with the view to liquidate them. Therefore, we are of the opinion that the phrase "*AIFMs(management companies) shall manage the side pockets with the sole objective of being liquidated*" should be removed from Art. 9(4) of draft RTS under AIFMD and Art. 9(6) of draft RTS under UCITSD.

Side pockets can be created for assets that are no longer liquid due to geopolitical events such as the closing of a stock exchange, or sanctions being imposed on particular assets. Such circumstances can change. In the first example assets will remain not listed until the reopening of the stock exchange. Once this happens, assets could become liquid again and be reintegrated in the fund, among other assets.

Side pockets inevitably include assets whose transferability has been compromised (mostly by unexpected legal or market developments) and where it is impossible to asses upfront the time horizon for such assets to become transferable again. Given the complexity and cost involved in managing a side pocket, the fund manager should be able to write down the value of the relevant investments to zero or transfer the relevant assets to an affiliated entity, if this reflects at that point a fair market price. This should be allowed, especially where the weight of the relevant position(s) in the overall portfolio is below 1%. The existence of robust governance around valuation of assets and the overall fiduciary duty of the fund manager towards its investors should be sufficient safeguards against the abuse of such possibility.

Q44. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards the characteristics of LMTs set out in Annex IIA of the UCITS Directive? Which other types of costs or benefits would you consider in that context?

We are of the opinion that minimal standards on the characteristics of LMTs can be in the interest of investors and comparability of solutions available in different Member States. What should however be avoided is any type of overregulation that would limit the discretion of the manager.

As regards possible costs, we would like to highlight that the use of ADTs, in particular when implicit costs (such as significant market impact) have to be included, is expensive. Therefore this element should also be taken into account when choosing this LMT in the view of the interest of investors, in particular for funds thar are not systemically relevant.

Q45. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the UCITS Directive?

We do not think there are further aspects to be considered by ESMA.

Q46. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards the characteristics of LMTs set out in Annex V of the AIFMD? Which other types of costs or benefits would you consider in that context?

Please see our response to question no. 44.

Q47. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the AIFMD?

We do not think there are further aspects to be considered by ESMA.

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ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages about 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

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