

BVI's response to the ESMA's consultation relating to draft regulatory technical standards on types of AIFMs (ESMA/2012/844)

BVI¹ gladly takes the opportunity to submit its views on the proposed regulatory technical standards determining certain types of AIFMs.

Q1: *Do you agree with the approach suggested above on the topics which should be included in the draft regulatory technical standards? If not, please state the reasons for your answer and also suggest an alternative approach.*

We agree with the proposal to focus the technical standards on the distinction between AIFMs managing open-ended and closed-ended AIFs and to decide about the need for further convergence tools at a later stage. Especially, we subscribe to the view that ESMA should first assess the extent of regulatory convergence already achieved by the Level 2 delegated regulation recently adopted by the EU Commission.

Q2: *Do you agree with the proposed definition of AIFMs of open-ended/closed-ended AIFs? If not, do you have any alternative proposal, in particular as regards the relevant frequency of redemptions for the open-ended funds?*

Q3: *Please provide qualitative and quantitative data on the costs and benefits that the proposed definition of AIFMs of open-ended/closed-ended AIFs would imply.*

We fully support the proposed criteria for distinguishing open-ended from closed-ended AIFs. In particular, we concur with the ESMA's opinion that special arrangements for management of liquidity risk such as lock-up periods, side pockets or gates should not be taken into account for determining whether the right of redemption is exercisable by investors at least once a year.

However, the lack of any limitations in terms of timeframes applicable under special arrangements might in some instances produce questionable results as regards classification of AIFs as open- or closed-ended. This pertains in the first place to the treatment of lock-up periods. In the German practice of closed-ended funds, it is very common to set up vehicles with very long initial lock-up periods of 10, 15 or even 20 years which usually accord with the point of time at which the fund initiator expects the fund assets to be ready for sale. After this period, investors are often granted annual termination rights upon 6 months notice. Thus, under the proposed technical standards such fund structures might be considered open-ended, even though they feature the traditional set-up of closed-ended vehicles.

¹ BVI represents the interests of the German investment fund and asset management industry. Its 78 members currently handle assets of EUR 2.0 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI's investor education programmes support students and citizens to improve their financial knowledge. BVI's members directly and indirectly manage the capital of 50 million private clients in 21 million households. BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.

Consequently, we believe that the length of the initial lock-up period should be restricted to a timeframe one could reasonably expect in relation to the open-ended fund model. In this regard, ESMA should take into account the approach for distinguishing certain types of closed-ended funds enshrined by Article 3(2)(b) and Article 21(3) third subparagraph of the Level 1 Directive. In the context of these provisions, "AIFs which have no redemption rights exercisable during the period of 5 years from the date of the initial investments" are subject to specific rules tailored to their closed-ended nature. **In our view, a lock-up period of 5 years or more represents an appropriate borderline for differentiating closed-ended from open-ended AIFs.**

Moreover, we are concerned about the general regulatory approach proposed to establish such a distinction. The draft regulatory technical standards differentiate solely between AIFMs of open-ended AIFs and AIFMs of closed-ended AIFs and thus appear to imply that a mixed solution where an AIFM manages both types of funds is not possible. Yet, there is nothing in the Level 1 Directive which prohibits AIFMs from managing concurrently open-ended and closed-ended AIFs. On the contrary, it is the common expectation that AIFM may apply for a management license under Article 7 AIFMD which covers the management of open-ended and closed-ended funds.

In addition, the Level 1 provisions on liquidity management and valuation anticipate that the systems and procedures to be established by AIFM are tailored to the specific AIFs ("for each AIF they manage", cf. Article 16(1) and (2), Article 19(1) AIFMD). It is by no means required that the liquidity management and valuation procedures apply without further differentiation to all AIFs managed by an AIFM.

Therefore, we request ESMA to adequately reflect the possibility of AIFM to manage AIFs of both open-ended and closed-ended type in its draft regulatory technical standards.

To reflect our above comments, the current wording of Article 1 in Annex VI should be modified as follows (changes marked up in bold and italics):

Article 1- Types of AIFMs

1. An AIFM may be ***one or both*** of the following:

- an AIFM of open-ended AIF(s);
- an AIFM of closed-ended AIF(s).

2. An AIFM of open-ended AIF(s) shall be considered to be an AIFM which manages AIF(s) whose unitholders or shareholders have the right to redeem their units or shares out of the assets of the AIF where all the following conditions are present:

- (a) the right may be exercised at least once a year;
- (b) the transaction is carried out at a price that does not vary significantly from the net asset value per unit/share of the AIF available at the time of the transaction;
- (c) no restriction or power provided for in the rules or instrument of incorporation of the AIF or any prospectus to apply special arrangements, such as side pockets, gates, suspensions, lock-up periods or other similar arrangements arising from the illiquid nature of the AIF's assets, is to be taken into account for this purpose.

The lock-up period referred to in the first subparagraph shall be considered to cover any minimum holding period during which unitholders/shareholders shall not have the right to exercise their redemption rights. Whether that period is set at the AIF level, with reference to the date of creation of that AIF or the date of commencement of activities, or at each individual unitholder/shareholder level, with reference to his or her date of subscription, shall be of no significance. ***The initial lock-up period at the AIF level shall be less than 5 years from the date of the initial investments.***

3. An AIFM of closed-ended AIF(s) shall be an AIFM managing AIF(s) other than the one described in paragraph 2.

4. Where a change in the redemption policy of the AIF(s) has the effect of changing the type of AIF(s) an AIFM manages, that AIFM shall **in this respect** follow the rules **for liquidity management and valuation** appropriate to the new type of AIF(s).

Q4: *Do you consider that any possibility to redeem the AIF's units/shares on the secondary market and not directly from the AIF should be taken into consideration when assessing whether AIFM is an AIFM of open-ended or closed-ended AIF(s)? Or do you consider that, as within the UCITS framework, only any action taken by an AIFM to ensure that the stock exchange value of the units of the AIF it manages does not significantly vary from their net asset value should be regarded as equivalent to granting to unitholders/shareholders the right to redeem their units or shares out of the assets of this AIF?*

We do not think that the general possibility to dispose of AIF units/shares on the secondary market should be of any relevance for determining the type of AIFs. After all, secondary market trading is common in different closed-ended products, but is usually conducted by third parties without closer involvement of the product provider or any implications for the product as such. Especially, no redemptions out of the portfolio assets are necessary to effectuate the disposal.

Therefore, it appears appropriate to align the approach with the UCITS framework and to provide that secondary trading should be deemed as equivalent to direct or indirect redemptions only if the AIFM takes action to ensure that the stock exchange values of the AIF does not significantly differ from its net asset value.

Q5: *Do you agree with the proposed approach as regards the treatment of hybrid structures? If not, please explain why and, if possible, provide alternative proposals.*

We agree with the approach proposed in Article 1(4) of Annex VI provided that the requirement to adapt to new rules is limited to the particular AIF the type of which has changed. It would be clearly inappropriate to demand e.g. enhancement of valuation frequency pursuant to Article 19(3) third subparagraph AIFMD in several closed-ended AIFs if only one of them acquires the open-ended status due to amendments to its redemption policy. Also in these circumstances, it is important to recognise that valuation and liquidity management standards may vary among the AIFs managed by one AIFM.

In this context, it should be noted that some Member States such as Germany will introduce profoundly different regimes for open-ended and closed-ended AIFs at national level. A subsequent change of the AIF status e.g. from closed- to open-ended should not prompt the necessity to restructure the vehicle in accordance with the national rules. Thus, ESMA should clarify that a modification of the redemption policy in an existing vehicle is solely relevant for the application of liquidity management and valuation standards under the AIFMD.

Our suggestions for respective adaption of Article 1(4) are included in the wording proposal in the reply to Q2/3 above.

Q6: *Do you see merit in clarifying further the notion of contracts with prime brokers and/or the notion of internally or externally managed? If so, please provide suggestions. In particular, if your answer is yes for the notion of internally or externally managed, please indicate which of the criteria already in recital (20) of the AIFMD need additional clarifications.*

From the viewpoint of BVI, there is no need to provide further clarifications to the notion of contracts with prime brokers or the notion of internally or externally managed AIFs.

Q7: *Do you consider that there is a need to develop further typologies of AIFMs where relevant in the application of the AIFMD? If yes, please provide details on the additional typologies sought.*

We indeed believe that it would be helpful to develop further typologies of AIFMs. Such determination appears of particular relevance for the proper functioning of the AIFM passport under Article 33 AIFMD. According to Article 33(1), the entitlement to manage EU AIFs cross-border depends on whether the AIFM is authorised to manage “that type of AIF”. However, due to the considerable divergences in the regulatory treatment of AIFs, it is uncertain to which extent fund types defined at national level will be deemed comparable to fund types existing in other Member States or indeed, even to AIFs lacking product regulation. This uncertainty could potentially impair the feasibility of cross-border management of AIFs.

The most obvious possibility to determine types of AIFs is on the basis of the applicable investment strategies. Therefore, we support the suggestion by ESMA for developing a typology of AIFMs based on the investment strategies of the managed AIFs.