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| 31 July 2015 |

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| Reply form for the  Draft regulatory technical standards under the ELTIF Regulation |
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| Date: 31 July 2015  2015/ESMA/1241 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper on Draft regulatory technical standards under the ELTIF Regulation, published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_ QUESTION\_ELTIF\_RTS\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* contain a clear rationale, including on any related costs and benefits; and
* describe any alternatives that ESMA should consider

**Naming protocol**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_ELTIF\_RTS\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be:

ESMA\_ELTIF\_RTS\_ESMA\_REPLYFORM or

ESMA\_ELTIF\_RTS\_ESMA\_ANNEX1

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

***Deadline***

Responses must reach us by **14 October 2015.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# General information about respondent

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| --- | --- |
| Name of the company / organisation | The Investment Association |
| Confidential[[1]](#footnote-2) |  |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | UK |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_ELTIF\_RTS\_1>

The Investment Association represents UK investment managers. We have over 200 members who manage more than €6.45 trillion for clients around the world. Our aim is to make investment better for clients so they achieve their financial goals, better for companies so they get the capital they need to grow, and better for the economy so that everyone prospers.

The Investment Association welcomes the introduction of an EU wide fund structure targeting investment in long term assets such as infrastructure. ELTIFs have the potential to channel much needed investment into long term projects such as infrastructure and provide funding for key SME sector of the European economy, which has found funding difficult to access from traditional sources in recent years.

However, in order to be successful ELTIFs need to provide an attractive investment proposition both for investors and product providers. Some of the features of the ELTIF are already proving unattractive for providers and investors alike, in particular the unclear restrictions in eligible assets (eg. for real estate and investment in loans), the limited flexibility on redemption rights, the requirement to have a defined lifecycle, the restrictions on selling to retail investors and the requirement on the manager of the ELTIF to review suitability on sales to retail investors.

Given these barriers, it is therefore imperative for the success of ELTIFs that when determining its RTS, ESMA adopts a flexible approach as far as possible, in particular when determining the types of risk that can be hedged through using derivatives, the lifecycle of the ELTIF and the assessment of the market for potential buyers towards the end of the ELTIF. Given the long term and illiquid nature of the ELTIF, it is important for investor confidence that managers can access the tools they need to manage key risks that if crystallised could significantly erode their investment returns. We would also request that, when determining the facilities requirements, ESMA take into consideration the significant technology advancements which have occurred since the requirement for facilities was included in the original UCITS directive, rather than copy across the outdated facilities requirements from the UCITS directive.

The Investment Association hopes that ESMA can provide in its RTS a sufficient level of flexibility to increase the likelihood of a successful take-up of ELTIFs.

<ESMA\_COMMENT\_ELTIF\_RTS\_1>

1. Do you agree that the abovementioned pieces of legislation and associated regulatory framework are relevant for the purpose of the present advice on Article 9(3) of the ELTIFs Regulation? Which other pieces of legislation and associated regulatory framework do you identify for that purpose?

<ESMA\_QUESTION\_ELTIF\_RTS\_1>

We do not consider IFRS 9 to be an appropriate point of reference for the purpose of the advice on Article 9(3) of the ELTIF Regulation. This is an international accounting standard that makes no reference to European fund regulation. As an accounting standard, it is not likely to be well understood by asset managers. It has also not been adopted for the purposes of fund accounting in a number of EU jurisdictions. By way of example, UK fund accounting standards are based on UK GAAP, which while consistent with IFRS has not adopted these standards in full.

Of the three pieces of legislation referred to in paragraph 10 of the consultation, CESR’s Guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS probably provides the more useful starting point since this relates to risk management within funds. The concept of Efficient Portfolio Management (EPM) used for UCITS is commonly applied within the European fund management industry. However, a more flexible version of the definition of hedging arrangements used for UCITS should be adopted for the purposes of the ELTIF Regulation. The definition used for ELTIFs will need a much broader reference than to financial derivative instruments and to security positions given the range and nature of the eligible assets for ELTIFs are significantly broader than for UCITS. The definition adopted by ESMA should allow sufficient flexibility for ELTIFs to enter into a transaction to offset any risks arising from the nature of the long term assets in which the ELTIF invests.

<ESMA\_QUESTION\_ELTIF\_RTS\_1>

1. Do you think that the main risks that are necessary to be covered at the level of the ELTIF are currency, inflation and interest rate risks? If no, which types of risk would the manager of an ELTIF potentially have to cover in your view?

<ESMA\_QUESTION\_ELTIF\_RTS\_2>

We agree that the risks identified are likely to be relevant to many, if not most, ELTIFs. However, this list only captures a small number of the risks that are likely to be relevant to many ELTIFs. ELTIFs will be able to invest in a diverse range of assets, ranging from small to medium size enterprises (SMEs), real estate, to infrastructure projects such as transportation, energy, water, etc. Furthermore, ELTIFs will have the flexibility to invest in such projects through equity and quasi-equity, securitised debt instruments, loan origination or units of other ELTIFs, EuSEFs and EuVECAs. It is clear that different ELITFs will face a variety of risks based on the nature of the underlying assets in which they invest, which may include, to list some non-exhaustive examples, market risk (especially in the case of listed SMEs), commodity risk, weather related risk, transportation risk, credit risk and insolvency risk (eg. a project in which an ELTIF invests might be jeopardised by disruptions to the supply chain were a key supplier to go insolvent, even if the ELTIF and its underlying investments had no credit exposure to the supplier). As such, we do not believe it is necessary or desirable for ESMA to seek to define an exhaustive list of risks that can be covered at the level of the ELTIF.

<ESMA\_QUESTION\_ELTIF\_RTS\_2>

1. Do you think that the approach to hedging should not limit ex ante the scope of risks that ought to be covered by the manager of the ELTIF?

<ESMA\_QUESTION\_ELTIF\_RTS\_3>

Yes, we agree the approach to hedging should not limit ex ante the scope of risks that ought to be covered by the manager of the ELTIF for the reasons given in our response to question 2. In addition, it would be helpful for ESMA to clarify that an ELTIF using a derivative instrument relating to commodities solely for the purposes of hedging commodity risk inherent in its underlying assets will not be considered as taking direct or indirect exposure to commodities for the purposes of article 9(2)(b) of the ELTIF Regulation.

<ESMA\_QUESTION\_ELTIF\_RTS\_3>

1. On the contrary, do you think that the approach to hedging should be tailored to the specific case of ELTIFs, and their possible eligible investments? Do you think that in this case the risks that might have to be covered by the manager of the ELTIF should be limited to the types of risk that were mentioned in question 2?

<ESMA\_QUESTION\_ELTIF\_RTS\_4>

The manager of the ELTIF should have the ability to identify the risks that need to be covered by the ELTIF based on the objective of the ELTIF and the eligible assets in which that ELTIF may invest. These risks can be outlined in the offering documents provided by the manager of the ELTIF. This flexibility is particularly important given the long term nature of the investments of the ELTIF, since any erosion of the value of the ELTIF’s assets resulting from the crystallisation of the identified risks would be compounded over the long investment cycle and by the inability of investors to exit their investment. It is therefore important for the success of ELTIFs that the manager has sufficient flexibility to manage all applicable risks through appropriate hedging arrangements. It is appropriate to provide high level guidance on hedging arrangements, but this should not seek to limit the risks that can be hedged through defining a restrictive list.

<ESMA\_QUESTION\_ELTIF\_RTS\_4>

1. Do you identify any consequences in terms of costs or scope of the eligible investments of the ELTIF if the risks that might be covered at the level of the ELTIF are limited to those that were mentioned in the impact assessment of the Commission?

<ESMA\_QUESTION\_ELTIF\_RTS\_5>

Limiting the risks that may be covered to those mentioned in the impact assessment of the Commission would limit managers of ELTIFs to a very restrictive list of risks that they could hedge. This list would constrain the manager of an ELTIF to a narrower list of risks they could hedge than those which could be hedged by the manager of a UCITS, despite the broader range of assets and risk exposures that may be taken by an ELTIF. If the manager of an ELTIF is unable to hedge any risk it has identified (and which can be hedged using an appropriate hedging instrument), the ELTIF will be at greater risk of financial loss over lifecycle of the ELTIF. Not only would that result in reduced gains, or even losses, for investors in the ELTIF, this could deter investors from choosing to invest in an ELTIF and product providers from choosing to use the ELTIF vehicle for an infrastructure fund in favour of an more flexible alternative vehicle.

<ESMA\_QUESTION\_ELTIF\_RTS\_5>

1. Do you agree with the proposed approach? Should you disagree, please provide reasons and propose an alternative approach and justify it.

<ESMA\_QUESTION\_ELTIF\_RTS\_6>

In view of the requirement in Level 1 of the Regulation to set a defined lifecycle for each ELTIF, ESMA’s proposal that the lifecycle be determined with reference to the individual asset within the ELTIF’s portfolio which has the longest lifecycle seems reasonable at face value. It is certainly preferable to an approach which determines the lifecycle of the ELTIF by reference to the average lifecycle of the ELTIF’s portfolio, which by definition would not be sufficient to cover the lifecycle of all assets.

However, the proposed approach assumes the lifecycle of all assets in the ELTIF’s portfolio will be known at the time the ELTIF is incorporated. This is not likely to be the case for many ELTIFs for two reasons. Firstly not all assets will in which the ELTIF will invest over its lifecycle will necessarily have been identified at the inception of the ELTIF (noting the ELTIF will have up to five years to invest in eligible assets). Secondly, not all assets will have a defined lifecycle. For example, equity investments in SMEs and real estate assets may have indefinite lifecycles, depending on the success of the enterprise in the case of the former and the longevity of the construction in the case of the latter.

Therefore, ESMA’s RTS should provide some flexibility for the manager to determine the lifecycle of the ELTIF by reference to the estimated longest lifecycle asset, or by reference to the estimated longest holding period for an asset (where the asset has an indefinite lifecycle). The RTS should also provide for sufficient flexibility for the manager to extend the lifecycle of the ELTIF after inception to the match the lifecycle of the individual asset with the longest lifecycle once the ELTIF is fully invested. This would avoid a manager either being unnecessarily restricted to the choice of assets available for it to invest in, or having to realise an asset at a sub-optimal value at the end of the ELTIF’s lifecycle.

<ESMA\_QUESTION\_ELTIF\_RTS\_6>

1. Do you agree with the risks identified and the related proposed criteria? Would you suggest the introduction of any additional/alternative risks/criteria? Please provide details and explain your position.

<ESMA\_QUESTION\_ELTIF\_RTS\_7>

We agree the assessment of the market for potential buyers should only extend to eligible assets, and should not extend to other assets in which the ELTIF may invest, for which illiquidity is unlikely to be a factor. However, the criteria proposed by ESMA is too prescriptive and contains factors which are impossible to assess with any reasonable predictability. For example, political and legislative changes are entirely at the discretion of governments and policy makers, and can be announced without warning. It is therefore not reasonable to expect a manager to identify such risks up to a year before these may crystallise – any such assessment will inevitably be based on conjecture and speculation. The requirement to identify whether any buyers are likely to require external finance is also problematic – this will require a level of due diligence that would be reliant on information which is not likely to be provided by the buyer until a sale is agreed in principle.

Managers of ELTIFs are likely to be experienced in exiting positions in illiquid assets through their experience of managing similar investments in AIFs and other investment vehicles. The process of realising assets will already be underway for a number of ELTIFs reaching the end of their lifecycles, particularly for assets with a shorter maturity period than the lifecycle of the asset. Some assets will have a pre-defined realisation process, eg. a debt security or a loan reaching its maturity at the end of an ELTIF. We therefore suggest the assessment should only require the manager of an ELTIF to identify and report on any material concerns it has on its ability to realise any of the assets of the ELTIF before the end of the ELTIF’s lifecycle at what it considers to be a fair value.

<ESMA\_QUESTION\_ELTIF\_RTS\_7>

1. Do you agree with the proposed valuation criteria? Would you suggest the introduction of any additional/alternative criteria? Please provide details and explain your position.

<ESMA\_QUESTION\_ELTIF\_RTS\_8>

We believe the existing valuation criteria in the AIFMD already provides sufficient criteria for determining the net asset value of the ELTIF for the purposes of Article 21(2)(c) of the ELTIF Regulation. We do not believe it is necessary to make reference to IFRS 13, and note that in the case of highly illiquid assets there may be insufficient market data in which to determine a valuation to this standard. The RTS should recognise that any valuation conducted on such an illiquid asset will be the valuer’s best estimate based on their knowledge and experience, and provided such a valuation is conducted in accordance with the requirements of the AIFMD such a valuation should be acceptable for these purposes.

<ESMA\_QUESTION\_ELTIF\_RTS\_8>

1. Do you agree that the abovementioned pieces of legislation and regulatory material are relevant for the purpose of the RTS on Article 25(3) of the ELTIFs Regulation? Which other pieces of legislation and regulatory material do you consider relevant for that purpose?

<ESMA\_QUESTION\_ELTIF\_RTS\_9>

The cost disclosure requirements should be aligned with the PRIIPs Regulation once this is finalised and following a suitable transition period. However, we recognise that this will not be available until after the ELTIF Regulation takes effect, and agree the CESR guidelines on the methodology for calculation of the ongoing charges figure in the key investor information document provides the best reference as an interim solution.

<ESMA\_QUESTION\_ELTIF\_RTS\_9>

1. Do you agree with the abovementioned assumptions?

<ESMA\_QUESTION\_ELTIF\_RTS\_10>

Yes

<ESMA\_QUESTION\_ELTIF\_RTS\_10>

1. Do you agree that the types of costs mentioned in the present paragraph are annual costs that could be expressed as a percentage of the capital?

<ESMA\_QUESTION\_ELTIF\_RTS\_11>

Yes

<ESMA\_QUESTION\_ELTIF\_RTS\_11>

1. Do you think that performance related fees would be relevant costs to be taken into account in the case of ELTIFs?

<ESMA\_QUESTION\_ELTIF\_RTS\_12>

Yes, and we believe managers of ELTIFs should have the flexibility to charge performance fees, provided these are appropriately structured and subject to suitable investor disclosure. However, we believe performance related fees should be disclosed separately from the annual costs as articulated in more detail in our response to question 13.

<ESMA\_QUESTION\_ELTIF\_RTS\_12>

1. How would you include performance related fees in the overall ratio referred to in paragraph 2 of Article 25?

<ESMA\_QUESTION\_ELTIF\_RTS\_13>

We believe performance related fees should be disclosed separately from the annual costs. Performance fees can vary substantially from year to year depending on the performance of the ELTIF and cannot be predicted with any reliable accuracy on an ex ante basis. Including these in an overall ratio alongside more predictable costs will reduce transparency for investors and could give them a misleading impression of the costs they are likely to bear. For example, in the event a performance fee is low or not payable for a particular year, the investor may be led to believe their overall cost for the following year will be at that lower level, and may therefore be surprised if there is an increase in their overall cost in the following year if a higher performance fee then becomes payable. The investor will have no visibility on why their overall fee has increased. Disclosing performance related fees separately will allow an investor to distinguish the annual costs fixed as a percentage of the NAV from the variable performance related costs, providing better visibility for the investor.

<ESMA\_QUESTION\_ELTIF\_RTS\_13>

1. Do you agree that the types of costs mentioned in paragraph 54 are fixed costs and that an assumption on the duration of the investment is necessary to calculate these costs in the numerator of the overall ratio mentioned in Article25(2), provided that this overall ratio is a yearly ratio?

<ESMA\_QUESTION\_ELTIF\_RTS\_14>

We agree that the establishment and acquisition costs are fixed costs for the purposes of the ELTIF, and agree an assumption on the duration of the investment is appropriate. Distribution costs may also be fixed costs depending on how these are structured and where they are paid by the ELTIF. However, where an intermediary is used, distribution costs may be paid by the investor directly to the intermediary, eg. in the UK, this is required following the implementation of RDR. Therefore it should be clarified that distribution costs should only be included in this calculation where they are paid by the ELTIF.

<ESMA\_QUESTION\_ELTIF\_RTS\_14>

1. Do you agree that the types of costs mentioned in paragraph 54 may be considered as fixed costs in the case of an ELTIF?

<ESMA\_QUESTION\_ELTIF\_RTS\_15>

We agree these are likely to be fixed costs.

<ESMA\_QUESTION\_ELTIF\_RTS\_15>

1. Do you agree with the proposed requirements? Would you suggest the introduction of any additional/alternative requirements? Please provide details and explain your position.

<ESMA\_QUESTION\_ELTIF\_RTS\_16>

We do not agree the facilities requirements derived from the UCITS Directive are appropriate for ELTIFs. The facilities requirements in the UCITS Directive date from the original UCITS Directive in 1985. Since then, significant technological advances have been made, in particular the development of the internet, mobile telephone (including more recently smartphones) and international call centres. These technologies are now accessible to the wider population. There is a reasonable argument that the increased penetration of this technology has rendered the requirement to have a facilities agent in each Member State obsolete for UCITS. However, this is particularly the case for ELTIFs, for which distribution is restricted to retail investors of relatively substantial means who are more likely to have access to this technology themselves or through an intermediary.

The RTS should therefore not require the physical presence of a facilities agent in each Member State. Instead, it should allow facilities to be provided in a member state remotely through a website or telephone service accessible to consumers in that Member State, in their language, conforming to the local laws of the Member State and providing payment facilities compatible with the payment systems of that Member State.

<ESMA\_QUESTION\_ELTIF\_RTS\_16>

1. What would you consider as appropriate specifications for the technical infrastructure of the facilities?

<ESMA\_QUESTION\_ELTIF\_RTS\_17>

Please refer to our response to question 16. As stated, the manager should be able to provide facilities remotely through means of a suitable website or telephone service. Where this is available, there should be no requirement to have a facilities agent with a physical presence in that Member State.

<ESMA\_QUESTION\_ELTIF\_RTS\_17>

1. In the event that the RTS enter into force after the date of application of the ELTIF Regulation and authorisations are granted between the date of application of the ELTIF Regulation and the date of application of the proposed RTS, do respondents see a need for specific transitional/grandfathering provisions for the proposed RTS?

<ESMA\_QUESTION\_ELTIF\_RTS\_18>

Yes, we believe suitable grandfathering clauses should be provided for if there is a substantial delay in the application of the proposed RTS after the date of application of the ELTIF Regulation.

<ESMA\_QUESTION\_ELTIF\_RTS\_18>

1. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the options as regards hedging? Which other costs or benefits would you consider in this context?

<ESMA\_QUESTION\_ELTIF\_RTS\_19>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_ELTIF\_RTS\_19>

1. Do you agree with the assessment of costs and benefits above for the proposal on the sufficient length of the life of the ELTIF? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

<ESMA\_QUESTION\_ELTIF\_RTS\_20>

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<ESMA\_QUESTION\_ELTIF\_RTS\_20>

1. Do you agree with the assessment of costs and benefits above for the proposal on the criteria for the assessment of the market for potential buyers? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

<ESMA\_QUESTION\_ELTIF\_RTS\_21>

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<ESMA\_QUESTION\_ELTIF\_RTS\_21>

1. Do you agree with the assessment of costs and benefits above for the proposal on the criteria for the valuation of the assets to be divested? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

<ESMA\_QUESTION\_ELTIF\_RTS\_22>

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<ESMA\_QUESTION\_ELTIF\_RTS\_22>

1. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards common definitions, calculation methodologies and presentation formats of costs of ELTIFs? Which other types of costs or benefits would you consider in this context?

<ESMA\_QUESTION\_ELTIF\_RTS\_23>

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<ESMA\_QUESTION\_ELTIF\_RTS\_23>

1. Do you agree with the assessment of costs and benefits above for the proposal on the facilities available to retail investors? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs that the proposal would imply.

<ESMA\_QUESTION\_ELTIF\_RTS\_24>

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<ESMA\_QUESTION\_ELTIF\_RTS\_24>

1. The field will used for consistency checks. If its value is different from the value indicated during submission on the website form, the latest one will be taken into account. [↑](#footnote-ref-2)