Response to ESMA Consultation on draft regulatory technical standards under the revised ELTIF Regulation

Overall introduction

On May 23rd ESMA released its consultation on the draft regulatory technical standards under the revised ELTIF Regulation1 (“the standards”). ESMA invited all industry stakeholders to respond to the ESMA Consultation by 24th August. This response aims at providing feedback to the draft standards. It was prepared in collaboration with our ELTIF Task Force which consists of around 30 private equity firms and their legal advisors with an in-depth expertise of the market segment interested in setting up new ELTIFs.

As the association representing both private equity and infrastructure fund managers - a vast proportion of the ELTIF landscape - Invest Europe is well placed to share with ESMA information about how our members plan to use the ELTIF label.

Before replying to the questions, Invest Europe would like to highlight a few general points to be taken into consideration.

Diversity of the ELTIF landscape...

Pursuant to the ESMA register2 the current ELTIF landscape consists of around 100 ELTIFs, the main (and arguably only) hubs being Luxembourg, France and Italy. The breakdown by asset class in terms of volume placed is relatively evenly distributed between private equity, infrastructure and private debt, with approx. 30% per asset class, the ELTIF market is diverse when it comes to the product features.

Some ELTIFs are exclusively distributed to professional investors (approx. 40% of the ELTIF market3). Even if the previous ELTIF Regulation allowed for minimum tickets of EUR 10,000, only a few asset managers have taken opportunity of the minimum ticket. Typically, the tickets have been of a higher amount (e.g. EUR 20,000 or EUR 30,000) and in several cases even stayed above a EUR 100,000 threshold due to either national product constraints (e.g. in France (fonds communs de placement à risques) or in the Grand-Duchy of Luxembourg (fonds d’investissement alternatifs réservés)) or to distribution strategies targeting primarily high-net-worth individuals.

We expect the current investor range to become more diversified under the new regime as the minimum ticket size is removed - which would theoretically allow to go for very small tickets (e.g., EUR 500 or even lower) and as managers increasingly ELTIF as an opportunity to offer long-term products to smaller clients. We expect ticket sizes to become lower as ELTIF expands, allowing more investors to access the product.

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In light of this, we encourage ESMA to engage with distributors of private equity and infrastructure funds, whose ability to present such products successfully to retail investors will ultimately determine the success of the ELTIF.

**leading to diverse fund structures**

This (increasing) diversity has an impact on how ELTIFs behave from a liquidity perspective and with their redemption features.

First ELTIFs that were set up were usually designed as closed-ended funds with a clear focus on illiquid long-term assets and with a fixed term which ultimately allowed to generate a certain income for the investors. These “closed-ended” ELTIFs, which will remain in use in the future, are unlikely to find the new provisions on liquidity relevant and, reversely, liquidity provisions will not be relevant to these ELTIFs.

As ELTIFs started attracting smaller non-professional investors - for which individual circumstances may change and who therefore are looking for liquidity windows - ELTIF managers have recently started setting up **products that allowed for more frequent redemptions**. These ELTIFs have increasingly taken evergreen or near open-ended forms. These are those that have expressed most interest in making use of ELTIF liquidity provisions. In this response, we will describe these as “evergreen ELTIFs”.

**Recognising the needs of different ELTIFs**

In paragraph 4 of its consultation document, ESMA helpfully noted there is distinction between these two types of structures. ESMA also recognised that ELTIFs do not need to have an end life to service the interests of their clients, as such redemptions are allowed “under certain conditions and provided liquidity management tools are used to avoid liquidity mismatches”.

We agree with ESMA that:

1) the draft technical standards should take into account **two forms of ELTIFs**: traditional long-term closed-ended funds with no redemption rights and evergreen semi-liquid structures with rolling subscriptions and redemptions

2) **redemption procedures**, as set out in the draft regulatory technical standards, **would not apply to long-term closed-end ELTIFs** - as these “shall not be able to request the redemption of their units or shares before the end of the life of the ELTIF”

3) liquidity provisions will **mostly be relevant for evergreen ELTIFs** and need to be tailored to their specificities

Every “evergreen” ELTIF manager we have spoken to when preparing this response shares the assumption that setting up a long-term, illiquid fund, requires careful consideration and that specific conditions are needed to meet investors’ liquidity demands without jeopardising the fund’s long-term viability.

However, all disagreed with the general mindset of the standards: that these conditions must necessarily be the “compilation” of different tools - such as minimum holding periods or notice periods - to be effective.

ELTIF managers have developed a wider range of tools to deal with liquidity. For example, contrary to the underlying assumption behind the standards, redemption requests for ELTIFs are typically not served out of the long-term assets but of the **liquid pocket of an ELTIF** (which may be up to 45% of the capital under the new regime) as well as by matching of subscriptions and redemptions, borrowings and cash, providing for a typical waterfall of redemption sources. In other words, the way ELTIFs marketed to retail investors will
manage liquidity is typically not by selling their long-term assets but by using side liquid pools in a more diverse way than will be allowed under the draft standards.

While current approaches obviously reduce the exposure of the ELTIF to illiquid long-term assets, this is, according to our understanding of our market, the price that managers have chosen as the most appropriate one to (a) serve liquidity needs of their clients (b) protect the illiquid long-term assets (whose sale is typically made impossible by the fact this capital is needed to make companies grow over the long-term).

Proposed standards, by insisting on the presence of a minimum holding period, specific liquidity management tools and minimum notice periods, do not reflect current market practices. The risk is therefore high that, proposed as they are, these standards will make it economically unattractive for many managers to set up ELTIFs.

In this paper we seek to describe how ESMA could cater for these situations while ensuring ELTIF managers are operating under liquidity conditions that are appropriate from an investor’s choice and financial stability perspective.

Getting the ELTIF liquidity conditions right is crucial: only a strong ELTIF take-up will ensure more EU retail investors can invest in long-term funds cross-border and contribute to the successes of the EU economy by indirectly investing into long-term projects.

We stand at the entire disposal of ESMA to share additional insights on market practices and to give it reassurance that these practices are in the best interest of the ELTIF clients and do not create concern for the wider economy.

**Hedging derivatives**

**Q1: Do you agree with the proposed approach in relation to the RTS under the abovementioned Articles 9(3), 21, and 26(2) of the ELTIF Regulation?**

In our view, the position taken by ESMA is in line with the requirements of the new Regulation and support the proposal for notifying the competent authority of orderly disposal of assets only “upon request”.

In respect to the standards under Article 21, it would be useful to clarify that, in case the AIFM does not intend to redeem investors’ units or shares after the end of the life of the ELTIF, it should only inform the authority of that intention.

**Costs disclosures**

**Q2: 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 ELTIF Regulation? Which other pieces of legislation and regulatory material do you consider relevant for that purpose?**

Yes, the Key Information Document (KID) cost section is a relevant piece of legislation although we argue that, as the KID is currently not sufficiently adequate for long-term products such as private equity funds, the ELTIF Prospectus should at least partly depart from some of the KID requirements. This is essential for managers to give their investors information that is suited to the realities of their funds.

As we explained in previous contributions, some of the costs distinctions made in the Key Information
Document (or the KII) are not fully relevant to private equity funds. We comment on these in more details in questions below and make suggestions as to what we believe should be the best approach, considering the importance of harmonization between frameworks.

While sufficiently detailed rules are necessary to ensure a level playing field in the implementation of the ELTIF Regulation, a one-size-fits-all approach to cost disclosure can prove challenging given the variety of ELTIFs and the expected increase in the diversity of ELTIFs under the revised regime. The distinction between closed-ended fixed-term fund and a semi-open evergreen fund is particularly relevant in that regard.

Q3: Do you agree with the abovementioned assumptions? In relation to the ELTIF cost ratio figures to be expressed as yearly percentages (of the capital of the ELTIF), would you see merit in expressing it instead in terms of maximum percentages (and, in the prospectus, only refer to the corresponding yearly figures included in the KID, or in the annual report of the ELTIF)?

Any average annual fee rate is calculated on the basis of an assumption of fund raising and not on the basis of an actual cost (which is not known at the time the prospectus is drawn).

Pre-determining what exact costs will be charged in advance and at what level is virtually impossible for long-term funds. For example, the private equity management fee - typically fixed at 2% (although some larger funds may set it at a lower percentage) - may be charged against the capital that has been raised and so may differ significantly depending on the ultimate size of the fund (it will always be related to the size of eventual profits). At the same time, fees charged against NAV cannot be assumed over the life of an evergreen fund.

In that context, there would indeed be benefit in allowing ELTIF managers to disclose a maximum percentage for each type of costs in the prospectus, with the actual percentage of such costs of course being disclosed each year in the annual report on an ex-post basis. Clarifying this will provide investors with clearer and more accurate disclosure.

Q4: Do you agree that the types of cost mentioned in the present paragraph are annual costs that could be expressed as a percentage of the capital? What are your views on the list of “other costs” referred to above in paragraph 32(b) which are suggested to be added, as compared to the list of “other costs” referred to in Article 25(1)(e) of the ELTIF Regulation?

We disagree that carried interest should be presented as a percentage of the capital - as it is a return on the profits and not per se a fee paid on the amount of the fund’s capital. In fact, any “standardized way” to present carried interest, for example as a percentage of the capital, is necessarily giving the investor information that is potentially misleading.

As a reminder, carried interest is a profit share mechanism typical to private equity (and therefore likely to be used by many ELTIFs), which aligns the interests of fund managers with those of investors. While carried interest is linked directly to the performance of the fund (as a performance fee), there are several elements of the carried interest arrangement and its calculation, which makes it different from traditional performance fees, including:

- **Carried interest is typically not paid each year:** while carried interest arrangements are agreed at the outset of the fund, cash will typically only be paid by the fund to the carried interest participants once investors have had their drawn capital back plus an agreed preferred return (as explained below).
Carried interest is usually only paid once the fund has achieved the “preferred rate of return”: at the outset of the fund, fund managers and investors agree the detailed terms of the carried interest arrangement. This will include a level of return (the preferred return) that will accrue exclusively to external investors, and the pre-determined formula for how returns will be shared between the fund manager and these external investors once this threshold has been achieved. This means that any investors into the fund will see both the payment of their original investment and an agreed return before any carried interest is paid to the fund manager. For the same reason, there is therefore no guarantee that carried interest will ever be paid: if the fund does not achieve this pre-determined level of return there will be no carried interest. For the avoidance of doubt, this means that, unlike funds in other asset classes that operate on a “high water” basis to trigger their carry, typical private equity fund structures only see carry generated if over the life of the fund investors get all their money back and achieve at least the level of preferred return agreed from the outset.

For these reasons, it can end up being very confusing to the investor to:

1) refer to carried interest as a % of the capital;
2) create an aggregate cost over a one-year period that would (or would not) include carried interest.

For the sake of investors, it is much more preferable to only refer to its overall impact in a qualitative way (“a certain % of the profit known at the fund’s onset will be shared above a certain level of return”) than trying to fit all information into a single number.

We would therefore suggest for the prospectus to contain a short sentence describing that the fund is subject to a profit-sharing mechanism above a certain hurdle. This would give the investor all information he or she needs to make the investment without trying to present carried interest – a profit sharing mechanism that is part of the fund’s design – as a real cost – which the fund would necessarily have to bear to continue to operate.

While this would represent a deviation to the approach in KID, this would be justified in light of the fact a significant proportion of ELTIFs will have such profit-sharing models.

Q5: Do you agree that the types of cost mentioned in paragraph 32 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 cost ratio mentioned in Article 25(2), provided that this overall ratio is a yearly ratio? Would you see merit in specifying what is to be meant by the “setting-up” of the ELTIF, as referred to in Article 25(1)(a) of the ELTIF Regulation? If yes, could you indicate which elements of the “setting-up” of the ELTIF should be clarified?

No. It is not always appropriate to consider distribution costs as one-off costs for an evergreen fund. Indeed, these costs may rather be of a recurring nature and may be difficult to predict at inception.

For closed-ended funds, distribution costs will indeed be a one-off cost and will only be linked to the fund’s set-up.

Moreover, and in line with other comments made to the costs’ section, our view is that it is important ESMA remains flexible in defining what is a “setting up cost” to ensure flexibility across different strategies and types of ELTIFs.
Q6: Do you agree that the types of costs mentioned in paragraph 36 may be considered as fixed costs in the case of an ELTIF?

Similar to our comments made on distribution costs, it may not be appropriate to consider costs relating to the acquisition of assets as one-off costs for an evergreen fund, as these costs may rather be of a recurring nature and may be difficult (if not at all impossible) to predict at inception.

In a private equity context, transactions/exit costs may be paid to an intermediary (such as an investment bank) to help buying or selling a company at the beginning and/or end of each investment (which is effectively the investment in a single business).

For any long-term funds, new investments - and therefore new acquisition costs - will occur over the first few years of the fund. It may therefore be that some of the acquisition costs will only become apparent several years after the prospectus is drawn out, making it difficult for the manager to assess in foresight what these costs will be.

For evergreen funds, these acquisition costs will be even harder to calculate as the acquisition of assets will continue years - or in some cases even decades - after the fund was “opened”. It is therefore hard to align ESMA’s views of acquisition costs being a “one-off” cost that is already known from the manager with the reality of a fund continuing to make new investments more than a decade after the publication of the Prospectus and where there is no possibility to have advanced knowledge as what will be the total amount of capital available for investments.

It is worth pointing out these costs may be linked to unrealised transactions (as the manager may sometimes determine that an investment should not be made after costs have been paid) - which could easily be mistaken as an “undue cost” despite being a necessary feature of the investment process, something that has relevance to future observations ESMA will have to make in the future on the theme of undue costs.

For all these reasons, we would suggest ESMA to be more open in its distinction between one-off costs and ongoing costs to allow the manager, depending on the structure of the ELTIF, to put the cost where it is most relevant - and not being forced to advertise, for example, an ongoing distribution or acquisition cost as a one-off cost.

Q7. Would you see merit in including a specific grandfathering clause (in relation to the RTS under Article 25(3) of the ELTIF Regulation) for ELTIFs benefitting from the grandfathering clause provided for in Article 2 of Regulation 2023/606?

Yes. A grandfathering clause would provide legal certainty and clarity to both managers and investors.

Redemption policy

Q8: Do you agree with the proposed amendment to the existing RTS under the first paragraph of Article 18(6) of the ELTIF Regulation?

We agree with ESMA that Article 2 of the RTS had to be modified to reflect the fact that the legislator no longer considers that the ELTIF shall be “sufficient in length” to cover the life-cycles of each of the individual assets of the ELTIF and rather whether it is “compatible” with such a cycle.
It is however unclear to us what point (e) of new Article 2 is designed to achieve and particularly whether it looks at the ability to reinvest proceeds as a factor in having a longer duration life of an ELTIF. We do not believe this should be a factor in determining the length of the fund.

**Q9: Do you agree with the proposed criteria to determine the minimum holding period (referred to in point (a) of paragraph 2 - Article 18(6)(a)) of the ELTIF Regulation? What are your views on the setting of a minimum of X years for all ELTIFs, irrespective of their individual specificities (with X equal to 3, for example), with respect to the abovementioned minimum holding period?**

As indicated in the introduction to this response, our response to this question focuses on evergreen structures and not on closed-ended structures. For the latter, the minimum holding period (MHP) referred to in point (a) of Article 18(2) would naturally not apply as there are in any cases no redemption opportunities and the life of the fund is much longer than what is proposed under a MHP.

For “near” evergreen structures, the MHP is a very significant concern as it does not fit with realities of how private equity managers seeking to market to investors with more pressing liquidity needs have addressed or are planning to address these needs.

**Issues with a Fixed MHP**

We appreciate that ESMA has taken a relatively flexible approach by suggesting that a MHP can be shortened under justification. However, we remain of the view that it is unnecessary to set a fixed minimum holding period of [X] years for all ELTIFs.

As explained in our introduction, the capacity to provide liquidity to investors will not necessarily (or even at all) be connected to the investment strategy of the ELTIF or the underlying assets of the ELTIF.

Liquidity may well be provided through one or more other means, such as a liquid sleeve of assets or matching of investor demand. Managers can also use a defined liquidity program from the start of the fund, such as incorporating redemption limits and different notice periods (as discussed further in these responses).

As such, in specific cases, we consider that if the manager of an ELTIF can demonstrate it can ensure liquidity to clients through other means, the obligation to have a minimum holding period should be able to be waived entirely (and not only reduced in length).

A more flexible approach towards a MHP will provide for greater variety of products in the market as managers will be able to develop and offer products with different length and style of “lock-up” periods (such as use of a soft-lock, where clients pay a charge for redeeming earlier than planned but can nevertheless redeem), rather than being restricted by a single MHP. This will benefit clients overall which will be able to choose between different types of products depending on their preferences.

**A much more complex requirement than it seems**

A MHP can create operational challenges for distributors to custody the assets (e.g., series accounting may be required or a dummy ISIN system) and conflict with market practices and regulations in some Member States, making the ELTIF less or non-viable in those jurisdictions.
A MHP will also be difficult to monitor and will not be practical in all circumstances. For instance, it will not be relevant for funds invested by insurers, as investors need to rebalance their portfolios (e.g. every 6 months or when investors approach retirement age), pay some fees or accommodate for specific cases of misfortune (“accidents in life” such as death, redundancy, disability...).

More broadly, it will be impossible for the ELTIFs to monitor a MHP as the majority of investors come through intermediaries/nominee accounts. The obligation will necessarily pass through such intermediaries to monitor and track. This process of intermediation also makes it difficult, if not impossible, for managers to monitor the aggregate concentration of retail and non-retail investors in the ELTIF, for the purposes of determining the minimum holding period, further complicating in practice the ability to set a fixed MHP.

A more realistic approach would be to require managers to consider the fund’s target market, in addition to a range of qualitative criteria, when determining the appropriate holding period for the particular fund.

A not always appropriate mechanism for the investor

Even if a MHP is set, a manager will not know when investors will look to redeem so the MHP will not really provide any more guidance or certainty as to when the ELTIF may receive redemption requests as the ELTIFs will be set up with rolling closings (monthly or quarterly). Where, as can often be the case, managers will have notice periods and limited redemption windows, a MHP will mean investors will be faced with unnecessary restrictions as to how and when they can redeem, leading in longer periods for them to receive their cash.

On a side note, PRIIPs KID disclosures prescribe a “recommended holding period”. It is important that this is clearly distinguished with the MHP, at the risk of confusing investors through the divergent use of these two concepts. While this does not as such represent an argument to move away from a mandatory MHP, it does show this concept can also create issues in itself.

Rather than the implementation of a fixed period for an MHP, we would suggest to solely rely on a series of criteria that could determine a period length appropriate to the fund’s characteristics. This would acknowledge (as noted immediately above) that some funds with specific features and mechanisms could have the means to provide clients with a lot of flexibility while others without such means would have longer periods. This will help support a more diverse and dynamic product range in the market.

Criteria to determine a minimum length

We do not think that the relevance of criteria 1(d)-(j) should be overemphasised, given that the capacity to provide liquidity to investors is unlikely to be connected to the characteristics of the underlying assets of the ELTIF.

Additionally, we struggle to understand the specific relevance of 2(b). The length or application of an MHP is never linked to the valuation procedures and the redemption policy. For example, the only link with the redemption policy is that the policy is not applicable during the MHP, since the MHP prevents any redemption.

As such, whilst the characteristics of the underlying assets should be taken into account to some extent, we do not think the criteria should overly weight the relevance of different aspects of underlying assets (and the investment management of the assets). The criteria should also take into account the liquidity management program and techniques intended to be used by a manager.
We think the most important criteria to take into consideration are:

- features and characteristics of the assets to be invested by the ELTIF (namely, their liquidity)
- type of strategy (PE, hedge, real estate,…) and expected portfolio
- life of the ELTIF
- date on which the portfolio composition and diversification rules apply (i.e., the time required to deploy the ELTIF’s portfolio into the required proportion of long-term assets)
- characteristics of the liquidity management system
- existence (or not) of redemptions limits

A manager should also be able to seek a reduction of this period during the life of the fund if it can demonstrate that the portfolio construction is already made (e.g.: due to the use of a seed portfolio).

Timing of the period

From our read of the ELTIF Regulation, it should be possible to allow redemptions before the end of the ramp-up period, subject to a MHP which could be shorter than this period. A clarification of the RTS in this respect would be helpful (in particular, with respect to the requirement to “invest all capital contributions” by the end of the minimum holding period).

The recitals of the RTS clarify that, although “this minimum holding period is aimed at the beginning of the life of the ELTIF, managers can implement lock-up period for subsequent investors and apply the same criteria as defined here if they deem it appropriate in view of equal treatment, financial stability and other factors”. This is a helpful clarification, which confirms that it is possible to organise redemption windows after the ramp-up period, with or without a MHP. This is already the case under the ELTIF 1.0 regime and should remain possible under ELTIF 2.0, as confirmed by the recitals.

We suggest that the concept of a MHP only focuses on the period before the end of the ramp-up period, as this is the time period when the manager wants to focus on acquiring assets to meet the threshold of eligible investments and does not really focus liquidity management. A MHP in fact only brings value when set during the ramp-up period.

Finally, it would be important to clarify that transfers are permitted during the MHP. In effect, transfers are equivalent to matching, which are also allowed during the period.

Q10: Do you agree with the proposed approach in relation to the minimum information to be provided to the competent authority of the ELTIF (referred to in point (b) of paragraph 2 - Article 18(6)(b) of the ELTIF Regulation)?

For closed-ended structures, we note that, as an AIF, the ELTIF is already subject to the AIFMD’s minimum and wide-ranging regulatory reporting requirements (which are due to be extended under AIFMD II). Consequently, we consider that minimum information requirements ELTIFs, coupled with the broader reporting requirements applicable to AIFs, are sufficient, subject to some small changes:

- Firstly, it should be clarified in limb (g) that such information needs to be specifically requested by the competent authority.
- Secondly, we consider the “10 days” requirement in limb 2 should be clarified as 10 Business Days.

For evergreen structures, we appreciate the thought that ESMA has given to the minimum information to
be provided to the competent authority of the ELTIF, and broadly agree with the list of information. However, we have the following comments on specific information items:

1b. The exact requirement here is not clear and should ideally be required to be complied with “as relevant”.

As many ELTIFs (regardless of underlying strategy) will offer a liquidity programme (such as using Repurchase Limits - see next bullets) and manage liquidity though structures such as a liquid asset pocket or funding redemption requests with the new subscription proceeds, borrowings, etc, there will not necessarily be a dilution effect. In these cases where dilution is not an area of focus, this should not be an obligation for the manager.

1d and e. As mentioned above, a manager typically does not link the liquidity profile of the assets in the portfolio of an ELTIF to the nature of the target investors. We also understand the information requirement set in para 1d does not mean that managers are meant to meet full redemptions forever.

2. It must be clear that any permanent cap on redemption referred in Article 18.2.d of the new ELTIF Regulation is a “permanent” cap that applies during each redemption window. It is therefore not part of liquidity management tools that are required to be “activated”, but rather of a defined liquidity programme that the manager has set and disclosed to investors at the launch of the ELTIF.

For example, where an ELTIF offers quarterly redemption and a manager as part of its liquidity programme for the ELTIF (which has been clearly disclosed in the ELTIF legal documentation) applies a Repurchase Limitation per quarter (e.g. maximum 5% of the assets referred in (b) of Article 9(1) (i.e. UCITS-eligible assets)), there should be no requirement for the manager to disclose/report that repurchase requests which exceed such limitation have been unsatisfied.

3a. The reference to “any possible” dilution effect may lead to a situation where the manager is prevented to operate until it has considered every option. Softening the language by removing the terms “any possible” may avoid information requirements being used as a barrier to the use of liquidity provisions.

4. As above, it should be made clear that this only applies to repurchase requests which would be unsatisfied and are within any Repurchase Limitation that has been set by a manager as part of its liquidity programme for the ELTIF. So, using the example above, a manager would only have the obligation to report if it is not able to repurchase up to 5% in a given quarter.

Q11:

a) Do you agree with the proposed approach in relation to the requirements to be fulfilled by the ELTIF in relation to its redemption policy and liquidity management tools, referred to in points (b) and (c) of Article 18(2) - Article 18(6)(c) of the ELTIF Regulation?

b) What are your views on the setting of a maximum redemption frequency on a quarterly basis, for all ELTIFs, irrespective of their individual specificities, as suggested in paragraph 83?

c) What are your views on the setting of a notice period of Y months for all ELTIFs (with Y equal to 12, for example)? What are your views on the options 1 and 2, set out in paragraphs 87 to 90, in relation to the specific requirements/circumstances where the notice period could be less than one year, and the numerical values of the parameters Z(1) to Z(4), under option 1, and Y, under option 2?

d) In your view, how do these requirements on the redemption policy and liquidity management tools of the ELTIF would compare to those applying to existing long-term investment AIFs which would be similar to ELTIFs (e.g. in terms of eligible assets)?
Where possible, please support your answers by providing examples of current liquidity set-up for similar long-term funds marketed to retail investors, analyses of the data available to assess the value of ELTIF long term assets and the length of the valuation process.

As described in previous questions, rules set out in Article 18 of ELTIF Regulation shall only be relevant for ELTIFs actually offering redemptions.

Hence, we have addressed the questions below only for evergreen ELTIFs or closed-ended ELTIFs offering liquidity solutions. For those open-ended ELTIFs, we would generally expect them to maintain a portion of the portfolio (which will vary in size from time to time) in liquid investments which will be used to satisfy redemption requests.

a) **Do you agree with the proposed approach in relation to the requirements to be fulfilled by the ELTIF in relation to its redemption policy and liquidity management tools, referred to in points (b) and (c) of Article 18(2) - Article 18(6)(c) of the ELTIF Regulation?**

We recognise that redemption procedures (e.g., the conditions, timeframes, formalities applicable to requests and processing of redemptions) should be outlined in the fund documents from a transparency perspective. However, the redemption procedure needs to be defined in a manner such that it takes into account the interests of the investors.

In general, the elements specified in Article 5(1) of the draft regulatory technical standards are elements that we would expect to include in an offering document of an open-ended fund.

While the ELTIF should maintain a pool of liquid investments to fulfil redemption requests in line with the redemption policy alongside other liquidity management tools, the policies should not be overly prescriptive as the correct approach will depend on the specific features of the ELTIF (as described in previous questions).

In that context, regulatory standards should ensure that the ELTIF has the flexibility to manage subscriptions and redemptions while maintaining liquidity consistent with its redemption terms. This will differ among each ELTIF depending on its investment objective and strategy. Managers will employ different methods of liquidity which will evolve during the life of the ELTIF depending on the ratio of subscriptions and redemptions. Imposing restrictive timelines for redemption procedures will only be overly cumbersome on the ELTIF and increase costs, making it less of an attractive option for fund managers.

It is therefore important for an open-end ELTIF to be treated in the same manner as any other semi-liquid evergreen structure. Thus, the redemption policy and liquidity management tools should ideally act as a guiding principle for the ELTIF instead of being mandatory requirements, while AIFMD liquidity provisions shall be sufficient to impose strict requirements. As a general principle, there should be an alignment with AIFMD rules to avoid forcing ELTIFs to have more complex requirements than other AIFs.

A comparison can be drawn here with the long-term asset fund (LTAF) regime in the UK, the attractiveness of which rests in part on the ability of the manager to determine a redemption policy and liquidity management tools as appropriate depending on the investment objective and strategy of the fund.

ESMA should avoid imposing disclosures that could lead to redemption runs. For example, if there are clear repurchase limitations (e.g.: total repurchases limited to 2% of NAV per month) in the ELTIF’s governing documents, there should be no requirement to disclose (e.g., on Manager’s website) that repurchase
requests which exceed such limitation have been unsatisfied. While transparency remains a crucial tool, ESMA could consider whether there could be targeted exemptions when publishing on website, and more generally to the public, creates material adverse effects to the ELTIF and/or its investors.

b) **What are your views on the setting of a maximum redemption frequency on a quarterly basis, for all ELTIFs, irrespective of their individual specificities, as suggested in paragraph 83?**

Quarterly redemptions - and monthly subscriptions - are the current market standard in case of semi-liquid evergreen structures.

However, if a manager is able to justify a different maximum redemption frequency period depending on the investment strategy of the ELTIF, we see no reason for it not to be able to do so. By way of comparison, the UK LTAF regime permits a maximum redemption frequency of monthly and this reflects potential future trends in the market.

While the draft technical standards do not comment on this, subscription windows should not have a defined period and managers should be able to set subscription windows at a different frequency than redemptions (noting that the valuation points would have to track the relevant subscription dates). This will also help managers to better manage liquidity and cashflows in the fund and reduce the need to use other liquidity tools.

Emphasis should be given to the ratio of inflow of subscriptions against the outflow of redemptions and the frequency of valuations.

c) **What are your views on the setting of a notice period of Y months for all ELTIFs (with Y equal to 12, for example)? What are your views on the options 1 and 2, set out in paragraphs 87 to 90, in relation to the specific requirements/circumstances where the notice period could be less than one year, and the numerical values of the parameters Z(1) to Z(4), under option 1, and Y, under option 2?**

While the fund documents should require the investors to provide the manager with a redemption notice in a specified timeframe, imposing a common standard timeframe for redemption notices on all ELTIFs would be restrictive as this does not take into account the fund's strategy and further, the internal processes of the fund manager. Moreover, a suggested timeline of 12 months is impractical especially if this is to be implemented alongside the quarterly redemption frequency limit suggested above.

Overall, the notice period timeline is largely subjective depending on both the fund manager and fund administrator's internal compliance procedures.

In practice, most evergreen funds which launched in the last few years, have a 1-month notice (or less) for their quarterly redemptions. In addition, these are typically capped at 5% of NAV per quarter. As indicated in our introduction, these evergreen funds tend to have designed and implemented liquidity mechanisms (e.g. liquidity bucket) precisely in order to meet investors’ need for liquidity. Such liquidity bucket is typically composed of cash, money market funds, corporate debt and other debt instruments, which have enough liquidity to be divested with very short notice in order to settle any redemptions. The redemption cap also helps ensure that the fund would not need to try to divest any private asset.

Therefore, ESMA’s view in the consultation paper “the sale of eligible assets may take some time, sometimes several months, as they are not liquid instruments.” is not accurate. Indeed, redemptions will be met by
either using available cash or by having a full waterfall of redemption sources so as to provide the investors with cash outflows (as opposed to selling the underlying portfolio investments) and to protect the interests of the non-redeeming investors who wish to remain invested in the illiquid assets. Importantly, the purpose of the notice period is hence to provide the fund manager with enough time to process such redemptions as opposed to processing the sale of illiquid assets to meet the redemption request. In this regard, option 1 as suggested by ESMA in the consultation paper i.e. “the ELTIF holds a minimum proportion of liquid assets in order to offer redemptions. The length of the notice period could be reduced according to the minimum amount of liquid assets held by the ELTIF.” is not appropriate as the percentage of liquid assets held by the ELTIF should not be tied to the redemption notice period.

Similarly, ESMA’s suggested option 2 i.e., “instead of setting minimum proportion of liquid assets to be held by the ELTIF, to calibrate the amount of possible redemption requests, if the duration of this notice period is less than one year”, is also not appropriate as the number of redemption requests could be subject to various external factors aside from the ELTIF’s expected cash flows and liabilities.

We note that Article 5(1)(j) of the draft regulatory technical standards includes reference to the maximum percentage of assets that are available to be redeemed. This should be the relevant area in which to consider liquidity risk, not notice periods for redemptions. Moreover, redemption limits (as a % of NAV per quarter) are easier to understand for investors.

d) In your view, how do these requirements on the redemption policy and liquidity management tools of the ELTIF would compare to those applying to existing long-term investment AIFs which would be similar to ELTIFs (e.g. in terms of eligible assets)?

Where possible, please support your answers by providing examples of current liquidity set-up for similar long-term funds marketed to retail investors, analyses of the data available to assess the value of ELTIF long term assets and the length of the valuation process.

As previously iterated, the redemption policy and liquidity management tools must be flexible as different funds will have different approaches in terms of management liquidity and will have different asset classes which mean different tools will be used. Managers will also have different subscription and redemption models depending on the fund’s strategy and asset class and will thereby employ different liquidity tools. As is seen with other semi-liquid evergreen structures, the underlying investments and the investor base will determine these factors and will evolve during the life of the fund, hence the managers should have flexibility to appropriately manage the fund.

The key control over liquidity risks in existing equivalent funds is a (typically quarterly) fund-level cap on the percentage of NAV that is available for redemption. This cap enables managers to control liquidity risk in the portfolio and the additional liquidity features set out below are designed to enhance this rather than offer an independent solution to managing liquidity risk.

Considering this, the requirement of mandatory anti-dilution mechanisms, and potential side effects, should be further considered. As redemptions will need to be satisfied out of liquid assets or for available cash, the ELTIF should not have to sell long-term assets to satisfy redemptions immediately (It may however sell these assets for long-term liquidity management).

a. Anti-dilution levies
It should be clarified if anti-dilution levies are to be levied, whether they are payable to the fund or the manager.

Again, if a fund has implemented the appropriate liquidity mechanisms, meaning that liquidity can be created quickly and without much friction and the fund would not look to divest any investments in private assets, then it would not seem necessary to command the addition of anti-dilution tools.

b. Swing pricing

Swing pricing does not seem appropriate for private equity funds in any circumstances. If the manager would have to dispose of investments, which is extremely unlikely for reasons laid out above, the process to dispose of private equity assets are typically long and will not allow to reflect the transaction expenses (resulting from the restructuring of the portfolio) in the NAV to be paid to exiting investors.

c. Redemption fees

These are more appropriate for private equity funds. The rate could decrease in time (to incentivize long-term investors) and this should include a discount on NAV. We also suggest that the final redemption price could be determined on a floating basis according to the NAV of the ELTIF as of the pay-out date, not the redemption date, in circumstances where immediate payment of cash redemption proceeds is not in the best interests of the ELTIF. While this model will not be used by all ELTIFs, it is an important feature of others.

d. Other policies

Redemption policies should include, among others, the ability to put soft locks in exchange for fees or deductions for early repurchases (e.g. shares that have not been outstanding for at least [1] year shall be repurchased at [95]% of repurchase price). Such “soft lock up” could work during the first minimum holding period and / or during the whole life of the fund if the shares are held less than e.g., 1 year by the relevant investor. Alternatively, the ELTIF could also consider imposing a “slow payout” mechanism whereby payment of all or a portion of redemption proceeds may be delayed.

We particularly welcome the use on a non-exceptional basis of gates which are disclosed to investors. These mechanisms, as long as they are clearly disclosed to investors, should be viewed as proper liquidity management tools, as set out in the contract agreed with investors. For instance, the latter could specify the percentage of assets concerned. Such gates disclosed to investors would be different from any additional gates used in exceptional circumstances. Gates linked to “exceptional circumstances” are different from the permanent Repurchase Limitation set forth in Article 18.2.d) (i.e. the % of UCITS-eligible assets). In our view the cap set forth in Article 18.2.d) should work in any instances (normal or extraordinary) and would not need to be “activated” if expressly set in the fund legal documentation.

Further, the fund manager should also have the ability to decline an automatic transfer of a redemption request not satisfied by way of operation of any cap in any particular redemption window into the next window.

Q12: Do you agree with the proposed criteria to assess the percentage referred to in point (d) of Article 18(2) - Article 18(6)(d))?

Liquid assets on the fund balance sheet are an important tool for managing and generating liquidity to satisfy redemption requests. For funds investing a large part of their capital in illiquid assets, a liquidity bucket will be continuously determined and actively managed based on e.g. (i) the investment strategy, (ii)
liquidity profile of the private assets, (iii) frequency of liquidity, (iv) limit on redemptions and (v) evolving market conditions.

All of this is to ensure that the size of the ‘bucket’ is appropriate to meet future investor needs while limiting the drag on performance so that investors get the most out of their investments in private assets.

While acknowledging that ESMA actions are limited by the Level 1 legislation, we first want to stress it is not market practice that the repurchase limitation be a % of only certain type of assets of the fund (here UCITS assets only). It is instead typically presented as a % of NAV per month/quarter. We believe such a presentation, in line with market standards, is better for the investors and for financial stability.

It would also be helpful to clarify that **redemptions may be limited to a fixed percentage by default**, even if such limit is lower than the percentage of liquid assets available for redemption from time to time.

a) **Minimum level of liquid assets not available for redemption requests**

Requiring a minimum level of liquid assets can often be restrictive and limit a manager’s ability to properly implement a private markets investment strategy. The size of pockets should be determined on a case-by-case basis depending on the specific features of each ELTIF. The criterion should depend on the nature of the fund, take into account the investor base that the ELTIF is intended to be marketed to and also take into account liquidity testing.

Most importantly, there is **no reason for less than 100% of the UCITS eligible assets to be available for liquidity purposes**. Any other option means that a manager will need to retain an even larger amount of UCITS eligible assets than they would otherwise like to utilise to provide for the liquid pocket they determine they need. This would in turn mean lower returns to investors and, ultimately, less investments in real assets.

Capping the amounts that can be redeemed is the right mechanism for protecting the ability to pay the maximum quantum of redemptions available at any one time, and a manager should not have two layers of asset requirements for the same purpose. We strongly suggest ESMA to avoid limiting the use of UCITS eligible assets as this could represent a significant barrier to the use of ELTIFs.

b) **Definition of a liquid asset**

Liquid assets are often not the first source of cash and there are other levers that should be considered (borrowing, cash available from subscriptions at the same valuation point etc.). An ELTIF should be allowed to fund repurchase requests from sources other than cash flow from operations, including, without limitation, the sale of assets, borrowings, return of capital or offering proceeds.

Liquid assets should also be deemed to contain not only UCITS assets but also **assets exposures to UCITS funds under specific conditions** (in particular, the time needed to collect such assets) and other liquid credit investments where the manager determines that those assets could be realised whether the timeframe between redemption requests being substituted and the redemption payment becoming due.

c) **Guidance on stress tests**

ESMA should set a framework or provide guidelines on stress tests. A minimum set of rules could guide each local regulator and avoid managers being treated very differently from one jurisdiction to another. It will
also strengthen the visibility and speediness of the regulatory approval process. Stress test parameters should in any case be flexible depending on the investment strategy.

d) Intermediaries

We believe paragraph 1.d) should be modified to capture liquidity ensured by intermediaries (such as insurance companies entering into ‘liquidity undertakings’). This should be taken into account in the overall assessment of the liquidity profile of the fund, especially when determining the minimum size of the liquid assets pocket.

e) Expected changes

Paragraph 4 creates an obligation to verify changes between the date of the assessment and the applicable redemption date. Such an obligation could end up being very burdensome and may be better replaced by an obligation to verify during the life of the ELTIF if the percentage originally defined (“date of assessment”) remains relevant.

Matching mechanism

Q13: Do you agree with the principle-based approach suggested above, in relation to the ESMA RTS under Article 19(2a)?

Yes, we agree that a principle-based approach is the most appropriate choice in the current context in which the practicalities and the impact of the matching request mechanism is not known.

Overall, if matching is to work as a process, it should have the following characteristics:

- It should always match subscriptions and redemptions
- It should give the ability to have both a secondary and primary market for purchases open at the same time
- the manager must have discretion over the amount of shares that may be traded on the secondary market
- transaction in a dark pool should be possible to prevent fund NAV distortion

On the US market, certain independent marketplaces already exist, e.g. LODAS (liquidity on demand as a service) platform which has built a secondary market to trade shares in certain retail funds. They organise auctions to trade shares. Such a well-regulated and supervised marketplace could be inspiring for the secondary markets that the new Regulation is introducing.

Q14: Do you agree with the proposals suggested above and corresponding draft RTS, in relation to the transfer process for both exiting and potential investors, and the role of the manager of the ELTIF or the fund administrator in conducting transfers, and the matching of respective requests?

Matching mechanisms described in the standards currently seem to indicate that any matching/transfer would not happen at NAV, which in turn means that such matching would not be possible at the liquidity points offered by the fund (i.e. subscription/redemption dates). Two investors should be allowed to be matched on NAV dates at a price derived from the relevant, prevalent NAV. Subscriptions and redemptions naturally happen on such dates in any case, and offering shares at a price not derived from NAV would be a significant departure from industry standards and other fund regimes (e.g. UCITS).
Some managers recently launched evergreen funds have been allowing matching on such dates at a pre-determined price based on NAV. Such funds have allowed transfers on NAV dates and, in addition, allowed matching on redemption date when the 5% redemption limit is hit to offer liquidity beyond the limit to investors who really need it. Said investors have been given the chance to opt in at the time of their redemption to indicate their intention of having their redemption fully redeemed even if the limit is hit. If there are enough subscriptions on the corresponding subscription date, investors would see the portion of their shares above the redemption limit be redeemed at a price equal to (NAV - 10% of NAV). This 10% penalty then remains within the fund for the benefit of the remaining shareholders.

The standards should not prevent such mechanisms from being applied since these provide liquidity to individuals who might need it at a fixed and known price based on the NAV rather than based on any other arbitrary secondary pricing methodology. Similarly, transfers should be allowed at NAV or at a fixed discount of NAV if intermediaries have clients looking for such transfer. This is very common in other fund regimes (e.g. UCITS) and there is no apparent reason to implement different mechanisms under the standards.

Q15: Do you agree with the proposed approach and corresponding draft RTS, in relation to the periods of time during which exiting and potential investors may request transfer of shares or units of the ELTIF? If both systems under Article 18(2) and 19(2a) coexist, how could the risk of arbitrage between different prices in the primary and the secondary markets be, in your view, mitigated? How could (retail) investors be ensured that the purchase or sale of shares on the secondary market will be executed at prices that reflect the value of the ELTIF?

We appreciate that there is no requirement of a lengthy notice period and that the flexibility is left to the manager to determine when shares can be transferred. As long as the process is clearly indicated in the fund’s rules and investors are treated fairly, we see no reason why conflicts of interest should arise.

Q16: Do you agree with the proposals above and the corresponding draft RTS, in relation to the determination of the execution price and the proration conditions and the level of the fees, costs and charge, if any, related to the transfer process?

We have no issues when it comes to the proposed approach. We note however that, also in the context of the Retail Investment Strategy, such exit fees should never be considered as undue costs, as they are directly related to a specific service (the ability to exit or enter the fund) and cannot be comparable to other fund’s fees.

Q17: Do you agree with the proposals above, and the corresponding draft RTS, in relation to the timing and the nature of the disclosure of information with respect to the transfer process conditions?

We have no issues with the proposed approach when it comes to the timing and the nature of disclosed information.

Others

Q18: Are you of the view that any of the requirements of the draft RTS under the amending ELTIF Regulation should be adjusted to take into account the specificities of listed ELTIF? If yes, could you specify which requirement should, in your view, be amended?
Our understanding is that it is unlikely for managers to be interested in setting up a listed ELTIF. Nonetheless, in such a situation, we do not believe that rules should be specifically adjusted for these types of ELTIFs (which will in any case be subject to general requirements applying to listed entities in the EU).

Q19: 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 redemption policy of ELTIF under Article 18(2) of the ELTIF Regulation? Which other types of costs or benefits would you consider in this context?

We do not agree that it would be a benefit to standardise the “operational and regulatory processes” as it would reduce the amount of flexibility managers can, with different funds and different structures, offer to their clients. Again the UK LTAF shows a regime can be put in place where the manager determines an appropriate redemption policy based on general liquidity requirements as set out in a fund regulatory framework (here AIFMD) - without needing to have specific prescriptive conditions that apply to all funds irrespective of their specificities.

From a cost’s perspective, some of the suggested approaches, for example the need to keep some additional assets aside which cannot be used in liquidity pools, will lead to lower returns for investors and so increase the cost of using ELTIFs compared to other instruments.

Finally, we disagree that there are no ways to improve the standards compared to the proposed baseline scenario. Based on our current understanding of the market, including beyond private equity, we do indeed expect, contrary to ESMA’s comments in its qualitative description of costs, that the vast majority of ELTIF managers are indeed planning to take a similar approach to redemption policy requirements, at least when it comes to not imposing minimum holding periods. They are also using other methods, such as soft locks and redemption limits, which could as much be of relevance to maintaining ELTIF’s strong liquidity profile than the tools currently proposed.

It can therefore be argued that current market practices can guide ESMA towards a more flexible framework that finds the right balance between investor liquidity needs and broader financial stability concerns.

Q20: 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 matching mechanism of ELTIF under Article 19(2a) of the ELTIF Regulation? Which other types of costs or benefits would you consider in this context?

We agree with the comments made by ESMA in its Impact Assessment that a principle-based mechanism has the most benefits compared to costs.

Q21: 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?

Arguably, more harmonisation between frameworks will necessarily help reduce compliance costs and should indeed be encouraged. It could also be argued that there is no need for an ELTIF Prospectus, which could simply refer to KID documentation.
Yet, it is essential to stress that the KID never was an appropriate document for long-term funds such as private equity and has long caused issues to their managers. In that context, deviation from the KID, as long as the KID remains drafted as it is, provides welcomed flexibility to managers.

Overall, it is important all frameworks, including the KID, leave manager sufficient flexibility in filling tables, both for the sake of customers (which are at risk of receiving misleading information) and managers (which are sometimes faced with impossible choices when preparing documents). Given the level of diversity across fund products, not least between closed-ended and open-ended structures, a standardised, detailed format may create more confusion to the investor than provide meaningful information.

Contact

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