BAI's comments on draft RTS under revised ELTIF Regulation

The BAI has intensively reviewed and discussed the ESMA draft of the regulatory technical standards (RTS) under the revised ELTIF Regulation together with its member companies and is pleased to take this opportunity to comment.

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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?

BAI agrees with the proposed approach in relation to the RTS under the abovementioned Articles 9(3), 21, and 26(2) of the ELTIF Regulation.

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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)?

BAI agrees 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.

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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)?

BAI agrees with the assumptions and understands that ESMA proposes to include the different types of costs – that coexist – in a consistent way. However, BAI does not see any merit in expressing maximum percentages since those could potentially be misleading to investors. In terms of the prospectus, BAI would prefer reference only to the KID a/o annual report.

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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?

BAI agrees that the types of cost mentioned in the present paragraph 32(b) are annual costs that could be expressed as a percentage of the capital. Though BAI disagrees on adding additional types of costs since the list will never be exhausted (e.g. calculation of tax figures is missing) and on the other hand will partly not apply; therefore this may only be confusing.

It may help to amend Article 25(1)(e) as follows: "any other costs debited to the ELTIF, including administrative, regulatory, depositary, custodial, professional service and audit costs." Of course, BAI knows that Article 25(1)(e) is not to be changed at the moment (perhaps in the next/upcoming review), though we believe a clarification in the RTS would be helpful.

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Q5: Do you agree that the types of cost mentioned in paragraph 33 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?

BAI agrees that the types of costs mentioned in paragraph 33 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. BAI does not see particular merit in specifying what is to be meant by the "setting-up" of the ELTIF, as long as (1) they have been debited to the ELTIF, (2) they are complete, (3) they are entitled to be set-up costs, meaning especially they were necessary to be incurred to set up the ELTIF in the given quality and in the best interest of the investor. An exhaustive list would be difficult to create.

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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?

During the life-cycle of an ELTIF, assets may typically be exited (sold) and new ones may be acquired (bought) in very different years, hence this would not be reflected in a meaningful manner compared to the other ongoing costs. BAI would recommend treating these costs like management and performance related fees according to Article 25(1)(c).

BAI also tends to disagree with the statement that the costs related to the acquisition of the main assets of the portfolio of the ELTIF (necessarily) largely exceed the part of these costs that are ongoing charges. This may not at all be true, e.g. for an ELTIF fund of funds with no entry fees for the sub-funds.

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

BAI encourages ESMA's statement in Article 37 of the consultation paper, that the detailed design of the presentation formats should not be fully standardized in the RTS. This may help the ELTIF provider reflect and explain fund specifics that could not be shown in a standardized format.

BAI does not see any necessity for a grandfathering clause for ELTIFs benefitting from the grandfathering clause provided for in Article 2 of Regulation 2023/606; such grandfathering may only lead to confusion from the investor angle.

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Q8: Do you agree with the proposed amendment to the existing RTS under the first paragraph of Article

18(6) of the ELTIF Regulation?

This is an extremely important topic for the future success of the new ELTIF regulation from BAI's perspective. We understand that unfortunately and despite strong market demand from private and institutional investors an open-ended ("evergreen") ELTIF (in combination with semi-liquidity features) is not foreseen in the ELTIF regulation. We would therefore suggest paving the way for the inception of "quasi-evergreen" vehicles (again in combination with reasonable semi-liquidity features). One first option to do so from our perspective would be to make use of Article 18(1) of the ELTIF regulation by providing for the right to temporarily extend the life of the ELTIF (as mentioned in the Article).

We would suggest issuing voting rights (long) before the end of the ELTIF, enabling investors to irrevocably vote for a temporary extension of the ELTIF (also meaning the investor would stay an investor in the ELTIF, notwithstanding other options for the investor to exit the ELTIF). With "long before" BAI would like to indicate a period of e. g. 3 or 5 years to enable the ELTIF manager a successful wind-down of the ELTIF. With "temporary extension" we would think of at least another 3 or 5 years. The votes would be weighted by NAV held. Non-voting should be allowed to be interpreted as a "yes"-vote for extension. Redemption as per the previous end of the life of the ELTIF should only be allowed for investors with a "no-vote". If e. g. 75% of the votes are yes or non-voting and 25% are no, the ELTIF manager would need to prepare for liquidity of 25% as per the previous end of the life of the ELTIF. No-votes should also be irrevocable, again notwithstanding other options for the investor to exit the ELTIF.

Regarding the provisions of Article 18(2) BAI would like to remark: We interpret redemptions as redemptions potentially netted with subscriptions (if any) for the same subscription/redemption day as laid out in the redemption policy; we would interpret the limit under (d) as the maximum that can be promised in the redemption policy yet that if redemptions exceed this percentage, the ELTIF manager may still satisfy more if he is capable to do so under the prevalent liquidity conditions of the ELTIF; the redemption policy should allow for carrying forward non-honored parts of the redemption requests and treating them preferentially at the next redemption date ("queuing up for exit").

Regarding the provisions of Article 18(3) we would like to add that – also in light of the market demand for semi-liquid structures – ELTIF providers may choose to go for very long ELTIF terms like e. g. 20 or 30 years and rely on semi-liquidity features during this lifetime before a potential extension will be voted upon (see above).

Remarks regarding Article 2 of the new RTS: even when planning well and abiding by all those provisions, it is impossible to exclude that certain investments either do not turn out well and cannot be exited or on the other hand turn out very well and should not be exited in order not to forego future performance opportunities. BAI understands that using continuation funds to catch such situations should always be possible. We understand this is also what is meant in Article 2(e).

Apart from the above remarks, we overall agree with the proposed amendment to the existing RTS under the first paragraph of Article 18(6) of the ELTIF Regulation.

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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?

BAI agrees with the criteria to determine the minimum holding period, whereas BAI disagrees with setting a minimum of X years for all ELTIFs. ELTIFs are managed by an AIFM – regulated under the AIFMD –, hence the determination of a minimum holding period should be within the prerogative of the AIFM.

The criteria should solely focus on qualitative features rather than quantitative. Subparagraph 3 of Article

3 of the draft RTS is a quantitative feature that should be left to the expertise of the AIFM. The arguments align with the comments on the AIFMD review. Rigid specifications are not helpful and the success of an ELTIF depends on the liquidity management of the AIFM. ELTIFs have various potential uses and are for a broad range of investors. It is important to not limit the development opportunities of an ELTIF that originate in the various asset classes. To lump them together would be an unnecessary restriction of the vehicle.

Furthermore, the setting of a minimum for all ELTIFs seems redundant, considering the qualitative features from subparagraphs 1 and 2. BAI urges ESMA to withdraw Article 3(3) from the draft RTS.

To emphasize this:

Paragraph 63 of the consultation paper (p. 29) seems to assume a fixed aggregated capital. This would not apply for semi-liquid (e. g. SICAV) structures that allow for ongoing additional subscriptions. This should be considered when assessing the suitability of a minimum holding period in combination with a point in time where the capital should have been invested (which may never happen for liquidity buffer reasons).

We do not see any merit of an overall minimum number of X years for all ELTIFs as mentioned in paragraph 64 of the consultation paper (p. 29-30). We can imagine e. g. a private credit ELTIF investing in rather liquid components like CLOs that could be ramped up rather quickly and it would be detrimental for such a fund to have an unnecessary minimum holding period. We would agree though that each ELTIF should have a defined minimum holding period and such period needs to be shown prominently to the end investors in good time before their subscription.

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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)?

BAI overall agrees 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), yet would amend the following:

RTS Article 4(d): the results, assumptions and inputs used for carrying out liquidity stress tests demonstrating whether and how, in severe but plausible scenarios, the ELTIF is able to ~~grant~~ *deal* with redemption requests. This includes the stress scenarios for the assets and liabilities, including redemption and collateral shocks, and the decrease in the value of the assets.

BAI would like to comment on Paragraphs 73 and 74 of the consultation paper (p. 31-32):

We understand the key issue is less that managers are not able to follow their investment strategy under stressed market conditions; It is rather about protecting them from inappropriate liquidity outflows for example in times of liquidity crunches. There is e. g. no way to cope with outflows, of say more than 50% of an ELTIF's NAV, if the fund invests predominantly in illiquid assets; Hence, it is a question of an adequate redemption policy to prevent this from happening. This will, for ELTIFs offering semi-liquidity, always involve defense mechanisms such as liquidity buffers (also through UCITS investments), credit lines, but also gating mechanisms and the option to temporarily suspend redemptions.

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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)?

BAI agrees 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 84?

Regarding the setting of a maximum redemption frequency on a quarterly basis, for all ELTIFs, irrespective of their individual specificities, as suggested in paragraph 84 of the consultation paper (p. 35), BAI is of the opinion that this may make sense for most of the ELTIFs, yet not necessarily for all, e. g. in the private credit space. Since the market shows that only few semi-liquid instruments use a higher frequency than quarterly and no ELTIF manager has any interest at all in their vehicle becoming illiquid, we do not see any necessity of setting such a maximum frequency.

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 88 to 91, 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?

BAI's view on the setting of a notice period of Y months for all ELTIFs (with Y equal to 12, for example) is as follows: Making use of notice periods is a very helpful and common tool for instruments with liquidity constraints due to the illiquid nature of their assets. Yet we do not see the necessity of an overall minimum notice period. Y=12 would clearly be way too long for certain instruments, especially on the private credit side. Please bear in mind that such minimum notice periods – if too long and not waivable – may prevent discretionary portfolio managers from being able to invest in ELTIFs in certain jurisdictions, which is clearly not helpful for the success of the new regulation.

BAI's view on the options 1 and 2, set out in paragraphs 88 to 91 of the consultation paper (p. 36-38), 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 is as follows: While it is helpful to show such relationships in the fund documentation, we do not see too much sense in defining a rule in the RTS that would set constraints, given the very different nature of ELTIF portfolio compositions. We would rather rely on NCAs to reject the approval of a new ELTIF in cases where the redemption policy seems to impose undue liquidity risk on the ELTIF's 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)?

Any AIF or ELTIF manager should be well aware of illiquidity risks and what it may mean for the manager to run into an illiquidity situation, with subsequent gating, suspension and in the worst case, dissolution of the fund in question. Such events can lead to significant commercial and reputational damage for the manager. That is why BAI would not expect an ELTIF, subject to additional and more stringent rules imposed by the ELTIF RTS to be the safer instrument as compared to a comparable AIF that would not qualify as an ELTIF for reasons of Article 19(1) and 19(2). It does make sense though to set standards what needs to be disclosed (e. g. parameters X, Y, Z as describe in the consultation paper) and how – meaning in a fair and clear manner, since the readers of the fund documentation may be less knowledgeable than an institutional AIF investor.

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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))?

In principle, BAI agrees with the proposed criteria to assess the percentage referred to in point (d) of Article 18(2) - Article 18(6)(d)), yet subject to following considerations: The number of criteria is obviously ample and versatile and their outcomes and interplay difficult to forecast over the lifetime of an ELTIF – which can be very long. Consequently, the percentage in question should always be chosen prudently.

The meaning of Article 6(2) of the RTS is not understandable: While it clearly may make sense to hold such a preserved percentage of UCITS funds, their sense and purpose must be to serve as additional source of liquidity, if a series of significant redemptions starts jeopardizing the ELTIF's liquidity. This will especially become relevant if e. g. for a series of quarters the maximum net redemption amount will be reached, which may e. g, happen in severe capital market crises or if the fund performs either very poorly or very well.

While BAI appreciates the flexibility that Article 6(3) offers, we would not recommend any ELTIF manager to (frequently) change this percentage since this leads to uncertainty and may trigger redemptions.

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

BAI agrees with the principle-based approach suggested above, in relation to the ESMA RTS under Article 19(2a). Two additional considerations: BAI considers the French example to be a very reasonable approach for such matching mechanism as a supporting liquidity mechanism next to the regular redemption policy. BAI would expect matching prices to be close to the NAV, so long as no gates are invoked; as soon as gating kicks in, matching prices may fall significantly. In case an ELTIF gets soft-closed due to a lack of investment opportunities a/o strong demand for the ELTIF, matching prices may also exceed the NAVs. There is an interplay between subscription, redemption behavior and the matching prices, which should overall help to create transparency. Especially in times of crises, this transparency may also exacerbate the situation for the ELTIF itself, yet still be helpful for the investors. Overall, BAI embraces the option to install such matching mechanism if it is not mandatory.

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Q14: Do you agree with the proposals suggested above and corresponding draft RTS, in relation to the transfer process for both existing 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?

BAI believes that this makes a lot of sense and agrees with the suggested proposals and corresponding draft RTS.

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Q15: Do you agree with the proposed approach and corresponding draft RTS, in relation to the periods of time during which existing 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?

Regarding paragraph 153 of the consultation paper (p. 54) BAI would be careful about restricting the use of the matching mechanism in order to prevent potential investor protection related issues in light of the coexistence of both mechanisms. Touching/suspending the matching mechanism would always be perceived as an alarm signal, potentially triggering redemptions, which would be very counterproductive. Otherwise, we agree with the proposed approach and corresponding draft RTS, in relation to the periods of time during which existing and potential investors may request transfer of shares or units of the ELTIF. If both systems under Article 18(2) and 19(2a) coexist, there is a potential rise of arbitrage that we would suggest be accepted for the following reason:

There is little ground to assume an existing investor will use the matching mechanism without setting a reasonable price limit, especially as long as the regular primary market under Article 18(2) works smoothly. Therefore, there is no reason to assume that prices under the matching mechanism get under pressure and arbitrage is even possible.

In this context, BAI could imagine ELTIF managers introducing a potential price limit feature for the matching mechanism “last available NAV”, which may help prevent mispricing.

As soon as the primary market under 18(2) gets under pressure (meaning gates may have to be invoked), it is fair to assume that the prices under the matching mechanism may fall below the last available NAVs, potentially even significantly. Yet in such a situation, arbitrage is not possible anymore and the matching mechanism may become a very important tool to save the existence of the fund, relieving redemption pressure from investors with liquidity needs.

When it comes to ensuring that the purchase or sale of shares from retail investors on the secondary market will be executed at prices that reflect the value of the ELTIF, BAI sees following mitigating measures: (1) We should not underestimate the knowledge and experience of retail investors in general, many of them are acting on secondary markets like stock exchanges and are aware of the mechanisms. Notwithstanding the above, following measures seem sensible in view of the potentially low liquidity in such a matching mechanism market under Article 19(2). (2) ELTIF managers could decide to not allow “market” limits. (3) Limits in relation to the last available NAV like “last available NAV”, “last available NAV -3%”, “last available NAV +2%” could help rather than absolute figures (which should of course also be allowed). (4) Mispricing mechanisms could be introduced by the ELTIF manager that would e. g. avoid matching prices outside a certain interval around the last available NAV, as long as no gate is invoked and no soft-close for subscription applies (meaning the market under Article 18(2) is fully functional), for example ±5%.

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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?

Paragraph 156 of the consultation paper (p. 55): Using the NAV would rather contradict the secondary market nature of the matching mechanism under Article 19(2). Using the NAV may be an option though for matching a sell and a buy order both with a “market” limit (if allowed so by the ELTIF manager, which BAI would not recommend in light of the potentially low liquidity on the matching mechanism market).

Paragraph 157 of the consultation paper (p. 55): Assuming a quarterly frequency of the primary market under Article 18(2), the matching mechanism under Article 19(2) may e. g. be used to offer additional liquidity in-between, so for example on a monthly basis. In this example, every three months there would be a trade date for both markets. BAI agrees it could be an option to have the trade date of the secondary market slightly after the trade date of the primary market to at least not encourage arbitrage in such a case.

Some considerations:

Arbitrage is very unlikely since for redemptions, you would be subject to a notice period, and you would need to hold the ELTIF for some time before even thinking of redeeming.

It is a fair behavior to try to enter the ELTIF through the secondary market instead of the primary market, trying to benefit from potentially better pricing. Yet it is unlikely this will work if the primary market is fully functional. Any buy orders on the secondary market as well as subscriptions on the primary market will always support the ELTIF's liquidity by mitigating potential pressure stemming from existing investors. Due to the notice period an investor, buying on the secondary market, can not immediately redeem. Therefore, arbitrage could only be played by making use of existing holdings. If so, also having a certain time delay between the trade dates of the primary and the secondary market does not really help.

It is in general also a fair behavior of an existing investor to try to exit an investment and to buy again cheaper later, although this is probably not the ideal investor for an ELTIF lacking the necessary long-term perspective. But this has nothing to do with arbitrage and we do not see any grounds that an ELTIF will particularly attract such investors.

To summarize:

Having trade dates for both the primary market under Article 18(2) and the matching mechanism under Article 19(2) on the same day does not seem to be of any detriment to us, although execution prices may differ. This is true for many exchange-traded UCITS funds (non-ETFs) on a daily basis.

Subject to our observations above, BAI agrees with the proposals 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.

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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?

BAI agrees with the proposals 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.

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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?

BAI has no comment.

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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?

BAI has no comment.

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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?

BAI has no comment.

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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?

BAI has no comment.

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