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France Invest's contribution to ESMA's consultation on draft RTS on open-ended loan-originating AIFs under the AIFMD

France Invest would like to thank ESMA for the opportunity to contribute to its consultation on draft RTS on open-ended loan-originating (LO) AIFs (LOFs) under the AIFMD. Established 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. It should be noted that, when they engage in private equity and private debt activities, our members ensure the strict separation of these two streams of activities.

The French market for debt funds is very active. In 2023, France was the top European country in terms of number of operations, ahead of the UK[1] (170 operations in France vs. 158 in the UK). French debt funds raised 9.5 bn EUR which will finance companies and infrastructure projects and invested 13.9 bn EUR[2]. **A large majority of these funds are closed ended funds aimed at institutional investors.** Indeed, in order to make long-term and active investments into unlisted businesses that require time to grow and evolve, VC/PE funds typically structure themselves as closed-ended AIFs with no redemption rights, which favours illiquid and large commitments from investors.

This being said, the attractiveness of the VC/PE asset class and the desire from some investors to commit capital into start-ups and scale-ups are driving an increasing number of VC/PE managers to offer products that are more widely available to retail clients. As retail clients generally require greater liquidity than institutional investors, open ended VC/PE funds (so called "evergreen funds" or "semi liquid funds") are becoming increasingly popular among retail clients, as well as insurers, due to their long-term nature and flexibility. In particular, **the private debt segment is increasingly successful in the context of the retailisation of our asset class,** notably thanks to its attractive risk/return profile ((regular income, reduced volatility, etc.). According to our estimations, **among the 19 evergreen (open-ended) French funds managed by our members which are open to non-professional investors**:

- **10 funds engage in loan origination activities**
  - 3 originate loans to finance infrastructures (loan origination representing over 90% of their activity, the rest of the portfolio being invested in liquid assets)
  - 3 originate loans to finance non-listed companies (loan origination representing over 90% of their activity, the rest of the portfolio being invested in liquid assets)
  - 1 large fund originates loans to finance companies (loan origination representing approximately 55% of its portfolio)
  - 3 other funds engage in loan origination activities for a less significant part of their activity
- These funds which engage in loan origination activities are managed by 6 of our members

Unlike traditional VC/PE funds, evergreen funds do not have a fixed lifespan. They continuously raise and invest capital, providing ongoing opportunities for investors to enter and exit the fund, thus offering greater liquidity at the fund level, compared to closed-end funds. At the same time, they are designed for long-term investments, well-suited to long-term projects such as projects in renewable energy, infrastructure, and other sustainable sectors, aligning

[1] *Private Debt Deal Tracker*, Deloitte
[2] Étude d'activité des fonds de dette privée en France en 2023 | France Invest

with the interests of investors looking for sustained growth over an indefinite period. Their purpose is to offer investors the potential for higher returns associated with private equity while providing a degree of liquidity not typically available in traditional private equity funds. For the fund manager to be able to maintain a long-term investment horizon without being forced to sell assets prematurely, these funds usually have restrictions on how much capital investors can withdraw at any given time. With their hybrid approach, semi-liquid structures offer access to the private equity asset class to a new range of clients with a different liquidity profile, with positive impact on the overall diversification of portfolios.

We welcome the recent revisions to the AIFM Directive and to the ELTIF Regulation, which bring significant improvements to both regimes. These changes will enable our members to make better use of the EU passports and expand the availability of their products to EU investors. Last autumn, **we actively participated in ESMA's consultation on Liquidity Management Tools under the AIFMD and UCITS Directive** and are confident that ESMA will work to ensure AIFMs have access to appropriate liquidity management tools. Similarly, it is crucial that the RTS on open-ended loan-originating AIFs under the AIFMD are thoughtfully developed.

General comments

- It is essential that **the AIFMD2 level 2 measures support the development of open-ended LOFs** in alignment with the Level 1 provisions of the Directive. The additional requirements for open-ended LOFs should remain consistent with the general obligations for AIFs, particularly those applicable to open-ended AIFs. Moreover, these measures should integrate seamlessly with the ELTIF framework.

- **Any additional obligations should be justified by the distinct characteristics of open-ended LOFs**. In other words, ESMA should avoid introducing requirements beyond existing obligations unless they are specifically warranted by the unique nature of LOF assets, i.e. loans.

- In terms of timing, **the level 2 measures should be finalized well before the Directive's application date** to ensure that market participants have adequate time to prepare and comply with the new regulations.

- ESMA emphasizes that compliance with the RTS does not automatically guarantee that the relevant LOF can benefit from the derogation allowing it to remain open-ended. **We caution against the risk of fragmentation in the implementation of the RTS and inconsistencies in interpretation by national regulators**. Discretionary interpretation by national authorities should be minimized to ensure uniform application.

- From a competitiveness perspective, **it is essential that the European framework remains no more stringent than that applied in other regions and takes into account a broad range of factors.** A restrictive "liquidity bucketing" approach should be strictly avoided.

- We would like to highlight the binary nature of the current definitions for open-ended and closed-ended funds, which fail to account for the concept of "semi-open" or "semi-closed" funds. For example, some funds, like UCITS, are highly liquid and allow investors to exit at any time, while, on the other hand, others are fully closed-ended, offering no exit opportunities at all until the fund's end of life. However, some other funds are essentially closed-ended even though they provide limited liquidity opportunities initially agreed upon with investors. Therefore, **differences between fully liquid funds and those with limited exit opportunities should be appropriately considered**.

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Detailed comments

SOUND LIQUIDITY MANAGEMENT

Q1: Are there any elements other than the redemption policy, the availability of liquid assets, the performance of liquidity stress tests and ongoing monitoring that AIFMs shall take account to demonstrate that the liquidity management system of the OE LO AIFs they manage is sound? If yes, please specify.

We welcome the principles-based approach adopted by ESMA and the multiplicity of factors that are included in the RTS as potentially relevant to determine an appropriate redemption policy. In particular, we welcome the inclusion of cash inflows in the list of factors set out by ESMA. It is important that ESMA acknowledges that each open-ended LO AIF will place more emphasis on specific factors depending on its characteristics.

It would be useful to clarify that there is a wide range of possibilities when it comes to sound liquidity practices for LO AIFs. The binary nature of the current definitions for open-ended and closed-ended funds fails to account for the concept of "semi-open" or "semi-closed" funds. For example, some funds, like UCITS, are highly liquid and allow investors to exit at any time, while, on the other hand, others are fully closed-ended, offering no exit opportunities at all until the fund's end of life. However, some other funds are essentially closed-ended even though they provide limited liquidity opportunities initially agreed upon with investors. Therefore, **differences between fully liquid funds and those with limited exit opportunities should be appropriately considered**.

As a general principle, **the liquidity management system should be designed depending in particular on the asset class, the investment strategy of the fund and the type of its investors, professional or not.** Aligning the liquidity profile of the investment fund with the liquidity profile of the assets of investment strategy is achieved by employing a combination of liquidity management tools ("LMTs"). The exact combination of these LMTs will depend on the nature of the investment strategy, the investor base and the maturity of the underlying assets. Similarly, the specification of each individual LMT (length of lock-up period, size of gate, etc.) will also be calibrated relative to other LMTs to ensure a broad alignment. In practice this means that there is rarely a one size fits all approach, and few industry standards or minimums which are appropriate to all scenarios.

In addition, we would like to underline that **any additional requirements applicable to open-ended LOFs should remain consistent with the general obligations for AIFs**, particularly those applicable to open-ended AIFs. Moreover, these measures should integrate seamlessly with the ELTIF framework.

Last, any additional obligations should be justified by the distinct characteristics of open-ended LOFs. In other words, ESMA should avoid introducing requirements beyond existing obligations unless they are specifically warranted by the unique nature of LOF assets, i.e. loans.

APPROPRIATE REDEMPTION POLICY

Q2: Do you agree with the list of factors set out in Article 2 of the draft RTS to be considered by AIFMs to establish an appropriate redemption policy for an OE LO AIF? If not, please justify your position.

Yes, we generally agree with the proposed list of factors to be considered by AIFMs to establish an appropriate redemption policy for an OE LO AIF. We would suggest adding to that list situations whereby the fund's liquidity is ensured by intermediaries. We would however like to note that **AIFMs should be required to consider only the factors that are relevant to the AIF** under consideration. Also, the interaction of these different factors should be taken into account.

As a general principle, **the appropriateness of the redemption policy should be evaluated holistically**, considering all relevant factors in an interconnected manner rather than assessing them independently. Effective and reliable liquidity risk management depends on the proper integration of these elements. It is this comprehensive articulation that enables the AIFM to demonstrate to its competent authority that the redemption policy is appropriate.

In this context, it is crucial that **the redemption policy is not treated as a mere "tick-the-box" exercise**, and **a restrictive "liquidity bucketing" approach should be strictly avoided**. The redemption policy must be tailored to each fund, ensuring a sufficient degree of flexibility across the various factors. The AIFM should have the responsibility to determine, on a case-by-case basis, the minimum holding period, the notice period (if any), and the redemption frequency.

We suggest rewording article 2 as follows:

In order to ensure that the redemption policy of the open-ended loan-originating AIF they intend to manage is appropriate, the AIFM shall **consider relevant factors including but not limited to** ~~, at least, consider the following factors~~:"

More specifically, regarding the factor set out in letter o of article 2:

We see no justification for the valuation of assets in the portfolio of open-ended loan-originating AIFs to differ from that of other AIFs. In our view, the general principles of the AIFMD should apply, as a separate regime is unnecessary.

We therefore suggest rewording letter o of article 2 as follows:

"The availability of a reliable, sound and up-to-date valuation of the loans and other assets in the portfolio, **~~corresponding to their estimated realisable value at the dates of redemptions~~**."

Q3: Are there any other factors that AIFMs shall consider to demonstrate that the redemption policy of the OE LO AIFs they manage is appropriate? If yes, please provide a list of such factors and explain why they shall be included.

We welcome the inclusion of the expected incoming cash flows of the portfolio in the list of factors that AIFMs shall consider when demonstrating that the redemption policy is appropriate.

Given that ESMA's list of factors is already extensive and <u>not exhaustive</u>, we do not see the need to propose any additional factors for AIFMs to consider when demonstrating the appropriateness of a fund's redemption policy

This being said, when the fund's liquidity is 100% ensured by intermediaries, this should be taken into account in the overall assessment of the liquidity profile of the fund. This approach is used by some firms today, primarily with insurance companies providing the guarantee.

Article 3 - AVAILABILITY OF LIQUID ASSETS

Q4: Do you agree that AIFMs that intend to manage OE LO AIFs shall determine an appropriate proportion of liquid assets to be able to meet redemption requests? If not, please justify your positions?

We recognise the role of liquid assets in supporting sound liquidity management practices for OE LO AIFs but do not agree with the consultation's emphasis on the availability of liquid assets being paramount.

In this context, we recommend that AIFMs that intend to manage OE LO AIFs shall determine, <u>at their own discretion</u>, an appropriate proportion of liquid assets to be able to meet redemption requests. However, this should be done

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considering the other parameters of the redemption policy.

We would like to highlight that the appropriate proportion of liquid assets to be able to meet redemption requests should be a target amount: in practice, it will be assessed over time by the AIFM, which will be able to adapt it during the life of the fund.

In addition, **there should be no regulatory minimum amount of such appropriate portion of liquid assets** and periods of reconstitution should be accommodated. The availability of liquid assets is one of several aspects which OE LO AIFs shall consider alongside a sound liquidity management system, stress testing, and an appropriate redemption policy having regard to the liquidity profile of any LO AIFs.

Q5: Do you agree with the list of factors that AIFMs shall consider to establish the appropriate amount of liquid assets? If not, please justify your position. Shall AIFMs consider other factors, and if yes what are these factors?

Yes, we generally agree with the list of factors that AIFMs should consider to establish the appropriate amount of liquid assets. As we understand it, these provisions would allow an AIFM to potentially only employ a very small proportion of liquid assets as part of its cash flow management, relying instead on other sources of liquidity and on LMTs to manage redemption requests.

However, in our opinion, the factor set out in letter p of paragraph 1 is too vague and should be specified.

Q6: Do you agree that cash flow generated by the loans granted by OE LO AIFs shall be considered as liquid assets? If not, please justify your position.

Yes, we agree that cash flow generated by the loans granted by OE LO AIFs should be considered as liquid assets.

Q7: Do you agree that AIFMs may consider other assets as liquid if they can demonstrate that these assets can be liquidated within the notice period, to meet redemption requests, without significantly diluting their value? If not, please justify your positions.

Q8: Are there any other types of assets that could be considered as liquid for the purpose of the availability of liquid assets? If yes, please give examples and explain why they could be considered as liquid for the purpose of the availability of liquid assets. Conversely, are there any other types of assets that shall not be considered as liquid? If yes, please specify.

While we support a non-exhaustive list of liquid assets, it should be explicitly clarified, either in the explanatory text or a footnote, that **credit lines** (i.e. cash) are included.

In any case, we would like to recall here that it is the overall liquidity at portfolio level that is relevant and that AIFMs should have the flexibility to determine the liquidity of the assets they manage and how these are used within their liquidity management framework.

Q9: In your practical experience, how do AIFMs that manage OE LO AIFs determine the level of liquid assets to be held by the fund to meet redemption requests? In particular how do they calibrate the amount of liquid assets with respect to the maturity of the loans granted and the number of loans in the portfolio?

Such management practices are not specific to OE LO AIFs. Therefore, there is no need to introduce specific rules for LO AIFs in addition to those applying to other open-ended AIFs.

In any case, it should be noted that, while liquid assets can play an important role supporting liquidity for LO AIFs, and are an important factor when considering the soundness of any liquidity arrangements, holding liquid assets is not always a necessary element of sound liquidity management practices.

Q10: Do you believe there should be a regulatory minimum amount of liquid assets to be held by an OE LO AIFs and, if yes, please specify it? Should this minimum apply across all types of OE LO AIFs, or should it differ among OE LO AIFs and, if yes, how?

No, **there should be no regulatory minimum amount of liquid assets to be held by an OE LO AIF**. AIFMs have a wide range of options beyond holding liquid assets to provide liquidity to investors and they should have the flexibility to determine what is the most appropriate amount of liquid assets for their open-ended LO AIFs.

Article 4 - LIQUIDITY STRESS TESTS

Q11: Do you agree with the draft provisions on liquidity stress testing set out in Article 4 of the draft RTS? If not, please justify your positions.

While stress tests can be valuable tools, they should not be regarded as a universal solution. Given the significant resources they require, stress tests should be applied with a focused approach.

We do not believe that there is a need to supplement the provisions on liquidity stress testing set out in the AIFMD level 1 rules. We would like to reiterate that any additional obligations imposed on open-ended LOFs should align with the general requirements applicable to (open-ended) AIFs. Any obligations beyond those applicable to (open-ended) AIFs should be justified by the unique characteristics of open-ended LO AIFs. The liquidity of LOF assets is comparable to that of other AIFs, and the general stress testing rules should apply uniformly.

In any case, the obligation to apply “conservative” scenarios should be clarified as the conservative character of such scenarios may be subjective.

Q12: What other parameters, if any, AIFMs managing OE LO AIFs shall take into account when performing liquidity stress tests?

AIFMs managing OE LO AIFs do not need to take any additional parameters into account when performing liquidity stress tests. Such stress tests do not need to be specific to open-ended loan originating funds as compared to other open-ended funds. The RTS should not further prescribe more parameters on how to conduct these liquidity stress tests.

Q13: What could be the criteria that would justify a frequency of liquidity stress tests higher or lower than on a quarterly basis?

As explained previously, there is no reason here to apply a treatment specific to open-ended LO AIFs as compared to other open-ended AIFs. the RTS should therefore not further prescribe parameters that would potentially determine the frequency by which these should take place. AIFMs are responsible for undertaking liquidity stress tests at their own discretion and the appropriate stress testing frequency is likely to be specific to the nature of the LO AIF and its investment strategy.

A minimum quarterly frequency for stress tests could only serve as a basic guidance and reference point. The different characteristics of liquidity of the loans, as well as of the AIFs’ LMTs and investor liabilities, mean that there are different frequencies that are most appropriate to each open-ended LO AIF beyond the common baseline of quarterly testing. For instance, a frequency of liquidity stress tests lower than on a quarterly basis could be justified by a lower redemption frequency.

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Article 5 - ONGOING MONITORING

Q14: Do you agree with ESMA's proposal on ongoing monitoring set out in Article 5 of the draft RTS? If not, please justify your position.

Q15: What are the parameters that AIFMs managing OE LO AIFs shall monitor to ensure that the AIF has a sufficient level of liquid assets to meet redemption requests?

We do not see any need for a specific approach to ongoing monitoring for open-ended LO AIFs as compared to general obligations applying to other funds. Liquidity must be looked at by the fund manager from a holistic perspective. We do not believe that the availability of liquid assets should be elevated above other elements when it comes to the ongoing monitoring of liquidity arrangements and whether these remain appropriate.

An important parameter to bear in mind with respect the liquidity monitoring of LO AIFs is that loans generate cash flows over time.

More specifically, the element set out in letter b of article 5 should be limited to expected cash flows and liabilities. Indeed, potential future liabilities are captured in stress tests.

Therefore, we suggest rewording letter b of article 5 as follows:

"the expected cash flows and ~~**potential future**~~ liabilities**"**.

Also, the element set out in letter e of article 5 is too vague. It should be specified that the behaviour of shareholders or unitholders relates to any obligation to keep their shares or units.

Therefore, we suggest rewording letter e of article 5 as follows:

"the behaviour of shareholders or unitholders **regarding any obligation in relation to the redemption of their shares or units"**.

Q16: How do AIFMs that manage OE LO AIFs monitor the liquidity of the loans originated by the AIFs?

ADDITIONAL QUESTIONS

Q17: If you are managing an open-ended loan-originating AIFs, please indicate:
a) the size of these funds, specifying the smallest size as well as the average size;
b) the number of loans originated by these funds, specifying the smallest number as well as the average number of loans;
c) the loan-origination strategy you implement (direct lending, mezzanine, distressed debt, venture debt, diversification strategy etc);
d) the policy of the fund regarding the management of non-performing loans;
e) the shortest, highest and average redemption frequency and, if any the notice period;
f) among the loans you granted, please indicate (as a % of the number of loans granted, and as a % of the total amounts of the loans):
i. the share of shareholders' loans;
ii. the share of non-performing loans;
iii. the share of loans whose maturity has been extended;

Currently, our members only manage a limited number of open-ended loan-originating AIFs. It is of utmost importance that the level 2 measures enable the development of open-ended LOFs in accordance with the level 1 provisions of the Directive.

Q18: If you are managing an open-ended loan-originating AIFs, have you already sold loans to meet redemptions requests? What were the main characteristics of the secondary market you used to sell them (i.e.: types of counterparties, time required to achieve the sales process, liquidity, overall cost of transaction etc)?

Q19: If you are managing OE LO AIFs, what are the types of loans originated, how frequently do you value them and what is their level of liquidity?

Q20: If you are managing OE LO AIFs, what are the liquidity management tools you are using to comply with the obligations set out in Article 16 (1) and (2) of the AIFMD? Are you also using liquidity management tools other than those listed in Annex V of AIFMD, and if yes, what are these tools?

As the market for open-ended AIFs develops, our members are gaining experience on the use of a variety of liquidity management tools (LMTs). Currently, we observe that suspensions of subscriptions, repurchases and redemptions as well as redemption gates and side pockets (on an ad hoc basis) are among the tools most frequently used by our members which manage semi liquid funds. Some of our members may apply redemption fees. Adjustments to entry/exit prices seem rather difficult to put in place as far as VC/PE funds are concerned. As for swing or dual pricing, they do not appear appropriate to our asset class. Last, redemptions in kind are difficult to implement in practice.

Considering that suspensions of subscriptions, repurchases and redemptions and side pockets can only be used as complementary LMTs and that redemptions in kind are not applicable to all types of investors, in practice, VC/PE managers are essentially left with a choice of LMTs between gates and extensions of notice period. In other words, it will be difficult for them to work out an adequate combination of LMTs depending on the typology of investors, the asset class and investment strategy, etc. Therefore, it is of utmost importance that that the implementation of tools as described in annex V of the AIFMD does not prevent the application of other additional liquidity management tools designed on a contractual basis as set out in the documentation of the fund. Indeed, some investors may be willing to agree to specific contractual arrangements regarding liquidity. In other words, both types of tools (legal and contractual) should be available to AIFMs.

The AMF conducted an analysis of the prospectuses of AIFs domiciled in France: https://www.amf-france.org/sites/institutionnel/files/private/2024-11/evolution-de-ladoption-des-outils-de-gestion-de-la-liquidite-dans-les-fonds-francais.pdf. In particular, this study shows that:

- French managers are well ahead of the requirement for European open-ended AIFs to have at least two LMTs by 2026.
- Gates are detected in 5% of private equity funds, but in 96% of assets of evergreen FCPR (fonds communs de placement à risque).
- Swing pricing remains very marginal for private equity funds
- ADL tools are totally absent from private equity funds
- 5.7% of the net assets of private equity funds are associated with a mention of the possibility of suspension by the manager, but this rate rises to 56% for evergreen FCPR
- 40% of private equity funds mention redemptions in kind (38% of FCPR evergreen funds) in their prospectus
- Private equity funds do not have any side pockets

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 the RTS on open-ended loan originating AIFs? Which other types of costs or benefits would you consider in that context?

Q22. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the AIFMD?

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Contact

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About France Invest

Established 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts roughly 440 management firms and 200 associate members.

Private equity supports unlisted companies for a fixed period of time and provides them with the equity capital, through the acquisition of minority or majority stakes in their capital, needed to finance growth and transformation projects. It supports the creation of start-ups (venture capital), participates in the growth and transformation of many regional SMEs and mid-caps (growth capital) and contributes to the transfer of companies (replacement capital).

France Invest's members represent one of the main growth drivers for the French and European economy and support a significant portion of employment in France and Europe. In 2023, French private equity and infrastructure players invested €31 billion in 2,700 companies and infrastructure projects. They raised €33 billion from investors, half of which abroad (just under one third at EU level excluding France), which will be invested over the next 5 years[3]. In addition to that, in 2023, private debt players (structures financing companies and infrastructure projects) invested €14 billion in 387 transactions and raised €10 billion that will finance new transactions in the coming years[4]. European companies, in particular start-ups and SMEs, are the main recipients of our members' investments. Over the 2017- 2022 period, over 330 000 jobs were created in companies backed by French venture capital and private equity[5].

In particular, during the pandemic, the venture capital and private equity industry has demonstrated its adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

[3] https://www.franceinvest.eu/activite-du-capital-investissement-francais-en-2023/
[4] https://www.franceinvest.eu/activite-des-fonds-de-dette-privee-en-france-en-2023/
[5] https://www.franceinvest.eu/croissance-et-creation-demplois/