Schroders response to ESMA consultation on the draft technical standards on open-ended loan-originating AIFs under AIFMD

11/03/2025

1.1 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.

***Schroders Response**: LOFs that are fully invested are generating reflows on a monthly basis via interest payments, maturities and amortization of exposures. The overall assessment of liquidity management should consider not just the availability of liquid assets at a particular moment in time, but the overall cashflow profile (i.e reflows and interest payments) of the LOF.*

1.2 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.

***Schroders Response:** With reference again to the answer in question 1, yes, we broadly agree with this.*

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.

Schroders Response: See our comment in answer to question 1 for additional factor to be considered. In terms of the wording of Article 1j ("other redemption conditions where applicable") we would also consider the specific gating policy and/or lockup period for redemptions that are contained in the offering memorandum for certain share classes or during a certain period of ramp up for the fund. In general, the stage of the fund life should be considered in this context when determining whether the liquidity management approach is adequate. For OE LO AIFs that have been operating for longer periods, their capacity to satisfy redemption requests and the absence of gating and/or failure without prejudice to investors should provide additional comfort that their redemption policy is managed appropriately.

1.3 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?

***Schroders response:** Yes, this should be the sole responsibility of the AIFM/AIF but we stress this should be a dynamic process.*

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?

<u>Schroders response:</u> ***We broadly agree. The AIFMs should also consider whether the fund maintains active credit lines and/or alternative sources of liquidity beyond the balance sheet.***

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.

<u>Schroders response:</u> ***Yes, we agree.***

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.

<u>Schroders response:</u> ***Yes, we agree. This is particularly important for SFDR Article 8 and 9 funds that must maintain certain ratios of sustainable assets to satisfy the pre-contractual disclosure criteria of the regulations. Cash and MMFs are considered "neutral" and other liquid instruments that satisfy the SFDR criteria should be considered in the total assessment of liquid assets to provide AIFMs with more flexibility in executing SFDR mandates without performance drag on the portfolio.***

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.

<u>Schroders response:</u> ***We would consider cash, listed government securities, highly liquid bonds over a certain NRSRO rating threshold (A rating or above) and money market funds above a certain (AAA) rating*****. as liquid.**

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?

<u>Schroders response:</u> ***The portfolio is constructed with careful consideration to amortization schedules, final maturities and the weighted average life (WAL) of each loan. Guidelines for duration (WAL) are included in the offering memorandum or binding investment guidelines of the fund. Liquidity management is based on maintaining a certain target investment level that, depending on the WAL of the fund and the liquidity of the underlying assets should avail a certain amount of "liquid" holdings at any given time. The definition of liquid holdings should be carefully considered (see comments above) particularly in the context of SFDR Article 8 and 9 funds which have significant obligations to maintain a certain level of "sustainable investments" in the portfolio, some of which may be liquid bonds that meet specific criteria. This should comprise part of the total amount of the fund's assets considered liquid for purposes of managing liquidity and honoring redemptions. To do this correctly requires consistent and timely***

monitoring of fund investment levels, liquidity levels and reflows of principal and interest on the portfolio in addition to the overall life of the portfolio and the profile of subscriptions and redemptions across the various share classes which may differ in terms.

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?

Schroders response: ***No. If an AIF can otherwise demonstrate adequate liquidity management, there should be no specific minimum level of liquidity.***

1.4 Liquidity Stress Testing

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.

Schroders response: ***Broadly, yes. Quarterly may be excessive based on the redemption profile of a specific LOF's share classes, but it's not an overreach to suggest quarterly as a basis but with flexibility as suggested by Article 4 (1).***

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

Schroders response: ***See our response to Q,11. If the fund only allows redemptions on a 6 month or 1 year advance notice basis, or has specific redemption periods outlined in the offering documents, it may not be necessary to do liquidity stress testing on a quarterly basis.***

1.5 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.

Schroders response: ***Broadly, yes.***

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?

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

Schroders response: ***We maintain close relationships with the borrower, have strict regular reporting requirements and covenants that are monitored by a dedicated team and conduct ongoing diligence and review of borrower credit ratings to ensure repayment capacity and/or structure interventions.***

Other questions (non-related to the proposals on the draft RTS)

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;**

<u>Schroders response:</u> ***Blue Orchard, a member of our group and dedicated impact manager, manages open-ended loan funds. Our Average size is US$1.3 billion (€1.196bn). Our largest fund is approximately US$2.7 billion (€2.48Bn) and smallest fund (currently in ramp up period) is approximately US$60 million (€55.2m).***

b) **the number of loans originated by these funds, specifying the smallest number as well as the average number of loans;**

<u>Schroders response:</u> ***Our largest fund carries between 200-300 instruments in its portfolio at any given time and originates approximately 200 loans per year.***

c) **the loan-origination strategy you implement (direct lending, mezzanine, distressed debt, venture debt, diversification strategy etc);**

<u>Schroders response:</u> ***Our largest fund is primarily senior lending, with some subordinated lending. Diversification is aggressive over more than 50 countries and a broad range of borrowers that are primarily regulated financial institutions in their country of operation.***

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;**

<u>Schroders response:</u> ***The shortest notice period for institutional share class is 1 month. The longest period is 1 year.***

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[8];**

Response: 0%

ii. **the share of non-performing loans;**

Response: 1.2%

iii. **the share of loans whose maturity has been extended;**

Response: We have not responded as it is not clear whether this is referring to extension on the basis of refinancing or on the basis of restructuring and/or non-performance of the asset.

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)?

<u>Schroders response:</u> ***No, we never had to sell loans to meet requests.***

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?

<u>Schroders response:</u> ***We originate bilateral and syndicated loans to financial institutions and financial intermediaries, the vast majority of which are regulated entities. The loans are valued monthly. They are generally considered illiquid on the basis of there being no secondary market.***

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?

<u>Schroders response:</u> ***The main tool we have at our disposal, but which has not been used, is a redemption "Gate" (annex V, paragraph 2 of AIFMD) that can be deployed in accordance with the offering memorandum.***

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?

<u>Schroders response:</u> ***We have no comment***

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

<u>Schroders response:</u> ***As noted in our responses to the questions on liquid assets, AIFMs that manage OE LOFs under Articles 8 and 9 of the SFDR have significant constraints on liquidity management in terms of what assets can be considered "neutral" versus "sustainable investments". These AIFMs should have the broadest discretion possible to consider highly liquid, listed assets as being sustainable investments if they can demonstrably show that the bonds or other liquid transferrable securities meet the sustainability objectives of the AIF and align with the investment criteria contained in the offering document of the AIF. The RTS should give specific consideration to the requirements of SFDR Article 8 and 9 funds to avoid creating unintended and unnecessary constraints on the AIFs ability to manage liquidity, performance and obligations under the respective pre-contractual disclosures to sustainable investment levels.***