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12 March 2025

ACC and AIMA Comments on ESMA's Consultation Paper on draft regulatory technical standards on open-ended loan-originating AIFs under the AIFMD

The Alternative Credit Council ("ACC")[1] and the Alternative Investment Management Association ("AIMA")[2] welcome the opportunity to comment on the European Securities and Markets Authority's ("ESMA") Consultation Paper on draft regulatory technical standards ("RTS") on open-ended loan-originating ("OE LO") alternative investment funds ("AIFs") under the AIFMD. We broadly agree with ESMA's overall approach to the RTS, particularly with ESMA's view that existing Level 2 requirements already provide an appropriate regulatory framework on liquidity risk management.

We agree with ESMA's approach to the RTS as a way to harmonise existing requirements and tailor them to the specificities of OE LO AIFs (also known as evergreen, semi-liquid or semi-open-

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[1] The ACC is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over $2 trillion of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

[2] AIMA is the world's largest membership association for alternative investments managers. Its membership has more firms, managing more assets than any other industry body and, through our 10 offices located around the world, we serve over 2,000 members in 60 different countries. AIMA's mission, which includes that of its private credit affiliate, the Alternative Credit Council (ACC) is to ensure that our industry of hedge funds, private market funds and digital asset funds is always best positioned for success. Success in our industry is defined by its contribution to capital formation, economic growth, and positive outcomes for investors, while being able to operate efficiently within appropriate and proportionate regulatory frameworks. AIMA's many peer groups, events, educational sessions, and publications, available exclusively to members, enable firms to actively refine their business practices, policies, and processes to secure their place in that success.

ended funds). Our only caveat is to emphasise that the RTS should follow the level 1 mandate rather than introduce additional requirements beyond those contemplated by the co-legislators. Additionally, we support the statement in AIFMD that the primary responsibility for liquidity risk management as well as for the selection, calibration, activation and deactivation of LMTs remains with the manager. This is acknowledged in ESMA's draft guidelines on LMTs under UCITS and OE AIFs and it would be a welcome addition to the RTS.

Our members have substantial experience managing investments in illiquid or level 3 assets and ensuring that where investors have some right of redemption this right is aligned with the liquidity profile of the assets and that such rights do not incentivise or create potential liquidity mismatches. Where redemptions rights are provided, the terms are established at the outset of the fund and work in a predetermined fashion consistent with the liquidity of the underlying portfolio.

These provisions are very relevant for the EU's private credit market, which our Financing the Economy 2024[3] research paper estimates to be, at least, $374bn in assets under management. Both in the EU and globally, demand for liquidity and open-ended private credit structures, as well as other private market structures, has increased over the past years and this trend is likely to continue.

For many investors, well-designed open-ended and evergreen structures provide an efficient way to gain exposure to private credit assets in a way which is customised to their needs. Such funds generally behave like open-ended vehicles with respect to subscriptions (e.g., in allowing new subscriptions over the life of the fund) and like closed-ended vehicles when it comes to redemptions (e.g., in returning value based on actual proceeds rather than a book valuation). As such, the liquidity associated with these vehicles is generally more limited in nature than the ability to redeem capital on demand. This is an important distinction given that the design of such structures often needs to reconcile potential mismatches between the less liquid profile of the assets and the liquidity profile of the investment fund.

There is no single or standard approach for private credit funds offering limited liquidity to investors, as this will be tailored to the specific characteristics of the fund, its assets and its investor base. Such structures, which can take multiple legal forms, operate on the basis that the liquidity offered to investors that is pre-determined and limited in nature, as opposed to traditional conceptions of liquidity as the ability to redeem capital on demand, which is how open-ended funds operate in other markets.

Aligning the liquidity profile of the investment fund with the liquidity profile of the assets of investment strategy is typically 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. Some of the key LMTs that all private credit funds will consider are described below:

[3] https://www.aima.org/compass/insights/private-credit/financing-the-economy-2024.html

Typical liquidity risk management tools employed by private credit fund managers[4]

Lock-up periods	• Preventing redemptions for a pre-determined period, typically at least a year from subscription.
Ex-ante investor gates	• Pre-determined limitation on the amount of invested capital a given investor can redeem at one time.
Ex-ante fund level gates	• Pre-determined limitation on the aggregate amount that all investors in a given fund can redeem.
Prescribed redemption windows	• Investors may only redeem at pre-determined intervals, can be monthly, quarterly or semi-annually.
Notice period	• Investors must provide minimum notice for redemption requests, typically at least 90 days.
Slow pay provisions	• Segregating an investor's share of the asset from the fund and returning it in line with the natural maturity of the asset.
Side pockets	• Arrangements that segregate assets from the main pool of assets in a fund until such time as they are realised.

It is also important to recognise that individual LMTs can be a sufficient mechanism to manage redemption requests. This is the case, particularly, with "slow pay provisions" whereby capital is returned to the investor in line with maturity of the asset rather than by reference to the NAV at the point of redemption. This LMT, which can be used both in open-ended and closed ended funds, ensures that the redemption policy is fully aligned with the liquidity of the asset, which means that specific OE LO AIFs that employ slow pay provisions would not necessarily have an operational need to hold liquid assets or employ other LMTs in order to provide liquidity to investors. While we provide more detailed responses to each question in Annex 1, we have included a summary of our key views below:

- **Certainty for AIFMs managing LO AIFs:** The Level 1 rules allow OE LO AIFs as a derogation from the general rule that LO AIFs should be closed-ended, however it does not mandate that the liquidity risk management systems of AIFMs are authorised or pre-approved by regulators before launching new funds. Article 46 of EU Regulation 231/2013 already requires AIFMs to have a liquidity risk management policy, and we do not believe that OE LO AIFs should be subject to any additional supervisory authorisation or pre-approval process. If AIFMs are required to wait for their national competent authority

[4] For more details on how side pockets function in the market, please see Qs 39-43 in AIMA's response to the ESMA's proposed Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive (submitted to ESMA and available here: https://www.aima.org/article/aima-bai-submit-responses-to-esma-level-2-drafts-on-liquidity-management-tools-under-aifmd-ucits.html)

("NCA") authorisation to know whether they can structure an OE LO AIF this would cause considerable delays and uncertainty in the market and would impede the provision of finance to the real economy by undermining the structuring of new LO AIFs. We also believe that ESMA should recognise more prominently in the RTS that there is a wide range of possibilities for OE LO AIFs to offer liquidity to investors, in line with the existing market practice outlined above.

- **Appropriate redemption policy:** 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. The inclusion of cash inflows in the list of factors is very welcome, as this is an important source of liquidity for many private credit funds. It is important that ESMA and NCAs acknowledge that some OE LO AIFs will place more emphasis on specific factors depending on the characteristics of each private credit fund, which are very diverse and accommodate a variety of strategies and structures. The determination of the redemption policy should not become a 'tick-the-box' exercise.

- **Availability of liquid assets:** 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 a paramount consideration. While the sale of liquid assets may be an appropriate way to manage liquidity for many strategies, for some it will not be and any requirements to hold liquid assets will only serve to create a cash-drag on the returns offered to investors. According to the level 1 rules, the availability of liquid assets is one of several requirements 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. Many private credit strategies have been able to operate within an open-ended structure without having to sell their liquid assets. It is therefore important that no regulatory minimum amount of liquid assets is assumed as necessary for all OE LO AIFs as this would be too prescriptive and would impede AIFMs from determining the most appropriate liquidity offered to investors.

- **Liquidity Stress Testing:** 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 broadly agree with ESMA's approach that AIFMs should have the flexibility to determine the most appropriate frequency of liquidity stress tests for their OE LO AIFs.

- **Risk retention:** ESMA should clarify in the RTS that OE LO AIFs will be relieved from the level 1 risk retention requirement for any loans or portions of loans that are sold to manage fund liquidity or satisfy redemption requests. Directive (EU) 2024/927 only contains a specific derogation in relation to redemptions in the context of liquidation of the fund. The level 1 text states that "[...] *derogations from the risk retention rules are necessary and should cover cases where the retention of part of the loan is not compatible with the implementation of the AIF's investment strategy or with the regulatory requirements [...]*". We understand that this broad statement encompasses the AIF's redemption policy and liquidity management capabilities, but this derogation should be explicitly included in the RTS.

- **'Limited liquidity AIFs':** There are types of AIFs that technically fall within the definition of being "open-ended", but in which there is not necessarily an obligation on these AIFs to offer liquidity in normal circumstances. In such funds, liquidity for investors is only available at the discretion of the fund manager and is considered on a case-by-case basis relative to the available liquidity in the fund. Taking into account that these funds are structurally more similar to a closed-ended fund of a perpetual nature, we invite ESMA to consider excluding such funds from the scope of application of the RTS. There is precedent for this under Irish regulation, where such an AIF is defined as a fund that offers redemption and/or settlement facilities on a less than quarterly basis; or provides for a period of greater than 90 days between the dealing deadline and the payment of redemption proceeds.

We would also emphasise that onerous, prescriptive rules that go beyond the requirements of the Level 1 text would undermine the EU's drive towards competitiveness. EU policymakers have an opportunity to implement these standards in a proportionate manner taking into account the broad objectives of simplification and competitiveness. We believe that with a favourable and principles-based regulatory environment policymakers will build on previous successes like the ELTIF reform to ensure that the European private credit market continues growing and improving the financing of the real economy.

We would be happy to elaborate further on any of the points raised in this letter or annex below. For further information please contact Nicholas Smith, Managing Director, Private Credit (nsmith@aima.org).

Yours sincerely,

Jiří Król

Deputy CEO, Global Head of Government Affairs, AIMA

Global Head of the ACC

Annex 1- Responses to specific consultation questions

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 agree that these are important elements. However, we believe that it would be useful for ESMA to clarify in the recitals to the RTS that there is a wide range of possibilities when it comes to sound liquidity practices for OE LO AIFs. The AIFMD level 1 rules and draft RTS present liquidity as a binary choice between open and closed-ended funds whereas in practice there are many ways in which liquidity can be structured for private credit funds. Private credit funds that offer liquidity will not generally offer full liquidity nor allow investors to exit at any time, as is usually the case with UCITS funds. Instead, they will typically offer a limited level of liquidity that is appropriate for their strategy and investors, taking into account the LMTs that are appropriate and available for the relevant investment strategy. As we have highlighted in our response to ESMA's consultation paper on the RTS on LMTs under the AIFMD and UCITS directives[5], we believe that ESMA's overall approach is overly orientated towards daily dealing funds with liquid assets and does not fully account for the ways in which AIFs manage liquidity when investing in alternative assets such as private credit.

Importantly, while we acknowledge that the Level 1 text allows OE LO AIFs as a derogation from the general rule that LO AIFs should be closed-ended, we believe that compliance with the provisions outlined by ESMA in the RTS should automatically allow AIFMs to structure their LO AIFs as open-ended. As currently drafted, it is not clear what the RTS is contemplating in Article 1(4) where it says "AIFMs that intend to manage an [OE LO] AIF shall be able to demonstrate to the competent authorities [...] that they have selected the appropriate [LMTs]" and there is a risk that NCAs interpret this provision to mean there should be a formal approval process for OE LO AIFs to be open-ended. Imposing an approval or authorisation process by NCAs for OE LO AIFs would not only go beyond the level 1 text, but by imposing additional requirements it would also lead to a less competitive market in which AIFMs would face delays and higher costs. This would likely undermine the structuring of new OE LO AIFs and impede the provision of finance to the real economy. Such an approach is also likely to lead to inconsistent approaches towards the implementation of the RTS by NCAs.

From a broader perspective, imposing an authorisation process and the resulting effect on new funds would run directly counter to the EU's focus on enhancing competitiveness and in particular the role of private financing to drive European competitiveness. While ESMA is not empowered or mandated to focus on competitiveness, we believe that at the very least, it should not pursue an approach which does the opposite, i.e., makes EU AIFs less competitive by adopting a position which is not required under the Level 1 framework as concerns the authorisation process.

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[5] https://www.aima.org/resource/aima-bai-response-to-esma-draft-regulatory-technical-standards-rts-consultation-on-liquidity-management-tools-lmts-under-aifmd-ucits.html

In its consultation, ESMA states that it has reached the conclusion that there are no gaps in the existing AIFMD level 2 provisions on liquidity management, so we believe that the imposition of additional requirements in these RTS would be unwarranted. Rather than requiring the approval of the NCA, AIFMs should be able to automatically structure OE LO AIFs in compliance with AIFMD's level 1 and 2 provisions once finalised.

Furthermore, as a principle, we believe that any additional requirements applicable to OE LO AIFs should remain consistent with the general obligations for AIFs and not go beyond this unless there is a strong justification for doing so.

Lastly, we would also like to highlight that there are also types of AIFs in the market that while technically fall within the definition of being "open-ended" (as investors may be able to redeem their investments during the lifetime of the fund), liquidity for investors is only available at the discretion of the fund. There is not necessarily an obligation on these AIFs to offer liquidity in normal circumstances (for example, it can be subject to sufficiently available "liquid" assets, or commercially reasonable efforts of the fund manager), and this is a much stronger LMT for a fund manager. Only if liquidity exists in the portfolio, considered on a case-by-case basis, would liquidity be provided at a future date following due notice. These funds are structurally more similar to a closed-ended fund of a perpetual nature, so we invite ESMA to consider excluding such funds from the scope of application of the RTS.

Such funds could be defined as "limited liquidity AIFs". There is precedent for this under Irish regulation, where such an AIF is defined as a fund that offers redemption and/or settlement facilities on a less than quarterly basis; or provides for a period of greater than 90 days between the dealing deadline and the payment of redemption proceeds. Such funds are not subject to any requirements on dealing frequency, minimum redemption quotas or timeframe for settlement, but instead must disclose that they are "open-ended with limited liquidity" (emphasis added).

Alternatively, we think it is possible to incorporate a concept of "AIFs offering discretionary liquidity only", along the lines of AIFs operating a subscription queue mechanism, where 7 units are issued incrementally at the point of funding fund manager-led capital calls rather than immediately at the point of subscription.[6]

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.

The factors listed in Article 2 are generally relevant, but we would not see these as an exhaustive list of matters which should be used to consider the appropriateness or otherwise of any redemption policy.

[6] While these types of fund do offer the potential for liquidity, they often do it through different LMTs which are not currently considered in the existing scope (such as investor votes on fund dissolution should redemption requests remain elevated over an extended period of time; ability to conduct a secondary market sale, etc.). A cash liquidity buffer is not generally maintained within the fund for this type of structure.

We welcome the principles-based approach adopted by ESMA and its recognition of the multiplicity of factors that influence the redemption policies of OE LO AIFs. Private credit funds follow a diverse range of strategies, each with unique characteristics, so flexibility is important for AIFMs to be able to determine the most appropriate redemption policy.

For example, there are multiple scenarios whereby both more and less frequent redemptions may be more appropriate for investors while still being compatible with the OE LO AIF's investment strategy. This includes managers that wish to manage a rolling multi-year lock structure. Furthermore, there are established private credit strategies like trade finance, asset backed lending and receivables where the underlying assets have maturity profiles that are naturally shorter than corporate lending or infrastructure debt strategies. These are vital business finance products and ones which align with the EU policy goal of supporting the availability of finance for SMEs. For strategies such as these, managers may wish to provide investors with more frequent redemptions where there is a natural alignment with the maturity profile of the assets. Shorter redemptions frequencies may also be appropriate for strategies with longer dated assets whereby the cashflows from the lending (e.g., periodic loan repayments) provide sufficient liquidity to permit this.

A further element to consider is how such factors interact with one another. For example, the way in which the frequency of redemptions aligns with other LMTs employed by the AIFM such as investor or fund level gates or caps, the average maturity of the underlying portfolio and any scheduled interest payments. Private credit funds in the market today that offer investors some form of redemption rights will typically consider the size of the gate alongside the frequency of the redemptions given the interplay between these two LMTs in light of expected maturity and the schedule of interest payments. For example, a 5% gate based on a quarterly frequency could also be structured as a 2% gate based on a monthly frequency (potentially also having a backstop of 5% over three consecutive months). While the outcome would be very similar under both scenarios, the possibility of more frequent redemptions may be more attractive to the investor. From an operational point of few, having more frequent but smaller redemption windows may be easier for managers and distributors to manage and administer than fewer and larger ones.

We would therefore caution against using these factors to assess any redemption policy on a 'tick-the-box' basis. AIFMs should have the flexibility to determine the appropriateness of their redemption policies in a holistic manner, considering all of the listed factors, and any other relevant ones, in the specific context of each OE LO AIF and their investor base. We believe that this could be achieved by the following amendment to Article 2:

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 which may include (but not limited to):*** *~~, at least, consider the following factors:~~"*

Additionally, we believe that it would be positive for ESMA to clarify what the "settlement period" referred to in Article 2(1)(i) is. We understand that this is intended to mean the settlement period of redemptions, not of the underlying assets being liquidated. Clarification on this point would be welcome.

Finally, we believe that Article 2(1)(o) risks creating the perception of additional requirements around valuation for OE LO AIFs. There are already extensive requirements around valuation specified under AIFMD and we do not think it is appropriate to create additional requirements for OE LO AIFs within these RTS. We would therefore propose removing this section of the RTS entirely or amending Article 2(1)(o) in the following manner:

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. We believe that the use of use of amortisations, repayments and interest income as the means to deal with redemptions should be recognised more prominently in the RTS, as this is a key source of liquidity for private credit funds.

We also believe that ESMA should also take into account and explicitly include the cases when an OE LO AIF's liquidity is guaranteed by intermediaries. This approach is used by some firms today, primarily with insurance companies providing the guarantee. Additionally, some sponsors may also provide redemption guarantees to investors. This is usually done through conditional share purchase agreements or guarantee letters. Therefore, subject to OE LO AIFs being able to demonstrate that such arrangements are appropriate and well-structured, we believe that this should also be included as a factor when assessing the overall appropriateness of a redemption policy.

Additionally, the use of investor and fund level redemption gates or caps, the operation of side pockets, and the use of slow-pay provisions should be explicitly included in the factors listed within Article 2. All are important LMTs for OE LO AIFs and while Article 2(1)(j) provides an opportunity for other redemption conditions to be considered, having these listed would provide greater certainty on this point.

We would also encourage ESMA to clarify that "redemption caps" are equivalent to redemption gates, as they are generally referred to in the market for the purposes of complying with the requirement to have two of the prescribed LMTs. Additionally, the draft RTS would benefit from including the operation of side pockets in this list of factors which can be considered.

Similar to Article 2 above, we would recommend that these factors should not be considered on a 'tick-the-box' basis. We would suggest a corresponding amendment to Article 3(1):

"*AIFMs that intend to manage an open-ended loan-originating AIF shall* ***consider relevant factors which may include (but are not limited to)****,at least consider the following factors…".*

Similar to points mentioned above, as currently drafted, it is not clear what the RTS is contemplating in Article 3(3) where it says AIFMs "*may also consider other investments made by the open-ended loan-originating AIF as liquid if they can demonstrate to the competent authorities […] that these investments can be converted into cash […]*". We are concerned that "demonstrate" could be interpreted too broadly by NCAs and this could lead to inconsistent approaches towards the implementation of the RTS by NCAs. The requirement to demonstrate should only be from a compliance/policy perspective, or on request from an NCA, rather than an approval process of some kind.

Lastly, we believe that a clarification around the use of LMTs would be helpful. While the AIFMD level 1 text mandates AIFMs to select at least 2 LMTs as part of their redemption policy and liquidity risk management, the ELTIF Regulation does not include such requirement. We believe that this can create confusion for OE LO ELTIFs, even though there is a general understanding that the ELTIF Regulation takes precedence over AIFMD as *lex specialis*. We believe that AIFMs managing OE LO ELTIFs are qualified to select the most appropriate number and type of LMTs. It would be positive for the adoption of the ELTIF vehicle if ESMA clarified in these RTS that the ELTIF Regulation takes precedence on matters such as this.

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 agree that liquid assets can play an important role supporting liquidity for OE LO AIFs and that this is an important factor when considering the soundness of any liquidity arrangements but disagree with ESMA's view that holding sufficient liquid assets is always a necessary element of sound liquidity management.

It is possible for some private credit strategies to provide a level of liquidity that is appropriate to their investment strategy and investors without the need to hold any liquid assets. In this regard, we welcome the acknowledgement that the cash flows generated by the assets can serve as a key source of liquidity for investors and treated as equivalent to a liquid asset. AIFMs will take different approaches to managing liquidity in order to meet redemption requests (which may include various different LMTs such as lock-up periods, long notice and/or settlement periods, fund- or investor-level gates, or redemptions in kind). Given these approaches may not include any "liquid assets", we believe it would not be appropriate for the AIFM to determine an appropriate proportion of liquid assets (other than 0%).

From the perspective of evergreen funds, it may not be appropriate in certain circumstances for an OE LO AIF to hold any proportion of liquid assets to meet redemption requests. Certain funds, by design, will not require a liquid portion, and the imposition of a liquid portion by result in performance drag. Many OE LO AIFs are structured with a "slow-pay" mechanism whereby upon receipt of a redemption request, the manager will make a determination as to the liquid portion and illiquid portfolio of the AIF as of the relevant redemption dealing day. The liquid portion will be paid within the normal settlement cycle, whereas the illiquid portion will be place in a side pocket attributable to the redeeming investor and realised in the normal course. This ensures no fire sales are required 10eactionn to redemptions.

The requirement for OE LO AIFs to hold a proportion of liquid assets is not a mandate from the updated AIFMD level 1 rules, although it is included in the ELTIF Regulation article 18(2)(d). Nevertheless, we welcome the flexibility proposed within the RTS, which will permit OE LO AIFs and their managers to determine the most appropriate percentage of liquid assets for their strategy. There may be some value in clarifying this element within the RTS that, while liquid assets are a consideration when determining the redemption policy, there should not be a required regulatory minimum amount of liquid assets.

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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 believe this is a fairly comprehensive list and agree with the framing of this as a principles-based approach that allows the AIFM to best determine the size of the proportion of liquid assets most appropriate for its strategy and the needs of its investors. 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 LMTs to manage redemption requests.

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, and we welcome the inclusion of this in the RTS. AIFMs should be able to determine such cash flows as liquid if these can be employed to meet redemption requests depending on the specific circumstances of each AIF.

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.

Yes, however, we read this to be a requirement for relevant assets to be generally liquid and able to hold their value in the event of a short-term sale (i.e., to meet redemption requests). We do not read this to be a prohibition on selling assets for less than their potential value (e.g., in stressed market conditions). Furthermore, we do not consider this provision to be prohibiting AIFMs from considering assets that may take longer to be sold as liquid assets (e.g., broadly syndicated loans which are often relied upon for liquidity by semi-liquid funds). They can be considered liquid due to the buoyancy of the secondary market, but may have notice periods that could be longer than the notice period of the relevant AIF. This should not prohibit assets of this nature being considered as liquid assets, where appropriate. It would be helpful for the RTS to clarify this.

It is also important to re-emphasise that for OE LO AIFs liquid assets are not necessarily required in order to meet the redemption terms in a fund. Instead, the key consideration is whether the liquidity of assets is aligned with the terms disclosed to investors and with the LMTs that are in place in the fund.

Regarding the proposed definition of a liquid asset, we do not believe it is necessary to include the phrase “without significantly diluting their value”. The term “significant value dilution” is not an appropriate criterion for defining a liquid asset, as “significant” is subjective and lacks clarity. The alignment of market price with asset value is a commercial matter that should be determined by the market and AIFMs. Additionally, the market price of an asset is influenced by numerous factors, such as currency fluctuations, the availability of buyers, and overall market volatility.

We also repeat our earlier comments regarding the use of the word “demonstrate” and how that could be broadly interpreted by the NCAs, and would add that it may be useful to clarify in Article 3(3) that assets which are usually regarded as liquid (i.e., cash, cash equivalents, Money Market Funds) need no demonstration.

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.

AIFMs should have the flexibility to determine the liquidity of the assets they manage and how these are used within their liquidity management framework. This will change over time and we do not think it is appropriate to set out which assets should be considered liquid, illiquid or semi-liquid in these RTS or for supervisory purposes more generally. We disagree with any approaches to "bucket" assets and funds into cohorts or liquidity categories based on their investment strategies. As we explained in our response to the Central Bank of Ireland ("CBI") discussion paper on macroprudential regulation[7], this is an unsophisticated approach which does not take account of the different types of investors and of the different financial techniques (such as hedging) used by funds that may look superficially similar.

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?

As noted above, while liquid assets can play an important role in supporting liquidity for OE LO AIFs, and are an important factor when considering the soundness of any liquidity arrangements, holding sufficient liquid assets is not always a necessary element of sound liquidity management practices.

Where liquidity arrangements do include the use of liquid assets there will be several factors which determine what an appropriate level of liquid assets may be. These will require consideration of the underlying assets within the OE LO AIFs portfolio, the income generated by the portfolio, its investment strategy, the liquidity needs of its investors, the results of stress testing over time, and the role of any financing arrangements, as well as the calibration of other LMTs such as those listed in Article 2 and the other factors we have highlighted in our response.

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. Such a blanket requirement could adversely affect the competitiveness of EU OE LO AIFs by imposing unnecessary constraints on their investment strategies and operational flexibility. We believe that AIFMs should have the flexibility to determine what is the most appropriate amount of liquid assets for their OE LO AIFs. Different types of OE LO AIFs have varying liquidity needs and risk profiles, which should be taken into account when determining appropriate liquidity requirements. A more tailored approach, considering the specific characteristics and investment

[7] https://www.centralbank.ie/docs/default-source/publications/discussion-papers/discussion-paper-11/aima-response-to-dp11.pdf?sfvrsn=eb25611a_7.

objectives of each OE LO AIF, would better serve the interests of investors and the broader market, and AIFMs are best placed to make this commercial judgment.

AIFMs have a wide range of options beyond holding liquid assets to provide liquidity to investors, including regular inflows of cash flows coming from the pool of loans, slow pay provisions, redemption gates and other LMTs. It is important to recognise that the liquidity of a fund is not only determined by the composition of the portfolio (see our response to Q9 above). Lastly, unlike ELTIFs, there is no requirement in the level 1 AIFMD rules for OE LO AIFs to have a minimum percentage of liquid assets.

Furthermore, based on investor feedback, there is a strong desire to avoid any proportion of liquid assets to meet redemption requirements. Investors fully understand the slow pay redemption mechanics and favor this over holding liquid assets, in particular, those assets which may be volatile in a time of greater volatility or liquidity needs. Sophisticated investors are comfortable with funds that have 100% exposure to their desired illiquid assets, as they may have exposures to liquid assets elsewhere. Moreover, investors find such evergreen OE LO structures attractive because they have the flexibility to manage their capital allocation to a particular strategy more efficiently, and they benefit from operational efficiencies by leveraging their existing due diligence or reducing the need to (re)negotiate terms when increasing their commitment when compared to allocating to a new fund or manager.

Lastly, we believe that the reliance on cash buffers can actually be pro-cyclical. IOSCO shares this view and does not recommend a minimum level of liquid asset holdings for OE funds, stating that:

"[...] a regulatory requirement to hold a minimum level of liquidity buffer may have unintended consequences, for example, if breaching regulatory thresholds is associated with restrictions on investors' ability to redeem shares. Such requirements may prompt investors to react to stress in a more pro-cyclical manner to avoid the consequences of a fund's crossing those thresholds, and can exacerbate vulnerabilities arising from structural liquidity mismatch. In response, managers may have to sell more assets than otherwise needed to replenish the reduced cash holdings. Minimum cash levels could also result in "cash drag" and "style drift" that deviates fund holdings from investors' desired asset allocation and moral hazard whereby managers would mechanically rely on regulatory liquidity buffer without considering the need to increase the liquid asset holding according to prevailing market conditions [...]".[8]

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.

Yes. While in principle 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 see value in the approach proposed in the draft RTS on the basis that AIFMs have the flexibility to determine the most appropriate frequency of liquidity stress tests for their OE LO AIFs. We are however concerned that the current drafting could be understood as mandating a minimum quarterly frequency for stress tests, which should instead serve as a basic guidance and reference point. The AIFMD level 1 text does not

[8] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD771.pdf

contain any specification of the frequency that stress testing should have beyond the statement in article 16 (1) that "AIFMs shall conduct regular stress tests". Furthermore, the AIFMD implementing regulation states in Article 48 that stress tests shall be conducted "at a frequency which is appropriate to the nature of the AIF [...], and at least once a year".[9]

While many private credit funds conduct quarterly stress testing, managers should be able to choose a lower or higher frequency. 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 OE LO AIF beyond the common baseline of quarterly testing. For example, during the lock-up period, AIFMs may decide to conduct stress testing less frequently. This flexibility allows AIFMs to allocate resources more efficiently and tailor their risk management practices to the specific needs and characteristics of their funds.

However, it is important to note in the RTS that while stress tests can be valuable tools, they are not a universal solution. These tests require significant resources and should only be applied as part of a focused approach in specific circumstances for the AIFMs to decide. There are inherent limitations to the precision of this tool, especially given its reliance on the availability of market data and the ability of historical observations to predict future investor behaviour. Therefore, it is important not to overly rely on stress test results as definitive indicators of the precise liquidity and redemption risk in a particular fund. For many OE LO AIFs other LMTs will be preferred to stress tests and employed more often, with stress tests being relevant but only used as a backstop.

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

AIFMs are responsible for undertaking liquidity stress tests at their own discretion. Therefore, 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 noted above 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 OE LO AIF and its investment strategy. Therefore, the RTS should therefore not further prescribe parameters that would potentially determine the frequency by which these should take place.

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.

Yes. A clarification in Article 5© would be welcome so that it reads: "*c) The amount **and timing** of subscriptions and redemptions*;".

[9] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:083:0001:0095:en:PDF

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?

As noted above, while liquid assets can play an important role supporting liquidity for OE LO AIFs, and are an important factor when considering the soundness of any liquidity arrangements, holding sufficient liquid assets is not always a necessary element of sound liquidity management practices.

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. UCITS-like requirements are not appropriate for OE LO AIFs which explicitly do not invest in transferable securities. Furthermore, monitoring of the level of "liquid assets" may not be beneficial in circumstances where an AIF is, by design, not intending to retain a portion of liquid assets, as outlined in our response to Q4.

However, in other circumstances, an AIFM may, for example, employ a liquidity reserve target ("LRT") which is the amount the AIFM deems necessary to hold as reserves to address liquidity mismatches, considering all potential inflows and outflows over a specified time horizon. It should be minimised while maintaining calculation integrity, typically using a probability-weighted approach that accounts for extreme market stress scenarios. This method enhances decision-making confidence, reduces reserve needs, and decreases forced selling incidents. The LRT is forward-looking, serving as an early warning and decision trigger, and reflects current portfolio compositions responsive to market volatility.

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

While many of the privately originated loans will be largely illiquid with little expectation of a (significant) secondary market for such loans, AIFMs managing OE LO AIFs have specific and detailed internal policies to monitor the liquidity of their portfolios, including the cash flows generated by these through repayments and amortisations. The liquidity of the portfolio is also assessed in relation to the LMTs available to the AIFM and the investor base.

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

Q17: If you are managing an open-ended loan-originating AIFs, please indicate:

While we do not have the precise data requested we would encourage ESMA to review our Financing the Economy 2023 (FTE 2023), Financing the Economy 2024 (FTE 2024) research papers and our white paper on trends in private credit fund structuring which provide data relevant to these questions. We have highlighted some key data points from these publications and other industry data sources for convenience below.

a) the size of these funds, specifying the smallest size as well as the average size;

The Pitchbook database does not discriminate between open- or closed-ended funds. Figures 3 and 4 provide an approximation into the percentage of these funds that are open-ended. Based on the Pitchbook database:

- The average fund size for a pool of 6,330 global funds is €528.74mn, ranging from less than €1mn to €20bn. These funds are active in direct lending, distressed, real estate, bridge financing, special situations, infrastructure, mezzanine and venture debt.
- For 1,683 direct lending global funds, the average fund size is €687.14mn, ranging from less than €1mn to €20bn.
- For 1,393 European (including UK and Switzerland) funds, the average fund size is €602.73mn, ranging from less than €1mn to €17.1bn.
- For 525 European direct lending funds, the average fund size is €880.6mn, ranging from €2mn to €17.1bn.

The Pitchbook database also provides relevant information regarding the fund size of evergreen funds, which are defined as those that raise money and spend it on a continual, open-ended cycle. These funds never close.

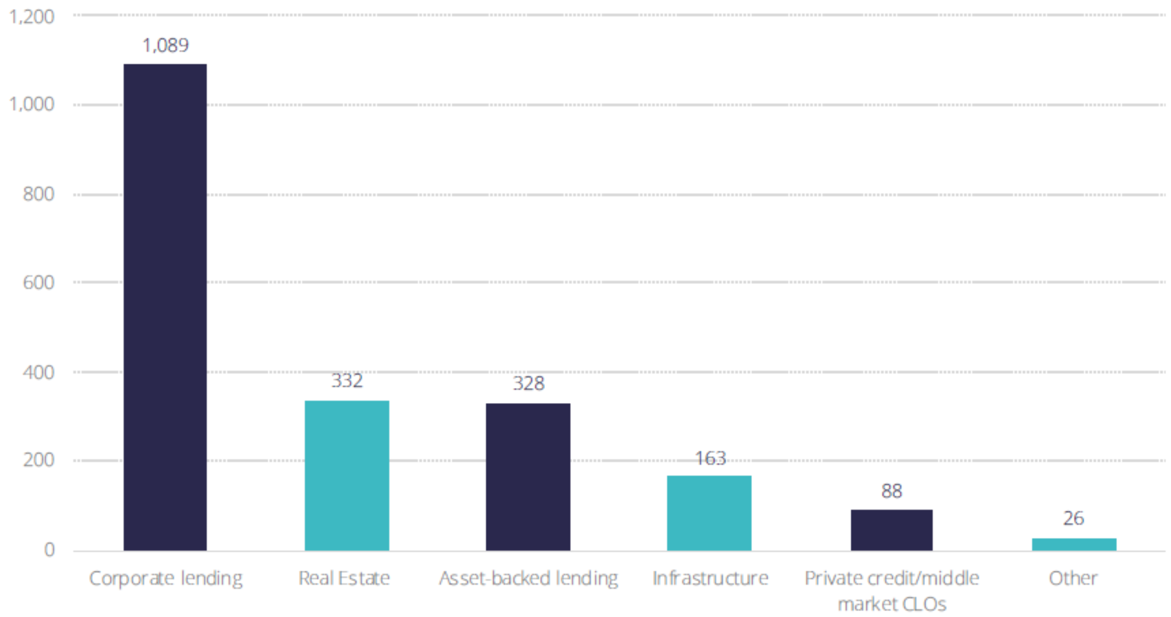
- A pool of 486 global evergreen funds (active in direct lending, distressed, real estate, bridge financing, special situations, infrastructure, mezzanine and venture debt) has an average fund size of €713.80mn, ranging from funds with less than €1mn in size to some close to €10bn.
- For 116 global direct lending evergreen funds, the average fund size is €652.8mn, ranging from less than €1mn to €7.5bn.
- For 46 European (including UK and Switzerland) evergreen funds, the average fund size is €409.9mn, ranging from €1.5mn to nearly €2bn.
- For 23, European (including UK) direct lending evergreen funds, the average fund size is €490.2mn, ranging from €7.8mn to €1.34bn.

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);

These figures provide information on the private credit market that ESMA may find relevant as context for its consultation. The data focuses on key private credit strategies as well as the types of structures and liquidity currently being offered to investors.

Figure 1: How much of your total private credit AuM is currently invested across these private credit strategies? (US$bn)* (FTE 2024)



* Figures based on reported business activity

Figure 2: What structures do you use to invest in private credit assets? (FTE 2023)

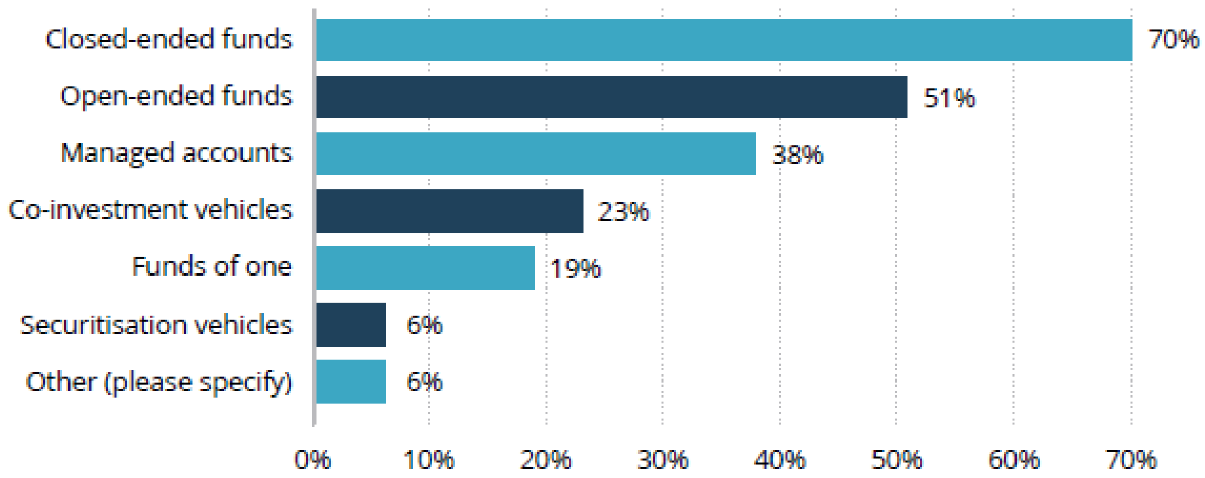


Figure 3: Estimated percentage of private credit assets managed within different investment structures (FTE 2023)

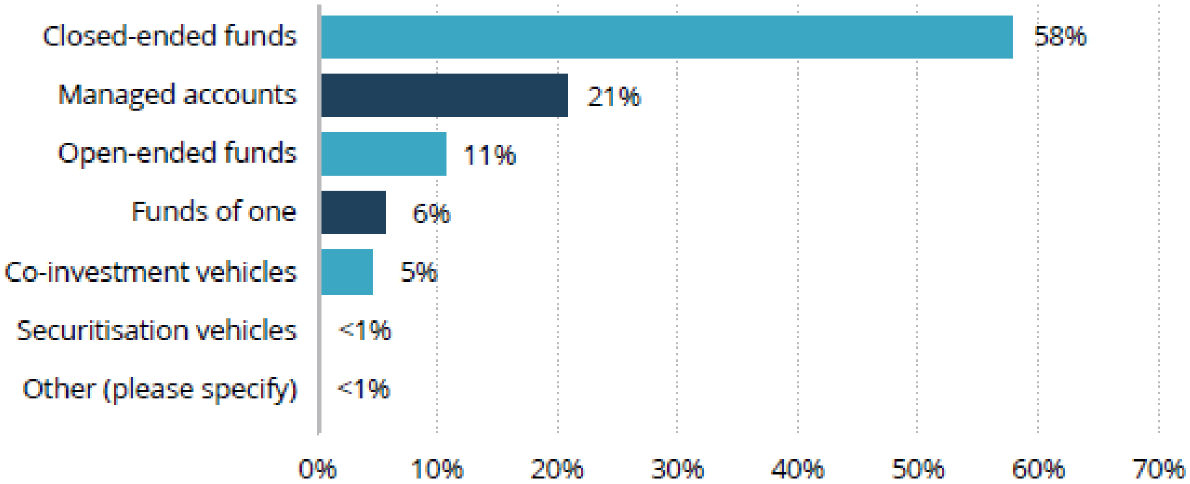
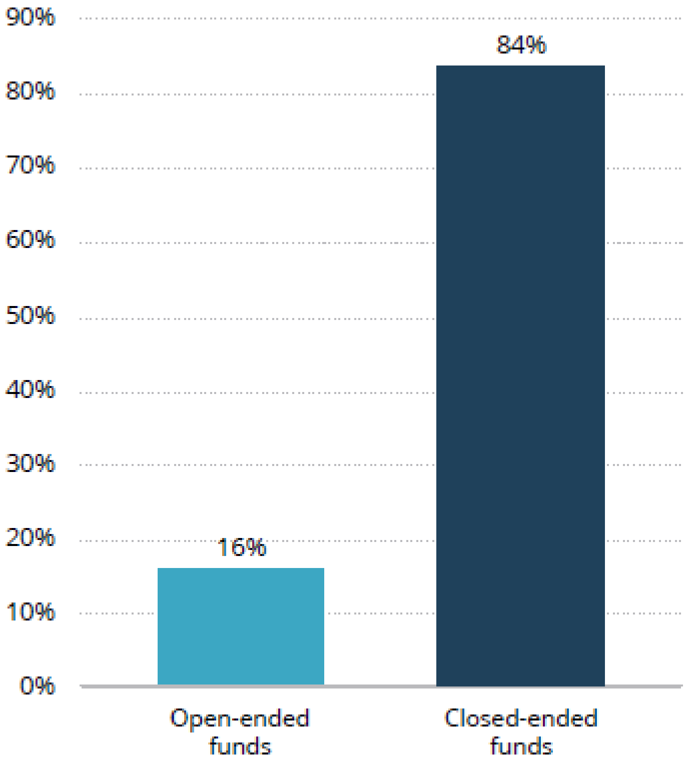


Figure 4: Private credit assets managed within commingled structures – estimated percentage of assets managed within open and closed-ended fund structures (FTE 2023)



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;

These figures partially answer ESMA's question by providing information on the liquidity offered to investors, including redemption frequencies, typical notice periods and the prevalence of other relevant LMTs.

Figure 5: What proportion of your private credit funds provide some type of liquidity to investors by allowing a right to redemption? (Paper on trends in private credit fund structuring)

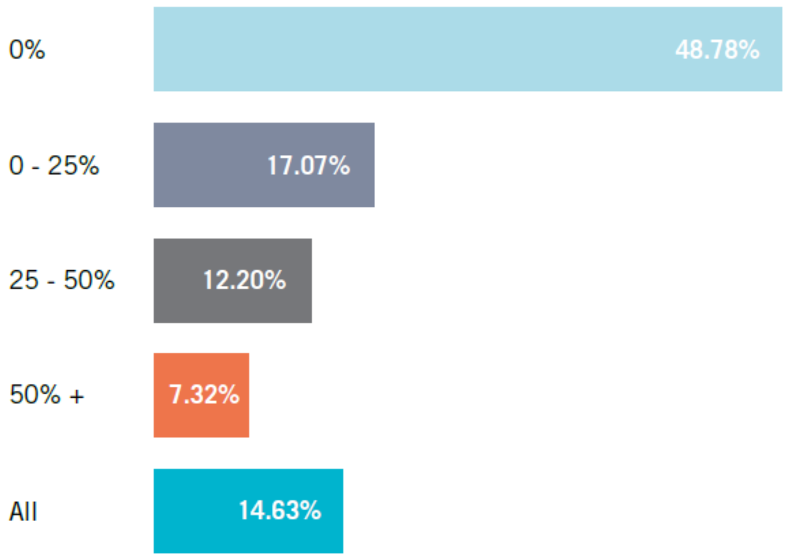


Figure 6: When can investor redemptions typically occur for your open-ended funds investing in private credit assets? (FTE 2023)

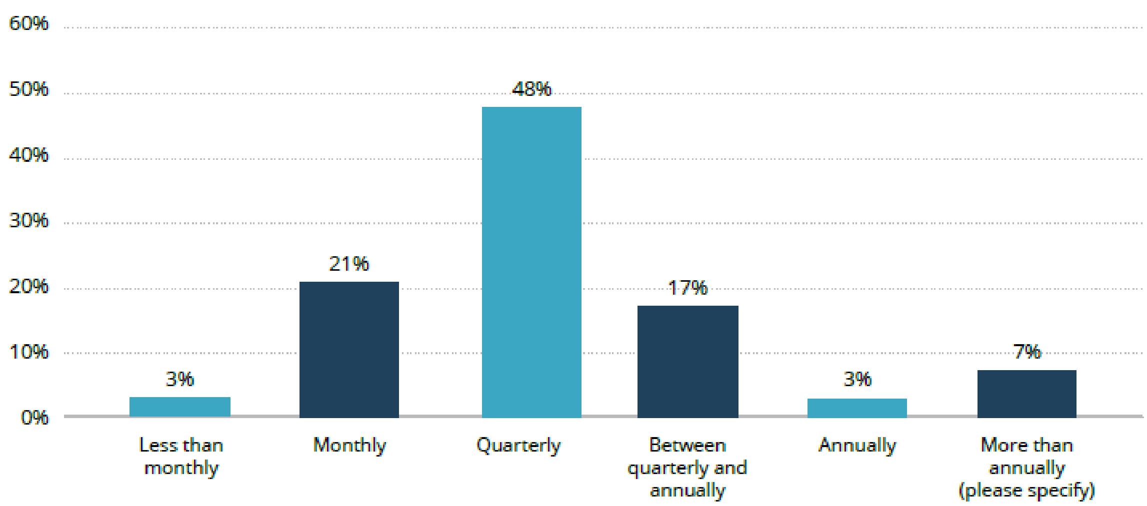


Figure 7: What is a typical notice period for your open-ended funds investing in private credit assets? (FTE 2023)

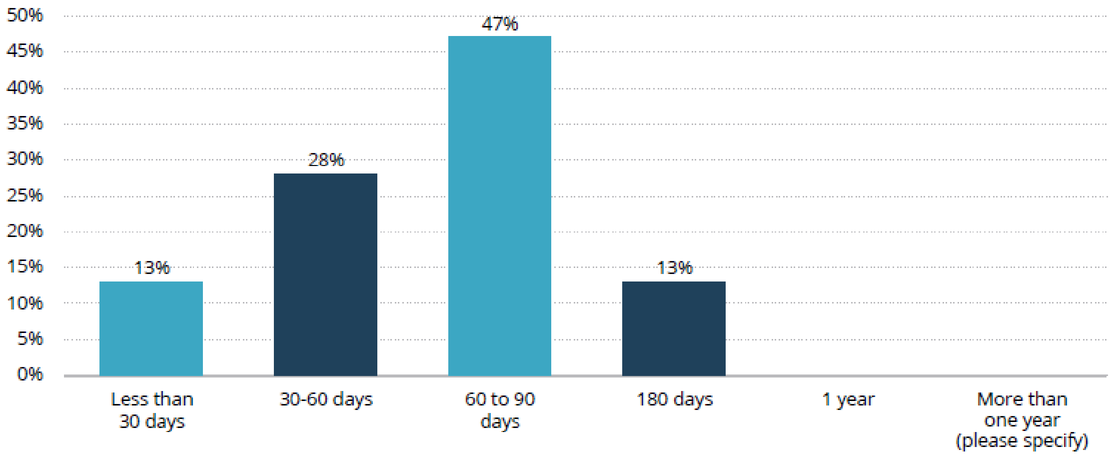


Figure 8: What percentage of your open-ended funds use lock-up periods? (FTE 2023)

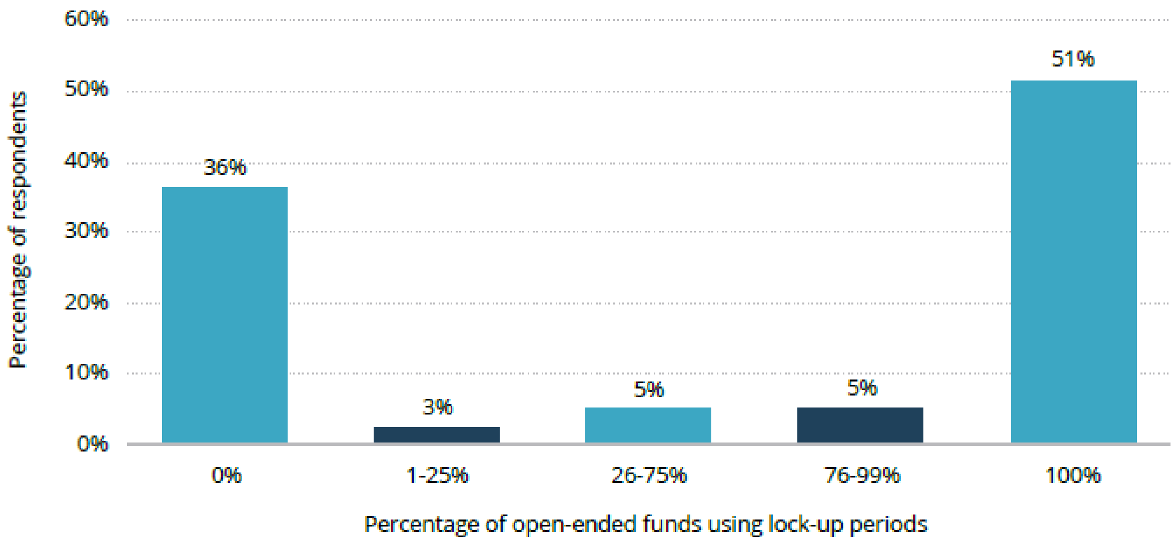
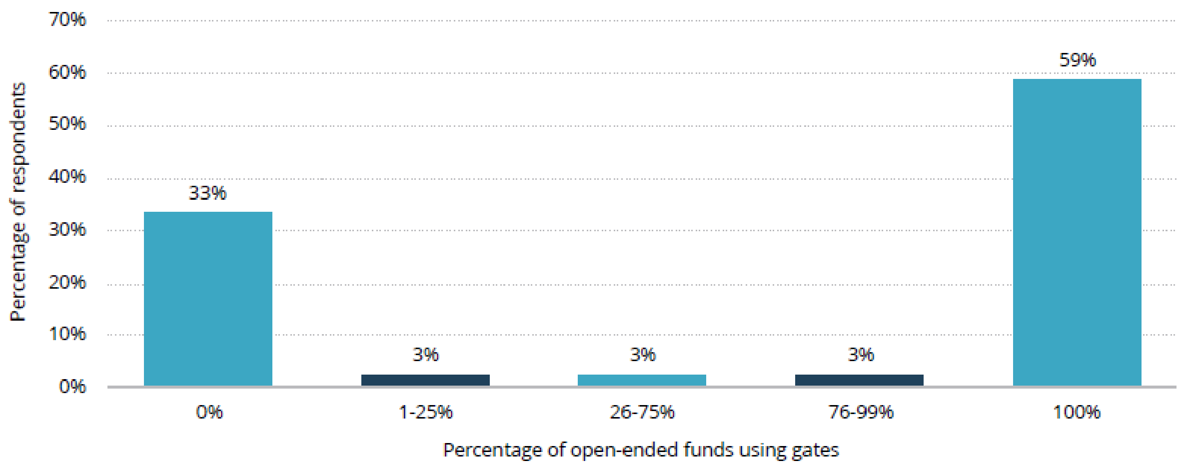


Figure 9: What percentage of your open-ended funds use gates? (FTE 2023)



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;

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)?

As noted above, the loans originated by private credit funds are generally considered illiquid and there is little expectation of a (significant) secondary market for such loans. This remains the starting point for most private credit funds despite there being some recent growth in the secondary market for these loans and the availability of liquidity.

We would also highlight some important differences between secondary market transactions which are led by the GPs (fund managers) compared to LPs (investors). For GPs, such transactions are likely to be related to the overall performance of the fund, for example reducing exposure to particular borrowers, sectors or markets, and relating to individual loans. For LP-led transactions, these typically involve an end investor seeking to rebalance their portfolio more generally and involve the sale of a pool of loans or their share of the fund's assets entirely as a block.

We expect there to be growth in both areas of the market as the private credit market develops and investors seek some liquidity from their loan portfolios.

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?

Our Financing the Economy 2024 research paper contains datapoints relevant to this question; our data refers to both open-ended and closed-ended funds.

Figure 10: How often are loans in your portfolio valued? (FTE 2024)

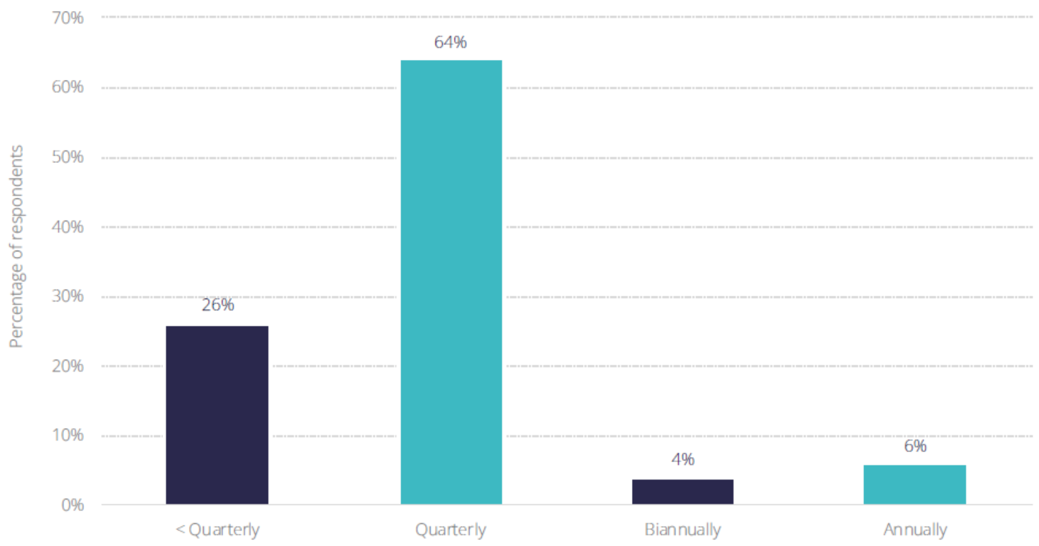
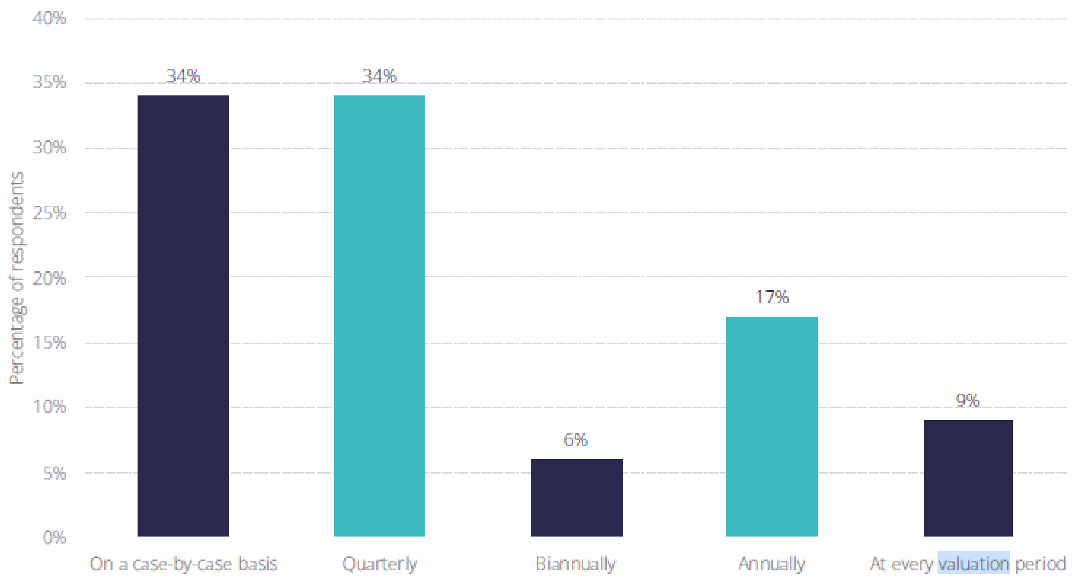


Figure 11: How often do you employ external valuation expertise? (FTE 2024)



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?

Figure 12 below sets out some of the typical LMTs used by our members to manage OE LO AIFs.

Figure 12: Typical liquidity risk management tools employed by private credit fund managers

Lock-up periods	• Preventing redemptions for a pre-determined period, typically at least a year from subscription.
Ex-ante investor gates	• Pre-determined limitation on the amount of invested capital a given investor can redeem at one time.
Ex-ante fund level gates	• Pre-determined limitation on the aggregate amount that all investors in a given fund can redeem.
Prescribed redemption windows	• Investors may only redeem at pre-determined intervals, can be monthly, quarterly or semi-annually.
Notice period	• Investors must provide minimum notice for redemption requests, typically at least 90 days.
Slow pay provisions	• Segregating an investor's share of the asset from the fund and returning it in line with the natural maturity of the asset.
Side pockets	• Arrangements that segregateassets from the main pool of assets in a fund until such time as the are realised.