

Reply form

On the Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **8 October 2024**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Call for Evidence in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_GLMT_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_GLMT_nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_GLMT_ABCD.

- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at <https://www.esma.europa.eu/press-news/consultations/consultation-liquidity-management-tools-funds> under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading '[Data protection](#)'.

Who should read this paper?

This document will be of interest to alternative investment fund managers, AIFs, management companies, UCITS, and their trade associations, depositories and their trade associations, as well as professional and retail investors investing into UCITS and AIFs and their associations.

1 General information about respondent

Name of the company / organisation	The Alternative Investment Management Association (AIMA) & the Bundesverband Alternative Investments (BAI)
Activity	Trade Association
Country / Region	International

2 Questions

Q1 Do you agree with the proposed characteristics of suspension of subscriptions, repurchases and redemptions? If not, please justify your position.

<ESMA_QUESTION_SLMT_1>

The Alternative Investment Management Associations (“AIMA”)¹ and the Bundesverband Alternative Investments² (“BAI”, and together with AIMA, “we” or “our”) welcome the opportunity to respond to ESMA’s consultation on the draft RTS on liquidity management tools under the AIFMD and UCITS Directive.

¹ The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA’s fund manager members collectively manage more than US\$3 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US\$1 trillion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

² BAI is the cross-asset and cross-product lobby association for the alternative investment industry in Germany and we consider ourselves as a catalyzer between professional German investors and suppliers of Alternative Investment products worldwide. The overarching goal is that German institutional and professional investors must be able to diversify their investment with regard to Alternatives better and more easily. The BAI is promoting a broad diversification which includes Alternative Investments as indispensable, in particular in terms of safeguarding long-term retirement pensions and the provision of money for construction, maintenance, and development of public infrastructure and renewable energies. BAI-members are recruited from all areas of the Alternative Investments’ industry, e.g. AIF managers and banks as well as service providers. At present, the BAI counts more than 300 national and international member companies and is growing continuously.

The diversity of AIF structures and investors requires a flexible approach to LMTs

As a general point, it would appear that the draft RTS are written mainly with retail investors under the UCITS regime in mind. The draft RTS do not take proper account of the full range of AIFs and their investors. The proposed requirements are not appropriate for AIFs, in particular for more complex funds and those investing in illiquid assets. Moreover, they do not seem to take into account the fact that AIFs generally have a professional investor base, with other levels of knowledge and experience, requiring a different level of investor protection.

The draft RTS seem to assume that there is a uniformity in fund structures and investor bases that is not the case in reality. This makes such prescriptive rules unworkable in practice. We call for a more principles-based approach where proper discretion is given to the fund manager to decide on the best course of action given prevailing circumstances, based on the best interests of the investors in the fund.

According to the draft RTS, suspension of subscriptions, repurchases and redemptions will only be activated in exceptional circumstances. By their very nature, such exceptional circumstances are difficult, if not impossible to predict. This makes it imperative that sufficient flexibility is provided in the draft RTS for fund managers to determine the best use and combination of LMTs. This is a central point which we will raise throughout our response below (and our response to the Guidelines consultation).

Managers should be able to choose to accept subscriptions during a suspension of repurchases and redemptions if done in a manner that maintains fair treatment of existing investors

We do not agree with the rationale of draft Article 1(1) requiring that subscriptions must be suspended whenever redemptions are suspended. While there may be merit to such an action in certain situations, it may not contribute to enhancing liquidity risk management in a range of situations and could, in fact, have a negative impact on the liquidity of the fund which would be detrimental to market stability and investors in the longer-term.

Market practice shows that subscriptions may be suspended in accordance with redemptions where the fund manager lacks input on a net asset value (NAV) calculation. This is an entirely separate issue to liquidity.

In our fund manager members' experience, fund documentation provided to investors outlining the circumstances under which subscriptions would be suspended does not

usually assume that suspending redemptions will automatically trigger the suspension of subscriptions. Introducing such a rule would be a change to existing market practice.

Secondly, while investors should always be made aware that the fund has suspended redemptions before subscribing, there could be instances when investors – particularly professional investors - may wish nevertheless to subscribe to the fund. This may be the case where an investor wishes to allocate their capital to a suitable investment opportunity (including situations where an investor may choose to take advantage of market opportunities such as buying low), and the fact that a suspension of redemptions is in place does not deter the investor because they do not intend to redeem their stake in the short-term. In such a situation, allowing for subscriptions while a suspension of redemptions is still in effect would support fund liquidity and could lead to the end of a suspension and allow investors that want to redeem to do so. While this may not be appropriate in all situations, that should not stop it from being an option in appropriate circumstances.

Thirdly, while the updated AIFMD and UCITS Directives contemplate suspensions of both subscriptions and redemptions, there is nothing in the Level 1 texts that requires these to be applied simultaneously. If the text is interpreted to mean that if an AIFM decides to suspend redemptions, (and repurchases and subscriptions must also be suspended), then a logical extension of that interpretation is that it would not be possible to suspend subscriptions without also suspending redemptions and repurchases, although surely this was not the result intended. For example, and without intended limitation, fund managers employing capacity constrained investment strategies will often suspend subscriptions if capacity is reached, a state which could well be temporary in nature. It would be inappropriate for redemptions and repurchases to be forced to be suspended concurrently in these situations.

There may be circumstances where a manager deems it appropriate that subscriptions and redemptions are suspended, but not repurchases. This is a common approach to making a controlled wind down of an AIF. Similarly, it does not always need to be the case that the fund as a whole is subject to a suspension where the purpose of the suspension is to wind down a particular share class and not the fund as a whole.

Lastly, we underline that suspension of NAV does not necessarily mean that redemptions or repurchases need to be suspended where redemptions are pro rata in specie as the NAV of the assets do not matter if investors are receiving their pro rata share of the assets.

For these reasons, we would propose that ESMA delete Article 1(1) and Recital 2 from the draft RTS.

<ESMA_QUESTION_SLMT_1>

Q2 Do you agree that orders that have been placed but not executed before the fund manager suspends shall not be executed until the suspension is lifted? If not, please explain why these orders shall be executed.

<ESMA_QUESTION_SLMT_2>

While we disagree that the ability to execute subscriptions should be suspended during the pendency of any suspension of repurchases and/or redemptions (see response to Question 1), we do believe that subscriptions should only be permitted to be executed during a suspension of repurchases/redemptions where the subscription order is placed or confirmed by the investor after the imposition of the suspension of repurchases/redemptions assuring that the investor had all the material facts about the suspension available to it when it placed or confirmed the subscription order.

<ESMA_QUESTION_SLMT_2>

Q3 Once the fund is reopened for subscriptions, repurchases and redemptions, what would be your approach to redemption orders that have not been executed before the fund was suspended?

<ESMA_QUESTION_SLMT_3>

In line with our answer to question 1 above and the importance of acknowledging the variety in fund structures and investor bases, what will happen after the end of a suspension needs to be assessed on a case-by-case basis, taking into account the specific circumstances of a fund.

IOSCO recognises that a one-size-fits-all approach to such requirements is not always appropriate. It states that “it would be impractical to pursue, as some have suggested, “a global ‘one size fits all’” prescriptive approach which tries to match different asset classes, fund investment strategies and redemption periods according to universally applicable standards”.³ We agree with this assessment.

³ Statement on IOSCO liquidity risk management recommendations for investment funds” (18 July 2019), at page 2.

Generally speaking, rules for professional investor funds do not contain hard limits on investor liquidity and rely on contractual freedom to manage the speed of redemptions in times of stress through the use of a wide variety of liquidity risk management tools. Some of these tools are often not available to retail investor funds (such as lock-up periods and redemption gates), which can result in a more flexible product design that responds to the needs of investors. Whatever approach is taken, however, it will still have to have been disclosed to investors in a fund's offering documents.

<ESMA_QUESTION_SLMT_3>

Q4 Do you think there are circumstances where subscriptions, repurchases and redemptions may not be reopened simultaneously? If yes, what are these circumstances?

<ESMA_QUESTION_SLMT_4>

We believe that there may be circumstances where subscriptions, repurchases and redemptions should not be reopened simultaneously. In line with our answers to Questions 1 and 3 above, this will need to be assessed by the fund manager based on the specific circumstances of each fund. The employment and calibration of the tools is a result of analysis of the liquidity needs of the investors, the liquidity profile of the assets, the liquidity of the strategy as well as any relevant financing arrangements.

As noted, there is not a strictly linear relationship between subscriptions, repurchases and redemptions. The starting point for the fund manager is to look at the different factors at play, noting that LMTs cannot be looked at in isolation. Key factors include the underlying investor base and how the typical cash flows of a fund will look over the lifetime of the fund. By undertaking that analysis, managers can assess how offering liquidity facilities may impact the cash position of the fund under different scenarios. Similarly understanding the liquidity needs of the investors - whether it is driven by a wish to trade or receive distributions- is important. This is the starting point to understand the case for how different LMTs might be used. And the particular approach will differ depending on whether the fund in question is investing in liquid, semi-liquid or illiquid assets.

Moreover, investors will have chosen their fund investment on the basis of, among other things, the disclosure regarding which LMTs may be used and how they may be applied as well as the investor's own risk appetite. Removing the flexibility on how LMTs are applied

by AIFMs decreases professional investor choices even though those investors may prefer different approaches.

It is for these reasons that sufficient flexibility and discretion should be given to the fund manager to utilize the combination of LMTs - including suspensions of subscriptions, repurchases and redemptions - in the best interests of all its investors.

<ESMA_QUESTION_SLMT_4>

Q5 Can you think of any further characteristics of suspension of subscriptions, repurchases and redemptions?

<ESMA_QUESTION_SLMT_5>

No comment.

<ESMA_QUESTION_SLMT_5>

Q6 Do you think there is merit for the characteristics of suspension of subscriptions, repurchases and redemptions gates to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_6>

We support the application of LMTs in different ways as between AIFs and UCITS, as between different strategies, and as between different share classes.

UCITS v. AIFs

Paragraph 27 also makes clear ESMA's view that the RTS for suspension of subscriptions, repurchases and redemptions must be the same between the AIFMD and the UCITS Directive. We submit that the RTS (and Guidelines) should treat AIFs and UCITS differently and be more flexible for professional investor products as the contractual freedom for professional investors should not be unduly restricted. Professional investors should not be subject to the same level of restrictions as retail investors. This approach is fully consistent with currently applicable European regulation (e.g., AIFMD including permissive marketing provisions for professional investors and the ELTIF Regulation including

concentration limits and investment restrictions only for those ELTIFs marketed to retail investors).

As we explain below, the distinction between AIFs and UCITS should also apply to redemption gates. Redemption gates provide a good example of how such difference in treatment between AIFs and UCITS is necessary to protect investors and safeguard the investment strategy of the fund.

Differences in strategies require different approaches

Investment strategies vary to a large extent between AIFs and UCITS. The latter framework is designed to offer high levels of liquidity to investors whereas levels of liquidity largely vary among AIFs and many types of AIFs – such as private credit funds – are specifically designed to hold illiquid assets and naturally their operation is different for redemptions.

AIFs with semi-liquid investment strategies will generally need different redemption gates compared with UCITS or AIFs with highly liquid strategies. In fact, redemption gates are the most frequently employed LMT among AIFMs employing a semi-liquid investment strategy. While we believe the RTS and Guidelines do not intend to disallow the use of redemption gates that do not meet their requirements, we are concerned that the approach of not allowing appropriately calibrated and disclosed redemption gates that do not meet the specific RTS and Guidelines requirements to count toward the two required LMTs under Section 16 of the AIFMD unnecessarily disadvantages semi-liquid strategies for which a redemption gate (albeit with different characteristics to those in the draft RTS and Guidelines) is far and away the most appropriate LMT on both a business-as-usual basis and under extraordinary circumstances.

AIFMs running semi-liquid strategies are aware that there is a substantial risk that at any given time one or more assets in the portfolio could become entirely illiquid or become harder than usual to value. It is for precisely the reason that the business-as-usual state for such semi-liquid funds is so potentially close to the extraordinary circumstances state for funds like UCITS that the AIFMs choose to structure the AIFs with the redemption gates in place. In this fashion investors are fully aware of the redemption limits before going into the investment. If the AIFM is now required to add two other ill-fitting LMTs in addition to the redemption gate which happens not to align with the restrictions placed on their use with UCITS in mind, the investors in the semi-liquid AIF are not being better served than they would be if the types of redemption gates were not in place.

Allowing the rules on redemption gates to differ based on the nature of the fund will allow for more appropriate rules in each case.

Differences in share classes require different approaches

We believe there is merit for the characteristics of LMTs to differ between different investment strategies and between AIFs and UCITS. We also submit that the characteristics of LMTs should be able to apply on a per share class basis, where justified.

As a general point, we strongly believe that applicability on a share class basis should be allowed, at the very least for AIFs in situations where this is necessary to allow for fair treatment of investors. Firstly, as a high-level point, the recurring notion that LMTs have to be applied equally to all share classes overlooks the fact that the profile of investors may be significantly different as between share classes (e.g., retail investors vs professional investors; external investors vs house/employee investors), which may mean the share classes are set up with different lock-ups or liquidity features to begin with. Secondly, share classes may differ in assets held, e.g. in the case of hedged currency classes. In this example, should one of those currencies become restricted for some reason without significant effect on the other classes, it should be possible to apply an LMT for that share class alone. It therefore does not make sense for some LMTs to have to be applied to all share classes.

To understand better the relevance of allowing applicability on a share class basis, we note the practice of tracking classes within a fund. At present, there are several Member States which allow AIF structures with tracking classes, i.e., each class within the fund tracks different asset(s) within the same fund. In Luxembourg for example, such tracking classes are used in the normal course of portfolio management. These classes are part of the ordinary fund strategy from the outset as they are set out in the fund documentation provided to investors.

Indirectly imposing a requirement that all share classes within the fund must have exposure to the same pool of assets as a result of the increased risk that a liquidity problem in assets to which an investor's shares do not have exposure may nevertheless mandatorily limit that investor's ability to redeem reduces the ability of the fund manager to tailor the fund's profile to the specific needs of investors.

As the (il)liquidity derives from the (il)liquid nature of the asset(s) in question, it is entirely reasonable for AIFs to allow the use of specific LMTs to a specific class/pool of asset(s). This

principle upholds the goal of fair treatment of investors by applying different rules to situations that are different.

For this reason, we recommend deleting Article 1(2) – “Suspensions of subscriptions, repurchases and redemption shall apply to all shareholders or unitholders” & Article 1(3) – “In the case of AIFs with multiple share classes, the suspension of subscriptions, repurchases and redemptions shall apply to all the share classes of the AIFs.”

In light of these considerations, we again highlight the importance of having sufficient flexibility and discretion for the fund manager to utilize the LMTs in the most optimal way.

<ESMA_QUESTION_SLMT_6>

Q7 Do you agree with the description of redemption gates and their characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_7>

We do not agree that ESMA's description fully captures the characteristics of redemption gates. Consistent with our answer to Question 5 above regarding suspensions, fund managers often deploy LMTs such as redemption gates not only as emergency measures but as integral parts of their liquidity management strategy for AIFs. These tools are carefully calibrated to the specific liquidity profiles of the fund's assets and investor base. This is a longstanding, tried-and-tested and effective method of liquidity management.

ESMA's current proposals, which seem to favour a uniform application of these tools, risk undermining the ability of managers to tailor their strategies to the unique needs of their funds and their investors. Experience shows us that providing for redemption gates as part of a regular redemption programme - rather than just in exceptional circumstances - can prevent a liquidity crisis from arising in the first place. The availability of tools such as redemption gates ensures both the protection of remaining investors and market integrity, so contributing to financial stability in critical moments.

We appreciate that some may view the operation of gates in this manner as simply being part of the fund's redemption approach and it is correct that this will be outlined in fund documentation provided to investors and part of the authorisation process with the relevant regulator. This would bring us to a distinction between LMTs used as part of the fund's regular redemption approach versus the use of LMTs in exceptional or emergency

situations. We are of the view that if redemption gates applied as part of the regular redemption approach of the fund are provided for in the fund documentation, approved by the regulator, then they should continue to be used by managers as is currently the case.

We believe the draft RTS support the conclusion that redemptions gates and other LMTs that do not meet the requirements of the RTS and Guidelines may still be used. We note that paragraph 15 of the consultation states that in addition to the two LMTs (only one for MMFs) that fund managers shall at least select under Article 16(2)(b) of the AIFMD and Article 18a(2) of the UCITS Directive, fund managers may also decide to use other tools than the ones referred to in the AIFMD and UCITS Directive to manage the liquidity of the fund they manage. However, when doing so, these other tools shall not be considered as LMTs for the purpose of complying with Article 16(2)(b) of AIFMD and Article 18a(2) of the UCITS Directive.

This is restated in Recital 21 of the draft RTS:

AIFMs may use other tools than the ones referred to in Annex V of Directive 2011/61/EU to manage the liquidity of the AIFs they manage but these other tools should not be considered as liquidity management tools for the purpose of complying with the obligation to select at least two liquidity management tools under Article 16(2)(b) of Directive 2011/61/EU.

We highlight this point to confirm that the tools which fund managers routinely use already to manage liquidity under normal market conditions - which are included in the fund documentation and which are not listed among the LMTs in the Annex - should continue to be used in the ordinary course of business, without affecting the operation of these LMTs outlined in the consultation, which in the case of redemption gates and side pockets in particular, appear to have been established with activation solely in extraordinary circumstances in mind. In contrast, the requirements for redemption fees, swing pricing, dual pricing, anti-dilution levies and redemptions in kind appear to have been developed with business-as-usual activation as the default state.

In practice, this means that the updated AIFMD regime will still allow for example the following:

- a limitation of redemptions in ordinary course of business expressed as a percentage of the NAV of the class per quarter (i.e. 10 % of NAV of Class X per quarter). Such a

limitation is relatively common for AIFs and would be a general and pre-agreed part of the design of the relevant AIF. This is distinct and separate to the possibility to activate redemption gates in exceptional circumstances.

- differentiation between share classes tracking different assets as part of the investment strategy vs. side pockets as LMT to be used in exceptional circumstances (see further information above in our answer to Question 6).

We believe that this interpretation is supported by the draft guidelines which state in paragraph 27 of the Background section that the selection of additional LMTs should be on the basis that “managers have the discretion to select more LMTs, as well as additional liquidity measures, according to the criteria set out in the previous paragraph ...” which refers to the legislative mandate at Level 1. Paragraph 17 of Annex IV of the Guidelines similarly states that managers should assess the suitability of the LMTs in relation to:

- (a) the fund’s pursued investment strategy and investment policy;
- (b) the structure of the fund in terms of, inter alia, the duration of the notice period, lock up period, settlement period and dealing frequency;
- (c) the liquidity profile of the fund and its underlying assets, as well as the fund’s liquidity demands, taking into account not only redemptions but also other potential sources of liquidity risk emanating from the liability side of the fund balance sheet (e.g., margin calls) under normal and stressed market conditions, as well as the results of the Liquidity Stress Testing (LST);
- (d) the fund’s redemption policy and the characteristics of its investor base; and
- (e) the fund’s distribution policy (e.g.: the levy to be applied by the platform).

Paragraph 37 of the draft Guidelines also states:

For funds marketed to retail investors, redemption gates should not be systematically activated to manage the fund’s liquidity on a day-to-day basis, but should be activated in specific circumstances and carefully calibrated, for instance, to address severe liquidity stresses or stressed market conditions where executing the sale of underlying assets could worsen liquidity issues for the fund. (emphasis added)

The lead-in modifier limiting this statement to funds marketed to retail investors implies that by extension it could be appropriate for a fund not marketed to retail investors to have

a redemption gate that is systematically activated (i.e., always on) to manage the fund's liquidity on a day-to-day basis. We believe this is appropriate and the principle should be applied throughout the discussion of redemption gates.

Moreover, we would also underline that in the case of semi-liquid funds, their existing redemption programmes will fit within the definition of a "redemption gate" under the Level 1 text. A "redemption programme" is a type of redemption gate (i.e., a mechanism, which is a permanent feature of the fund, like any redemption gate, to restrict redemptions that exceed a certain threshold over a specified period) and is a very effective LMT. This is a key feature of semi-liquid private market funds and a very useful tool to enable them to manage liquidity.

This view is supported by paragraph 38 of the draft Guidelines which suggest that managers should set and disclose activation thresholds in the fund's documents – this is exactly what already happens in the case of redemption programmes and demonstrates how a redemption programme is a suitable form of redemption gate under the rules.

As we outline on several occasions throughout this document, it is imperative that semi-liquid funds and their characteristics are taken into account. Such funds should be able to use their current redemption programmes as one of the two required LMTs. We believe ESMA should clarify in the RTS that this is the case.

Additionally, if these funds are forced to engineer two other LMTs into their documents this will be futile as those LMTs will seldom be used and will not have a meaningful impact on the liquidity management of the fund.

Finally, we would also recall the legislative mandate to develop technical standards under Article 16(2)(g) of AIFMD and Article 18a (3) of the UCITS Directive, as contained in the draft RTS. The legislative mandate states as follows:

When developing those draft regulatory technical standards, ESMA shall take account of the diversity of investment strategies and underlying assets of AIFs. Those standards shall not restrict the ability of AIFMs to use any appropriate liquidity management tool for all asset classes, jurisdictions and market conditions.

For these reasons, and consistent with our point above, we believe sufficient flexibility and discretion should be given to the fund manager to utilize the combination of LMTs

including not impeding the continuing use of appropriate tools in the ordinary course of business to manage fund liquidity.

However, we would encourage ESMA to make clear that such terminology used as a result of the current Level 2 work is not meant to stand for the proposition that such longstanding liquidity management practices are now being deemed unauthorised in certain situations or must always be utilised in a certain way. We would also encourage ESMA to take an approach that provides maximum flexibility in the design and use of redemption gates so that the types of redemption gates that to date have been authorised and found acceptable by competent authorities, but which do not meet the narrow requirements imposed by the draft RTS and Guidelines are not considered appropriate LMTs for purposes of Section 16 of the AIFMD.

We would like to recall that under the Level 1 text, ESMA is empowered under Article 16(2g) of the AIFMD and Article 18a(3) of the UCITS Directive to “develop regulatory technical standards to specify the *characteristics* of the liquidity management tools” (emphasis added) set out in Annex V of AIFMD and Annex IIA of the UCITS Directive, respectively. As a result, ESMA is not empowered by these provisions to specify the *conditions* under which those tools may be deployed. Again, we recall the mandate to ESMA in Article 16(2g) of the AIFMD which states that the Level 2 standards “shall not restrict the ability of AIFMs to use any appropriate liquidity management tool for all asset classes, jurisdictions and market conditions.”

We recommend that Article 2 of the RTS should clarify that the reference to a redemption gate being a “temporary” restriction (as outlined in paragraph 29) is referring to the activation being temporary, rather than the mechanism itself.⁴

<ESMA_QUESTION_SLMT_7>

Q8 The draft RTS provides that the redemption gate threshold shall be expressed as a percentage of the NAV of the fund considering the net redemption orders

⁴ Similarly, in the draft guidelines 6.5.3.2 at paragraph 40 it says “The use of redemption gates should not be restricted in terms of the maximum period over which they can be used (maximum duration of redemption gates), or the maximum number of times that redemption gates can be activated (maximum use of redemption gates), as long as ***it [the activation of the gate triggered under the activation criteria]*** remains temporary in nature. These matters should be determined by the manager on a case-by-case basis.” We would suggest that the drafting is not entirely clear and could be clarified with the amendments we put forward in **bold and italics**. Please see our response to the guidelines consultation for more details.

for a given dealing day. Are you aware of any other method that ESMA should consider in the RTS? If yes, please explain.

<ESMA_QUESTION_SLMT_8>

As we have explained in Question 6 and elaborated on in the questions that follow, we believe that redemption gates (and the other LMTs) should be capable of being applied to share classes on differing terms where the liquidity profiles of the share classes differ (e.g., based on the assets or liabilities to which the class is exposed). In this regard, we suggest the following revision to the proposed AIF-related RTS (including but not limited to the threshold setting requirement) to facilitate application at the class level:

1. A redemption gate shall include an activation threshold predefined as the net redemption orders an AIF receives **for the fund or share class** for a given dealing date in proportion to the NAV of the AIF **or relevant share class, as applicable**.
2. When the net redemption orders **for the fund or share class** for a given dealing date exceeds the **relevant** activation threshold, the redemption gate may be automatically activated or at the discretion of the AIFM or fund Board if applicable.
3. When the **relevant** activation threshold is exceeded, the AIFM or fund Board may decide to execute all redemptions orders **for the fund or share class, as applicable**, in full, at the condition that the full execution of the redemption orders **for the fund or share class, as applicable**, is compatible with the liquidity structure of the AIF **and the share class as applicable**, that it applies equally to all redeeming shareholders or unitholders **in the fund (or share class, as applicable)** and that the interest of non-redeeming investors is preserved.
4. When a **fund-level** redemption gate is activated, the same level of redemption gate shall apply to all redeeming shareholders or unit-holders in proportion to their redemption orders. **When a share class-level redemption gate is activated, the same level of redemption gate shall apply to all redeeming shareholders or unit-holders from that class in proportion to their redemption orders. ...**

Lastly, consistent with our answer to the previous question, we propose that the RTS should afford some flexibility in relation to the application of redemption gate

thresholds (net vs gross), noting that semi-liquid funds often apply their redemption programmes to their gross (rather than net) redemptions.

<ESMA_QUESTION_SLMT_8>

Q9 Do you agree that redemption gates may be either activated automatically when the activation threshold is exceeded or that the fund manager/ fund Boards may decide whether or not to activate the redemption gate? Do you believe that automatic activation of redemption gates could create a first mover advantage?

<ESMA_QUESTION_SLMT_9>

We agree with Article 2(2) which provides for the option that when the net redemption orders for a given dealing date exceeds the activation threshold, the redemption gate may be automatically activated or at the discretion of the AIFM or fund governing body.

We believe it is important to maintain this option at the discretion of the fund manager. This is also relevant due to the potentially detrimental effect on fund liquidity and possibility for deviation in local implementation if this is not stipulated clearly in the RTS.

<ESMA_QUESTION_SLMT_9>

Q10 Do you think that the automatic activation of redemption gates shall not be permitted for some types of funds. If yes, please explain your position.

<ESMA_QUESTION_SLMT_10>

Maximum flexibility should be retained as regards the activation of redemption gates. We believe it is appropriate for all funds, managers and governing bodies to have the proposed option of automatic or manual application.

<ESMA_QUESTION_SLMT_10>

Q11 Do you agree that the activation threshold shall not be expressed at the level of the single redemption order? If not, please justify your position.

<ESMA_QUESTION_SLMT_11>

Please see our answer to Question 14 below.

<ESMA_QUESTION_SLMT_11>

Q12 In the case of activation of redemption gates, do you agree that investors should have the right to cancel the non-executed part of their redemption orders? In particular, should there be a different approach between UCITS and AIFs?

<ESMA_QUESTION_SLMT_12>

We do not believe that AIF investors should have the absolute right to cancel the non-executed part of their redemption orders in the case of activation of redemption gates regardless of the fund's rules and instruments of incorporation. While there may be merit in allowing retail investors in UCITS to cancel the non-executed part of their redemption orders, introducing such a right in the context of AIFs and professional investors could interrupt the fund manager's liquidity planning. This is especially so in the case of AIFs invested in illiquid assets which require a longer time horizon to sell.

We submit that ESMA should differentiate between UCITS and AIFs here. For AIFs, it should be possible for an AIF to have redemption terms that disallow the withdrawal of a redemption request once made at the sole option of the investors. We have suggested some revised language for AIF RTS Article 2(5) below:

When a redemption gate is activated, the non-executed part of the redemption orders shall be carried forward to the following dealing date unless the shareholders or unitholders have requested the cancellation of the non-executed part of their redemption orders, ***or the fund's rules and instruments of incorporation and disclosure documents provide otherwise.***

We believe that the decision to carry non-executed orders forward should remain subject to the discretion of the AIFM and should not be mandatory. Automatic carry forward is not currently a universal market practice.

Following on from this, Article 2(6) of the RTS states that "[n]on-executed parts of redemption orders that are carried forward to the next dealing date may have priority over redemptions orders submitted for the following dealing date". Subject to the question of non-executed orders being carried forward, we emphasise the importance of retaining the

discretion for fund managers regarding priority over redemptions. This is because in an abnormal market situation, it would encourage investors to submit their redemption orders as early as possible, thereby exacerbating the liquidity situation of the fund. We would suggest that the RTS clarify that the managers / offering documents of a relevant fund may grant such discretion for priority but are not required to do so.

The language of Article 2(6) seems to signal that view, even if the fund disclosure makes clear that redemptions are processed pro rata at the first dealing day after the gate, subject to the gate applying again at that point, investors could be entitled to priority treatment due to the terms of the RTS.

We note that Paragraphs 36 and 39 of the discussion use this more appropriate formulation:

The fund manager/fund Board shall specify in advance, whether the part of redemption orders that have not been executed, as a result of the activation of the redemption gate, and that have been carried forward to the next dealing date, shall have any priority or not over redemption orders submitted for execution at the next dealing date.

This language removes the potential for misunderstanding.

<ESMA_QUESTION_SLMT_12>

Q13 Do you think there is merit in having different characteristics of redemption gates for different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_13>

As a general point, we believe that there is merit in having different characteristics of redemption gates for different investment strategies and between AIFs and UCITS. Please see our answer to Question 6 above.

In line with our previous answers, we submit that there should be proportionate flexibility for fund managers to determine the appropriate use of redemption gates, and this is particularly the case for AIFs when compared with UCITS funds, given the wide variety of investment strategies within the alternative space which necessitate a bespoke approach from the fund manager.

Further, we believe that applicability of redemption gates should also be based on a share class basis. Please see our responses to Question 6 above and also our further explanation in our response to Question 14 below.

<ESMA_QUESTION_SLMT_13>

Q14 In the case of funds with multiple share classes, do you agree that the same redemption gate shall apply to all share classes? If not, please justify your position.

<ESMA_QUESTION_SLMT_14>

As we point out above and consistent with our explanation to Question 6, redemption gates should be available on a per class basis. To facilitate this, we put forward in response to Question 8 some suggested revisions to Article 2(1) - (4) of the RTS.

Investor level gates

The consultation notes that the activation threshold shall not be expressed at the level of the single redemption order but rather at the fund level arguing that this prohibition would ensure that investors be treated fairly. In our view and in the experience of our manager members, the reality is to the contrary. Various types of investor level gates are useful tools to ensure that the investors are treated fairly; if properly selected/calibrated having regard to the fund strategy and the investor base.

For example, if fund-level gates only were allowed, larger investors who have their own market intelligence can move quickly compared with smaller investors. As a result, the professional investors could harvest a first mover advantage to redeem their entire holding and “use up” the entire permitted redemption volume before other (smaller) investors place their orders.

In addition to the considerations and proposed amendments we put forward regarding share classes in our responses to Questions 6 and 8, we believe investor level gates should be permitted when structured as a limit on the percentage of that investor’s holding which can be redeemed at each redemption dealing day subject to the same investor-level gate applying to all investors in the class or fund (as applicable)).

We would also suggest that the RTS should clarify that where investors are able to redeem their shares/units up to a certain threshold of NAV - as we have set out above regarding

semi-liquid fund's redemption programmes in our answer to question 7 - this should be considered a partial restriction which is compliant with the Level 1 text definition of "redemption gate" because investors can, partially, redeem their investment up until then NAV threshold is met by the fund. We believe the RTS and/or Guidelines could usefully clarify this.

<ESMA_QUESTION_SLMT_14>

Q15 Can you think of any further characteristics of redemption gates?

<ESMA_QUESTION_SLMT_15>

No comment.

<ESMA_QUESTION_SLMT_15>

Q16 Do you agree with the description of extensions of notice period and their characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_16>

No comment.

<ESMA_QUESTION_SLMT_16>

Q17 Do you agree that the same extension of notice period shall apply to all investors or different extensions of notice periods per share class/unit shall be allowed? Please justify your position.

<ESMA_QUESTION_SLMT_17>

As we explain in our answer to question 6 above, we call for the RTS to allow applying all of the LMTs including extensions of notice periods on a per share class basis, when justified. We believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_17>

Q18 Do you agree that extensions of notice period may be applied for a pre-defined period of time (for a pre-defined number of dealing dates)? If not, please justify your position.

<ESMA_QUESTION_SLMT_18>

No comment.

<ESMA_QUESTION_SLMT_18>

Q19 Do you think there is merit for the characteristics of extensions of notice period to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_19>

We believe there is merit for the characteristics of extensions of notice period to differ between investment strategies and between AIFs and UCITS as explained in our response to Question 6. As regards different investment strategies, the fund manager is best placed to determine the most appropriate way in which to manage liquidity having regard to the underlying assets in the fund, and by extension how LMTs such as extensions of notice periods should be applied.

As regards the difference between AIFs and UCITS, as we explain in our answer to Question 6, the RTS (and Guidelines) should treat AIFs and UCITS differently and provide more flexibility for professional investors as they should not be subject to the same level of restrictions as retail investors.

Investment strategies vary to a large extent between AIFs and UCITS. The latter framework is designed to offer high levels of liquidity to investors whereas many types of AIFs – such as private credit funds – are specifically designed to hold illiquid assets and they operate differently for redemptions. AIFs with illiquid investments will generally need different approaches to extensions of notice periods when compared than UCITS. Allowing for the rules on extensions to notice periods to differ based on the nature of the fund will allow for more appropriate rules in each case.

<ESMA_QUESTION_SLMT_19>

Q20 How would you execute redemption orders that have been placed but not executed before the notice period is extended? Would you execute them under the original notice period, or would you execute them at the following dealing day?

<ESMA_QUESTION_SLMT_20>

Ordinarily, they would be executed under the original notice period, unless extreme circumstances (e.g. a severe liquidity strain) made this unfeasible, in which case the order might need to be deferred to the next dealing day.

As a general point however, this should be dealt with on a case-by-case basis, and so determined by the fund manager, having regard to the specific circumstances and the best interests of the fund and its investors. Again, this is why flexibility and discretion are key to ensuring an appropriate suite of LMTs aimed at safeguarding the fund's liquidity risk management.

<ESMA_QUESTION_SLMT_20>

Q21 How would you ensure fair treatment of investors when deactivating the extension of notice period?

<ESMA_QUESTION_SLMT_21>

No comment.

<ESMA_QUESTION_SLMT_21>

Q22 Do you agree with the description of redemption fees and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_22>

We note that paragraph 51 explains that redemption fees may be expressed as a range, the minimum of which cannot be zero. We agree that a range should be permissible but we disagree that the minimum could not be zero. In contrast to paragraph 51, we highlight

paragraph 55 of the RTS consultation and also section 83 of the Guidelines, both of which suggest that a threshold may be applied based on the size of a redemption, in which case a nil redemption fee appears to be allowed. We therefore believe that the RTS should make clear that a redemption fee of zero or a range where the minimum is zero are both permissible.

It is the experience of our manager members that some funds apply a redemption fee of up to 1% of the redeemed amount, which is reserved for extraordinary market circumstances when necessary to protect investor interests and which in some cases have never been activated. That is to say, such redemption fees have always been zero for those funds. We believe this to be an appropriate tool to manage liquidity but it seems not to comply in full with the description of a redemption fee in the RTS.

Additionally, we believe there should be room to base a threshold for activation of the redemption fee not only on the amount of redemptions, but also on the estimated costs of redemption, estimated at the time of redemption. It is important to note that the (implicit) costs of transactions do not only depend on the size of the redemptions, but also on how volatile markets are when orders are executed. We would add that volatile markets do not necessarily represent stressed market circumstances. Thus, large redemptions do not necessarily lead to high transaction costs, and the opposite is also true, i.e. small redemptions do not necessarily imply low transaction costs. Fund managers need some flexibility to ensure that a redemption fee can be activated when necessary to protect investor interests.

We request ESMA deletes the stipulation in paragraph 51 that redemption fees may be expressed as a range, the minimum of which cannot be zero. This would bring the description into line with market practice and also make it consistent with paragraph 55 of the RTS consultation and section 83 of the Guidelines.

<ESMA_QUESTION_SLMT_22>

Q23 Can you think of any other redemption fee mechanism than the ones described above? If yes, please provide examples.

<ESMA_QUESTION_SLMT_23>

No comment.

<ESMA_QUESTION_SLMT_23>

Q24 Do you think there is merit for the characteristics of redemption fees to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_24>

In line with our answer to Question 6 above, we believe there is merit for the characteristics of redemption fees to differ between investment strategies and between AIFs and UCITS. As regards different investment strategies, the fund manager is best placed to determine the most appropriate way in which to manage liquidity having regard to the underlying assets in the fund, and by extension how LMTs such as redemption fees should be applied.

As regards the difference between AIFs and UCITS, as we explain in our answer to Question 6 above, the RTS (and Guidelines) should treat AIFs and UCITS differently and be more permissive for professional investor products as the contractual freedom for professional investors should not be unduly restricted. Professional investors should not be subject to the same level of restrictions as retail investors.

Investment strategies vary greatly between AIFs and UCITS. The latter framework is designed to offer high levels of liquidity to investors whereas levels of liquidity largely vary among AIFs and many types of AIFs – such as private credit funds – are specifically designed to hold illiquid assets and naturally their operation is different when it comes to redemptions. AIFs with illiquid investments will generally need different approaches to redemption fees when compared with UCITS or AIFs with highly liquid strategies.

We also think there is merit for the RTS to allow for redemption fees to apply on a per share class basis, when justified. As we explain in our answers to Question 6 above, we believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_24>

Q25 Do you agree with the description of swing pricing and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_25>

We agree with the description but would also emphasise that swing pricing is not just a tool to be used in stressed conditions, in fact it is frequently used on a day-to-day basis through all market conditions. The ongoing use of swing pricing in normal market conditions where there are significant net capital flows means that it can be deployed without a stigma effect in extreme market conditions.

Secondly, we agree that the swing factor should reflect the estimated cost of liquidity and would add that this should be done on a best-efforts basis. We note that there is some inconsistency in the wording throughout the RTS, where it says “estimated cost of liquidity” in some places, but simply “cost of liquidity” in others. It should say “estimated” throughout in recognition of the fact that the ability to set an appropriate swing factor relies on the ability of the manager to assess the expected costs of transacting and accessing liquidity, which is not always possible.

Swing pricing frequently utilises modelling and automated data feeds, but it is not automated from start to finish. As such, flexibility for managers in operationalising this ADL remains paramount.

<ESMA_QUESTION_SLMT_25>

Q26 Can you think of any characteristics of swing pricing that the ones described above?

<ESMA_QUESTION_SLMT_26>

No comment.

<ESMA_QUESTION_SLMT_26>

Q27 Do you think there is merit for the characteristics of swing pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_27>

Yes, in line with our answers to Question 6 above, as a general point we believe that the characteristics of LMTs – including swing pricing - should usually differentiate between investment strategies and between AIFs and UCITS, for the reasons already outlined in our responses to Questions such as 13, 19 and 24 above.

We again highlight the importance of having sufficient flexibility and discretion for the fund manager to utilize the LMTs in the most optimal way (including the discretion to activate or deactivate them), having regard to the underlying nature of the fund's assets and the best interest of the fund's investors.

<ESMA_QUESTION_SLMT_27>

Q28 Do you agree that in the case of funds with multiple share classes, the same swing factor shall be applied to all share classes? If not, please justify your position.

<ESMA_QUESTION_SLMT_28>

No, we do not agree that in the case of funds with multiple share classes, the same swing factor shall be applied to all share classes. As outlined in our answers to Questions 6 and 14 in particular, we believe there is merit to allow for the RTS to allow for LMTs – including swing pricing and the associated swing factor - to apply on a per share class basis, when justified. As we explain above, this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

Swing pricing is a process for adjusting a fund's NAV to effectively pass on transaction costs stemming from net capital activity (i.e. flows into or out of the fund) to the investors associated with that activity during the life of a fund, excluding a ramp-up period or termination period. It is only fair that a relevant swing factor is applied to those investors associated with the relevant activity during the life of the fund, i.e. affected investors should be subject to the particular swing factor while unaffected investors should not. Share classes with exposures to different assets or liabilities may be subject to different levels of transaction costs.

Similar to the point above about fund managers using LMTs in the ordinary course of business, the investment fund documentation will lay out explicitly the use and application of swing pricing to investors before they commit their capital to the fund and it is on this basis that investors will commit, i.e. in the knowledge of which asset classes to which they

are exposed and subject to any relevant swing pricing mechanism relevant to that asset class.

<ESMA_QUESTION_SLMT_28>

Q29 Do you agree with the description of the dual pricing and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_29>

No comment.

<ESMA_QUESTION_SLMT_29>

Q30 Are there any other calculation methods for dual pricing that should be considered? If yes, please give example.

<ESMA_QUESTION_SLMT_30>

No comment.

<ESMA_QUESTION_SLMT_30>

Q31 Do you think there is merit for the characteristics of dual pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_31>

Yes, in line with our answers to Question 6 above, as a general point we believe that the characteristics of LMTs – including dual pricing - should usually differentiate between investment strategies and between AIFs and UCITS, for the reasons already outlined in our responses to Questions such as 13, 19 and 24 above.

We again highlight the importance of having sufficient flexibility and discretion for the fund manager to utilize the LMTs in the most optimal way (including the discretion to activate or

deactivate them), having regard to the underlying nature of the fund's assets and the best interest of the fund's investors.

In line with our answers above, and as outlined in our responses to Questions 6 and 14 in particular, we also call for the RTS to allow applying LMTs on a per share class basis, including for dual pricing, when justified. We believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_31>

Q32 Do you agree with the description of the anti-dilution levy and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_32>

We believe that there are other characteristics that should be taken into account in the description of the anti-dilution levy. It is important to ensure that fund managers retain full flexibility on selection and terms of anti-dilution levies to be used in their funds. As we explain in our answer to Question 22, it should be possible to base a threshold on the estimated amount of transaction costs, not just on the net activity in the fund.

Similarly, having adequate flexibility concerning the terms of the anti-dilution levies is important. This also allows the fund manager to address costs of frequent trading or market timing (i.e. when investors engage in short term trading) and to compensate long term investors in the fund as opposed to investors with frequent trading activity in circumstances where such frequency creates costs that would be unfair to pass on to other investors in a fund.

<ESMA_QUESTION_SLMT_32>

Q33 Are there any other calculation methods for anti-dilution levy that ESMA shall consider? If yes, please give example.

<ESMA_QUESTION_SLMT_33>

No comment.

<ESMA_QUESTION_SLMT_33>

Q34 In the case of funds with multiple share classes, would you see the possibility for different anti-dilution levies depending on share classes? Please justify your position.

<ESMA_QUESTION_SLMT_34>

In line with our answers above, and as outlined in our responses to Questions 6 and 14 in particular, we also call for the RTS to allow applying LMTs on a per share class basis, including for anti-dilution levies, when justified. We believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_34>

Q35 Do you think there is merit for the characteristics of anti-dilution levy to differ between different investment strategies and between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_35>

Yes, in line with our answers to Question 6 above, as a general point we believe that the characteristics of LMTs – including anti-dilution levies – should usually differentiate between investment strategies and between AIFs and UCITS.

The ESRB highlights in its response to the current consultation that the FSB and IOSCO “have pointed out that anti-dilution LMTs are suited to funds that invest in less liquid assets.”⁵ This underscores the points we make in our answers to Questions 6, 13, 19, 24 and 31 that there is often a significant difference in way that liquidity is managed between UCITS and AIFs, and hence the RTS should provide for such differentiation in their approach.

Further, as we highlight in our response to Question 5 above, it is important to bear in mind how these LMTs generally are used by fund managers in practice. We highlight the comment by the ESRB in replying to the current consultation that “[a]nti-dilution tools are

⁵ [ESRB response](#) to the ESMA consultation on draft Regulatory Technical Standards and Guidelines on liquidity management tools, 16 July 2024, page 8.

most effective as part of the day-to-day management of the fund, i.e. even during normal market conditions, and where their use is transparent to investors.”⁶

We again highlight the importance of having sufficient flexibility and discretion for the fund manager to utilize the LMTs in the most optimal way (including the discretion to activate or deactivate them), having regard to the underlying nature of the fund’s assets and the best interest of the fund’s investors.

<ESMA_QUESTION_SLMT_35>

Q36 Do you agree with the description of redemptions in kind and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_36>

We do not agree with the description of redemptions in kind and the corresponding characteristics.

We would also emphasise that the choice of LMTs for semi-liquid funds is very limited. Semi-liquid funds often have a mix of retail and professional investors, and whilst the guidance suggests redemptions in kind can be used for funds that target both professional and retail investors, redemptions in kind can only be used for professional investors which narrows the scope of one of the two required LMTs.

Furthermore, as redemption in kind is not categorised as either a quantitative or anti-dilution tool (ADT) LMT, it may not be possible for funds to select redemptions in kind as one of their two mandatory LMTs in light of the guidance that suggests that funds should have one quantitative and one ADT. It is important that the RTS clarifies that AIFMs may choose any two LMTs from the list in Annex V Level 1, (2) – (8), as appropriate for the fund to ensure redemptions in kind could be one of the two required LMTs, which accords with the Level 1 text.

Secondly, the characteristics as written do not fully consider the mechanics of agreements with authorised participants in the case of exchange-traded funds (ETFs). When, in the normal course of regular dealing activities relating to the direct redemption of shares in a UCITS ETF by an authorised participant/market-maker,

⁶ *Id.*

delivery in whole or in part of underlying securities held by, or on behalf of the UCITS ETF to authorised participants/market makers in satisfaction of such dealing request should not be considered an activation of the redemptions in kind mechanism in the context of Annex IIA liquidity management tools.

<ESMA_QUESTION_SLMT_36>

Q37 Can you think of any characteristics of redemptions in kind?

<ESMA_QUESTION_SLMT_37>

We note that the draft RTS on redemptions in kind are complemented by the draft Guidelines⁷ which propose certain further limits regarding redemptions in kind in paragraph 6.5.3.4. In particular, we highlight the requirement that if a redemption in kind is activated, an independent third party (e.g., the fund auditor, depositary) should perform the valuation of the asset(s).

We do not believe there is a justification to require the external audit generally, especially if all investors are professional investors. There should be no obligation to subject the valuation of redeemed assets to an external audit because in many cases the redemption in kind is done on a pro rata basis in respect to all redeeming investors. The value retained for the redemption is then less important because it cannot have an impact on the fair treatment of the redeeming investors.

Also, in the ordinary course of business for some funds, the NAV (at which investors are redeemed) is calculated and units are redeemed based on the valuation of the AIFM/external valuer (not depositary or auditor) and we believe that such a valuation should be sufficient.

For those cases where the redemption in kind is done for some investors, while other investors are redeemed in cash or in other cases where the context would justify this given the type of assets the fund invests in, we believe that the investors should either be able to request an audit report if justified, or at least, be able to waive the requirement of audit report and waive any possible ex-post claims if it happens that the value retained for the redemption in kind was over-or under-valued.

⁷ Please also see our response to the draft ESMA guidelines.

For retail funds, we acknowledge that it could be beneficial to require such audits to protect retail investors who would not necessarily be able to assess whether an audit report could be beneficial or not, and also to protect the fund governing body from any subsequent claims, especially because it may not be possible to obtain a waiver. In such a case, having a clear differentiation between the characteristics on redemptions in kind between UCITS and AIFs is imperative.

We do not think that increasing the depositaries' oversight duties in relation to redemptions in kind would add any value in comparison with the cost of such valuation/audit which would need to be supported by the fund.

<ESMA_QUESTION_SLMT_37>

Q38 Do you think there is merit for the characteristics of redemption in kinds to differ between different investment strategies between AIFs and UCITS? If yes, how?

<ESMA_QUESTION_SLMT_38>

Yes, we note the requirement for an independent third party to carry out a valuation of the assets, and the fact that this should only apply to retail investors and not to professional investors in AIFs.

While the consultation paper acknowledges at several points (for example in paragraph 32 on redemption gates) the need to avoid any possible conflict between the draft RTS and the ELTIF Regulation, there is an inherent tension between the ELTIF Regulation on the one hand and the draft RTS on the other around redemptions in kind. The ELTIF Regulation permits redemptions in kind (to retail investors or professional investors) subject to certain specified conditions being met (including a written request from the relevant investor(s)). In contrast, the draft RTS here only permit the activation of redemptions in kind to meet redemptions requests from professional investors – Article 8(2).

We note that AIFMD Article 16(2b) provides the following limits with respect to redemptions in kind:

Redemption in kind as referred to in Annex V, point 8, shall only be activated to meet redemptions requested by professional investors and if

the redemption in kind corresponds to a pro rata share of the assets held by the AIF.

By way of derogation from the fourth subparagraph of this paragraph, the redemption in kind need not correspond to a pro rata share of the assets held by the AIF if that AIF is solely marketed to professional investors, or if the aim of that AIF's investment policy is to replicate the composition of a certain stock or debt securities index and that AIF is an exchange-traded fund as defined in Article 4(1), point (46), of Directive 2014/65/EU.

It is not entirely clear how this would work for a fund with both professional and retail investors. As a result, we would question whether many fund managers in practice are able to justify the use of redemptions in kind as one of the two minimum mandatory LMTs.

Further, we note that the drafting is not entirely clear in Article 8(3) as to whether the requirement for AIFMs to apply the same type of transfer of assets (i.e. pro rata share of each asset or not) to all redeeming professional investors applies to professional only funds. Even if that requirement is for professional only, illiquid funds will not be able to carry out a pro rata split of illiquid assets making it an unsuitable option for liquidity management. We would encourage ESMA to revise the drafting here to provide more clarity and allow for fund managers' discretion to decide whether the same type of transfer of assets applies regardless of whether the fund is for professional investors only.

Finally, we also call for the RTS to allow applying LMTs on a per share class basis, including for redemption in kind, when justified. We believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_38>

Q39 Do you agree with the description of side pockets and the corresponding characteristics? If not, please justify your position.

<ESMA_QUESTION_SLMT_39>

There appears to be some confusion around the terminology for side pockets and their operation in practice. We also highlight, as we explain in our answer to Question 7 above, that the longstanding practice of using LMTs such as side pockets should continue to be allowed unimpeded in the ordinary course of business, regardless of the specific characteristics of side pockets to be used in exceptional circumstances.

Paragraph 87 of the consultation document notes that side pockets “mean separating certain assets, whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances, from the other assets of the fund.”

In line with our answer to question 7, it would appear that redemption terms that are structural (i.e. agreed in the fund documentation) and are not one of the two chosen LMTs (side pockets are not allowed to be one of the two chosen LMTs) will still be permitted going forward, but there may be confusion regarding the description of such a tool.

We would like to clarify that side pockets are different to ordinary “tracking classes” which we discuss in our answer to Question 6 above. The experience of our manager members is insightful in this regard. In Luxembourg, the term side pocket was traditionally only used when a portion of the assets became illiquid. These assets would then be allocated to a closed-ended tracking share class and the redemption rights could only be exercised in relation to the other class(es). The side pockets are different to ordinary tracking classes (i.e. a class tracks a specific asset) which are used in the normal course of portfolio management and which are not uncommon in Luxembourg.

In Ireland, by way of contrast, the legal approach has typically taken a broad view on what a side pocket is, for example a liquidating / run-off share class (provided for in the fund documents) could be considered to be a side pocket. This approach has been adopted because the approach of the competent authority has typically not permitted the types of separate portfolio tracking classes as permitted in Luxembourg (requiring instead that all share classes within the fund have exposure to the same pool of assets).

We submit that it would be helpful to ensure that these portfolio management tracking classes (which are part of the ordinary fund strategy and hard-wired from the outset) are not captured by the proposed side pocket regulation (i.e., side pockets as LMTs in exceptional circumstances).

<ESMA_QUESTION_SLMT_39>

Q40 Do you agree that in the case of UCITS, side pockets created by physical separation should only be done with the creation of a new UCITS where the assets for which there are no problems are placed? If not, please explain your position.

<ESMA_QUESTION_SLMT_40>

No comment.

<ESMA_QUESTION_SLMT_40>

Q41 Can you think of any other characteristics of side pockets that ESMA should consider? In particular, do you think that the characteristics of side pockets shall differ between UCITS and AIFs (in addition to the creation of side pockets via physical separation of the assets)? If, yes please elaborate.

<ESMA_QUESTION_SLMT_41>

According to Article 9(7) “[a]fter the side pocket is created, AIFMs shall manage the AIF according to the AIF rules.” Although it is obvious that a side pocket that is a share class would be managed according to the fund rules of the original AIF, it is perhaps less obvious where the side pocket was done via physical separation. It seems logical, however, that the side pocket formed that way would be subject to the fund rules of the side pocket (since it is by definition a separate AIF from the rest of the original assets) rather than the fund rules of the vehicle housing the assets not in the side pocket.

We also note that neither account nor physical segregation is expected to work for long/short strategies. This is because the potential loss on a short position is unlimited, which makes it impossible to ensure that enough assets are left in the side pocket to meet future liabilities.

Finally, in line with our answers above, and as outlined in our responses to questions 6 and 14 in particular, we also call for the RTS to allow applying LMTs on a per share class basis, including for side pockets, when justified. We believe this should be allowed at least for professional AIFs in situations where this is justified for fair treatment of investors.

<ESMA_QUESTION_SLMT_41>

Q42 Do you see merit in specifying further the characteristics that side pocket created by means of accounting segregation should have? If yes, can you please explain how you have created side pocket via accounting segregation? Have you encountered any legal constraints or are you aware of any legal constraints in your jurisdiction that may limit the use of side pockets via asset segregation?

<ESMA_QUESTION_SLMT_42>

No comment.

<ESMA_QUESTION_SLMT_42>

Q43 Do you agree that the assets in the side pocket should always be managed with the view to liquidate them? Or could there be circumstances, where a reintegration with the normal assets could be contemplated? Please explain.

<ESMA_QUESTION_SLMT_43>

The draft RTS consider that once created, side pockets should be managed with a view to liquidate the assets in the side pocket. It is useful to clarify that the manager should be permitted to make follow-on investments in relation to a side-pocketed assets to the extent that this is considered useful in the manager's discretion (i.e. if the manager believes such additional investment would increase the liquidity of the asset or not making the additional investment will damage the value of fund's holding). This would be fully in line with the use of side pockets in practice and consistent with the liquidity management goals of the current consultation.

We recognise that while the primary purpose of side pockets is to manage illiquid or distressed assets such that the fund's assets are protected, there could be circumstances where reintegration of side-pocketed assets may be in the fund's best interests, taking into account developments in the market, access to different jurisdictions or other factors.

For example, a distressed asset may become temporarily illiquid while it goes through a work-out process, following which it becomes liquid again and may then form part of the main portfolio. Further, it should be clear that to the extent the investment is realised in full or in part, the proceeds of such realisation may be reinvested into the main portfolio (assuming accounting based segregation) as continuing investors may prefer to continue to be exposed to the assets of the fund rather than receive a cash payment (in which case

the side pocket shares are switched for shares in the main portfolio). Finally, it is proposed that a side pocket should be closed to repurchase; this is not advisable as side pockets assets are often realised over time and repurchase would be the method to make partial returns to investors – without this capability, investor cash will remain locked up in a side pocket longer than necessary.

In this light, we submit that Article 9(4) should be amended to delete the reference to “sole objective of being liquidated.” Again, we believe it is important that managers retain flexibility and discretion to decide on the treatment of side pockets in the best interest of the fund and its investors.

<ESMA_QUESTION_SLMT_43>

Q44 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 characteristics of LMTs set out in Annex IIA of the UCITS Directive? Which other types of costs or benefits would you consider in that context?

<ESMA_QUESTION_SLMT_44>

No comment.

<ESMA_QUESTION_SLMT_44>

Q45 Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the UCITS Directive?

<ESMA_QUESTION_SLMT_45>

No comment.

<ESMA_QUESTION_SLMT_45>

Q46 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 characteristics of LMTs set out in Annex V of the AIFMD? Which other types of costs or benefits would you consider in that context?

<ESMA_QUESTION_SLMT_46>

No comment.

<ESMA_QUESTION_SLMT_46>

Q47 Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the AIFMD?

<ESMA_QUESTION_SLMT_47>

On the ESG question, we do not believe there are any additional aspects that ESMA need to consider.

On innovation, we believe that the implementation of these new rules and importantly, the real-world experience of applying LMTs by fund managers provides an opportunity for innovation. An important theme that we have highlighted throughout this consultation response is that of flexibility for fund managers. Providing sufficient flexibility for fund managers to implement the LMTs in question will allow for future innovation to enable more efficient liquidity management practices to emerge.

<ESMA_QUESTION_SLMT_47>