Frankfurt am Main,
28 June 2019

BVI's response to the ESMA Consultation Paper on draft regulatory technical standards under Article 25 of the ELTIF Regulation

BVI[1] welcomes the opportunity to comment on the proposed standards for cost disclosure by ELTIFs. In fact, we believe that the initiative at hand should be used by ESMA in order to provide for clarifications to some important open questions relating to cost calculations by real asset funds based on the PRIIPs regime. Currently, the lack of legal clarity leads to divergent approaches to cost calculations at the fund level which means that cost figures of real asset funds disclosed under PRIIPs and in particular under MiFID II are not comparable for potential investors. Since the approach to cost calculations outlined in the consultation paper is based upon the PRIIPs concepts, it is imperative that ESMA provides for further guidance on applying such concepts for ELTIF portfolios that may consist of direct holdings of real assets, private equity investments or loans. Our suggestions for relevant clarifications with regard to investments in real assets are presented in our answers below.

Q1: *Taking into account the new cost disclosure framework introduced by the PRIIPs Regulation, do you agree that the abovementioned pieces of legislation and regulatory material are relevant for the purpose of the RTS on Article 25(3) of the ELTIF Regulation? Which other pieces of legislation and regulatory material do you consider relevant for that purpose?*

We agree that that the four pieces of legislation and regulatory material suggested by ESMA are relevant for the purpose of the RTS on Article 25(3) of the ELTIF Regulation. We are not aware of any other relevant materials.

Q2: *Taking into account the new cost disclosure framework introduced by the PRIIPs Regulation, do you agree with the abovementioned assumptions? In particular, do you agree with the proposal included in paragraph 21 above? With respect to the overall cost indicator, would you see merit in aligning the level 1 framework on cost disclosure under the ELTIF Regulation with the PRIIPs level 2 framework on cost disclosure?*

We agree with the general aim to ensure the greatest possible consistency of cost disclosures for one and the same product. Therefore, we support in principle the alignment in the understanding of relevant cost elements with the PRIIPs framework and the inclusion of references to PRIIPs provisions. However, the current PRIIPs framework suffers from certain deficiencies which should not be perpetuated under the ELTIF regime. This pertains in particular to the following elements of cost calculations under PRIIPs:

- <u>Inappropriate and unsuitable methodology for calculating transaction costs:</u> The basis for these concerns is the PRIIPs "arrival price" methodology which introduced market movements (also

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's more than 100 members manage assets of some 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 22% in the EU Germany represents the largest fund market as well as the second fastest growing market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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called "slippage" – i.e. the time between the order and its execution) and thus leads to consistently erroneous and misleading transaction costs. In the context of real assets, however, calculation of transaction costs in accordance with the "arrival price" methodology makes even less sense. The "previous independent valuation price", which is to be used as the arrival price for real estate transactions and thus as the reference value for the calculation (cf. annex VI para. 19 of the PRIIPs RTS), has no relevance for determining transaction costs since the actual acquisition or disposal price does not include any implicit cost elements. The acquisition costs of real assets are known in detail and already disclosed in the annual fund reports. They encompass in particular notary and brokerage fees, land registry costs and taxes for real estate transfer. **Thus, costs of transactions in real assets should be calculated by summing up those actual identifiable cost items directly associated with a transaction.**

- Lack of clarity with regard to cost calculations for real asset funds: The understanding of "other costs" for ELTIFs and other funds investing in real assets is not at all clear. In the context of PRIIPs disclosures, it is still heavily contested among the industry whether (1) operating costs incurred at the level of the asset and (2) interest payments for debt financing shall be considered cost and thus, included in the summary cost indicator. A detailed description of the problems and our suggested solutions are presented in our reply to Q3 below.

The technical specifications for the PRIIPs KID, including the approach to calculating transaction costs, are currently under review with the final ESA report being due by the end of 2018. Against this background, we urge ESMA to account for this ongoing work its technical advice under the ELTIF regime. Any references to the PRIIPs RTS should be kept dynamic and should be able to reflect the potential evolvement of the PRIIPs standards in order to ensure consistency of cost disclosures for investors.

With regards to retail investors not only receiving the ETLIF overall cost ratio and the PRIIPs RIY figures, we do not see the value of ELTIF managers being required to explain the differences between those two figures. In fact, the problem of diverging cost disclosures will probably pertain to all funds, or even all PRIIPs distributed to retail investors, and not be limited to ELTIFs. Investors will generally receive annual cost ratios as part of the MiFID II ex-ante cost information in addition to the PRIIPs RIY figures. Any solutions or measures meant to enhance investors' understanding should be thus discussed for all PRIIPs and certainly not exclusively for ELTIFs currently representing a very small fraction of retail investments.

Lastly, we agree with ESMA's suggestion to use the UCITS CESR guidelines as a right basis for the ELTIF's overall cost indicator and concur that the PRIIPs' reduction-in-yield indicator should not be used.

Q3: *Taking into account the new cost disclosure framework introduced by the PRIIPs Regulation, do you agree that the types of cost mentioned in the present paragraph are annual costs that could be expressed as a percentage of the capital?*

Management fees, performance fees and other costs (incl. administrative, regulatory, depositary, custodial, professional and audit costs) are indeed annual costs that can be expressed as a percentage of the capital. However, the understanding of "other costs" for ELTIFs and other funds investing in real assets is not at all clear. In the context of PRIIPs disclosures, it is still heavily contested among the industry whether (1) operating costs incurred at the level of the asset and (2) interest payments for debt financing shall be considered cost and thus, included in the summary cost indicator.

Since real assets are an essential part of the eligible investments for ELTIFs, we believe that the technical standards under the ELTIF Regulation offer an opportunity for ESMA to clarify these issues, possibly by cooperating and interacting with the ESAs' working groups on the PRIIPs review. In this regard, we urge ESMA to take into account the following arguments:

- Treatment of operating costs relating to real assets: Non-apportionable operating costs of real assets such as incidental expenses (including payments for water and waste disposal, road cleaning, other cleaning services, energy supply, real estate tax and insurance coverage) and maintenance costs (including maintenance work and inspection performance, renovation and repair measures) are incurred by any person holding real estate or other real assets. They are not specific to the management of investment funds nor related to property management or similar services, and thus should not be relevant for the purpose of recurring cost calculation. By way of comparison, costs incurred in the operations of exchange traded companies are clearly not to be taken into account when calculating recurring cost figures for funds investing in equities or having equities as underlyings. Such operating costs have an impact on the market value of the relevant stocks, but are not included in the cost calculations. In order to ensure comparability of cost information to investors, the same approach should apply to funds investing in real assets. If the basis for cost calculation were different e.g. for equity and real estate funds (by including costs incurred at the level of individual assets in the latter case), this would delude prospective investors and create detriments for ELTIFs at the point of sale.

- Interest payments for debt financing of real assets: Financing costs in relation to real estate or other real assets are inherent to any economically viable investment in these asset classes. They are not specific to the management of investment funds and thus should not be taken into account in the recurring cost calculation. Debt financing of real assets serves the purpose of optimising the return on equity with a view to enhancing investors' performance. Recurring interest payments at asset level which are an intrinsic part of this investment strategy should thus not be viewed as a cost. Moreover, a meaningful cost disclosure should enable investors to determine the costs of managing a specific fund as an extra cost in comparison to direct investments in the relevant assets. If fund management costs were to be mingled together with costs inherent to direct investments e.g. in real estate, investors would not be able to make meaningful comparisons of management cost-efficiency across products. On balance, qualifying regular interest payments on asset financing as costs would undermine the economic purpose of debt financing and be detrimental to the comparability of different investment products under a cost perspective.

Q4: *Taking into account the new cost disclosure framework introduced by the PRIIPs Regulation, do you agree that the types of cost mentioned in paragraph 24 are fixed costs and that an assumption on the duration of the investment is necessary to calculate these costs in the numerator of the overall ratio mentioned in Article 25(2), provided that this overall ratio is a yearly ratio?*

Costs for setting up the ELTIF and its distribution costs are one-off costs for which the duration of the investment is necessary to calculate the corresponding costs.

Q5: *Taking into account the new cost disclosure framework introduced by the PRIIPs Regulation, do you agree that the types of costs mentioned in paragraph 27 may be considered as fixed costs in the case of an ELTIF?*

We agree that costs relating to the acquisition of the main asset of the ELTIF portfolio should be considered as one-off costs and therefore be calculated based on the duration of the investment.

Q6: *Do you agree with the views expressed in paragraph 28 on the presentation formats of the costs in the context of the ELTIF cost disclosure?*

We agree that the PRIIPs presentation format cannot be used for ELTIF, as it relies on the RIY methodology, and that the CESR's UCITS KIID template should be used as a basis instead. We also share ESMA's view that given the nature of ELTIF as a vehicle aimed primarily at professional investors, the presentation format should not be further standardised.

Q7: *Given that the RTS enter into force after the date of application of the ELTIF Regulation and authorisations have been granted between the date of application of the ELTIF Regulation and the date of application of the proposed RTS, do you see a need for specific transitional/grandfathering provisions for the proposed RTS?*

We see a need for specific transitional/grandfathering provisions for the proposed RTS in order to ensure legal certainty for ELTIF managers and investors. In general, since the understanding of cost elements and their calculation are supposed to rely to a great extent on PRIIPs standards, we believe that the entry into force of the proposed RTS should be aligned with the date of application of the revised PRIIPs standards in order to avoid unnecessary consecutive modifications of ELTIF prospectuses and confusions among (potential) ELTIF investors.

Q8: *Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards common definitions, calculation methodologies and presentation formats of costs of ELTIFs? Which other types of costs or benefits would you consider in this context?*

The proposed further clarifications with regard to the calculation of ongoing cost elements as well as transaction costs for ELTIFs would significantly enhance comparability of cost disclosures. We would expect that such clarifications would also impact cost calculations for other funds investing in real estate or other real assets and thus, have a positive effect on the general quality of cost information under PRIIPs and MiFID II. These benefits should be taken into account in the further analysis.