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8 October 2024

BVI¹ response on the consultation paper on Draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive

We would like to take this opportunity to respond to ESMA's [consultation paper](#) on Draft Regulatory Technical Standards on liquidity management tools (LMTs) of UCITS and open-ended AIFs.

It is of utmost importance that the draft RTS and ESMA guidelines meet the objective of the AIFMD review that LMTs are effective and efficient in stressed market conditions. We therefore see a need for extensive adjustments to the draft RTS in particular to take better account of existing practices in the use of LMTs (such as redemption gates), to replace the high level of detail with more principle-based rules and to better consider the processes and structures of open-ended funds that mainly invest in illiquid assets.

Suspension of subscriptions, repurchases and redemptions

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

Even though we are aware that the definition of a suspension also includes suspensions of subscriptions, ESMA should nevertheless carefully consider whether funds should be allowed to remain open unilaterally in exceptional cases despite a suspension of redemptions.

In practice, there are cases (particularly for funds with illiquid investments) in which funds have to suspend redemptions but remain open for subscriptions. The reason for this is that these funds regularly need more time to sell the illiquid assets. In the meantime, they therefore only have the option of generating additional liquidity through further subscriptions of units or shares. This would benefit all investors because dilution stemming from the potential selling of assets could be reduced or avoided. An obligation to suspend redemptions and subscriptions at the same time would therefore impair the ability to create the necessary liquidity in funds suffering from temporary liquidity problems. As the suspension of redemptions is a significant intervention for investors, practicable solutions should therefore be sought here in the interests of investors, as otherwise a formal legal interpretation of the wording of the definition with reference to the word "and" would lead to dramatic consequences. This is because these types of funds could then not only be temporarily suspended because - especially in stressed market phases (as the current difficulties in the real estate market show) - a sale of assets can last for more than a year. As a result, these fund types would regularly run into liquidation, which could be avoided if additional liquidity could be created through further subscriptions.

We therefore request that Article 1(2) of the draft RTS be amended accordingly.

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. Asset managers 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 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund 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.



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.

Yes, we agree. Still, in the case a shareholder or unitholder requests the cancellation of the non-executed part of his redemption order, this request should be subject to the consent of the manager, such consent not unreasonably withheld.

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?

In general, if an investor has passed a redemption order before the suspension of the fund, this order should be executed once the fund has reopened.

Nevertheless, in practice there may be cases in which the order is tied to a notice or holding period or other restrictions (e.g. redemption gates). Solutions would therefore have to be found to ensure that in these cases – depending on the structure of the other LMTs – the unexecuted order expires and has to be placed again by the investor (if he still wishes to redeem). It would be particularly unfortunate from the investor's point of view if existing deadlines had to start all over again. **It would therefore be very helpful to adapt Article 1(4) of the draft RTS to the effect that exceptions to the principle stated therein are also permissible if other LMTs are associated with the previously placed order.**

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

For reasons of investor protection, it could make sense to differentiate between the investment strategy (such as investing in liquid assets like UCITS or illiquid assets) when it comes to publishing the suspension. **We refer in this respect to our answer to Q1.** We would also like to point out that it might be beneficial for all investors if subscriptions were still possible during times of closure, in particular for funds invested in illiquid assets, in order to regain liquidity to satisfy suspended or upcoming redemption requests after re-opening of the fund.

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

We do not consider it necessary to specify any further aspects.

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?

In particular, the LMT 'redemption gates' is intended to prevent a redemption suspension (fund closure) in the interest of investors. Compared to fund closure, that LMT is to be regarded as a milder measure, i.e. it is used to avoid fund closures. Nevertheless, the practical implementation of redemption restrictions in particular is complex and does not depend solely on the individual risk appetite and the investment strategy of the respective funds. Redemption gates are only intended as a temporary restriction. This means that, also in distinction to the suspension of redemption, the tool can only take



effect in phases of short-term liquidity crises when the manager could be able to process the remaining open orders or new orders in full and within a short period of time. However, it must then be possible to sell the assets held by the fund swiftly at reasonably appropriate prices. This will generally not be the case with real assets. In any case, processing the remaining order (e.g. by postponing to the next trading day, as is currently laid out in the draft RTS) would be feasible for funds which mainly invest in liquid or less liquid assets, but is not expedient for real estate (RE) or private equity (PE) funds, as it is not possible to procure liquidity for real asset investments in the short term. The process of always considering the remaining order or new orders on the next trading day cannot be repeated for months which are needed to sell the real assets and thus generate additional liquidity. Otherwise, this would be a mere delay of an inevitable suspension of redemption without giving the investor an advantage by using the redemption gate. Instead, it might even extend the overall period of time during which the investor has no means to redeem his shares. We would therefore see this as a clear violation of the principle of always acting in the best interests of investors. A quarterly, half-yearly or even yearly postponement might be a feasible option for such kinds of funds.

However, in answering the question raised by ESMA, characteristics of suspension of subscriptions, repurchases and redemptions gates should be defined flexibly enough to account for at least the different asset classes.

Redemption gates

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

The practical implementation of redemption gates is particularly complex and depends not only on the individual risk tolerance and investment strategy of the respective funds. In the automated world of mass business with retail funds, the entire process handling between the management company, custodians and depositaries must be automated and the relevant steps must be coordinated. Unfortunately, however, this cannot be implemented with the two solutions proposed by ESMA for the mass market of retail funds. **We therefore strongly disagree with the proposed characteristics in paragraph 35 of the consultation paper, recitals 4 and 5 and Article 2(5) of the draft RTS that only two solutions of redemption gates should be allowed, namely (1) the non-executed parts of redemption orders shall be carried forward to the following dealing date or (2) the shareholders or unitholders have requested the cancellation of the non-executed part of their redemption orders.**

More flexibility should be allowed here, taking into account existing and established solutions from practical experience in the EU (cf. Germany, France) where the unexecuted order (not in full, but partial) expires automatically as long as this has been agreed in advance with the investors in the terms and conditions of investment. We refer to the solutions we have found for redemption gates in Germany. Together with the German banking associations representing the custody account keepers and depositaries, we have established a [guideline](#) on the practical implementation of redemption restrictions (gating) for open-ended securities funds (especially UCITS). The guidelines take into account the entire process chain – from the asset management company to the depositary and the custodians. The ‘pro rata solution with expiry of the residual order’ developed for the German market is also permitted in France (see AMF [Instruction](#), DOC-2017-05). In an intensive exchange with all parties involved, we have succeeded in setting up a pragmatic and, for the first time in the EU, automated process for the mass business of mutual funds. The solutions found here are the result of lengthy discussions and coordination that took more than two years and have now also been implemented in the IT systems of the companies involved. It would therefore be extremely unfortunate if the two most important fund markets in the EU



were no longer allowed to use well-considered and well-functioning mechanisms just because of mere formalism (which is not justified).

There are no investor protection related reasons to prevent the expiration of a residual order in the case of a redemption gate. The investor is informed in the sales documents about how residual orders that have not been executed due to the redemption gate are handled. The fact that communication with some investors is only carried out by post and not by email is not a problem specific to the expiration of the residual order in the event of a redemption restriction, but rather affects every flow of information (including, for example, the suspension of unit redemptions). Furthermore, the investor has chosen this method of communication.

The definition of redemption gates, as stipulated in the AIFMD or UCITS Directives, does not contradict this interpretation:

- The reference to only a ‘temporary’ restriction does not entail that an expiration of the residual order would be excluded. Instead, similar to the suspension of redemptions, the wording only clarifies that the LMT may not be used endlessly but only for a limited period of time.
- In particular, Article 1(2)(b) of the UCITS Directive does not militate against such an approach. A UCITS is defined as an undertaking with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets. We refer to **paragraph 12 of the Vandamme Report** ‘Towards a European market for the undertakings for collective investment in transferable securities’ (Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985). When establishing the UCITS Directive, this commentary reflects the spirit of the UCITS Directive that is still valid today. It takes the following approach to the interpretation of Article 1 of the UCITS Directive:

*’12. It is to be noted that although, in principle, UCITS of the open-ended type issue their units without restriction – according to demand, therefore – and unit-holders can withdraw at any time by requesting the repurchase of redemption of their units, **there are nevertheless cases in which the issue of units might be subject to a time-limit or restricted to certain periods or perhaps a maximum amount; similarly, although there must be provision for repurchase or redemption, it might be restricted to certain periods.** Undertakings applying such restrictions fall within the scope of the Directive.’*

The original EU legislator already assumed that the investor's request for redemption could be limited in general (and thus also in terms of amount). Any other interpretation would render the application of most of the new LMTs introduced into the UCITS Directive impossible to apply if the investor always had a right to unlimited redemption.

In addition, if gating is activated for a limited period, carrying over the residual to the next trading day and, in particular, prioritising its execution over newly received orders can conflict with the management company’s obligation of fair treatment of investors.

Example:

UCITS X has agreed with its investors that the redemption of units may be restricted if the investors’ redemption requests exceed a threshold of ten per cent of the NAV on a valuation day. The redemption restriction may last up to a total of 15 business days; however, the liquidity situation and any resulting restriction must be determined on a daily basis (in the case of redemption on



each trading day). On day 0, the NAV is 10,000. On day 0, the custodian places client orders for investment fund X in the amount of 2,000 (here: 20 per cent of the NAV). The investors' redemption requests exceed the fixed threshold of ten percent (1,000) by 1,000. After assessing the liquidity situation of the fund, the manager activates the redemption restriction in the interest of the investors and limits the orders for day 0 to 1,000. Thus, the order received on this day cannot be fulfilled beyond 1,000. The NCA and the investors are informed of this on the website. In the order processing, the placed orders for day 0 are served proportionately in the amount of 50 percent (1,000) (the same for each order). The remaining orders in the amount of 50 percent (1,000) expire. For the orders received on the following day (day 1), the manager must reassess whether the redemptions will have to be restricted again. The investor has the option to request the manager to redeem investment fund units again on the next earliest settlement day (day 1). The manager therefore decides on each trading day (in the case of a daily redemption option) whether and on the basis of which quota it restricts the redemption. The manager may restrict redemption in this way for a maximum of 15 consecutive business days.

In this context, we would like to also highlight that the proposed solutions do not work for AIFs with illiquid assets such as real estate (RE) and/or private equity (PE) funds. Redemption gates are only intended as a temporary restriction. This means that, also in distinction to the suspension of redemption, the tool can only take effect in phases of short-term liquidity crises when the manager might be able to fill the remaining open orders or new orders in full and within a short period of time. However, it must then be possible to sell the assets held by the fund swiftly at reasonably appropriate prices. This will generally not be the case with real assets. In any case, processing the remaining order (like postponing to the next trading day, as is currently laid out in the draft RTS) would be feasible for funds which mainly invest in liquid or less liquid assets, but is not expedient for RE or PE funds, as it is not possible to procure liquidity for real asset investments in the short term. The process of always considering the remaining order or new orders on the next trading day cannot be repeated for months which are needed to sell the real assets and thus generate additional liquidity. Otherwise, this would be a mere delay of an evitable suspension of redemption without giving the investor an advantage by using the redemption gate. Instead, it might even extend the overall period of time during which the investor has no means to redeem his shares. We would therefore see this as a clear violation of the principle of always acting in the best interests of investors. A quarterly, half-yearly or even yearly postponement might be a feasible option for such kinds of funds.

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

We refer to the German industry [guidance](#) on redemption restrictions according to which the threshold value is measured as a percentage of the NAV. In this context, the manager is free to determine the threshold value itself in the investment fund rules based on the liquidity profile of the fund.

However, we do not agree that the threshold should consider the net redemption orders for a given dealing day. In order to be able to decide whether the gating should be activated, the manager should assess the available liquidity in the investment fund after the order acceptance deadline. For this purpose, the manager should on the one hand assess the liquidity of the assets in the investment fund and on the other hand have knowledge of the total order volume to be able to determine a quota for the pro rata approach. To be able to calculate the quota exactly, the manager therefore needs the information on gross orders of the inflows and outflows of investment funds to determine the available liquidity.



Moreover, the net approach can be problematic since, for funds where subscriptions are managed through a queuing system with capital calls made on demand, subscription orders might already be partially or fully allocated to upcoming investments and binding commitments made by the AIF and thus, cannot be used to meet redemption requests (e.g. the case of real estate funds).

We therefore request amending Article 2(1) of the draft RTS and deleting the reference to “net” redemption orders.

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?

In principle, we welcome the proposed flexibility to either activate the gating automatically when the threshold is exceeded or to decide only after the manager's discretion. In our view, however, it should always be up to the manager to decide whether the redemption gate needs to be activated if the threshold value is exceeded based on the liquidity profile of the fund.

We do not see the danger of a first-mover advantage as the biggest obstacle to automated activation. On the contrary, in our view, an automated system is more likely to entail the risk that the gate has to be activated when the threshold is exceeded, even though there is still sufficient liquidity in the fund to meet all investors' redemption requests. The automatic mechanism proposed here could be therefore an unacceptable restriction of investor rights.

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.

We refer to our answer to Q9. The automatic mechanism proposed here could be an unacceptable restriction of investor rights.

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.

We support that the activation threshold shall not be expressed at the level of the single redemption order.

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?

We refer to our answer to Q7. When developing the characteristics of LMTs, ESMA should ensure that a large number of solutions already established on the market continue to be permitted. Therefore, the approach for redemption gates should not be defined too narrowly and the expiry of the redemption order (with partial execution of the original order) should also be permitted as a solution.

However, the practice of using a pro-rata approach with expiry of the residual order must be distinguished from the general principle that, of course, after the order acceptance deadline, no corrections may be made to the order in favour of individual investors. However, it is a completely different matter if



the manager decides to cancel the open remaining order for all orders as part of using the LMT agreed with the investors.

Moreover, we also agree that investors should have the right to cancel the non-executed part of their redemption orders (individually) as another solution. This solution is particularly suitable for funds that have a limited number of investors or where the investors are known to the manager. In the mass business of retail funds (with more than thousands of investors) such an approach, however, can no longer be mapped manually in the systems within a short time period.

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?

No, we don't see merit in having distinctions depending on the investment strategies and between AIFs and UCITS. Rather, the requirements should be flexible enough to cover all investment strategies.

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.

We agree that the same redemption gate shall apply to all share classes.

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

We refer to our answer to Q7. Please consider also the approach where the unexecuted order (not in full, but partial) expires automatically as long as this has been agreed in advance with the investors in the terms and conditions of investment.

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

First, we consider it ambiguous that the extension of notice periods shall be the period of time added to the normal notice period that shareholders or unitholders shall respect when placing their redemption order. It must be clarified that the regular 'notice period' can be zero when applying this LMT. Therefore, Article 3(1) of the draft RTS should be deleted or amended in such a way that also the one-off agreement of a long notice period is recognised as compliant with this LMT.

The 'minimum period that is appropriate for the fund', as referenced in No. 3) of the relevant Annex to the revised UCITS and AIFM Directives, can obviously range from zero to more than a year, depending on the specificities of the fund in question. There is no indication whatsoever that the revised Directives have any kind of "absolute" minimum period in mind. It would also make no sense since the effectiveness of an extension of notice period as an LMT is not correlated to any kind of "regular" notice period. In this context, the history of the definition of the extension of the notice period in the Annexes of the AIFMD Review should be considered. Originally, the Commission had proposed that a notice period refers to the period of advance notice that investors must give to fund managers when redeeming their shares. The Council then added a sentence to this: *'The use of notice periods as a liquidity management tool entails extending the period of advance notice to provide the fund manager with the possibility of addressing redemption requests within a longer time frame.'* The new sentence was only a clarification in the Council that a long notice period is sufficient to allow the fund manager to process



redemption requests within a longer time frame. The shortening of this definition that then took place in the trilogue should therefore not change this assessment.

Here, too, it might be helpful to distinguish between funds that invest in liquid assets and those that invest in rather illiquid or illiquid assets.

Therefore, the starting point should be that units/shares in an open-ended fund can in principle be redeemed daily. However, should the asset manager decide to set a longer notice period, this should then also be recognised in the draft RTS as an example of the extension of the notice period. Otherwise, it could lead to significant valuation inconsistencies in practice if open-ended funds that have already agreed long notice periods (such as twelfth months) then had to agree additional (long) notice periods on top of that. In this context, we refer to the clarification in footnote 29 of the IOSCO recommendation that a long notice period could be envisaged to protect remaining investors and reduce the risk of fire sales and first mover advantage.

Moreover, we request ESMA to delete **Article 3(4) of the draft RTS** because that approach proposed here cannot be implemented in a standardised way in the mass business of retail funds.

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.

Yes, we agree that the same extension of notice period should be applied to all investors.

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.

Yes, we agree that extensions of notice period may be applied for a pre-defined period of time. However, it should be the decision of the manager to define the period of time.

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?

We refer to our answer to Q16. We would not generally differentiate between UCITS and AIFs here, but rather according to the type of investment. Deviations could be justified for illiquid assets in particular. However, an AIF can also be structured like a UCITS in terms of its investment strategy, which is why there would then be no differences.

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?

In general, we opt to execute them under the original notice period. We must keep the ground rules of the fund otherwise it would be synonym of the fund's closing. However, the extended notice period should also apply to orders that were received prior to the activation of this LMT and have not yet been executed. We assume that the decision to extend the cancellation period is/can typically only be made after the cut-off of the fund and that these previously received orders could lead to the fund manager not being able to fulfil all orders of the day.



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

To ensure fair treatment of investors the following approach could be an example:

- The manager makes sure that all investors can benefit from the deactivation;
- The manager keeps a chronological consistency regarding the execution's orders. Once the extension of the notice period is deactivated, the first orders to be executed are those that have been the first submitted before the extension of the notice period.

Redemption fee

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

We do not fully agree with the description of redemption fees and the corresponding characteristics. In detail:

- Redemption fees should not be considered as predetermined, as in some cases managers must keep some flexibility in that regard.
- We strongly disagree with the proposed approach to also account for the implicit costs of portfolio transactions, in particular, including any estimated significant market impact of assets sales to meet those redemptions. Such an approach does not appear practicable for a predetermined fee, firstly with regard to the procurement of (external) data and the associated costs, and secondly with regard to the effect on the amount of the liquidity costs. In general, a rather generic approach should be used here without any claim to 100 per cent accuracy. This applies all the more as the fee is already predetermined when the fund is launched and can therefore no longer take into account the specific circumstances in the event of a crisis. This certainly differs from the other ADTs, which can then also additionally modify the premium via individual factors.
- Moreover, we would like to request to delete **Article 4(2) of the draft RTS** or to distinguish between funds which mainly invest in (less) liquid and illiquid assets. As IOSCO already states in its ADTs recommendations (footnote 29), there are cases where using a pro-rata approach to estimate the transaction cost is not possible: for example, for open-ended funds that allocate a significant proportion of their AUM in inherently illiquid assets, such as real estate and private equity funds. In these cases, a long notice period and/or a pre-determined discount of the NAV unit price (similar to a fixed redemption fee) to be received by redeeming investors, could be envisaged to protect remaining investors and reduce the risk of fire sales and first mover advantage. **It should therefore at least be recognized that the discount solution mentioned here by IOSCO is also recognized as a redemption fee.**
- We also disagree with Article 4(3) of the draft RTS whereafter redemption fees shall be levied in favour of the AIF or of the UCITS. We do not see any added value in this since the decision as to which LMT should be selected always lies with the manager. Therefore, we see this regulation rather as a restriction of the manager's decision-making leeway.



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

No.

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?

We refer to our answer to Q22.

Swing pricing

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

In general, we agree with the description of swing pricing and the corresponding characteristics. With one exception: The detailed approach, including the significant market impact as part of the implicit costs, is far too broad. At present, we do not have any information on the effort that such significant market impact entail in practical implementation. In any case, IOSCO's and ESMA's proposals do not appear practicable, firstly with regard to the procurement of (external) data and the associated costs, and secondly with regard to the effect on the amount of the liquidity costs. In general, a rather generic approach should be used here without any claim to 100 per cent accuracy. As one solution, it could be clarified that the market impact to be set in advance can only be estimated (instead of a precisely anticipated manner).

In Germany, for instance, we have implemented a more general approach: the swing factor takes into account the transaction costs caused by an excess of redemption or issue requests. The swing factor is determined by the management company depending on various parameters (e.g. taking into account transaction costs, bid/offer spreads, market price impact).

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

We do not see any other characteristics of swing pricing that should be taken into account.

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?

As ESMA itself states in its draft guidelines, managers should consider the selection of swing pricing for funds whose underlying assets are actively traded and information on trading costs (bid/ask) is available and frequently updated, particularly where the funds invest mainly in assets with market contingent liquidity costs. This already results in a differentiation that swing pricing (like all ADTs according to the current ESMA proposals) is not suitable for funds that invest in illiquid assets and therefore cannot estimate the transaction costs.

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.



We agree the same swing factor shall be applied to all share classes. This is current practice in Germany.

Dual Pricing

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

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

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?

In Germany, we currently do not have any practical experience with the LMT dual pricing. Due to the comparability of that tool with swing pricing, please refer to our comments on swing pricing.

Anti-dilution levy

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

In Germany, we currently have little practical experience with the LMT ADL. We see ADL as a complicated variant of swing pricing, so that the other variants of swing pricing (such as full or partial) would be preferable in practice. Due to the complexity of the procedure for ADL, it does not make sense to use only ADL, but not the other (more common) variants of swing pricing. Regarding the comparability of the two tools, please refer to our comments on swing pricing.

In particular, the detailed approach, including the significant market impact as part of the implicit costs, is far too broad. At present, we do not have any information on the effort that such significant market impact entail in practical implementation. In any case, IOSCO's and ESMA's proposals do not appear practicable, firstly with regard to the procurement of (external) data and the associated costs, and secondly with regard to the effect on the amount of the liquidity costs. In general, a rather generic approach should be used here without any claim to 100 per cent accuracy. As one solution, it could be clarified that the market impact to be set in advance can only be estimated (instead of a fully precisely anticipated manner).

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

We are not aware of any other calculation methods for anti-dilution levy that ESMA could consider.

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.

We do not see the possibility for different anti-dilution levies depending on share classes.

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?



We refer to our answer to Q27 on swing pricing which can also be applied to dual pricing.

Redemption in kind

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

We request to amend the wording “blocks of securities” in **Article 8(1) of the draft RTS**. As long as this LMT is also to be applied to open-ended AIFs, the focus here should not be unilaterally on securities, but on all assets that can be eligible by a fund.

According to Article 16(2b) subparagraph 4 AIFMD and Article 18a(2) subparagraph 4 UCITS Directive, the restrictions on redemption in kind with regard to retail investors shall only apply if the in-kind redemption is used as a mandatory LMT within the meaning of Annex V No. 8 AIFMD or Annex IIA No. 8 UCITS Directive. In practice, a large number of AIFs that also have ‘semi-professional investors’ (investors that are not considered professional but conform to certain standards of professionalism) currently use the LMT of the redemption in kind, which is a very effective LMT in these areas. We therefore request clarification that it may also be permissible in the interests of investors to continue to use this LMT as an additional LMT (in addition to the two mandatory LMTs). The AIFMD review explicitly leaves room for manoeuvre here, according to which fund management companies may voluntarily use further LMTs in addition to the two mandatory LMTs.

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

No.

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?

No, we don't see merit in having distinctions depending on the investment strategies and between AIFs and UCITS.

Side pockets

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

Yes, we agree.

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.

In general, we do not agree.

According to the **current frameworks in Europe**, the AIFMD provides for the possibility to implement side pockets so that, in principle, according to EU requirements, AIFs may use this tool. The prerequisite is that it is also authorised nationally. The UCITS Directive, on the other hand, does not explicitly



regulate this tool (until the AIFMD review comes into force). However, from the legal point of view, Article 1(5) of the UCITS Directive requires that the Member States shall prohibit UCITS which are subject to this Directive from transforming themselves into collective investment undertakings which are not covered by this Directive. This means that the separated part must still provide for the UCITS redemption conditions. Moreover, it is debatable whether non-valuable or illiquid assets may be transferred into a new UCITS shell at all as long as they do not qualify as eligible asset under the UCITS Directive.

According to an ESMA [statement](#) on side pockets (in view of the impact of the Russian invasion of Ukraine on the portfolio of the fund), side pockets in UCITS could be permissible where the liquid and illiquid assets are segregated **by way of transferring the liquid assets** to a new UCITS or to a new compartment of the initial UCITS. This means that the illiquid part would maintain under the existent UCITS (and would be part of suspension of redemption or liquidation).

This would lead to the following impact in practice: the creation of a side pocket with only liquid assets entails the not inconsiderable risk that the tax authorities will regard this as a taxable (non-cash) distribution. If it is also stipulated that the liquid part (which can be much larger than the illiquid part) must be transferred, this can have major implications from a tax perspective. In order for the investor not to be taxed on the actual substance and only enjoy the compensatory effect many years later when redeeming the units in the future, he would have to return the units of the new liquid UCITS immediately, which would run counter to the very intention that investors should continue to participate in the liquid part – with all the advantages and disadvantages of a UCITS – as before.

However, the current legal situation for UCITS has now changed to such an extent that the LMT side pockets are also expressly recognised. **Therefore, we would welcome it if in future not only the liquid assets can be transferred to another UCITS, but the manager is given the option to transfer the illiquid or the liquid assets to the side pocket.** In our view, there is a need for clarification in the draft RTS.

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.

No, we don't think of any other characteristics that should be considered by ESMA.

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?

We refer to our answer to Q40.

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.



No, we do not agree on the fact that assets in the side pocket should always be managed with the view to liquidate them.

For example, various events, for instance geopolitical events, can have for consequence the closing of stock exchanges. This resulting in the fact that some assets aren't listed for a certain period until the reopening of the stock exchange. This leads to the temporary placing of such assets in the side pocket until they can be reintegrated in the fund among normal assets.

Cost-Benefit analysis

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?

It is very difficult to determine ex-ante the future costs at the current moment. This applies to the overall costs of implementation as well as on the differentiation between costs caused by the Level 1 provisions and those caused by the clarifications by ESMA. However, these costs are expected to be significant.

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

No.

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?

We refer to our answer to Q 44.

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

No.
