Frankfurt,
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BVI[1] remarks on ESMA's Final Report on Draft Regulatory Technical Standards (RTS) on Liquidity Management Tools (LMTs) and ESMA's Final Report on Guidelines on LMTs of UCITS and open-ended AIFs

We would like to comment on the above-mentioned final reports as follows and believe that there is still considerable room for improvement from a practical and legal perspective:

I. Draft RTS on LMTs

1) Inconsistency in the use of the terms "net asset value of the fund" and "net asset value per share or unit"

Since it is particularly important for the implementation of swing pricing to know which reference value the swing factor is to be applied to, we request consistent and precise wording. According to the definition of swing pricing in Annex V No. 5 of the AIFMD and Annes IIa No 5 UCITS Directive, the net asset value (NAV) **of the units or shares** of an investment fund should be adjusted by the application of the swing factor. However, the draft RTS provided by ESMA only refers to the NAV of the investment fund, which is technically incorrect at this point. Therefore, the following wording should be amended as follows:

a) Draft RTS on LMTs of AIFs

- In recitals 14, 15 and 16, the words 'net asset value' should each be supplemented by the words '***<u>per unit or share</u>***'.
- Recital 17 sentence 4 should be amended as follows: "Subscribing investors should pay the net asset value ***<u>per unit or share</u>*** calculated using ask asset prices and redeeming investors should receive the net asset value ***<u>per unit or share</u>*** calculated using bid asset prices."
- Article 6(2) should be amended as follows: "The swing factor shall be expressed as a percentage of the net asset value ***<u>of the units or shares</u>*** of the AIF."
- Article 6(3) sentence 2 should be amended as follows: "In either case:
  (a) if the difference between the redemption orders and the subscription orders for a given dealing date results in net redemptions, the swing factor shall be deducted from the net asset value ***<u>of the units or shares</u>*** of the AIF;
  (b) if the difference between the redemption orders and the subscriptions orders for a given dealing date results in net subscriptions, the swing factor shall be added to the net asset value ***<u>of the units or shares</u>*** of the AIF."

[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 EUR 4.5 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 26%, 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.

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b) Draft RTS on LMTs of UCITS

- In recitals 13, 14 and 15, the words 'net asset value' should each be supplemented by the words '***per unit or share***'.
- Recital 16 sentence 4 should be amended as follows: "Subscribing investors should pay the net asset value ***per unit or share*** calculated using ask asset prices and redeeming investors should receive the net asset value ***per unit or share*** calculated using bid asset prices."
- Article 5(2) should be amended as follows: "The swing factor shall be expressed as a percentage of the net asset value ***of the units or shares*** of the UCITS."
- Article 5(3) sentence 2 should be amended as follows: "In either case:
  (a) if the difference between the redemption orders and the subscription orders for a given dealing date results in net redemptions, the swing factor shall be deducted from the net asset value *of the units or shares* of the UCITS;
  (b) if the difference between the redemption orders and the subscriptions orders for a given dealing date results in net subscriptions, the swing factor shall be added to the net asset value ***of the units or shares*** of the UCITS."

2) Gross and net orders – redemption gates and fees

A new sentence should be added to Article 3(3) of the Draft RTS on LMTs of AIFs and Article 2(3) of the Draft RTS on LMTs on UCITS to the effect that the decision on the payout ratio must be based on the gross issue and redemption orders of the relevant day.

- According to the Draft RTS (Article 3(3)(a) of the Draft RTS on LMTs of AIFs and Article 2(3)(a) of the Draft RTS on LMTs of UCITS), the activation threshold is expressly stipulated as the minimum payout amount and thus as available liquidity. For a management company to decide whether redemption gates must be activated, it must assess the available liquidity in the fund after the order acceptance deadline. To do this, it must firstly assess the liquidity of the fund portfolio and secondly have knowledge of the total order volume in order to be able to determine a ratio for the pro rata approach. In order to be able to calculate the ratio precisely, the management company requires regular and permanent information on uncleared gross issue and redemption orders. It is therefore essential to convert the systems to an information flow that reflects the gross orders.

Example for the need of gross redemption orders of cash inflows and outflows:

1. Calculation of the pro rata quota by the management company on the basis of the reported net orders: The fund has a single distribution partner. On a given day, its customers place buy orders amounting to 60 and redemption orders amounting to 100. In accordance with the netting principle, the sales partner only reports a redemption order amounting to 40 to the depositary/management company. The management company now determines that it can only create liquidity amounting to 20 at fund level. On the basis of the (net) order information available to it, it therefore calls the gating with a pro rata quota of 50 percent. Accordingly, it only processes the existing net redemption order in the amount of 20. 20 therefore ultimately flows out of the fund.

If the sales partner were now to settle the customer orders in its possession in accordance with the pro rata quota of 50 percent communicated to it by the management company, the result would be as follows:

- Full execution of the gross buy-orders of 60, with the result that the fund receives 60.

- Gated execution of gross redemption orders of 100 at 50 percent, resulting in an outflow from the fund of 50.

On balance (60 inflow ./. 50 outflow), the fund should therefore ultimately receive 10 on the basis of the sales partner's calculation.

This results in an irresolvable discrepancy between the management company's accounts on the one hand and those of the sales partner on the other.

2. Calculation of the pro rata quota by the management company on the basis of the reported gross redemption orders:

The gross redemption orders that are available for servicing: 20 liquidity to be created at fund level plus 60 cash inflows to the fund from the existing gross buy orders, i.e. a total of 80.

The management company compares these available 80 with the gross redemption orders received of 100, resulting in a pro rata ratio of 80 percent for the gating to be called out.

The fund thus receives 60 from buy orders and at the same time spends 80 on redemption orders. The difference of -20 corresponds to the liquidity to be made available at fund level; the result is therefore correct from the management companies' point of view.

The sales partner then settles the customer orders on the basis of the pro rata ratio of 80 percent communicated to him by the management company as follows: buy orders at 100 percent, cash inflow to the fund therefore is 60; redemption orders of 100 at 80 percent, cash outflow from the fund therefore is 80. This results in a net outflow from the fund of 20, which corresponds to the calculation of the management company.

This shows that an accurate calculation of the pro rata quota by the management company is only possible if it has the gross buy and sell orders "un-netted".

- In addition, according to recital 12 of the Draft RTS on LMTs of AIFs and recital 11 of the Draft RTS on LMTs of UCITS, redemption fees may only be based on gross redemption orders. This means that the two tools (redemption gates and fees) cannot be combined if the decision on the activation of a gate is based on netted orders.

- 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).

3) Specifications of AIFs investing in illiquid assets

The Draft RTS on LMTs for AIFs does not adequately address the specific characteristics of open-ended AIFs investing in illiquid assets and therefore requires urgent individual adjustments so that LMTs also work for these fund types.

a) Article 3(2) Draft RTS on LMTs for AIFs (redemption gates)

We request the Commission to amend the opening sentence in Article 3(2) of the Draft RTS on LMTs for AIFs as follows:

> "The activation threshold shall be based on the total net or gross redemption orders for an AIF received for a given dealing date ***<u>or a period of time</u>*** and shall be expressed in one of the following ways: […]"

ESMA's solution in referencing only on a given dealing date does not work for AIFs with illiquid assets such as real estate and/or private equity funds that regularly provide for longer holding or notice periods. Here, it is important to monitor the accumulated redemptions for a certain period of time and to align further measures accordingly. Example: the individual dealing day does not give the manager a complete picture of the extent of redemptions in the case of a 12-month notice period. If, for instance, EUR 500,000 is redeemed on a dealing day, this is not yet a problem for the AIF if it is a single event. However, if EUR 500,000 is redeemed on each dealing day during the 12 months, the AIF might definitely have a problem. Setting a specific period of time (e.g. quarterly, half-yearly or even annually) in addition to a given dealing date could be a practical option for such funds.

In the feedback statement, ESMA acknowledged that the vast majority of respondents argued that a period of time approach might be more suitable for some funds and this method provides a more comprehensive view of redemptions trend over time (cf. paragraph 39 of ESMA's final report on the draft RTS on LMTs). Nevertheless, ESMA did not take this approach into account in its final RTS. Instead, the authority left these comments completely uncommented in its feedback statement.

b) Article 5(1) Draft RTS on LMTs of AIFs (redemption fees)

We request the Commission to establish a more flexible approach of specifying the characteristics of the cost of liquidity that must be taken into account within a predetermined range of a redemption fee. Here, for example, a distinction could be made between AIFs that mainly invest in (less) liquid and illiquid assets.

ESMA's proposal taking into account the estimated explicit and implicit costs of redeeming units or shares, including any estimated significant market impact of asset sales to meet those redemptions ignores that such an approach makes no sense at all for certain open-ended funds which mainly invest in illiquid assets (such as real estate or private equity funds) since due to the special features of illiquid assets, a causation-based distribution of transaction costs caused by unit redemptions and unit issues would in principle not be possible when calculating the NAV. If an illiquid asset (such as real estate) has to be sold due to a surplus of redemptions and insufficient liquidity in the fund, then this sale is usually intended to cover the redemption requests of a certain longer period. In addition, such transactions of illiquid assets are a costly procedure that can extend over a long period of time. However, the transaction costs would actually be incurred on certain days and, in the case of a daily calculation of the net asset value, would only affect individual and not all originators of the transaction arbitrarily and disproportionately.

As IOSCO already states in its ADTs recommendations (footnote 29), there are cases were an 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 recognised that the discount solution mentioned here by IOSCO is also recognised as a redemption fee.**

Regardless, we believe that an approach of establishing detailed exceptions for each individual use case is too far-reaching. We therefore call for a principle-based approach guided by the proportionality principle and the investment/redemption strategy as well as the investor structure. In particular, it cannot be ignored that an open-ended fund with a limited number of investors who co-operate with the manager concerning intentions to subscribe and redeem units or shares of the fund must be treated differently from those where the investor structure is more comprehensive and not known down to the last link (such as funds offered to a wide range of retail investors). The same applies, for example, to funds with a restricted group of investors and a long-term investment horizon, in which an early exit has an economically disadvantageous effect on the investor and thus a sudden in-creased return demand, which the manager is confronted with, is not to be expected. However, fragmentation by fund type and asset categorisation should be avoided. Therefore, it must be the task and decision of an asset manager to examine whether there are special circumstances in the individual case that could make the possibility of certain LMTs useful. Otherwise, we need a broader range of exemptions where the use of certain LMTs can regularly have no added value for liquidity management. However, such a case-by-case exemption list and bucketing approach will lead to a very static set of rules that does not allow for flexibility in times of crisis.

4) Freedom of methods

The comprehensive freedom now granted in terms of the methods used to implement individual LMTs may lead to problems in practice (particularly in settlement processes, as custodians and depositaries cannot commit to a standard but must be prepared for all modalities). In particular, the new option in Article 2(3)(b) of the draft RTS is not practicable in settlement, especially when several order chains are linked to netting of redemption requests and subscriptions.

II. Transitional period in the guidelines on LMTs for existing funds

We request the Commission to also introduce a transition period for existing funds in the RTS in line with the ESMA guidelines.

Based on the mandate in the AIFMD review, ESMA has only provided for a transition period of twelve months for existing funds in its guidelines (cf. paragraph 4 of the final ESMA guidelines). However, this transition period will come to nothing if no corresponding provision is included in the draft RTS. Even though the RTS only describes the characteristics of the individual LMTs, it may still appear that these requirements must be applied without restriction to all funds, including existing funds (or those already using LMTs), from the date on which the RTS enters into force (16 April 2026). This would mean that these existing funds would have to adapt their already established processes or implement new processes accordingly as soon as the RTS comes into force, even though ESMA has expressly specified a transition period in its guidelines.

In our view, the error lies in the unclear legislation at Level 1, which does not provide for a corresponding transitional arrangement for the RTS. However, the EU legislators clearly intend that the mandate given to ESMA to also establish a transitional arrangement for existing funds should apply in principle.