

BVI's¹ response to the Consultation Paper “Draft regulatory technical standards under the ELTIF Regulation” published by ESMA on 31 July 2015 (ESMA/2015/1239)

BVI greatly welcomes the initiative on creating a uniform regime for European Long-Term Investment Funds (ELTIFs). We share the EU regulator's appraisal that facilitation of investments with long-term perspective should benefit both the European economy in its search for reliable sources of financing and institutional investors striving for stable returns. Despite the overall positive evaluation of the introduction of ELTIFs and the need for pooled investment vehicles which allow investments in small and medium-sized institutions as well as infrastructure projects, we have raised our concerns that the relevant legislation features a number of shortcomings which might put into question the general market acceptance of ELTIFs. This relates in particular to the portfolio composition and investment limits and the flexibility in the lifetime of funds. In addition, we would favour different regimes tailored for institutional investors on the one hand and retail investors on the other hand including more flexibility with regard to redemption rights for the latter. As ELTIF is one of the key priorities of the Capital Markets Union, the RTS should not provide for additional restrictions which could further inhibit the acceptance of the product ELTIF and the success of the CMU. In this regard, we highly appreciate ESMA's approach showing to a significant extent the interest in finding practicable solutions.

Q1: Do you agree that the abovementioned pieces of legislation and associated regulatory framework are relevant for the purpose of the present advice on Article 9(3) of the ELTIFs Regulation? Which other pieces of legislation and associated regulatory framework do you identify for that purpose?

While we appreciate ESMA's considerations regarding existing regulation on risk hedging, we generally do not believe that European Fund regulation should incorporate by reference International Accounting Standards for the following reasons:

- The standard focuses on general hedging without taking into account specific features of investment funds or even infrastructure funds. IFRS 9 or any interpretation thereof may conflict with fund accounting rules or the objectives of the ELTIF Regulation.
- The incorporation would create a dependency on the interpretation of IFRS 9 by the International Accounting Standard Board and the IFRIC. Hence, compatibility with European legislation is not ensured, since European legislation is not the main/only focus of the IASB.
- The standard is neither accessible easily nor easily understandable, therefore the ultimate consequence of its application is difficult to assess.

We generally agree with the approach in the draft RTS to define hedging arrangements and to require that these serve the purpose of mitigating risks of the ELTIF.

¹ BVI represents the interests of the German investment fund and asset management industry. Its 91 members manage assets of more than EUR 2.6 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.



Q2: Do you think that the main risks that are necessary to be covered at the level of the ELTIF are currency, inflation and interest rate risks? If no, which types of risk would the manager of an ELTIF potentially have to cover in your view?

We agree with ESMA's proposal of the draft RTS which do not aim at defining or categorizing any risks having regard to the scope of the eligible assets of the ELTIF. We generally do not see any merit in defining the risks exhaustively which the ELTIF manager may be allowed to hedge. The types of risks depend on the type of ELTIF. Furthermore, it is a challenge to ensure that all risks where a hedging need may occur would be covered. In addition, from a regulatory point of view it should be sufficient to generally define what qualifies as hedging arrangement and to restrict hedging to arrangements which serve the purpose of mitigating the ELTIF's risks (cf. answer to Q1). Formally, the ELTIF Regulation does not foresee a definition of the risks but a definition of the criteria where the derivatives serve the purpose of hedging risks.

Q3: Do you think that the approach to hedging should not limit ex ante the scope of risks that ought to be covered by the manager of the ELTIF?

Yes, we do not think scope of risks should be limited ex ante, cf. answer to Q 2.

Q4: On the contrary, do you think that the approach to hedging should be tailored to the specific case of ELTIFs, and their possible eligible investments? Do you think that in this case the risks that might have to be covered by the manager of the ELTIF should be limited to the types of risk that were mentioned in question 2?

Yes, we think the approach to hedging should be tailored to the specific case of ELTIF. We do not think, however, that it should form part of the fund rules since it might limit the ability of investment managers in specific situations to hedge risks where necessary. Rather the general approach as proposed by ESMA is sufficient and practicable: Qualification as hedging instrument and mitigation of risks should be appropriate to provide the restriction required by Level 1 while at the same time capturing all measures for hedging purposes.

Q5: Do you identify any consequences in terms of costs or scope of the eligible investments of the ELTIF if the risks that might be covered at the level of the ELTIF are limited to those that were mentioned in the impact assessment of the Commission?

Limitations on the types of risks to be covered by hedging may make it difficult for the ELTIF manager to properly hedge all risks that require hedging. This has the potential to affect attractiveness of investment in the ELTIF.

Q6: Do you agree with the proposed approach? Should you disagree, please provide reasons and propose an alternative approach and justify it.



We appreciate ESMA's understanding that the ELTIF manager may not have identified all assets in which the ELTIF will invest at the beginning of the ELTIF's life cycle. This takes into account situations where the asset manager may not have already negotiated the respective terms of the acquisition or investment for all eligible assets. It also closely relates to the general challenge for the ELTIF manager to identify at least five eligible investment assets, negotiate the investment or acquisition terms and duration for all of them in order to ensure compliance with the investment limits.

Like the proposed text in Art. 3 of the draft RTS, we believe that ESMA should clarify that the definition of the life cycle is only be relevant for the eligible investment assets as defined in Art. 10 of the ELTIF Regulation. It is only necessary to provide rules for the long-term assets to be sufficient in length. We therefore suggest amending Art. 2 as follows:

"1. For the purpose of Article 18(3) of Regulation (EU) 2015/760, the life of an ELTIF shall be considered sufficient in length to cover the life-cycle of each of the individual **eligible investment** assets **as defined in Article 10 of Regulation (EU) 2015/760** where: (...)"

Q7: Do you agree with the risks identified and the related proposed criteria? Would you suggest the introduction of any additional/alternative risks/criteria? Please provide details and explain your position.

We agree with ESMA's general statement that for the disposal of ELTIF assets, the market risk is the most relevant risk. The draft RTS, however, do not only focus on market risk since they also take into account political and legal risks. We do not think that there should be a general requirement to include a statement regarding these risks into the disposal schedule. Those risks are usually difficult to predict and hence difficult to handle. In addition, we believe that a requirement to include these risks may provide for less not more convergence between national regulators. Some regulators may be inclined to require a full list of all potential legal risks which may arise, others may only request a general statement. We hence would ask ESMA to delete the requirement to provide information on these risks (e and f).

More importantly, we think that the requirement to assess whether potential buyers are dependent on external financing is not feasible in practice or in cases it is feasible comes at a cost. A potential buyer may or may not be willing to provide the ELTIF manager with information how he intends to finance the purchase. Should the ELTIF manager be required to provide this information for the schedule, he would have to negotiate provision of such information with the potential buyer and would potentially have to give up another position in order to get this information. Furthermore, this requirement suggests that the ELTIF manager already started all negotiations with potential buyers. Depending on the respective eligible asset, this might not be the case. For example, in case there is a strong demand for the asset to be sold, the ELTIF manager may want to postpone negotiations for tactical reasons. Consequently, we would therefore suggest that ESMA also deletes the element whether potential buyers are dependent on external financing (b).

Q8: Do you agree with the proposed valuation criteria? Would you suggest the introduction of any additional/alternative criteria? Please provide details and explain your position.



We do not agree on ESMA's suggestion to discard the baseline scenario. The AIFM Regulation requires application of a fair, appropriate and transparent valuation methodology (Art. 67 para. 1 subpara. 2). In addition, it requires the AIFM to apply the designated valuation methodology across all AIFs managed by the same AIFM (Art. 69 para. 4 AIFM Regulation). If an AIFM currently uses another valuation system than the fair value measurement proposed by ESMA, he would either have to run two valuation systems in parallel (for all AIFs on the one hand and for ELTIFs on the other hand) or he would even be legally or for practical purposes obliged to apply the ELTIF valuation method to all his funds.

AIFs cover a broad range of funds and hence since implementation of AIFMD, the market has applied the AIFMD valuation rules also to assets which would qualify as eligible investment assets under the ELTIF Regulation. Any new set of rule would add unnecessary complexity to the existing rules. We therefore do not believe that the rules under AIFMD (which an ELTIF manager who also manages AIFs has to comply with) do not provide for sufficient convergence. Rather, it would be inconsistent to require different kinds of valuation for the same type of assets just because these are packaged differently.

We therefore suggest the following amendment to Article 4 of the RTS:

"(.....) (a) (.....); and

(b) for eligible investment assets as defined in Article 10 of the Regulation (EU) 2015/760, the valuation shall be based on the price that would be **reasonably** received to sell an asset in an orderly transaction between market participants at the measurement date **or any other valuation consistent with the Regulation (EU) 231/2013.**"

This would on the one hand clarify that the valuation methodology proposed by ESMA is generally considered a methodology which is in line with the AIFM Regulation but on the other hand give sufficient flexibility for the AIFM to apply the methodologies he currently uses also to the ELTIF.

Q9: 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 ELTIFs Regulation? Which other pieces of legislation and regulatory material do you consider relevant for that purpose?

We agree with ESMA's approach to use the existing work on cost disclosure for UCITS until the PRIIPs Regulation and its implementing rules enter into force. Any deviation from the existing rules on cost calculation according to the UCITS framework should be evaluated carefully in order to avoid a third set of rules for the cost disclosure which would only apply for one year.

Q10: Do you agree with the abovementioned assumptions?

We generally agree with the reference to the CESR guidelines. We also would like to emphasise that we support ESMA's understanding that the costs listed in Art. 25 para. 1 are only costs charged by the fund if they are borne by the investor (directly or indirectly). Consequently, the overall cost ratio according to Art. 25 para. 2 should only comprise all these costs and not any costs that are not charged by the fund. For instance, an up-front subscription fee which is charged directly by the distributor and is



not included in the product costs should not form part of the cost disclosure and the overall cost ratio, but be disclosed by the distributor at the point of sale. Furthermore, we agree that unlike the ongoing charges figure, the overall cost ratio as provided for in the ELTIF Regulation has to include one off costs such as entry costs charged by the fund. In this regard, we agree with ESMA that such costs could be calculated on the assumption that the investment horizon equals the life of the ELTIF.

Generally, it should be made clear as a matter of principle that double counting of cost items should be avoided. In this regard it is important to note that retrocessions are generally not debited to the fund on a separate basis, but e.g. paid out of the management fee charged by the fund manager. In this case, it should be clear that such payments should not be accounted for twice and should only be accounted for within the section “management fee” and not in addition as “distribution fee”.

Furthermore, the respective cost items in Art. 25 para. 1 have to be defined clearly. For instance, depending on the ELTIF structure, setting up the ELTIF may include costs for legal advice regarding the fund structure or costs for drafting the prospectus. Those costs could be considered as costs of setting up the ELTIF but also as administrative / professional service costs. Based on the experience with costs charges of closed-ended funds in Germany, a clear distinction may be drawn with the issuance of the marketing notification that is required for all AIFs according to the AIFMD, hence also for all closed-ended funds. All costs incurred before such issuance could be considered as costs of setting up the ELTIF, all costs following this issuance would be allocated to the other costs items.

Q11: Do you agree that the types of costs mentioned in the present paragraph are annual costs that could be expressed as a percentage of the capital?

Yes, we strongly agree. An expression in percentage terms does not require assumptions regarding the investment period or the amount invested which may significantly differ between investors. Furthermore, regarding costs relating to the acquisition of assets and administrative fees, these are not predictable in advance. We would therefore appreciate a clarification that, where actual costs are not available, the ELTIF manager may base the cost disclosure in the prospectus on reasonable estimations.

Q 12: Do you think that performance related fees would be relevant costs to be taken into account in the case of ELTIFs?

We believe that ELTIFs, like other closed-ended or open-ended funds, could charge performance related fees to investors.

Q 13: How would you include performance related fees in the overall ratio referred to in paragraph 2 of Article 25?

We believe that performance fees cannot be reasonably asserted in an ex-ante disclosure. This means that the amount of performance fees disclosed in a prospectus may be misleading, as the application and the amount of the fee will be dependent on the future return of the fund. We thus believe that such



incidental costs should be excluded from the overall ratio and rather be disclosed separately due to their incidental nature. A similar approach is currently being contemplated as a possible disclosure option under the PRIIPs Regulation.

Q14: Do you agree that the types of costs mentioned in paragraph 54 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?

We agree with respect to the costs of setting up the ELTIF. We also agree with respect to the distribution costs but only insofar as retrocession payments will not be included (cf. answer to Q10). In particular with respect to ongoing retrocession payments, these are no fixed costs but depend on the specific agreement with the distributor and may vary over time. We also agree that the overall ratio should be calculated as a yearly ratio.

Q 15: Do you agree that the types of costs mentioned in paragraph 54 may be considered as fixed costs in the case of an ELTIF?

Yes, we agree that the yearly ratio should be calculated by dividing the total value of these costs by the life of the ELTIF (in years). We assume that the reference to Article 22 in paragraph 58 in fact was intended to refer to Article 25. In this respect, we agree that there should be no detailed design of the cost presentation. We would, however, appreciate a clear distinction between the cost items listed in Art. 25 (cf. answer to Q10). Further, a statement that the detailed design should be at the discretion of the ELTIF manager would help avoiding a situation where NCAs determine further details at national level which would result in an incoherent application of the ELTIF Regulation.

Q 16: Do you agree with the proposed requirements? Would you suggest the introduction of any additional/alternative requirements? Please provide details and explain your position.

We appreciate that the specification of the facilities as suggested by ESMA would allow an ELTIF manager to set up such facilities exclusively online. We support this approach since we believe that a requirement to set up a physical facility at each member state would no longer reflect the technology developments and would increase the administrative costs for the ELTIF. Today, the access to information, payments and issue handling services can be provided without having a physical facility in each member state in which the ELTIF is marketed.

Q 17: What would you consider as appropriate specifications for the technical infrastructure of the facilities?

Cf. answer to Q16.



Q 18: In the event that the RTS enter into force after the date of application of the ELTIF Regulation and authorisations are granted between the date of application of the ELTIF Regulation and the date of application of the proposed RTS, do respondents see a need for specific transitional/grandfathering provisions for the proposed RTS?

We would only see a specific need if the delay will be significantly longer than one month. We currently have no indication that ELTIFs are to be launched by December 9, 2015.

Q19: Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the options as regards hedging? Which other costs or benefits would you consider in this context?

We agree that option 2, narrowing the range of risks the ELTIF manager would be entitled to hedge, would be costly.

Q 20: Do you agree with the assessment of costs and benefits above for the proposal on the sufficient length of the life of the ELTIF? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

[derzeit keine Antwort geplant]

Q 21: Do you agree with the assessment of costs and benefits above for the proposal on the criteria for the assessment of the market for potential buyers? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

We do not agree with ESMA's assessment. All information for which the ELTIF manager would have to rely on third party sources (such as the financing of a potential buyer) will come at a cost.

Q 22: Do you agree with the assessment of costs and benefits above for the proposal on the criteria for the valuation of the assets to be divested? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply.

We disagree with ESMA's assessment that the costs are limited. In particular for AIFMs who have implemented valuation methodologies other than the one proposed by ESMA for ELTIFs would have to either use two different valuation methodologies or be required to switch all valuation methodologies used for AIFs to the one required under the ELTIF Regulation. This will lead to additional costs for the ELTIF manager.

Q 23: 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?



[derzeit keine Antwort geplant]

Q24: Do you agree with the assessment of costs and benefits above for the proposal on the facilities available to retail investors? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs that the proposal would imply.

The crucial point of the cost evaluation is whether the ELTIF manager will be allowed to provide the facilities by technological means.