Feedback statement of
Bundesverband Alternative Investments (BAI e.V.)
on ESMA Consultation Paper
Draft regulatory technical standards on open-ended loan-originating AIFs under AIFMD (ESMA34-1985693317-1085)

I. Preliminary note

The German Alternative Investments Association (Bundesverband Alternative Investments e.V,. **BAI**) welcomes the opportunity to respond to this consultation paper. As an industry association we represent more than 300 national and international members active in the institutional alternative investments sector (i.a. infrastructure, private equity, private debt, liquid alternatives), representing the entire value chain (asset manager, funds, banks, service providers, etc.). Likewise institutional investors (insurance companies, pension funds, occupational pension schemes, etc.) are represented in our investor board so that our activities have a dedicated focus on the asset owner side and their investment topics and needs as well.

First of all, we observe among both our large number of private debt firms, but also institutional investors a growing interest in open-ended private market funds, i.a. in the context of evergreen funds. Those typically operate as open-ended investment vehicles with no fixed term, allowing investors to subscribe and exit during the fund's lifetime. Despite these characteristics, fund managers have various mechanisms to create a liquidity profile that appropriately reflects the illiquidity of the underlying assets, which is as well in line with requirements stated by investor. At the same time, investors are offered flexible exit options throughout the fund's duration without waiting for its maturity, although redemptions may be subject to certain restrictions. As a result, the liquidity of these vehicles is generally more limited than that of a traditional open-ended fund structure.

For further details please refer to our recently published **Investors' Guide to Private Markets Evergreen Funds**. BAI_Evergreen_Guide.pdf

Secondly, in practice, there are many ways in which liquidity can be structured for private credit funds. Private credit funds that offer liquidity will not generally offer full liquidity nor allow investors to exit at any time, as is usually the case with UCITS funds. Instead, they will typically offer a **limited level of liquidity that is appropriate for their strategy and investors**, taking into account the LMTs that are appropriate and available for the relevant investment strategy. We therefore ask ESMA to acknowledge this well-established practise and the specific circumstances of private market strategies which are different from full-liquid UCITS (like) strategies.

In consequence, there is no single or standard approach for private credit funds offering limited liquidity to investors, as this will be tailored to the specific characteristics of the fund, its assets and its investor base. And the ESMA RTS should reflect this more clearly. Such structures, which take multiple legal forms, operate with a view of liquidity that is pre-determined and limited in nature, as opposed to traditional conceptions of liquidity as the ability to redeem capital on demand, which is how open-ended funds operate in other markets.

Thirdly, regarding the concept of the draft RTS we would also refer to another, formal / administrative aspect.

With regard to – maybe misleading – wording in the draft RTS stakeholders and especially NCAs could interpret e.g. Article 1(4) where it says "AIFMs that intend to manage an [OE LO] AIF shall be able to demonstrate to the competent authorities […] that they have selected the appropriate [LMTs]" in a manner that there has to be a formal approval process for OE LO AIFs to be open-ended. However, we **do neither see any basis for this in the level 1 text, nor would this be practical (delay in authorisation, additional costs, etc.) or justified imposing an approval or authorisation process by NCAs for OE LO AIFs.** In any case this would undermine the structuring of new OE LO AIFs and impede the provision of finance to the real economy. From our understanding it goes without saying that compliance with the provisions outlined by ESMA in the RTS automatically qualify AIFMs to structure their LO AIFs as open-ended. Finally, regarding recent initiatives by the EU to strengthen competitiveness, onerous and prescriptive rules that even go beyond the requirements of the Level 1 text would undermine such initiatives and put European funds in an disadvantage.

II. Feedback on the consultation paper

Q1: Are there any elements other than the redemption policy, the availability of liquid assets, the performance of liquidity stress tests and ongoing monitoring that AIFMs shall take account to demonstrate that the liquidity management system of the OE LO AIFs they manage is sound? If yes, please specify.

We overall agree that these criteria are most relevant for AIFMs to demonstrate that the liquidity management system of the OE LO AIFs they manage is sound, however, we would like to stress that the RTS should acknowledge that there is some flexibility in applying these criteria, especially, that the criterion "availability of liquid assets" is not considered to be a mandatory requirement, but other tools / parameter can also be applied and are equivalent.

Overall we believe that there is too much focus on the concept of "availability of liquid assets" as this is of course one relevant aspect, however, other tools / parameter should be available, too. Other concepts are for example liquidity and / or redemption guarantees by third parties / intermediaries / sponsors as a substitute for own fund liquidity. So far we do not see that these tools / concepts are discussed or included in these RTS. But we believe that these concepts should also be included in the assessment of the appropriateness of a redemption policy.

Q2: Do you agree with the list of factors set out in Article 2 of the draft RTS to be considered by AIFMs to establish an appropriate redemption policy for an OE LO AIF? If not, please justify your position.

We do agree that this list reflects relevant aspects for a sound redemption policy so that AIFMs should refer to them, if and where applicable. AIFMs should be flexible which criteria they consider and implement. The wording in Art. 2 should reflect this and it would be helpful to stipulate "may include" instead of "shall include".

With regard to Article 2(1)(o) we would like to emphasize that valuation of loans / assets is already required and stipulated for in AIFMD and ancillary regulation so that this criterion should be deleted as these RTS should not be (mis-)understood to trigger new / additional valuations.

Q3: Are there any other factors that AIFMs shall consider to demonstrate that the redemption policy of the OE LO AIFs they manage is appropriate? If yes, please provide a list of such factors and explain why they shall be included.

See our answer to Q1.

Q4: Do you agree that AIFMs that intend to manage OE LO AIFs shall determine an appropriate proportion of liquid assets to be able to meet redemption requests? If not, please justify your positions?

As already emphasized we believe that the concept of liquid assets is one (!) important concept, however, it should be possible to make use of other concepts as laid down in our answer to Q1. We definitely see specific private credit strategies which do not require liquid assets, but nevertheless are able to provide a level of liquidity that is appropriate to their investment strategy and investors. Thus, the RTS should provide for flexibility and allow different approaches to manage liquidity in order to meet redemption requests, including lock-up periods, notice and/or settlement periods, different types of gates, redemptions in kind, etc. The RTS in consequence should allow in these cases no liquid assets.

Q5: Do you agree with the list of factors that AIFMs shall consider to establish the appropriate amount of liquid assets? If not, please justify your position. Shall AIFMs consider other factors, and if yes what are these factors?

Yes.

Q6: Do you agree that cash flow generated by the loans granted by OE LO AIFs shall be considered as liquid assets? If not, please justify your position.

Yes.

Q7: Do you agree that AIFMs may consider other assets as liquid if they can demonstrate that these assets can be liquidated within the notice period, to meet redemption requests, without significantly diluting their value? If not, please justify your positions.

Yes, we agree. However, depending on the strategy a dilution of value may occur and this might even be in the interest of the investors so ESMA should not prohibit / restrict such sales in general. This should be in the discretion of the AIFM.

Q8: Are there any other types of assets that could be considered as liquid for the purpose of the availability of liquid assets? If yes, please give examples and explain why they could be considered as liquid for the purpose of the availability of liquid assets. Conversely, are there any other types of assets that shall not be considered as liquid? If yes, please specify.

We strongly advocate for a high degree of flexibility also regarding this aspect and thus, there should not be an – exhaustive – list of liquid assets in this RTS. Instead AIFMs should have the flexibility to determine the liquidity of the assets they manage and how these are used within their liquidity management framework.

Q9: In your practical experience, how do AIFMs that manage OE LO AIFs determine the level of liquid assets to be held by the fund to meet redemption requests? In particular, how do they calibrate the

amount of liquid assets with respect to the maturity of the loans granted and the number of loans in the portfolio?

Relevant criteria are: the underlying assets within the portfolio, the income generated by the portfolio, its investment strategy, the liquidity needs of its investors, the results of stress testing over time, and the role of any financing arrangements, as well as the calibration of other LMTs such as those listed in Article 2 and the other concepts / parameter we have stated above.

Q10: Do you believe there should be a regulatory minimum amount of liquid assets to be held by an OE LO AIFs and, if yes, please specify it? Should this minimum apply across all types of OE LO AIFs, or should it differ among OE LO AIFs and, if yes, how?

No. See answers above. The concept of liquid assets is only one (!) concept and there are other equivalent concepts which do not require liquid assets.

Q11: Do you agree with the draft provisions on liquidity stress testing set out in Article 4 of the draft RTS? If not, please justify your positions.

In general, yes.

Q12: What other parameters, if any, AIFMs managing OE LO AIFs shall take into account when performing liquidity stress tests?

As already stated, it should be stated that AIFMs are responsible for undertaking liquidity stress tests at their own discretion. Therefore, the RTS should not further prescribe more parameters on how to conduct these liquidity stress tests.

Q13: What could be the criteria that would justify a frequency of liquidity stress tests higher or lower than on a quarterly basis?

Following our answer to Q12, the RTS should not further prescribe parameters that would potentially determine the frequency by which stress tests should take place.

Q14: Do you agree with ESMA's proposal on ongoing monitoring set out in Article 5 of the draft RTS? If not, please justify your position.

Yes.

Q15: What are the parameters that AIFMs managing OE LO AIFs shall monitor to ensure that the AIF has a sufficient level of liquid assets to meet redemption requests?

Following our answers above we have to affirm that we do not believe that the availability of liquid assets should be elevated above other elements when it comes to the ongoing monitoring of liquidity arrangements and whether these remain appropriate.

Q16: How do AIFMs that manage OE LO AIFs monitor the liquidity of the loans originated by the AIFs?

While many of the privately originated loans will be largely illiquid with little expectation of a (significant) secondary market for such loans, AIFMs managing OE LO AIFs have specific and detailed internal policies to monitor the liquidity of their portfolios, including the cash flows generated by these through repayments and amortisations. The liquidity of the portfolio is also assessed in relation to the LMTs available to the AIFM and the investor base.

Q17: If you are managing an open-ended loan-originating AIFs, please indicate: a) the size of these funds, specifying the smallest size as well as the average size; b) the number of loans originated by these funds, specifying the smallest number as well as the average number of loans; c) the loan-origination strategy you implement (direct lending, mezzanine, distressed debt, venture debt, diversification strategy etc); d) the policy of the fund regarding the management of non-performing loans; e) the shortest, highest and average redemption frequency and, if any the notice period; f) among the loans you granted, please indicate (as a % of the number of loans granted, and as a % of the total amounts of the loans): i. the share of shareholders' loans; ii. the share of non-performing loans; iii. the share of loans whose maturity has been extended.

n.a.

Q18: If you are managing an open-ended loan-originating AIFs, have you already sold loans to meet redemptions requests? What were the main characteristics of the secondary market you used to sell them (i.e.: types of counterparties, time required to achieve the sales process, liquidity, overall cost of transaction etc)?

n.a.

Q19: If you are managing OE LO AIFs, what are the types of loans originated, how frequently do you value them and what is their level of liquidity?

Q20: If you are managing OE LO AIFs, what are the liquidity management tools you are using to comply with the obligations set out in Article 16 (1) and (2) of the AIFMD? Are you also using liquidity management tools other than those listed in Annex V of AIFMD, and if yes, what are these tools?

n.a.

Q21. 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 RTS on open-ended loan originating AIFs? Which other types of costs or benefits would you consider in that context?

n.a.

Q22. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the AIFMD?

n.a.

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<u>Contact:</u>

Bundesverband Alternative Investments e.V. (BAI)

Frank Dornseifer, attorney-at-law
- Managing Director -

Poppelsdorfer Allee 106
53115 Bonn
Tel.: +49 (0)228-96987-50
dornseifer@bvai.de
www.bvai.de

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BAI-members are recruited from all areas of the Alternative Investments' industry, e.g. asset managers, alternative investment funds, banks as well as service providers. At present, BAI counts more than 300 national and international member companies and is growing continuously.