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France Invest's contribution to ESMA's consultation on draft RTS on Liquidity Management Tools under the AIFMD and UCITS Directive

France Invest would like to thank ESMA for the opportunity to contribute to its consultation on draft RTS on Liquidity Management Tools under the AIFMD and UCITS Directive.

In order to make long-term and active investments into unlisted businesses that require time to grow and evolve, VC/PE funds typically structure themselves as closed-ended AIFs with no redemption rights, which favours illiquid and large commitments from investors. Traditionally, these funds are aimed at investors that are either institutional (pension funds, insurers, banks, sovereign wealth funds, fund-of-funds…) or experienced (family offices, entrepreneurs…). Furthermore, most sales of VC/PE funds to retail investors are intermediated and/or in the form of packaged products, such as life insurance contracts through which insurance companies may provide some degree of liquidity to final clients.

This being said, the attractiveness of the VC/PE asset class and the desire from some investors to commit capital into start-ups and scale-ups are driving an increasing number of VC/PE managers to offer products that are more widely available to retail clients, e.g. ELTIFs. As retail clients generally require greater liquidity than institutional investors, open ended VC/PE funds (so called "evergreen funds" or "semi liquid funds") are becoming increasingly popular among retail clients, as well as insurers, due to their long-term nature and flexibility.

Unlike traditional VC/PE funds, evergreen funds do not have a fixed lifespan. They continuously raise and invest capital, providing ongoing opportunities for investors to enter and exit the fund, thus offering greater liquidity at the fund level, compared to closed-end funds. At the same time, they are designed for long-term investments, well-suited to long-term projects such as projects in renewable energy, infrastructure, and other sustainable sectors, aligning with the interests of investors looking for sustained growth over an indefinite period. Their purpose is to offer investors the potential for higher returns associated with private equity while providing a degree of liquidity not typically available in traditional private equity funds. For the fund manager to be able to maintain a long-term investment horizon without being forced to sell assets prematurely, these funds usually have restrictions on how much capital investors can withdraw at any given time. With their hybrid approach, semi-liquid structures offer access to the private equity asset class to a new range of clients with a different liquidity profile, with positive impact on the overall diversification of portfolios.

We warmly welcome the improvements to the AIFM regime introduced through the recent revision of the AIFM Directive, as they will offer an opportunity for our members to make greater use the EU passport and offer their products more widely to EU investors. In this context, it is of utmost importance that appropriate liquidity management tools are available to AIFMs and the RTS on Liquidity Management Tools under the AIFMD carefully designed.

<u>General comments</u>

- As our members are AIFMs which predominantly manage AIFs, **we do not have a broad view on the management of UCITS**. Therefore, our comments focus on draft RTS on Liquidity Management Tools under the AIFMD

- This being said, LMTs should be selected and designed depending in particular on the asset class, the investment strategy of the fund and the type of its investors, professional or not. For instance, protection issues are different for professional investors, which may contractually agree to specific liquidity arrangements when they invest in a fund.

- We would like to highlight the binary nature of the current definitions for open-ended and closed-ended funds, which fail to account for the concept of "semi-open" or "semi-closed" funds. For example, some funds, like UCITS, are highly liquid and allow investors to exit at any time, while, on the other hand, others are fully closed-ended, offering no exit opportunities at all until the fund's end of life. However, some other funds are essentially closed-ended even though they provide limited liquidity opportunities initially agreed upon with investors. These funds should not be subject to the same liquidity requirements as UCITS. Therefore, **it is important to differentiate between fully liquid funds and those offering limited exit opportunities**, **which should have greater flexibility regarding the tools used to manage liquidity risk**.

- ELTIFs are a specific type of AIFs and, as such, **evergreen ELTIFs should comply with the provisions of the AIFM regime**. Recital 31 of the ELTIF Regulation notes that "*where the rules or instruments of incorporation of an ELTIF provide for the possibility of redemptions during the life of that ELTIF, the provisions on liquidity risk management and liquidity management tools set out in Directive 2011/61/EU apply*"**.** As a consequence, a **smooth articulation** between the two frameworks should be ensured.

- As the market for open ended AIFs develops, our members are gaining experience on the use of a variety of liquidity management tools (LMTs). However, **at this stage, we might not have a full and precise view on each and every tool listed in annex V of the AIFMD**. Currently, **we observe that suspensions of subscriptions, repurchases and redemptions as well as redemption gates and side pockets (on an ad hoc basis) are among the tools most frequently used by our members which manage semi liquid funds**. Some of our members may apply redemption fees. Adjustments to entry/exit prices seem rather difficult to put in place as far as VC/PE funds are concerned. As for swing or dual pricing, they do not appear appropriate to our asset class.

- Considering that suspensions of subscriptions, repurchases and redemptions and side pockets can only be used as complementary LMTs and that redemptions in kind are not applicable to all types of investors, in practice, **VC/PE managers are essentially left with a choice of LMTs between gates and extensions of notice period**. In other words, it will be difficult for them to work out an adequate combination of LMTs depending on the typology of investors, the asset class and investment strategy, etc.

- Therefore, it is of utmost importance that that **the implementation of tools as described in annex V of the AIFMD does not prevent the application of other additional liquidity management tools designed on a contractual basis** as set out in the documentation of the fund. Indeed, some investors may be willing to agree to specific contractual arrangements regarding liquidity. In other words, both types of tools (legal and contractual) should be available to AIFMs.

Detailed comments

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.

No. The suspension of subscriptions, repurchases and redemptions is a popular tool among our members which manage open ended AIFs. This being said, we observe that, currently, in France, **the suspension of subscriptions may not take place at the same time as the suspension of repurchases and redemptions**, in some cases, for example to allow new capital inflows while preventing forced asset sales during periods of market stress. Subscriptions and redemptions are two distinct mechanisms. While the suspension of redemptions is a liquidity management tool, the suspension of subscriptions can be used in certain situations, which are not necessarily liquidity crises, such as difficulties in valuing the assets of the fund or when the fund has reached its maximum size

More importantly, we would like to clarify that **the implementation of the suspensions as described in annex V of the AIFMD does not prevent the application of other liquidity management tools such as suspensions designed on a contractual basis** as set out in the documentation of the fund. In other words, both types of suspensions (legal and contractual) should be available to AIFMs.

Last, we would appreciate clarification on who should be informed about the future plan for the fund and how.

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.

We believe that **investors should not have the right to cancel the non-executed part of their redemption orders**, as this would increase the liquidity risk. To the least, **AIFMs should be allowed to decline investors' cancellation requests**.

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?

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

As explained in our response to Q1, reopening subscriptions before redemptions can serve as a transitional step toward fully reopening the fund, allowing new capital in the fund.

Subscriptions and redemptions are two distinct mechanisms. While the suspension of redemptions is a liquidity management tool, the suspension of subscriptions can be used in certain situations such as difficulties in valuing the assets of the fund or when the fund has reached its maximum size.

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

As explained previously, subscriptions and redemptions are two distinct mechanisms.

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?

Yes.

AIFMs should benefit from flexibility regarding the proposed characteristics depending on the nature of the underlying assets and the investor base, and should be allowed to consider alternative characteristics, provided they are well documented in the funds' legal documents.

The level of knowledge of investors should be a relevant factor from this perspective. Some types of semi-liquid AIFs behave fundamentally differently than UCITS – and it is important that their specificities are acknowledged by the RTS.

Redemption gate

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

We welcome the clarification by ESMA that "permanent" gates (i.e. suspension of redemptions on a pre-determined NAV threshold for a dealing date) are possible. In other words, we welcome the recognition that "temporary" in the context of the definition of redemption gates only refers to the activation of the gate, not the fact that there might be a permanent mechanism to restrict redemptions above a certain NAV threshold.

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.

Redemption gates are widely used by our members which manage open ended AIFs.

In our opinion, **the redemption gate threshold should be expressed as a percentage of the NAV of the fund considering the redemption orders - not the net redemption orders - for a given dealing day**. Indeed, some subscription orders may have already been allocated to upcoming investments. In such case, it will not be possible to use them to meet 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?

We agree that redemption gates should be either activated automatically or by the fund manager when activation thresholds are exceeded. However, it is important to preserve flexibility by not being fully constrained to activate automatically the redemption gate once the threshold is exceeded. The activation should remain in the hand and at the discretion of the fund manager.

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.

No – the automatic activation of redemption gates should be kept as an option for all types of funds.

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.

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 believe that **investors should not have an absolute right to cancel the non-executed part of their redemption orders**, as this would increase the liquidity risk. To the least, **AIFMs should be allowed to decline investors' cancellation requests**.

ESMA should differentiate between UCITS and AIFs on this matter. AIFs should be able to include terms in their offering documents that do not permit the cancellation of a non-executed order where a redemption gate has been activated.

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?

Yes. Please see our response to Q12.

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.

No, **we do not agree the same redemption gate shall apply to all share classes**.

Some share classes may be marketed in different countries, through different channels, to investors with different redemption requirements. Therefore, maximum flexibility should be maintained with regards the liquidity of a fund's various fund unit/share classes. It should be noted that **equal treatment of investors is assessed at the level of each unit or share class**, and that appropriate transparency vis-à-vis investors must of course be applied.

For instance, professional investors might agree to stricter liquidity terms when investing in a fund, as their larger investments require more time for the manager to accommodate their redemption requests.
Q15. Can you think of any further characteristics of redemption gates?

Extension of notice period

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

It should be possible to apply different extensions of notice periods to different share classes to cater for the specificities of investors in each share class (e.g. professional vs. non professional).

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. It should be possible to apply different extensions of notice periods to different share classes to cater for the specificities of investors in each share class (e.g. professional vs. non professional).

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.

Depending on the nature of the fund, its underlying assets, and the circumstances, AIFMs should have the flexibility to choose whether they apply extensions of notice period for a pre-defined period of time or for an indefinite period as the time required to return to normal operations cannot be always anticipated.

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?

Yes.

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?

We suggest leaving such decision **at the manager's discretion.** The AIFM should be able to choose whether or not the extended notice period applies to redemption orders that have been placed but not executed before the notice period is extended.

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

Redemption fees

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

Redemption fees are ill suited to semi-liquid, private market fund strategies. For example, it would be practically difficult for illiquid funds to come up with a predetermined range, as it would be challenging to estimate the cost of liquidity in stressed market conditions for illiquid investments and the range may vary widely depending on asset type. Q23.Can you think of any other redemption fee mechanism than the ones described above? If yes, please provide examples.

As of now, few of our members apply redemption fees as a tool to manage the liquidity of the open-ended funds they manage.

We propose introducing the possibility to design **a redemption fee mechanism based on the period of time over which the investor actually held the shares** as compared to the recommended holding period of the fund. This would be particularly suited to VC/PE funds which are invested in long term assets and need visibility on subscriptions and redemptions.

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?

Yes. It is important to leave more flexibility for semi liquid AIFs.

Swing pricing

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

This LMT is not suited to semi-liquid, private market fund strategies. Because semi-liquid funds hold, mostly, illiquid investments, it is not possible to get a pre-determined mechanism to adjust value of units based on liquidity. In some cases, the assets cannot be disposed.

Today, few of our members use swing pricing to manage the liquidity of their evergreen funds.

At the end of 2022, the AMF updated its doctrine on liquidity management tools, and in particular set out the framework and general rules for defining a calculation methodology for swing pricing mechanisms for VC/PE funds. France Invest set up a working group to consider the practicalities of implementing such a mechanism, taking into account the specific features of our asset class. The key conclusion of the working group is that **swing pricing is ill suited to our asset class,** mainly because of the lack of visibility on the actual costs attached to the reconstitution of the fund's pocket of liquid assets.

- In our sector, given the time required to carry out transactions, the transaction costs associated with a reorganization of the fund's portfolio implied by the subscription and redemption orders will generally be known <u>after</u> these orders have been carried out. Swing pricing in VC/PE could therefore only take into account an <u>estimate</u> of these costs, and not the actual costs.
- Also, in our sector, transaction costs can vary significantly from one transaction to another, depending on the size of the line to be sold and the complexity of the transaction.
- Additionally, the fund may have to sell a line in its portfolio which is larger than the actual amount needed to reconstitute its cash position, which will entail additional transaction costs attached to the reinvestment of the surplus.
- Finally, it should be kept in mind that the urgent sale of a line may have potential impacts on its valuation.

As a result, **it should be possible to assess the transaction costs associated with a reorganization of the fund's portfolio on a flat rate basis**, for example over the three preceding years.

More generally, **we call ESMA to give sufficient flexibility to managers to choose LMTs that are most appropriate to their liquidity characteristics**.

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

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?

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.

<u>Dual pricing</u>

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

In our view, when a fund has multiple share classes which reflect different cost structures, **it should be allowed to use multiple factors** i.e. one for each share class.

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?

<u>Anti-dilution levy</u>

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

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

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.

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?

Redemption in kind

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

First of all, we would like to highlight that redemptions in kind are considered here as a liquidity management tool to be used only in the context of liquidity management, and not in the context of normal operating conditions. If our members are well aware of the advantages of this tool, including for investors - in terms of transaction costs, preservation of the value of the assets, alignment with their strategy, transparency on the underlying assets, etc. - **practical considerations seem to hinder its implementation**.

In particular:

- redemptions in kind may avoid the additional costs implied by holding a share of a fund (i.e. the functioning of a fund, including the involvement a depositary) as compared to the costs of directly holding a share of a startup or unlisted company;
- redemptions in kind allow an alignment with the investors' strategy, especially in the VC sector whereby companies need time to develop.

Redemptions in kind are one of the LMTs that managers can choose from the list of tools set out in annex V of the Directive. However, **such redemptions should not prohibit the use of redemptions in kind as defined on a contractual basis in the fund documentation as part of the redemption policy of the fund**.

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

We would suggest that Article 8 is amended to explicitly confirm that redemption in kind can be selected as one of the two minimum required LMTs for funds that are marketed to both professional and retail investors, where it is considered appropriate to do so by the fund manager (e.g. because its liquidity management strategy overall is suitable taking into account its investor base as a whole).

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?

Side pockets

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

It should be possible to use new funds or sub-funds. Article 9 of the draft RTS should include **sub-funds** alongside share classes and funds […] (cf. p. 44 of the CP).

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.

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.

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?

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.

We are not supportive of the proposal that assets in the side pocket should always be managed with the view to liquidate them.

For example, there are cases, such as geopolitical events, which may trigger an unexpected and temporary closure of stock exchanges. This would result in some assets not being listed until the reopening of the stock exchange. This would lead to the temporary placing of these assets into a side pocket until they can be reintegrated into the fund among the unimpacted assets.

Others

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?

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

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?

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

Contact

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About France Invest

Established nearly 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts roughly 440 management firms and 200 associate members.

Private equity supports unlisted companies for a fixed period of time and provides them with the equity capital, through the acquisition of minority or majority stakes in their capital, needed to finance growth and transformation projects. It supports the creation of start-ups (venture capital), participates in the growth and transformation of many regional SMEs and mid-caps (growth capital) and contributes to the transfer of companies (replacement capital).

France Invest's members represent one of the main growth drivers for the French and European economy and support a significant portion of employment in France and Europe. In 2023, French private equity and infrastructure players invested €31 billion in 2,700 companies and infrastructure projects. They raised €33 billion from investors, half of which abroad (just under one third at EU level excluding France), which will be invested over the next 5 years[1]. In addition to that, in 2023, private debt players (structures financing companies and infrastructure projects) invested €14 billion in 387 transactions and raised €10 billion that will finance new transactions in the coming years[2]. European companies, in particular start-ups and SMEs, are the main recipients of our members' investments. Over the 2017- 2022 period, over 330 000 jobs were created in companies backed by French venture capital and private equity[3].

In particular, during the pandemic, the venture capital and private equity industry has demonstrated its adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

[1] https://www.franceinvest.eu/activite-du-capital-investissement-francais-en-2023/
[2] https://www.franceinvest.eu/activite-des-fonds-de-dette-privee-en-france-en-2023/
[3] https://www.franceinvest.eu/croissance-et-creation-demplois/