

RESPONSE TO CONSULTATIONS

ESMA

**Draft Regulatory Technical Standards on Liquidity Management
Tools**

under the AIFMD and UCITS Directive



association of the
luxembourg fund industry

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

The proposed Regulatory Technical Standards ('RTS') introduce the characteristic of concomitance between subscriptions and redemptions. The proposed RTS stipulate that:

"The suspension shall apply simultaneously to, subscriptions, repurchases and redemptions [...]

The fund is reopened simultaneously for subscriptions, redemptions and repurchases"

in Paragraph 26 of Section 2.2. This requirement is also explicitly laid down in the recital (Paragraph 2) and in Article 1(1) of the proposed RTS.

This characteristic imposes a symmetry on the Liquidity Management Tool ('LMT') which does not echo to the asymmetric nature of financial markets' liquidity. This additional constrain creates a discrepancy between the funds' liquidity (coerced to be symmetrical) and the underlying assets' liquidity (empirically and economically asymmetrical). As a consequence, the first tool of the Annex V of the AIFM Directive and of the Annex IIA of the UCITS Directive as amended by the Directive (EU) 2024/927, would have a very limited scope and ability to address liquidity challenges and protect investors' best interest under varying 'exceptional circumstances'.

The relevance of allowing for non-simultaneous application of suspension of subscription and redemption is stemming from two main factors:

- Firstly, the liquidity of the underlying assets to be bought and sold to process subscriptions and redemptions is itself asymmetric. Industry first-hand experience and academic evidence highlight that price impact after purchases and sales displays asymmetry (Chan and Lakonishok, 1995) and that this asymmetry depends on the prevailing market conditions (Chiyachantana, Jain, Jiang and Wood, 2004) and the size of the underlying market. Similarly, the COVID pandemic stress was characterized by distinct periods when market agents could not sell, market agents could sell but not buy and market agents could neither buy nor sell.
- Secondly, non-simultaneous application of suspension of subscription and redemption can help to improve the fund's liquidity in presence of investors with heterogeneous behavior. In this context, for example, allowing for subscriptions while suspending redemptions could result in significantly shorter and less impactful redemptions suspension than if the application would have been simultaneous.

Furthermore, although managers can use any other appropriate tools than the ones included in the list, this formal definition of 'suspension' per the RTS could result in the unintended incentive for managers not to rely on the non-simultaneous forms of suspension, such as soft closes mentioned in Paragraph 16 of Section 2.2., even though it would be the best tools to protect investors under specific circumstances.

Accordingly, ALFI recommends to adapt Article 1(1) by allowing subscription and redemption to be managed and suspended independently. These should be allowed to function

independently and still qualify as per the tool in the Annexes of the AIFMD and UCITS Directives.

Finally, the industry agrees that where fund managers accept subscriptions during a suspension of repurchase and redemptions this should be done in a way that maintains fair treatment of both new and existing investors, typically by providing transparency to investors on the matter. The current draft RTS text would restrict investor choice and mean that investors who may wish, for various reasons, to nevertheless subscribe to a fund that has suspended redemptions could not do so with appropriate disclosure.

Chan, L. K., & Lakonishok, J. (1995). The behavior of stock prices around institutional trades. *The Journal of Finance*, 50(4), 1147-1174.

Chiyachantana, C. N., Jain, P. K., Jiang, C., & Wood, R. A. (2004). International evidence on institutional trading behavior and price impact. *The Journal of Finance*, 59(2), 869-898.

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.

The RTS mention the possibility not to execute orders that have been placed. The industry focus is on how to treat fairly these non-executed orders. The RTS remain silent on this operational aspect. In this respect, a critical tool lies in the possibility to 'cancel orders'. In some cases, the manager offers the possibility for investors to cancel orders that cannot be executed. In other cases, managers systematically cancel orders that cannot be executed. Against this background, the RTS should cater for these different cancelling orders scenarios. While the possibilities to adopt different scheme should be maintained, the transparency on this process should be brought to investors in appropriate ex-ante disclosures.

Accordingly, ALFI recommends to consider the possibility to cancel orders and allow for different cancellation schemes in line with appropriate investors disclosures.

As a side note, it is also relevant to remind that other LMTs, such as settlement deferral, are available to facilitate the processing of placed but not executed orders. This highlights the importance of relying on the full range of tools and the flexibility it provides to adapt to different operational contingences.

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?

Question 2 illustrates possible approaches (order cancellation, settlement deferral, etc). Some other methods such as non-executing orders taking priority over subsequent orders exist. Yet, the prevailing principle remains the fair treatment of investors and the mitigation of situation where certain investors could take advantage over others. Preserving this principle can take different forms depending on the operational set-ups and market circumstances. The appropriate course of actions and method depends on these factors and needs to be assessed by the manager.

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

Yes, there are circumstances where investors' best interest and underlying assets liquidity call for subscription and redemption to be managed independently. Question 1 details those situations that relate to:

- the asymmetric liquidity of the underlying assets for purchases and sales (price impact, quantities, etc); and
- the improvement of fund level liquidity with heterogenous investors preference.

In order suspension to be an effective tool under a broader set of market conditions and to promote the wide use of LMTs specifications by managers, it is pivotal for redemption and subscription suspensions to be allowed to function independently and to still qualify as per the tool in the Annexes of the AIFMD and UCITS Directives.

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

Other characteristics are raised in Question 1 and Question 2 and notably refer to:

- the management of subscription and redemption independently when it comes to suspension; and
- the possibility to cancel orders that are not executed according to a scheme disclosed to investors.

Another secondary and operational comment relates to the practice of switching and transferring orders (from one fund to another). This specific transaction is not mentioned in the draft RTS and has operational implication when interacting with the activation of LMTs.

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?

The characteristics are believed to be similar. Nevertheless, it is relevant to bear in mind that the application of the suspensions would sensibly differ due to the economic and operational divergences (NAV frequency as an illustration) between AIFs and UCITS.

Please note that the question is mixing two LMTs: suspension and gate. It is believed that this is unintentional as the question belongs to the suspension section while gating is in the next section. The current answer was drafted under the assumption that the question focuses on suspension.

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

While most of the described characteristics are in line with the industry understanding and practices, one feature relating to the threshold severely impedes the redemption gate

capability to manage liquidity, adapt to market circumstances and protect investors. While an exceedance of the threshold prompts a discretionary choice of the manager on whether to activate gating or not, redemption levels below the threshold does not offer this flexibility and strictly prevent the manager from activating redemption gates.

Redemption gates are particularly relevant for funds *“whose assets might become less liquid during stressed market conditions and/or that might take longer time to sell”* – (ESMA34-1985693317-1097)

Hitherto unknown scenarios of stress, could result in situation where proceeding orders below the threshold would still worsen the liquidity issues of the fund. In the past, severe episodes of evaporating liquidity, systematic or market specific, have resulted into temporary yet non-negligible liquidity costs for unanticipated transaction levels. Accordingly, material transaction costs may materialize even for modest level of redemption (in percentage term) below the threshold:

- under specific market conditions; and
- for large funds (in term of asset under management in monetary term).

Under such conditions, the current description of redemption gates in the RTS would not allow to protect remaining investors.

This shortcoming is further aggravated by the fact that the threshold is agnostic to the size of the fund. An interaction effect can materialize when liquidity is evaporating in the underlying assets' market and that the absolute size of the fund is material. Although, the redemption expressed in percentage of the net asset value ('NAV') may appear modest, it could still lead to encounter liquidity constraints and costs. From an asset perspective, the quantity to be absorbed by the market is in monetary unit term and not in percentage term. For example, certain large fixed-income funds focusing on particular segments of the market could illustrate this situation.

Against this background, ALFI recommends to allow for redemption gating below the threshold when the market conditions and the absolute transaction size make it an imperative in order to protect remaining investors. A binding threshold would weaken the ability of the LMT to adapt to fast changing market conditions and extreme market circumstances. An adaptative threshold framework with:

- an indicative threshold;
- appropriate disclosure on the fact that gating can take place for redemptions below the threshold under severe conditions; and
- specific governance for activation below the indicative threshold;

rather than a binding threshold would allow to reach the two prime objectives: investor disclosure and protection. In addition, such approach would be consistent with the framework relying on adaptative thresholds proposed for other LMTs such as for swing pricing.

In addition to the primary threshold related recommendation, some operational considerations are given to the relevant notions of priority (Paragraph 6 of Article 2) and the level of redemption gate applied to all shareholders (Paragraph 4 of Article 2). Regarding the priority process, this is a relevant operational topic and the accompanying text of the consultation provides more details, notably Paragraph 36 Section 2.2.3, than the draft RTS. ALFI recommends to reflect this level of details in the RTS. Regarding the level of redemption gate applied to all shareholders, while the

notion of equal treatment of investors is embraced, the industry discussions triggered by this consultation highlighted a long lasting and significant operational challenge in gating part only of a given redemption. For one very large redemption, in case of concentrated ownership, executing part only of a given redemption could be operationalized and effective in relieving the liquidity pressure. But in case of numerous and atomized redemptions, the activation of partial gating to all redemptions causes a substantial operational challenges, risks and costs in a non-Paretian manner. Indeed, the application of partial redemption to all redemptions across the board and without distinction would result in a costly process being applied even for negligible redemptions without any liquidity impact onto the fund profile. This consideration is further emphasized by distribution models aiming at providing an access to capital market for retail investors in Europe. Consequently, ALFI recommends to introduce a notion of proportionality to this requirement to acknowledge for the operational realities and cost-benefit trade-off.

Semi-liquid funds additional considerations

[In addition, flexibility in redemption restrictions is uniquely important for semi-liquid investment strategies compared to UCITs, and redemption gates (or other forms of redemption restrictions, as described below) are the most frequently employed LMT among AIFMs employing a semi-liquid investment strategy.

It is advocated that a "redemption programme" which is a type of redemption gate (i.e. a mechanism, which is a permanent feature of the fund, like any redemption gate, to restrict redemptions above a certain NAV threshold in a particular dealing period) is explicitly acknowledged in Article 2 of the RTS as an effective LMT. This is a key feature of semi-liquid private market funds and a very useful tool to enable them to manage liquidity.

To avoid any confusion, we suggest for ESMA to clarify that "temporary" in this context means only the activation of the gate, not the fact that there might be permanent mechanism to restrict redemptions above a certain NAV threshold. We would suggest that activation of such a liquidity management tool be permitted as a permanent fixture of a repurchase program, for which the determination on application of limitations, or changes in the repurchase limitations or programme as a whole may be "activated" in the discretion of the AIFM or appropriate management entity of the fund.

Further, where investors are able to redeem their shares/units up to a certain threshold of NAV, as is currently the case in semi-liquid fund's redemption programmes, this should be considered a partial restriction (because they are restricted on the percentage of NAV they can redeem up to), which is compliant with the Level 1 text definition of "redemption gate" because investors can, partially, redeem their investment up until then NAV threshold is met by the fund. It is proposed that the RTS includes language to clarify this point, for example, a new paragraph in the Guidelines: "*Where investors are able to redeem their shares/units up to a certain threshold of NAV, this should be considered a partial restriction because investors can, partially, redeem their investment up until the NAV threshold is met by the fund*".

Finally, we advocate that the decision to carry non-executed orders forward is left at the discretion of the AIFM, and/or in accordance with the offering documents of the fund, and is not mandatory.

Automatic carry forward is not something that all AIFMs will currently employ so is something that should only be permitted where the fund documents provide for this.

NCAAs when overseeing fund managers/AIFMs should consider the appropriateness of such measure based on the AIF's liquidity profile and its target investors (including likely distribution channels). Certain channels of distribution may struggle with accurately reflecting investor requests to cancel unsatisfied repurchases when automatically rolled over or may have operational difficulty in putting additional repurchase requests when previously unsatisfied requests remain uncleared in an internal system. In practice, automatic carry-forward of redemptions creates an effective queue for repurchases (even when satisfied pro rata) and may incentivize investors to over-submit redemption requests or to submit redemption requests artificially early compared to the liquidity an investor desires, in order to gain priority in any potential queue or extended proration scenario, which can generally result in unnecessarily elevated redemptions for a further extended period to the detriment of all remaining and redeeming investors.

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.

Threshold expressed as a percentage of the NAV is common market practice. In addition, scaling the redemption by the NAV (denominator) allows for comparability across time regardless of the changing size of the fund. Finally, before anything else, this is a well comprehensible criterion for investors largely acquainted with this standard.

On the other hand, the answer to Question 7 highlights the shortcoming of relying on a threshold expressed as a percentage. While the percentage is a beneficial communication and disclosure tool, it has limited economic meaning to foresee the impact of a redemption on the liquidity profile of the fund and underlying assets. Indeed, in order to assess this impact, the relevant criterion is the absolute size in monetary term to be sold on the market to honor the redemption. For example, the same net redemption percentage for two funds with comparable investment policy could have drastically diverging implications in term of liquidity depending on the size of the fund and the size of underlying assets' market.

It is common for semi-liquid funds, for example, to apply a percentage limitation in a redemption programme based on the gross redemptions (i.e. excluding subscriptions) rather than net redemptions, enabling the fund's Board and/or AIFM to determine whether any changes or suspension to the repurchase programme should be made (i.e. changes to activation, appropriately determined based on the fund's liquidity).

Against this background, ALFI recommends to:

- rely on an indicative threshold instead of a binding threshold (as explained in Question 7) for redemption gate; and
- allow for other units of measurement (beyond NAV percentage) to express the threshold such as monetary unit or a combination of units (percentage and monetary).

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?

ALFI agrees that the activation should not be mechanically and automatically triggered. The role and discretion of the fund manager is essential to adapt to novel market conditions, address particular investor base and redemption dynamic, and avoid preemptive runs. The benefits of increasing investors sophistication have been accompanied by more attempts from certain investors to anticipate on the activation of different LMTs. This preemptive behavior can annihilate the virtues of LMTs and further exacerbate liquidity issues. When the trigger for activation becomes too easily predictable the risk of such preemptive behavior increases. This is observed in practice and also evidenced in academia. For example, it has been demonstrated that the liquidity restrictions introduced (including gating) by the MMF reform exacerbated the run on some MMFs during COVID (Li et al, 2021). Accordingly, it is believed that indeed an automatic activation would render the activation more predictable by some investors and therefore more prone to preemptive run and first mover advantage.

ALFI recommends to preserve the managers discretion for activation of gating above the threshold but also below the threshold as detailed in Question 7. This discretion in both cases would support the capability to adjust to a gamut of market conditions, adapt to particular investor base and redemption dynamic, and make activation less predictable.

Li, L., Li, Y., Macchiavelli, M., & Zhou, X. (2021). Liquidity restrictions, runs, and central bank interventions: Evidence from money market funds. *The Review of Financial Studies*, 34(11), 5402-5437.

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.

n/a

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.

n/a

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?

There are several approaches to treat non-executed orders. Cancellation being one of them. It is all-important to highlight that one prime objective of quantity based LMTs is to create more certainty for the investment manager to dispose of the assets in an orderly manner. While many cancelation schemes are possible, it is important that they do not reintroduce uncertainty preventing the portfolio manager to dispose of the assets in the best possible way for investors. In order to illustrate the point that cancellation can create additional complexity and uncertainty, one can consider the situation where upon receipt of the redemption orders on a

particular dealing day, an investment manager will start selling assets in order to cover redemption orders. If, in the meantime, investors cancel their redemption orders while some assets are already disposed, or in the process, managers may have to readjust their portfolio, possibly re-purchasing assets that may generate additional transaction costs and issues. Furthermore, the timing involved in the communication between investors and transfer agent may generate further uncertainties and friction to be born ultimately by the fund.

In order to create this more anticipable environment different investment fund managers are considering different schemes, such as:

- Systematically cancelling non-executed orders and new redemption orders have to be resubmitted should the investors want to proceed with the non-executed part.
- Providing the investment fund manager with the possibility to decline cancellation requested by the investors if the disposition has started.

Accordingly, providing an irrevocable right for the investor to cancel non-executed order may give rise to excessive uncertainty with unintended consequences on the cost born ultimately by investors. On the other hand, the cancellation scheme is an important parameter for investors and should be appropriately disclosed.

In addition, the process of reverting to investors to enquire about their choice for the non-executed part of the redemption may prove tedious, operationally hazardous and costly for funds with higher NAV frequency.

Consequently, ALFI recommends for the cancellation right not to be automatic and mandatory, and for the RTS to allow for an entire sequence of cancellation schemes. In this context, ALFI recommends for the scheme to be clearly laid out to investors in the relevant documents.

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?

Beyond AIFs and UCITS, the current drafting of the RTS regarding redemption gates does not make distinctions based on the nature of the underlying assets and the nature of the investor base. In certain particular circumstances, the level of prescription of the RTS may not match the investor protection objectives. More proportionality could be considered in this respect.

Furthermore, and not limited to this question, many of the LMTs in the RTS as currently drafted are not available to subsets of AIFs, particularly semi-liquid strategies. For example, swing pricing and dual pricing are not generally considered appropriate for funds offered to individual investors, extension of notice period could prove operationally problematic for many monthly-dealing semi-liquid funds (particularly accounting for appropriate pre-commitment transparency), and it is stated in AIFMD Level 1 that redemptions in kind should only be available to professional investors leaving the LMT unavailable to AIFs offered to mass affluent individuals or retail investor ELTIFs. The encouragement of ESMA is sought to allow AIFs to appropriately select two from any of the LMTs to allow for flexibility in LMTs to be tailored proportionately for AIFs.

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.

The principle of fair treatment of investors promoted in this question and associated RTS is

understood and embraced. In practice, certain very specific cases may create interpretation such as:

- The case of a share class used to segregate the asset in an accounting segregation approach of side pocketing.
- The case and treatment of seed money.
- The establishment of share classes with different characteristics in a fund to reflect different investor profiles, different geographic marketing and different distribution channels, for which the differing repurchase limitations are clearly disclosed and appropriately tailored to investors.

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

The notion of gate has only been covered from the redemptions perspective. However, the possibility to gate subscriptions also provides for an effective tool to protect investors in the fund. This other side of the gating tool could be explicitly included in the description of the characteristics of the gate.

See also secondary comment relating to with switch and transfer orders as in Question 5.

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

It is commented that extensions of notice period must account for appropriate pre-commitment communication to investors and are likely to be unattractive to individual investors. Furthermore, certain investors or channels of distribution may be unable to appropriately process redemptions with an extended notice period – e.g. if extension means NAV for an applicable monthly repurchase date is not struck before the extended notice period, certain distributors will not be able to place redemption trade requests without NAV or be able to collect redemption requests from applicable ultimate beneficiaries in time for the extended notice deadline. Therefore, it would be important to ensure that a fund's calibration of extended notice may be proportionately tailored, and potentially differently applied, across different classes to support proportionate application to investors.

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.

The principle of fair treatment of investors promoted in this question and associated RTS is understood and embraced. In practice, certain very specific cases may create interpretation such as:

- The case of a share class used to segregate the asset in an accounting segregation approach of side pocketing.
- The case and treatment of seed money.
- The establishment of share classes with different characteristics in a fund to reflect different investor profiles, different geographic marketing and different distribution channels, for which the differing repurchase limitations are clearly disclosed and appropriately tailored to 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.

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 to ensure this tool is proportionately tailored.

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?

Having different features of extensions to notice periods across funds can help producing the most effective outcome for the management of liquidity. Characteristics of extensions of notice periods should be able to depend on the types of investors – leaving funds only offered to professional and/or sophisticated investors given more flexibility – or the fund’s profile – with semi-liquid funds with the ability to serve their clients in light of these characteristics.

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?

As stated in Question 3, some other methods such as non-executing orders taking priority over subsequent orders exist. Yet, the prevailing principle remains the fair treatment of investors and the mitigation of situation where certain investors could take advantage over others or are timewise treated unfairly.

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

Fairness is to be ensured with appropriate disclosure and simultaneous deactivation for all investors. This encompasses establishing priority principles to avoid unintended overtake of later redeeming investors over earlier redeeming investors.

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

Redemption fees should be mentioned at the same time as subscription fees, as liquidity is impacted when investors subscribe or redeem.

We would like to point out that redemption fees may not always be predeterminable “fixed costs”, as stated in paragraph 49. ESMA RTS. We suggest to remove “fixed” or to clarify that these costs may be fixed, if they are not influenced or determined by fund flows.

Paragraph 50. ESMA RTS outlines that “redemption fees shall impose on redeeming shareholders or unit-holders the explicit and implicit estimated costs of portfolio transactions

caused by redemptions, including any significant market impact of assets sales to meet those redemptions.”

As regards “implicit (transaction) costs”, we want to remind that depending upon the fund structure the bid/ask spread, particularly any consideration of market impact, will not be known at the time the fund is valued and these would therefore be estimated in advance.

We would also like to point out that alternative funds will have additional or rather different characteristics for Real Estate funds, because the “explicit” costs will vary depending on location (e.g. on notary fees that are different in each country, local taxes etc.), although it is possible to estimate with reliable data. For “implicit” costs, which are driven by demand, it will depend on the quality of the property and market conditions. Due to the lack of market data, we want to point out that it is hard to estimate the “implicit” cost accurately and given it is based on a lot of subjectivity, there is a risk that there is a wide difference in the calibration for similar funds. This in turn will inevitably lead to higher costs chargeable to the funds as managers instruct professional advisors to assist in demonstrating the fair treatment of investors in the process.

Returning to the notion of “market impact”, which is the difference in price in the fund valuation at which subscriptions/redemption are transacted to that actually achieved via security purchase/ sale. We do not believe that the assessment of market impact should be mandatorily required. While ALFI understands why this could be desirable, we do not believe it can be readily measured or modelled, particularly for fixed income securities, where a number of factors that may move in different directions or magnitudes (and cannot be disaggregated) may play a role in price slippage: such as spread widening, liquidity premium based on trade size, secular market sentiment.

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

As noted above we would propose to include “subscription fees”.

In addition, as regards “Significant Market Impact” mentioned in paragraph 50 of the present consultation, we would like to remind that also IOSCO mentioned in its Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes that “an assessment (e.g., slippage assessment) is needed before the sale / purchase is made, taking into account the size of the transaction, asset class, market structure and the prevailing market conditions [...]”.

Whilst slippage can act as a proxy for “market impact” we would like to outline that one deals with different calculations.

- Slippage is the difference in cost from the cost at time of the decision to place the trade to the cost of the actual trade achieved.
- Market impact is the difference in price in the fund valuation at which subscriptions/redemption are transacted to that actually achieved via security purchase/ sale.

Whilst we agree that liquidity costs should be measured as the cost estimate to be incurred by the fund to buy or sell a pro rata slice of the fund, even though a fund may not transact in a pro rata manner. We choose the word estimate because realistically we are dealing with an estimate – considering for example costs in different asset classes or sub asset classes, but not security by security.

Furthermore, it can be highlighted that many semi-liquid AIFs have a fixed temporary early redemption fee (e.g. a 2% fee for redemptions requested within the first year of investment), known as a "soft lock". In practice this fee can act as a more effective disincentive to redeem than a lower permanent redemption fee (in the form set out in the RTS), and flexibility to impose a temporary redemption fee for a set period or multiple periods may more effectively allow a fund to scale or manage redemption activity and liquidity during periods of liquidity stress. It is proposed that a soft lock mechanism is included as an alternative for AIFs over UCITS.

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?

Redemption fees are used for different purposes. In theory it could be used for commercial considerations, which we do not see as an association in practice. Redemption fees are nevertheless used when redemptions have an impact on the investment strategy of the fund (e.g. portfolio repositioning during the recommended holding period which triggers costs to the fund that should not have occurred but for the redemption during the recommended holding period).

When looking at alternative investments, especially real estate, the two anti-dilution mechanisms that can be seen as appropriate are redemption fees and anti-dilution levies. For illiquid investments, such as real estate, it is difficult to determine an appropriate anti-dilution levy or redemption fee, especially when implicit costs are to be considered. The European real estate investment community, through other associations such as INREV, has addressed this matter detail and we believe there is no need for prescriptive measures to be introduced. We need to avoid scenarios where a fund would be expected to transact properties in order to satisfy redemptions, whereas in reality it is likely to be the last resort option (using unencumbered cash and facilitating secondary trades are likely favored options).

It is noted that, additionally, the appropriate application of redemption fees will depend on not only the nature and liquidity of the underlying assets of a fund, but on the target investor base of the fund proportionate to the liquidity profile of the investment strategy. In order to meet the needs of specific investors, particularly mass affluent individuals, managers would need flexibility to set a redemption fee appropriate for the market and should be in a position to determine how such perpetual fee should be applied – e.g. whether on redemption orders exceeding a percentage of NAV, aggregate repurchase requests or individual repurchase requests, and whether applied as a perpetual fee or more appropriately applied during a period of time.

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

As an Association, we have extensively written on Swing Pricing, which in our own definition provides essentially a mechanism to attribute the estimated cost of underlying capital activity to those subscribing/redeeming and thereby protects existing shareholders from impacts caused by the capital activity of others.

Swing pricing is part of the NAV calculation process and, as such, it should be subject to an appropriate internal policy, governance and transparency as well as a strong control environment. There should be appropriate documentation, particularly of any exceptions to the swing pricing process.

Paragraph 63 of the RTS refers to section 6.5.4.2 of the draft Guidelines, which expressly outlines that “when calibrating swing pricing, managers should ensure that the full cost of liquidity, in light of the market conditions, is incorporated in the swing factor [...]”. As outlined above, managers cannot ensure full cost of liquidity in all circumstances, as it may sometimes not be possible. In addition, we would like to point out that the RTS refers to “estimated cost of liquidity”.

ALFI suggestion to align the wording of the Guidelines (section 6.5.4.2 of the draft Guidelines) with those of the RTS to: “When calibrating swing pricing, managers should ensure that the “estimated” ~~full~~ cost of liquidity[...]”

Whilst we agree with the characteristics that have been identified in the consultation, we would like to underline the fact that swing pricing is an estimation of costs based on historical data, which means it assesses the historical average costs prior to transacting on behalf of an investor (capital activity).

We encourage every asset manager to assess as to whether swing pricing is the most appropriate anti-dilution method for the characteristics of the particular fund in question and the asset class(es) that the fund invests in. If it is decided that swing pricing is the appropriate mechanism for a given fund, the following should be considered:

- Can estimated net cash flows be robustly determined, in time and in a format that can be consumed by operational processes?
- Are appropriate and robust data sources, including trading data, available to incorporate into the calculation of the swing factor?
- Is full or partial swinging most appropriate for the fund in question?
- Once the decision is made to apply swing pricing, what is the appropriate swing factor for a particular fund?
- If partial swing is adopted, what is the appropriate swing threshold for a particular fund?
- Would multiple thresholds and multiple swing factors be appropriate? If yes, under which circumstances?
- What are the appropriate procedures, processes and controls governing swing pricing generally and in the case of special events, such as stressed markets or specific fund events?
- What level of disclosure and transparency is appropriate?

- We furthermore recommend our members to take into consideration the [CSSF FAQ](#) on swing pricing when drafting their own swing pricing policy and/or processes and/or procedures (hereinafter “policy”), in particular:
- Governance - the policy should be consistently applied, and processes outlined therein

- should be embedded in the fund NAV calculation process;
- The key principles relating to the application of swing pricing: eligible funds, partial/full swing, single/multiple factors, single/multiple thresholds, elements to be included in the calculation of swing factors, practice concerning disclosures, basis for calculation of certain elements (e.g. swung NAV or unswung NAV).
 - The policy should be broad enough to allow the co-existence of different criteria and arrangements;
 - The circumstances should be set out under which the swing factor applied may exceed the maximum level laid down in the prospectus and related internal and regulatory communication and approval processes;
 - The treatment of material swing errors, in line with CSSF Circular 02/77, as amended, and of immaterial swing errors, in line with the CSSF FAQ on swing pricing;
 - The contingency procedures, that is, consideration should be given to what, if any, additional processes and procedures may be invoked during an emergency situation, such as a global pandemic (e.g. a more frequent review and/or review process for swing factor/threshold changes, "fire drills", special sub-committees);
 - Escalation procedures and processes should be set out.

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

No specific addition

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?

Swing factors and thresholds would typically reflect the different cost estimates depending on the underlying asset class a fund is invested into, meaning less liquid asset classes in AIFs compared with traditionally liquid UCITS.

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.

Where funds have multiple share classes, the NAV of the fund is the sum of the net assets of the different share classes. Each share class has its own NAV per share dependent on its weighting in the fund and the number of shares within each of the share classes. The individual share classes may differ in terms of expense rates, distribution policies, currencies or minimum holdings.

So yes, with the increasing development of new types of hedged share classes (e.g. currency hedged), the transaction costs may increasingly be incurred at share class level. As share class level costs become significant, it could become appropriate to consider an additional swing factor at share class level. It is conceivable in these cases that the fund will swing in one direction and the share class in the opposite direction, such that the share class swing factor may be added to or deducted from the fund level swing factor to arrive at a share class-specific factor. The technology changes required to achieve this are more complex than with fund-level-only swing factors, and this is currently not market practice.

We would like to point out that other liquidity management tools should also be considered.

For example, for funds which may include non-ETF share classes using swing pricing and ETF share classes passing transactions costs / dilution to an authorised participants.

In addition, we would like to point out general operational implementing considerations around swing pricing. Some managers will have more experience and sophistication in their use of swing pricing as an ADT, with experience in some instances of more than 20 years. This needs to be compared with managers that may not be using swing pricing to date or that have only started implementing swing pricing recently, or managers of funds for which swing pricing is not appropriately suited (e.g. as it is generally not for semi-liquid, private market strategies).

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

We note that the characteristics mentioned for dual pricing do not consider foreign exchange (FX) costs or market impact spreads that you may have depending on where a fund invests. This comment relates to paragraph 67. a) and b) ESMA RTS.

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

We would like to point out that not the entire investment fund industry is set up to introduce "dual pricing" across their fund ranges.

Some of our members indicated that they have single priced funds with spreads, as opposed to paragraph 69. first bullet with the requirement for two NAVs.

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?

No.

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

We suggest to reword paragraph 73 ESMA RTS as follows:

"73. Anti-dilution levies are charged to redeeming or subscribing investors in the case of a change in the net capital activity of the fund (i.e. if the number of redemptions exceed the number of subscriptions or vice-versa)."

As regards paragraph 77 ESMA RTS, we would like to remind of our response under question 22 above, where we outline that redemption fees may not always be predeterminable. We suggest to remove "fixed" or to clarify that these costs may be fixed, if they are not influenced or determined by fund flows.

It is suggested that fees paid to an AIF by unit-holders or shareholders based on repurchases within a certain period from the date of subscription (i.e. "soft lock") should be considered as an available form of anti-dilution levy.

As regards paragraph 78 ESMA RTS, we believe that the bullet on the pre-determined activation threshold would need to be elaborated on. In addition, the example provided in the third bullet is misleading and needs to be revisited. The example provided are misleading.

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

Most of our members would calculate this in the same way as swing factors.

For semi-liquid strategies, managers often implement an early repurchase deduction of a fixed percentage of the net asset value of shares sought for redemption for investors redeeming within a certain period after initial subscription. This calculation protects non-redeeming investors while a fund scales in size and may be applied in phases to ensure efficacy.

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.

No.

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?

No.

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

The reliance on the notion of pro rata in order to protect the non-redeeming parties which are not providing prior consent is theoretically sound. However, the principle of pro rata should be defined. Indeed, while in theory a pure pro rata is possible, in practice only a 'quasi' or 'near' pro rata can be achieved. Accordingly, the notion of pro rata should be defined providing some flexibility and room for manoeuvre operationally.

A definition of quasi pro rata (or near pro rata) could refer to a modification that does not substantially alter the portfolio profile and characteristics. Characteristics that may be considered include:

- the fund's risk return profile;
- the fund's liquidity profile; and
- the fund's compliance with portfolio (legal and contractual) rules.

In addition, this definition of quasi pro rata is fully aligned with actual disposition methods relied upon to serve classical not in-kind redemptions.

ALFI recommends to define in the RTS the notion of pro rata similarly to the notion of quasi pro rata as defined above. This would allow to achieve the pivotal objective of leaving remaining investors with a consistent investment prior and after the redemption in kind takes place and aligning the approach with other not in-kind redemptions.

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

An additional provision that has been adopted by certain jurisdictions in order to protect the non-redeeming investors is the intervention of an independent party to ensure that the redemption in kind is done at arm's length. This is for instance relevant in the context of valuation.

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 specific comment

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

No specific comment as description matching regulators and supervisors' guidance at the start of the Russia-Ukraine war such as [ESMA public statement](#) and [CSSF FAQs](#).

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.

While the legal basis of this interpretation is understood, this would present a significant limiting factor for UCITS compared to AIF. Accordingly, it would unintendedly provide for UCITS with less options to protect investors and more complexity. For example, creating a new UCITS with the assets for which there are no problem may trigger reporting issues such as continuity in risk and performance reporting (such as, but not limited to, PRIIPS KID for instance), corporate actions related issues such as merger event and possible tax events for investors. Moving the assets with "problems" to a new fund would prevent from encountering such hurdles and mentioned side-effect.

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 specific comment.

However, several questions (Question 14, 17, 28, 34) of the consultation ask whether the respondents agree that the same LMTs characteristics should apply to all investors and all share class/unit. In the specific case of accounting segregation, it is possible that the share class dedicated to hold the assets with valuation and legal issues would be subject to different applications of the other potential subsequent LMTs than the share classes of the fund with the remaining assets. A clarification that share classes created for accounting segregation (side-pocket) are out of scope of these questions (Question 14, 17, 28, 34) would be beneficial.

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?

In the recent geopolitical context as well as the guidance provided by authorities, regulators, and supervisors (e.g. [ESMA public statement](#) and [CSSF FAQs](#)), applications of both physical and accounting segregation based side pocket have been observed in Luxembourg. This diversity highlights that the two approaches are possible and useful to optimally serve different cases. It is also useful to mention that the cost of implementing side pocket is non negligible and prevented some investment fund managers to activate side pockets in the last years.

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.

n/a

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 anticipated that costs will be stemming from multiple factors such as implementing LMT, including adaptation of different processes and systems, training and learning, prospectus review and information to investors, IT developments, particularly for EU Member States where such tools are not yet used. These are relevant criteria for assessing the implementation timeline.

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

No specific comment

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?

No specific comment

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

No specific comment