# ESMA Consultation on Draft regulatory technical standards on open-ended loan-originating AIFs under the AIFMD

*5 March 2025*

**Introduction**

INREV* welcomes the opportunity to respond to the consultation on draft regulatory technical standards on open-ended loan-originating AIFs under the AIFMD. We share ESMA's aim to support liquidity in open-ended loan originating funds. Therefore, we hope our comments make a constructive contribution to this important initiative from our perspective representing global capital investment into real estate investment funds across the European Union.

Although not directly related to questions asked in the consultation, we would like to draw ESMA's attention to some areas of uncertainty we have identified regarding the loan-originating AIF rules more generally, which we believe merit consideration.

<u>Definition of "capital of the AIF"</u>

In AIFMD II "capital of the AIF" is defined as "aggregate capital contributions and uncalled capital committed to an AIF…". This definition is appropriate for closed end funds, which have capital commitments from investors that are called as funding needs arise. However, that is not typically how investment into open end funds is structured, and where the capital is typically determined based on the net asset value (NAV) of the fund rather than on capital contributions and uncalled capital. The unintended challenges in applying the definition to open-end funds pertain to both AIFMD II and ELTIF 2.0 Regulation, which applies a very similar wording of the definition of the capital.

Other parts of the definition, such as "calculated on the basis of amounts investible after deduction of all fees, charges and expenses that are directly or indirectly borne by investors" also raise questions on interpretation for both open- and closed-end funds.

<u>Other interpretation points</u>

Under Art. 15(4e)) an AIF cannot grant loans to its AIFM/staff/related entities, etc. A literal reading of the prohibition could result in uncertainty regarding loans not made for investment purposes, which include profit sharing payments advanced to General Partners early in the fund life, in respect of entitlements to distributions. These payments are typically characterised as "interest-free loans" in LPAs and are a partnership accounting mechanism rather than a true "loan" in a commercial sense. They should not be (and do not appear to be intended to be) caught by the restriction on lending to related entities, and in any case, these payments to the GP do not carry the risks associated with external lending which the regulation aims to address.

Another example where a literal reading of the definition of "loan-originating AIF" could have unintended consequences concerns internal funding arrangements within group structures where debt funding provided by the AIF to an AHC or other subsidiary within the group could mean that the AIF is considered to be a "loan-originating AIF," bringing it within the scope of the regulations on OE LOFs. Although we understand that this situation is also not intended to be enough to make the AIF a "loan originating fund", the lack of clarity on the point could cause uncertainty in the fund market.

## Responses to consultation questions

**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.**

No, we think the list of elements covers the important factors. We agree that it is the correct approach to leave certain practicalities (including timing) of how an AIFM should make the relevant demonstration to the competent authorities of its home Member State to the discretion of those competent authorities.

**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.**

Yes, the list seems to cover the major factors that should be considered to establish an appropriate redemption policy. However, we recommend that AIFMs should only need to take into account any *relevant* factors listed in Article 2, rather than *all* of them (as is currently required by the inclusion of the words “at least”), although we do agree that this list should not be considered to be exhaustive. In other words, we suggest that the AIFM should be able to choose which factors to consider when determining the redemption policy.

AIFMs should have the flexibility to determine the appropriateness of their redemption policies taking account of all relevant circumstances (including consideration of such specified factors that are relevant and any other appropriate ones), in the specific context of the AIF in question. We suggest the following amendment to Article 2:

> *“In order to ensure that the redemption policy of the open-ended loan-originating AIF they intend to manage is appropriate, the AIFM shall~~, at least,~~ consider ~~the following~~ **relevant** factors **which may include but are not limited to**:”*

We do note that redemption policies are designed and agreed with investors in fund documentation at the time an AIF is established, and do not tend to be amended during the life of the AIF. Therefore, the factors listed in Article 2 will need to be considered prospectively at that stage based on reasonable expectations.

**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.**

The factor that we believe should perhaps receive more emphasis is the actual frequency of redemption opportunities allowed in the fund documentation. There is an assumption that some open-end funds are highly liquid and offer frequent redemption opportunities. In the real estate world, while we believe that most loan originating funds for institutional investors are closed end, most others are “semi-open ended” and only offer redemption opportunities both infrequently and subject to a variety of LMTs, although legally falling within the definition of “open-end funds” under AIFMD.

Institutional investors such as pension funds and insurers invest for the long term in real estate debt in order to match the generally stable income flows derived from the assets with their long-term liabilities. They do not typically invest in open end real estate funds for liquidity, but rather because they are “evergreen” and institutional investors can invest for an indefinite period of time with stable income flows without needing to re-invest their capital every so-many years. Infrequent redemptions are normal in loan originating real estate and infrastructure funds for institutional investors, and in some cases redemption intervals may be very long, for example every five years, reflecting the long tenor of the underlying assets.

To develop this point further, even with real estate and infrastructure assets there will be scenarios whereby both more and less frequent redemptions may be more appropriate for investors while still being compatible with the AIF’s investment strategy. This includes managers that on the one hand are providing shorter term liquidity financing bridging more complex refinancing of real estate assets, which will be loans of shorter duration than are typical in real estate or infrastructure debt strategies. For strategies such as these, managers may wish to provide investors with more frequent redemptions where there is a natural alignment with the maturity profile of the assets. Shorter redemptions frequencies may also be appropriate for strategies with longer dated assets whereby the cashflows arising from the assets are considered to provide sufficient liquidity to permit such redemptions (noting that this will not always be the case).

**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?**

The drafting of the RTS implies that this should be set up front (with the reference to “AIFMs that intend to manage…”) based on the AIFM’s targeted portfolio and assumptions about investor behaviour etc. While it may be possible to set a target proportion at that stage, we suggest that there needs to be flexibility for both any target proportion (if required) and the actual amount of liquid assets held to change as a result of actual events and taking into account the results of ongoing monitoring and stress tests. The appropriate proportion of liquid assets should also be considered in light of the actual overall portfolio composition.

It is also important to stress the difference between redemptions that must be met by a sale of the underlying assets and redemptions that can be met through other means, for example a matching subscription, or the creation of a liquidating class of shares/units in which redeeming investors simply hold shares/units until maturity of the underlying loans. It is only net redemptions that represent a liquidity risk and there is no liquidity mismatch if there is no need to sell anything. This is important in considering deferrals and other mechanisms as liquidity management tools. In such cases, we suggest that it is possible that no/a low proportion of liquid assets would be appropriate and we suggest that there is merit in the RTS clarifying this.

To this end we note that there is no requirement for OE LO AIFs to hold a proportion of liquid assets in the updated AIFMD level 1 rules (although it is included in the ELTIF Regulation article 18(2)(d) – a clear distinction with the more retail investor focused product). We welcome the flexibility proposed within the RTS, which will permit OE LO AIFs and their managers to determine the most appropriate percentage of liquid assets for their strategy.

**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?**

Please see our comments in response to Question 4 above.

In line with our comment on the drafting of Article 2, we recommend that AIFMs should only need to take into account any *relevant* factors listed in Article 3 paragraph 1, rather than *all* of them (as is currently required by the inclusion of the words "at least"), although we do agree that this list should not be considered to be exhaustive. AIFMs should also be able to take into account any other factors they consider to be relevant when determining the appropriate proportion of liquid assets and we suggest amending the drafting as follows:

> *"AIFMs that intend to manage an open-ended loan-originating AIF shall~~, at least,~~ consider the following **relevant** factors when determining the appropriate proportion of liquid assets**, which may include but are not limited to**:"*

We further suggest that the AIF's investment policy should also be considered as a factor when determining the appropriate proportion of liquid assets, for example whether the policy is to generally hold loans until maturity.

It is not clear to us what the reference to "redemption caps" in (g) is referring to. Does this mean redemption gates, as covered by the new Annex V AIFMD list of LMTs? If so, we consider that is covered by (f) already.

**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, we agree that AIFMs should be able to take this into consideration, though ultimately whether or not to consider the cash flows as liquid assets should be an AIFM determination on a case by case basis in line with the investment policy and redemption policy of the AIF in question.

**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. The definition of loan-originating AIF permits holding up to 50% of assets in non-originated loans (including loans acquired on the secondary market), therefore AIFMs should be able to take these into account.

We recommend that the reference to “duration of the notice period” in paragraph 3 of Article 3 be amended to also refer to “and settlement period”, for consistency with the rest of the RTS and market practice on timing of payments.

We also recommend that the reference to “without significantly diluting their value” in that same paragraph be amended to make it clear that this applies to any dilution in value resulting solely from the need for a fire sale to meet the redemption, and should not prevent assets from being treated as liquid by reason that the market generally for those assets is depressed at the relevant time, or looks like it may move adversely during the redemption notice/settlement period.

**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.**

Please see our comments in response to Question 4 above.

**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?**

N/A - we have no further comment in response to this question except to note that there is no one size fits all approach to such determinations and they will be case specific.

**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, we do not believe there should be a regulatory minimum amount of liquid assets. Please see our comments to Question 4 above.

**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.**

Yes, we generally agree, noting that the appropriate frequency of stress testing should be for the AIFM to determine as appropriate to the nature of the AIF having regard to the AIF’s overall liquidity profile as set out in the implementing regulation.

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

We do not consider that the RTS needs to mandate any additional parameters in this respect.

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

Please see our comments in response to Question 3 above.

**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, we generally agree.

In line with our comment on the drafting of Article 2, we recommend that AIFMs should only need to take into account any *relevant* factors listed in Article 5, rather than *all* of them (as is currently required by the inclusion of the words "at least"), although we do agree that this list should not be considered to be exhaustive. AIFMs should also be able to take into account any other elements they consider to be relevant as part of their ongoing monitoring.

As mentioned in our responses to Question 2 and 5, we therefore suggest amending the drafting as follows:

> *"In order to ensure that the liquidity management system of the open-ended loan-originating AIF they manage remains compatible with its investment strategy and redemption policy, AIFMs shall~~, at least,~~ monitor on an ongoing basis **any relevant** ~~the following~~ elements **which may include but are not limited to**:"*

**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?**

The frequency of redemption opportunities, the maturity of loans originated, the opportunity for investors to redeem via a secondary market sale of its shares or units to another investor and inflows of subscriptions noted above would be a good start.

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

This element is monitored within the AIFM's liquidity management system and defined procedures established for this purpose.

**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;**

**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)?**

**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?**

**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?**

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

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