ALLEN & OVERY

ESMA finalises the draft RTS on ELTIFs

December 2023

The ELTIF regime was revised earlier this year to address the low uptake of the product in the market. The amended ELTIF regulation will enter into force on 10 January 2024 but many asset managers were awaiting the regulatory technical standards (the **draft RTS**) to decide whether to launch an ELTIF. ESMA finally published its final draft RTS, which contain provisions on minimum holding periods, minimum notice period, minimum liquid assets and maximum redemption limits. The draft RTS are not adopted yet and the European Commission may still amend or reject them.

On 19 December 2023, the ESMA published its final report on the draft RTS under the revised ELTIF Regulation[1].

The draft RTS cover:

– the circumstances in which the use of financial derivative instruments solely serves hedging purposes;

– the circumstances in which the ELTIF's life is compatible with the life cycles of its individual assets and the different features of the ELTIF redemption policy;

– the circumstances for the use of the matching mechanism, i.e. the possibility of full or partial matching (before the end of the life of the ELTIF) of transfer requests of units or shares of the ELTIF by exiting ELTIF investors with transfer requests by potential investors; and

– the costs disclosures.

[1] Regulation (EU) 2015/760 of 29 April 2015 on European long-term investment fund, as amended

Key takeways

1. **Minimum holding period:** the minimum holding period for an investor is determined by the ELTIF manager which must take into account various factors such as the investment strategy, the asset classes, the investor base, the liquidity profile, the valuation procedures, the extent of borrowings, lending and securities financing transactions used, the portfolio, the assets' life, the redemption policy and the investment phase of the ELTIF. The ELTIF manager must also demonstrate to the competent authority of the ELTIF the appropriateness of the minimum holding period (Article 3 of the draft RTS).

2. **Maximum quarterly redemption frequency:** If an ELTIF allows redemptions during its life, it must adopt a maximum quarterly redemption frequency, unless the ELTIF manager can justify to the competent authority of the ELTIF why a higher frequency would be more appropriate. The ELTIF manager must provide to the competent authority of the ELTIF at the time of its authorisation detailed information on the redemption policy, the frequency of redemption, the valuation procedures, the liquidity stress tests and the liquidity management tools of the ELTIF and inform it of any material changes within three business days. (Article 5 (4a) of the draft RTS).

3. **Impact of the notice period for redemptions on the minimum liquid assets and redemption limits:** The ELTIF manager will also have to set a notice period for redemptions of, in principle, a minimum of 12 months.

   If it is less than 12 months, the length of the notice period will determine the minimum percentage of liquid assets that the ELTIF should hold and the maximum percentage of assets that redemptions can represent (see below table).

Notice period	*Minimum percentage of liquid assets*	*Maximum percentage of assets that redemptions can represent (redemption gates)*
9-12 months	13%	50%
6-9 months	27%	45%
3-6 months	40%	40%
1-3 months	40%	35%
0-1 month	40%	20%

   If the notice period is less than three months, the ELTIF manager must further justify to the competent authority of the ELTIF the consistency of the notice period with the redemption policy requirements and the investors' interest (Article 5 (4a) of the draft RTS). However, the ELTIF manager may request an exemption from this requirement from the competent authority of the ELTIF for ELTIFs marketed solely to professional investors (Article 5(10) of the draft RTS).

4. **Selection of one minimum liquidity management tool (LMTs):** To manage liquidity, the ELTIF manager must choose and apply at least one of these tools: anti-dilution levies, swing pricing or redemption fees. However, if these tools are inadequate for the ELTIF, the ELTIF manager can explain to the competent authority of the ELTIF why other tools are more suitable for the investors'

interests (Article 5(7) of the draft RTS). The ELTIF manager can also ask the competent authority of the ELTIF for an exemption from using any tools if the ELTIF is only marketed to professional investors.

5. **Mandatory redemption gates:** the ELTIF manager must determine the percentage to apply redemption gates, which may limit the amount of redemptions that can be processed at a given date. The RTS provides a list of factors to be taken into account for setting that percentage (Article 6 of the draft RTS) when it is not already set in the table above. It may also implement gates in other specific circumstances, such as risk to financial stability or stressed market conditions.

6. **Matching mechanisms**: The draft RTS specify the rules and procedures for the matching of transfer requests between exiting and new investors in the prospectus or constitutional documents[2] of the ELTIF. The ELTIF manager must disclose in the constitutional documents of the ELTIF the format, process, timing, frequency, duration, dealing dates, deadlines, settlements and pay-out periods, the safeguards of investors' interest and the notice period, if any. The draft RTS also require the ELTIF manager to clearly disclose the differences between the redemptions and matching mechanisms in terms of frequency, periods, execution price and notice period (Article 7 of the draft RTS). It must also set out the rules to determine the execution price, the exit or purchase fees, and the pro rata conditions for the matching of transfer requests in the constitutional documents of the ELTIF. The execution price is based on the net asset value of the ELTIF, unless the ELTIF manager can justify the use of other tools to ensure the fair treatment of all investors. The pro rata conditions are the rules for dealing with any imbalance between exit and purchase orders, ensuring that the requests are either cancelled, carried over, or executed on the basis of a criterion established by the ELTIF manager. The pro rata conditions shall be based on the size of each exit order and the available assets of the ELTIF, unless the ELTIF manager can justify a different approach (Article 8 of the draft RTS).

7. **Costs disclosures:** The draft RTS specify the calculation and presentation of costs disclosures to the investors in the prospectus of the ELTIF, using common definitions, calculation methodologies, and presentation formats for the different types of costs. They aim to align the cost disclosure with the existing cost disclosure requirements in other regulatory frameworks, such as PRIIPs Regulation[3], to the extent possible. The draft RTS define the costs of setting up the ELTIF, the costs related to the acquisition of assets, the management and performance related fees, the distribution costs, and the other costs, and provides the methodologies for expressing them as percentages of the capital of the ELTIF. The draft RTS also define the overall cost ratio of the ELTIF as the ratio of the total costs to the capital of the ELTIF, and provides the formula for the calculating thereof based on the sum of the annual costs and the average of the fixed costs referred to above over the recommended holding period of the ELTIF. The draft RTS require the costs section of the prospectus of the ELTIF to contain a presentation of costs in the form laid down in the Annex to the RTS, which includes a table with the one-off and ongoing costs. The draft RTS also impose that the prospectus of the ELTIF contains narratives presenting both the PRIIPs overall reduction in yield figure and the ELTIF's overall cost ratio and explanations of any potential differences between those figures, in the case of ELTIFs subject to the PRIIPs Regulation (Article 12 of the draft RTS).

[2] ie. the rules or instruments of incorporation of the ELTIF
[3] Regulation (EU) No 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products, as amended

European Commission has until March 2024 to influence the final outcome of the RTS

Although the ESMA report is final, the content may still evolve as the European Commission can reject or amend them within three months. If this is the case, ESMA will have six weeks to review the RTS. If adopted, the RTS shall enter into force on the day following their publication in the Official Journal of the European Union. The RTS will repeal the Delegated Regulation 2018/480.

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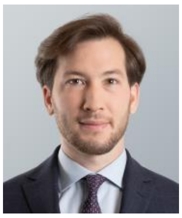

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