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Final Report

Draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive

Table of Contents

1 Executive Summary

Reasons for publication

The revised AIFMD and UCITS Directive[1] provide that ESMA shall develop draft regulatory technical standards (RTS) to determine the characteristics of liquidity management tools (LMTs)[2] available to AIFMs managing open-ended AIFs and to UCITS.

On 8 July 2024, ESMA published a Consultation Paper (CP) on the proposed draft RTS. The public consultation closed on 8 October 2024. This final report includes the revised RTS developed taking into account the feedback received to the consultation.

Contents

Section 2 summarises the feedback received to the consultation that ESMA carried out and explains how ESMA has taken this feedback into account.

Annex I contains the feedback statement to the public consultation.

Annex II contains the legislative mandates to develop draft RTS.

Annex III sets out the cost-benefit analysis related to the draft RTS.

Annex IV contains the full text of the draft RTS under the AIFMD.

Annex V contains the full text of the draft RTS under the UCITS Directive.

Next Steps

The draft RTS set out in this final report have been submitted to the European Commission for adoption. From the date of submission, the European Commission shall take a decision on whether to adopt the RTS within three months. The Commission may extend that period by one month.

[1] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds (europa.eu)
[2] The lists of LMTs are set out in Annex V of AIFMD and in Annex IIA of the UCITS Directive

2 Overview

2.1 Public consultation

1. On 8 July 2024, ESMA published a Consultation Paper (CP) on the proposed draft RTS on Liquidity Management Tools under the AIFMD and UCITS Directive. The consultation closed on 8 October 2024.

2. ESMA received 33 responses, from asset managers (and their associations), investment services companies, industry associations and one consumer association. The non-confidential responses are available on ESMA's website[3].

3. ESMA consulted the Securities and Markets Stakeholders Group (SMSG), but the SMSG chose not to opine on these RTS.

4. The content of the responses and ESMA's feedback is outlined in the Feedback Statement in Annex I, question by question.

2.2 Amendments to the RTS following feedback to the consultation paper

5. Following the public consultation, ESMA introduced the main following changes to the draft RTS under the AIFMD and the UCITS Directive.

   Introducing some flexibility for redemption gates

6. In the draft RTS in the CP, ESMA set out that redemption gates shall be expressed as a percentage of the net asset value (NAV) of the AIF and UCITS, after having considered all redemption orders received at a given dealing date. Considering the feedback received, ESMA introduced some flexibility in the way the activation threshold of redemption gates shall be expressed.

7. For AIFs, the final draft RTS provides that the activation threshold shall be expressed in a percentage of the NAV of the AIF, or in a monetary value (or a combination of both), or in a percentage of liquid assets.

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[3] Consultation on Liquidity Management Tools for funds

8. However, for UCITS, ESMA did not amend the draft RTS for the activation threshold which shall be expressed only in a percentage of the NAV of UCITS in line with nature of UCITS that can only be invested in liquid assets.

9. With respect to redemption orders to be considered for the calculation of the activation threshold, ESMA also introduced some flexibility to account for different market practices. Hence, both final draft RTS provide that either net or gross redemption orders shall be considered for the determination of the activation threshold.

10. Finally, ESMA included an alternative method for the application of redemption gates. Under this alternative method, redemption orders below or equal a certain pre-determined redemption amount can be fully executed while redemption orders above this redemption amount are subject to the redemption gate. The purpose of this alternative mechanism is to avoid small redemption orders to be affected by large redemption orders that drive the amount of redemption orders above the activation threshold.

Removing the provisions on the application of LMTs to share classes

11. The draft RTS on which ESMA consulted included provisions on the application of LMTs to share classes, requiring the same level of LMTs to be applied to all share classes (e.g. when fund managers extend the notice period of a fund, the same extension of notice period shall apply to all share classes).

12. However, ESMA concluded that the mandate of the RTS did not support the development of specific and comprehensive provisions on the level of application of LMTs to share classes. ESMA therefore removed these provisions from the final draft RTS under the AIFMD and the UCITS Directive.

Application of the rules of redemption in kind to ETFs

13. Respondents to the consultation alerted ESMA on the unintended consequences of the rules on redemption in kind for the functioning of the primary market of ETFs. According to these respondents, there was a need to recognise or confirm that when authorised participants use redemptions in kind for the purpose of creation/redemption of units/shares of ETFs, this should not qualify as LMT, and therefore the rule on the pro-rata approach shall not apply to them when the ETF is not replicating an index.

14. ESMA acknowledged the issue and included a new provision in the RTS clarifying that the rule on the pro-rata approach in the case of redemption in kind did not apply to authorised participants and market makers operating on the primary market of ETFs.

3 Annexes

3.1 Annex I – Feedback Statement

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

15. While many respondents agreed with the draft characteristics, several respondents commented that managers shall not obliged to close at the same time subscriptions and redemptions (or repurchases), and that depending on the market conditions there might be an interest in keeping funds open for subscriptions while at the same being closed for redemptions (or the other way round).

ESMA's response:

16. ESMA took note of the comments made by several respondents that there might be circumstances where fund managers might need to close only subscriptions or only repurchases or redemptions.

17. However, in light of the definition of suspension of subscriptions, repurchases and redemptions set out in the AIFMD and UCITS Directive, ESMA did not change the approach in the final draft RTS. Indeed, the definition in the AIFMD and UCITS Directive is clear that when fund managers use this Liquidity Management Tool ('LMT'), subscriptions and redemption (or repurchases) are closed.

18. ESMA recalls stakeholders that suspension of subscriptions, redemptions and repurchases, is not part of the two LMTs that fund managers shall at least select. This LMT is always available to fund managers, and they may activate it only in exceptional circumstances.

19. However, fund managers may use other LMTs, in addition to the ones referred to in Annex V of AIFMD and in Annex IIA of the UCITS Directive but these other tools should not be considered as liquidity management tools for the purpose of complying with the obligation to select at least two liquidity management. These additional tools may include for example so-called 'soft closures' that consist in suspending only subscriptions of the fund.

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.

20. The majority of respondents generally agreed that redemptions orders that were placed but not executed before the fund is suspended shall not be executed before the suspension is lifted.

21. However, according to respondents, there could be circumstances where this approach may present a number of operational issues and therefore a certain level of discretion and flexibility should be granted.

ESMA's response:

22. In light of the feedback received, ESMA removed the obligation for fund managers not to execute redemption orders until the suspension is lifted. Indeed, ESMA concluded that it would not be proportionate to impose only one way of treating these redemption orders since different practices and rules exist in the market.

23. However, ESMA believes that fund managers should disclose to investors how they treat redemption orders in the case of suspension of subscriptions, redemptions and repurchases. For AIFMs, this information should be part of the disclosure obligation under Article 23(h) of AIFMD and for UCITS it should be specified in the prospectus. The relevant requirements may also be subject to specific national rules.

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?

24. Regarding the treatment of non-executed redemption orders once the suspension is lifted, respondents generally called for flexibility to reflect existing practices in this regard. In particular, it should be up to fund managers to decide which approach is the most suitable in case of a particular fund.

ESMA's response:

25. Consistently with the approach taken in the response to Question 2, ESMA did not set any prescriptive rules regarding the execution of orders placed but not executed before the fund manager close the fund.

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

26. Many respondents confirmed that there may be circumstances where it is justified to reopen subscriptions while keeping the fund close for redemptions/repurchases. According to them, additional capital gathered through new subscriptions could be used to improve the liquidity of the fund by purchasing liquid assets. This would also help reduce any dilution

and would allow fund managers to avoid actions that would be more far-reaching, as the liquidation of the fund or the creation of side pockets.

27. For some respondents, reopening subscriptions only could be seen as an intermediary step before reopening the fund completely.

ESMA's response:

28. ESMA took note of the responses provided by stakeholders and did not set any provisions about how fund managers shall lift suspension of subscriptions, redemptions and repurchases as these provisions were not considered as characteristics of this LMT.

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

29. Generally, respondents did not make any suggestion for additional characteristics of suspension of subscriptions, repurchases and redemptions.

ESMA's response:

30. Considering the feedback from the consultation, ESMA did not introduce any further characteristics of suspension of subscriptions, repurchases and redemptions.

Q6. Do you think there is merit for the characteristics of suspension of subscriptions, repurchases and redemptions to differ between different investment strategies and between AIFs and UCITS? If yes, how?

31. Most respondents believed there was no merit for the characteristics of suspension of subscriptions, repurchases and redemptions to differ between different investment strategies and between AIFs and UCITS.

ESMA's response:

32. Considering the feedback from the consultation, ESMA did not introduce any differences in the characteristics of suspension of subscriptions, repurchases and redemptions between different investment strategies and between UCITS and AIFs.

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

33. Respondents to the consultation generally agreed with the constituting elements of redemption gates as set out in the draft RTS under the AIFMD and the UCITS Directive. However, many respondents found the way the characteristics were defined too restrictive

and called for more flexibility to recognise other existing marketing practices, in particular in the case of AIFs.

ESMA's response:

34. Based on the feedback from respondents, ESMA introduced several changes to the draft RTS under the AIFMD and the UCITS Directive as explained in the response to the subsequent questions.

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.

35. Regarding the determination of the redemption gate threshold, while respondents generally agreed that, in many instances, it is expressed as a percentage of the NAV of the funds, many of them mentioned alternative methods and urged ESMA not to prohibit them by defining only one acceptable method.

36. According to these respondents, in cases of some asset classes, it is more appropriate to express the activation threshold as the size of the underlying market and not as the size of the fund. For example, it is possible to calculate the size of a particular real estate market and deduct an absolute transaction size that the market will be able to absorb. In that case, the redemption threshold would be expressed as an absolute monetary value threshold and not as a percentage of the NAV of the fund.

37. In the same manner, while respondents agreed that redemption orders can be determined taking into account the net redemption orders for a given dealing date, almost all respondents advocated for more flexibility.

38. First, according to many respondents, there could be circumstances under which considering net redemptions might not be the best approach. In some jurisdictions, redemption gates are commonly calculated as the total amount of gross redemption orders on a certain date. Moreover, where subscriptions are managed with capital calls made on demand, subscription orders might already be partially or fully allocated to upcoming investments and binding commitments made by the AIFs. These subscriptions cannot therefore be used to meet redemption requests (e.g. the case of real estate funds). Therefore, many respondents suggested to remove the reference to 'net' redemptions orders in both RTS.

39. Second, instead of looking at a single dealing point, the vast majority of respondents argued that a rolling period approach might be more suitable for some funds. According to these respondents, this method provides a more comprehensive view of redemptions trend

over time, allowing for a less reactive and more stable approach. It could be useful in circumstances when redemptions received over a period of time cumulatively exceed a level which could, according to the manager, be absorbed by the market without a significant impact. For example, a fund with a bi-weekly dealing frequency could use a rolling three-month period to determine the activation threshold, rather than relying on a single dealing day. Additionally, under such an approach, reimbursements would be made up to a minimum percentage specified by the manager and disclosed in the fund rules, which may differ from the activation threshold level. This would also ensure an equal treatment of investors, as the gate would be applied uniformly once activated.

ESMA's response:

40. In light of the feedback received, ESMA introduced some flexibility in the RTS on AIFMD by allowing the activation threshold to be expressed in a percentage of the NAV of the AIF, or in a monetary value or as a combination of both, as well as in a percentage of liquid assets. This amendment was justified by the obligation for ESMA to consider the diversity of investment strategies and ESMA concluded that a monetary value might be more appropriate than a percentage of the NAV for some types of AIFs.

41. However, considering the support received for the UCITS RTS, ESMA did not modify the provision for the activation threshold that shall only be expressed as a percentage of the NAV of the UCITS.

42. In addition, in light of the feedback received and existing market practices, ESMA amended the two draft RTS by allowing fund managers to consider gross redemption orders received at a given dealing date.

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?

43. For the activation of redemption gates, most respondents argued that redemption gates shall not be activated automatically when the activation threshold is exceeded and that fund managers shall always take the decision to activate redemption gates when the activation threshold is exceeded.

44. Therefore, according to the majority of respondents the activation threshold should be treated as an indicative guide above which manager should consider whether or not to activate the redemption gate.

ESMA's response:

45. ESMA took note of the feedback received and concluded that the mandate on the draft RTS did not include elements related to the decision-making process for the activation of redemption gates.

46. Therefore, ESMA did not include in the final draft RTS under the AIFMD and the UCITS Directive any provision specifying if redemption gates can be activated automatically or not.

47. However, ESMA added a new provision according to which redemption gates shall not be activated if the activation threshold has not been exceeded.

48. ESMA also clarified that when redemption gates are activated, AIFMs and management companies shall execute all redemption orders for a level that corresponds to at least the activation threshold of the redemption gate, unless the redemption gates are not applied to redemption orders below a certain predefined amount, as per the alternative redemption gate mechanism introduced in the final draft RTS (see response to Question 11).

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.

49. Respondents to the consultation generally provided the same answer as for Question 9 above.

ESMA's response:

50. As explained in the response to Question 9, ESMA did not include in the final RTS under the AIFMD and the UCITS Directive any provision regarding the decision-making process and governance of redemption gates.

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.

51. Respondents generally agreed that the activation threshold shall not be expressed at the level of the single redemption order. However, several respondents noted that fund managers shall be allowed to use a proportionate approach in these regards and, in particular in cases when it can be justified by the interest of smaller unitholders. Indeed, there can be circumstances where there is a huge disproportion in the size of redemption orders placed by different investors.

52. For example, a fund where the activation threshold is set at the level of 10% receives total redemption orders of 15%. However, among orders placed there is one that accounts for 12% and other orders that account for the remaining 3%. In such case, it would be in line with the overall interest of the investors to partially postpone the order of 12% and allow for the smaller orders to be redeemed completely. It would definitely be contrary to the interest

of all investors to redeem the order of 12% (up to the level of the threshold) and postpone smaller orders. The advantage of this proportionality approach is also that it would reduce the operational issues that a gating could trigger for the underlying investors (e.g. in case of significant redemptions from distributors, platform, nominees).

ESMA's response:

53. In light of the feedback received, ESMA amended the provision on redemption gates by adding a second mechanism that fund managers may use. While this second mechanism considers all redemption orders received at a given dealing date to determine whether the activation threshold is exceeded, it would allow fund managers not to apply redemption gates to individual redemption orders that are below a certain pre-determined amount. The purpose of this mechanism would be to avoid small redemption orders to be penalised by big redemption orders that trigger the application of redemption gates.

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?

54. Many respondents referred to different market practices regarding the treatment of the non-executed part of their redemption orders and invited ESMA not to set too prescriptive rules. According to respondents, in some cases, the non-executed part of redemption orders is automatically cancelled or automatically postponed to the following dealing dates. In other cases, investors may have the right to ask for their cancellation.

ESMA's response:

55. In light of the feedback received, and consistently with the approach taken for the suspension of subscriptions, redemptions and repurchases, ESMA did not include any provision on the treatment of the non-executed part of redemption orders in the final draft RTS under the AIFMD and the UCITS Directive.

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?

56. The majority of respondents did not see merit in having different characteristics of redemption gates for different investment strategies and between AIFs and UCITS.

ESMA's response:

57. As explained in the response to Question 8 above, following the consultation, ESMA introduced some differences between AIFs and UCITS for the determination of the activation threshold.

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.

58. Several respondents to the consultation commented that there might be cases where it would make sense to apply different redemption gate thresholds per share classes.

ESMA's response:

59. ESMA took note of the responses and concluded that since redemption gates shall take into account all redemption orders (i.e. not applied at single redemption orders), fund managers shall apply the same level of redemption gate to all investors, and consequently to all share classes of the funds.

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

60. Most respondents did not make any suggestions of additional characteristics of redemption gates beyond the various comments made to the proposed draft characteristics.

ESMA's response:

61. Considering the feedback received, ESMA did not introduce additional characteristics on redemption gates but amended some of the draft characteristics as highlighted in the responses to the questions above.

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

62. Several respondents agreed with the description of extensions of notice period.

63. Some stakeholders argued that extensions of notice period may be used also to mitigate the impact on remaining investors in case of large redemptions and not only in situations where the liquidity conditions of a fund or in the relevant market have worsened.

64. It was also noted that extensions of notice period should not change the nature of the fund and its dealing frequency and that they should exclude the settlement period. In addition, some respondents found unclear how orders received during the extended notice period should be handled once the extension ends.

65. In addition, several respondents believed that it should be possible to apply different extensions of notice periods to different share classes of the same fund.

66. Some respondents commented that it should be possible to adapt the extension of notice period to the size of the redemption order, if this is fully disclosed in the prospectus (so

called “incentive notice periods”). These "incentive notice periods" are mainly for institutional investors and give fund managers enough time to handle large redemptions. According to these respondents this mechanism protects retail investors from potentially negative impacts of large redemptions.

67. Some stakeholders explained that certain distributors may struggle to process redemptions with extended notice periods and funds should tailor extended notice periods appropriately across different share classes to support a proportionate application to investors.

68. Finally, according to some respondents, it should be clarified that the regular notice period can be zero when applying this LMT, and Article 3(1) of the RTS should be amended to recognize one-off long notice periods as compliant. Second, the "minimum period" for notice should be flexible, because it depends on the specificities of the fund. Lastly, open-ended funds, which are redeemable daily, should have the flexibility to set a longer notice period, and this should be recognised in the RTS as part of the extension of the notice period.

ESMA’s response:

69. ESMA agreed that extensions of notice period shall not change the nature of UCITS and AIFs. Consequently, ESMA added a new provision in both RTS prescribing that when AIFMs and management companies extend the notice period of funds they shall not modify the dealing frequency of the fund.

70. However, with respect to the length of the regular notice period (i.e. before the extension), ESMA did not include any provisions in the final RTS as it is not covered by the mandate of the RTS.

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.

71. Most respondents disagreed with ESMA’s proposal that the same extension of notice period shall apply to all share classes. According to stakeholders, different extensions of noticed periods should be allowed when one or more share classes are reserved to professional/institutional investors, as their orders are larger and may highly impact the liquidity position of the fund. Hence, the manager should have the flexibility to decide whether to apply the same or different extensions of notice period.

72. Another respondent suggested that not only should institutional investors be subject to longer notice periods than retail investors, but that the extension of notice periods may apply exclusively to them.

73. It was also argued that UCITS funds with daily NAV should have the same extension of notice period for all share classes. However, for private asset funds, different extensions should be allowed for retail and professional share classes to help manage liquidity and large redemption orders.

74. On the contrary, some stakeholders argued that the same extension of notice period should apply to all investors, to ensure fair treatment between unitholders.

ESMA's response:

75. ESMA took note of the comments received and concluded that there was no mandate for the RTS on the characteristics of LMTs to determine how LMTs shall be calibrated when they are activated. Therefore, ESMA did not include in the two final draft RTS how AIFMs and management companies shall apply and calibrate extension of notice periods at the level of share classes.

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.

76. The views of respondents were split on this point as some respondents believed that fund managers shall specify for how many dealing dates the notice period will be extended whereas other pointed that it might be difficult to predict ex-ante when the circumstances causing the need to extend the notice period will end and hence some flexibility might be required. Several respondents agreed that the extension of notice period may be applied for a pre-defined period whereas a few stakeholders were of the view that fund managers should define the period.

77. One stakeholder asked for clarification on whether the extension may be extended again after the defined period has ended, while another respondent suggested that the pre-defined period could be renewed if liquidity market conditions do not improve. Moreover, the extension may be expressed in number of dealing dates.

78. One consumer association argued that pre-defined periods of time could facilitate communication of this tool to investors. Additionally, the conditions and lengths of the extensions must be included in the pre-contractual information.

ESMA's response:

79. ESMA concluded that the mandate of the RTS did not empower ESMA to determine the level of application of LMTs to share classes and consequently removed this provision from the final draft RTS.

80. With respect to the question as to whether the notice period could be further extended after the defined period has ended, ESMA is of the view that there is nothing that prevents AIFMs and management to activate again this LMT if they determine that this is justified by the market conditions.

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?

81. For many respondents there was no merit for the characteristics of extensions of notice period to differ between investment strategies and between AIFs and UCITS. Although, some of them pointed out that enough flexibility shall be maintained to adapt to different circumstances.

82. It was also argued that RTS should provide fund managers with enough flexibility in structuring extensions of notice period based on the fund’s profile, investment strategies, and investor categories, without imposing mandatory and prescriptive rules.

83. Few stakeholders agreed that notice periods could differ based on the asset classes in which the fund invests, while one respondent saw merit in differentiating the characteristics of extensions of notice period according to different investment strategies. Other respondents believe that a distinction should be made based on both these asset classes and investment strategies.

84. Few respondents believed that differences between investment strategies, as well as between UCITS and AIFs, were justified. Additionally, funds not publicly offered (certain AIFs) should be excluded from the RTS if redemption procedures are agreed upon by investors. A maximum extension period for UCITS funds should also be set.

85. In addition, one stakeholder suggested that the notice period should consider factors like dealing frequency, asset types and the time required to sell assets at a fair price for redemptions and agreed that the length of any extension should be at the discretion of the manager or the fund's board.

ESMA’s response:

86. ESMA agreed that the length of the extension of the notice period may differ according to investment strategies and the type of assets in which funds invest. However, with respect to the characteristics this LMT, based on the feedback received, ESMA did not deem necessary to introduce any difference between UCITS and AIFs or between investment strategies.

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?

87. Several respondents claimed that orders would be executed under the original notice period. However, as highlighted by some of them, when severe circumstances arise the order may be deferred to the next dealing day.

88. Moreover, many respondents emphasised the importance of flexibility, as the manager would deal with this on a case-by-case basis and some respondents suggested that this decision should be completely left to the fund manager.

89. One respondent explained that orders were generally executed under the original notice period, however the extended period applies to unexecuted orders received before the LMT activation. As the decision to extend is often made after the fund's cut-off, this may unable the fund manager to fulfil all orders for the day.

90. One consumer association explained that the decision depends on which option is least harmful to the investor. An extension of the notice period restricts the investor's right to redeem shares but may be necessary to protect the fund's financial stability. The rules should consider the different scales of retail and institutional investors' orders and their potential impact in a stress situation, with more reasons to apply the extended notice period to large institutional orders.

91. As pointed out by one respondent, the main principle was the fair treatment of investors and the mitigation of situations where certain investors could gain an unfair advantage or be treated unfairly due to timing. Other methods, such as prioritising non-executed orders over subsequent ones, exist.

ESMA's response:

92. Consistently with the suspension of subscriptions, redemptions and repurchases and redemption gates, ESMA did not include any prescriptive provisions on how AIFMs and management companies shall execute redemption of orders that have been placed but not executed before AIFMs and management companies extend the notice period.

93. However, ESMA believes that fund managers should disclose to investors how these redemption orders would be treated. For AIFMs, this information should be part of the disclosure obligation under Article 23(h) of AIFMD and for UCITS it should be specified in the prospectus. ESMA also recognises that in certain jurisdictions this may be subject to national rules.

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

94. To ensure equal treatment of investors, redemption orders should be prioritised based on objective criteria. Therefore, as some respondents argued, it would be beneficial to maintain chronological consistency by executing orders in the order they were placed. Another stakeholder stated that all accumulated redemption requests must be processed in a fair and predefined manner.

95. One respondent added that priority should be given also considering the type of share or unit class and the size of the orders. However, two stakeholders argued that chronological sequencing is not required if sufficient liquidity is available to meet all redemption requests.

96. Moreover, some respondents believed that the fair treatment of investors could be guaranteed also by ensuring that all investors benefit from the deactivation of extended notice periods.

97. Some stakeholders argued that fairness could be ensured through appropriate disclosure and simultaneous deactivation for all investors. Specifically, another respondent emphasised that appropriate disclosure included information provided in the pre-contractual documents.

ESMA's response:

98. ESMA took note of the comments received and consistently with the response to question 21, ESMA did not include any provision on the treatment of orders when the extension of notice period is deactivated.

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

99. Some respondents simply agreed with the description of redemption fees and the corresponding characteristics without making any comments.

100. Several stakeholders expressed concerns about the requirement for fees to be pre-defined, arguing that it does not adequately reflect the variable nature of liquidity costs, and that greater flexibility would be needed. As a result, they recommended removing the word "predetermined" requirement from Article 4(1), while one of them suggested amending the provision to state that “this fee may exceed its predefined range in exceptional circumstances."

101. A few stakeholders claimed that including implicit costs, especially market impact, was impractical for a predetermined fee, especially given the cost of data and the unpredictability

of liquidity costs. Therefore, these costs should be estimated on a “best effort” basis and included only if deemed material. Furthermore, in the case of real estate funds, the transaction costs are even harder to estimate due to local factors like taxes and notary fees, as well as the quality of the property and market conditions.

102. Two respondents argued that Article 4(2) of the draft RTS should be deleted or modified to distinguish between funds that invest mainly in liquid assets and funds that invest mainly in illiquid assets.

103. Moreover, two respondents focused on semi-liquid private market fund strategies, arguing that redemption fees are not suitable for them. According to these respondents, it would be difficult for funds invested in illiquid assets to define a predetermined range for redemption fees due to the challenges in assessing liquidity costs, and the range may vary widely depending on asset type. Therefore, managers should have flexibility to set redemption fees to be able to meet investors’ interests.

104. Some stakeholders noticed that the requirement in Article 4(7) of the draft RTS according to which all investors placing redemption orders within the same redemption fee level must pay the same fee was problematic, as market impact is calculated at the sub-fund level based on total redemptions and not at the level of individual orders. Hence, it may not be possible to differentiate the level of the fee based on the level of redemption.

105. Some respondents highlighted that redemption fees are not only used as a LMT but also to encourage investors to hold investments for the recommended period, with fees often decreasing over time, or to penalise breaches of lock-up periods.

ESMA’s response:

106. Regarding the comment made by some respondents that redemption fees could be set within a predetermined range, ESMA deleted the first paragraph of Article 4 and slightly amended paragraph 2 to be in line with the definition of redemption fees in the AIFMD and the UCITS Directive.

107. In addition, ESMA deleted the provision that redemption fees shall be paid to the fund because this characteristic is already part of the definition of redemption fees in the AIFMD and the UCITS Directive.

108. On a related note, ESMA clarifies that so-called ‘exit fees’ (for which there is no legal definition) mentioned by some respondents, are different from redemption fees, in so far as exit fees are not paid to the fund and are not meant to protect remaining investors from dilution caused by redemption orders.

109. Regarding the comments that redemption fees may not be appropriate for some types of funds, ESMA took good not of these observations and stress that this comment cannot be addressed in the context of the RTS on the characteristics of LMTs and invite stakeholders to refer to Section 5.5.3.1 of the Final Report on the guidelines on the selection and calibration of LMTs where guidance is provided.

110. Similarly, ESMA did not include in the final draft RTS that the market impact shall be calculated on a best effort basis as this was not a characteristic.

111. Finally, ESMA removed from the draft RTS under the AIFMD and the UCITS Directive, provisions that related to the actual levels of redemption fees as these provisions were not considered as characteristics.

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

112. A couple of respondents proposed adding subscription fees to the framework.

113. Additionally, another respondent recommended allowing soft lock mechanisms (e.g., 2% fee for early redemptions within the first year) for AIFs, as they can be more effective than permanent redemption fees, especially during liquidity stress.

114. One respondent noticed that other redemption fee mechanisms were used. For example, a redemption fee, in conjunction with an extended notice period, could be a highly effective tool when both institutional and retail investors invest in the same fund. In their jurisdiction, a progressive redemption fee is proposed that depends on the length of the extended notice period, the amount of the order or the length of detention.

115. However, another stakeholder observed that for now, redemption fees were not commonly used to manage liquidity in open-ended funds. They proposed designing a mechanism based on the period over which the investor holds the shares compared to the recommended holding period. Another respondent added that a degressive scale should be applied depending on the time the investment is held. Hence, the redemption fee would reflect both the costs of selling an asset and the costs unamortised in the fund's NAV.

116. One respondent added a few observations on the description of redemption fees. First, the fund's documentation should only indicate a maximum rate and not also a minimum rate. Second, transaction costs include both execution costs and the estimated market effects.

ESMA's response:

117. ESMA did not take on board the suggestion to include subscription fees in the draft RTS because subscription fees are not part of two LMTs that fund managers shall at least select for the UCITS and open-ended AIFs they manage.

118. In the same manner, ESMA did not add any new provision on the disclosure of information to investors because provisions on disclosure were not in scope of the mandate of the draft RTS.

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?

119. Many respondents claimed that there was no merit for the characteristics to differ between investment strategies and between AIFs and UCITS.

120. One respondent explained that redemption fees should be based on the actual purchase and selling costs of the financial instruments within the fund and these costs should be adjusted if market conditions lead to long-term average changes.

121. Several stakeholders argued that a distinction should be made based on the liquidity profile of the asset classes in which the fund invests. One of them added that the application of redemption fees should also consider the investor base, with flexibility for fund managers to set fees based on investor needs, such as applying fees to large redemption orders or over specific periods.

122. One respondent stated that semi-liquid AIFs should be granted more flexibility. According to two respondents, higher flexibility may be granted in case of AIFs that invest in private assets.

123. Few stakeholders believed that redemption fees should vary both between investment strategies and between UCITS and AIFs, in order to allow for a high level of flexibility for this LMT. Fund managers should decide the proper way to manage liquidity, and how to apply redemption fees.

124. Additionally, one respondent pointed out that professional investors should not be subject to the same level of restrictions as retail investors. Moreover, they expressed support for the option to apply redemption fees on a per share class basis, especially for professional AIFs, where this is justified to ensure fair treatment of investors.

125. Two respondents argued that funds that were not publicly offered (some AIFs) should not be subject to the RTS on LMTs when the redemption procedure is determined in agreement between the investors of the fund.

ESMA's response:

126. ESMA took note of the comments and observations made by respondents, and in light of these, did not introduce any differences between UCITS and AIFs, or between investment strategies, for the characteristics of redemption fees.

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

127. Some stakeholders emphasised that swing pricing was not just for stressed market conditions, but it was also regularly used in normal market conditions with significant net capital flows, helping to reduce stigma and improve investors understanding. One of them pointed out that swing pricing could be applied if assets could be valued fairly. However, in extreme market conditions where fair value pricing was not possible, swing pricing was not an appropriate tool, and gating or suspension may be used instead. Moreover, during market disruptions (e.g., March 2020), the swing factor should be adjusted based on various inputs beyond just screen prices, involving collaboration from trading, portfolio management, and risk teams.

128. According to many respondents, swing factors should reflect the estimated cost of liquidity on a best-efforts basis, and the terminology in the RTS (and Guidelines) should be consistent, using "estimated" throughout. A few of them added that materiality of implicit costs should be considered, and they should be included in the swing factor only when appropriate.

129. It was also argued that because swing pricing is part of the NAV calculation it requires strong governance, transparency, and control. Additionally, key considerations when applying swing pricing include data robustness, swing factor and threshold determination, governance, and disclosure.

130. Some respondents claimed that managers should have flexibility in applying LMTs to best serve investors' interests and fit the fund's liquidity characteristics. Two of them argued that swing pricing was not suitable for semi-liquid private market fund strategies, such as venture capital/private equity funds, due to the illiquid nature of their assets and the difficulty in estimating transaction costs. Another respondent added that swing pricing was not the most suitable LMT for real estate AIFs.

131. Two stakeholders noted that although swing pricing uses models and automated data, it still required human oversight, hence flexibility in its application is essential.

132. One respondent disagreed with the draft RTS, arguing that the AIFMD and the UCITS Directive only empowered ESMA to define the characteristics of LMTs, without limiting the

use of any appropriate LMT. Specifically, they claimed that Article 5 of the RTS restricts how swing pricing should be applied.

133. Some respondents recommended that the RTS define swing pricing as a mechanism designed to prevent dilution caused by portfolio transaction costs. Additionally, swing factors shall be calculated separately for subscriptions and redemptions, be tiered based on the size of net flows and market conditions, and thresholds should be established to trigger swing pricing.

134. Two stakeholders argued that pricing mechanisms (swing pricing, dual pricing or anti-dilution levies) to protect against dilution in direct property funds should reflect high transaction costs, particularly real estate transfer taxes, rather than the bid-offer spread of underlying properties. Moreover, the RTS should focus on general principles for unit pricing, rather than imposing specific rules that may not suit all asset classes.

135. One consumer association emphasised that swing pricing should only be used by funds with a proven track record in estimating these costs and attributing them to subscriptions and redemptions. Additionally, retail investors should receive clear information on the mechanism, including the actual NAV and the swing factor applied.

ESMA's response:

136. Considering the broad support for the draft RTS on swing pricing, ESMA only made few changes to the characteristics on swing pricing. The changes consisted mainly in making some provisions more normative in line with the nature of draft RTS. ESMA also removed the provision on the application of swing pricing at the level of share classes as further explained under the response to Question 28 thereafter.

137. ESMA agreed that swing pricing might not be appropriate for some funds and referred to Section 5.5.3.2 of the Final Report on the ESMA Guidelines on the selection and calibration where guidance is provided.

138. Regarding the comments on the necessity of a governance framework for swing pricing, ESMA noted that the mandate of the RTS is limited to the characteristics of LMTs and hence cannot be addressed in the RTS.

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

139. Some respondents could not see any further characteristics of swing pricing, while another one advocated for greater transparency on swing pricing mechanisms, as visibility on the price of mutual fund holdings was essential for institutional investors.

140. Another respondent clarified the difference between first-mover advantage (‘FMA’) in funds versus in markets. Swing pricing aims to address FMA within funds, not in markets. Even with swing pricing, investors could still redeem for reasons unrelated to FMA, such as responding to market conditions or rebalancing their portfolio. Swing pricing via adjustments to the fund NAV discourages opportunistic transactions, but it should not prevent redemptions altogether. In markets, FMA arises when some investors act ahead of others based on changes in market fundamentals or conditions, which is a natural part of market functioning. This aligns with the FSB’s view that redeeming in anticipation of further market deterioration does not equate to benefiting from FMA.

141. Lastly, one respondent argued that for private markets it was more delicate assessing the amounts of various costs to integrate in the swing factor. Therefore, they recommended defining the authorised types of costs to integrate.

ESMA’s response:

142. In light of the feedback received, ESMA did not introduce any new provisions for swing pricing in the draft RTS under the AIFMD and UCITS Directive.

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?

143. Several respondents emphasised the need for sufficient flexibility and discretion for fund managers to apply LMTs optimally, considering the nature of the fund's assets and the best interests of investors.

144. A few stakeholders agreed that the characteristics should differ between investment strategies but not necessarily between AIFs and UCITS.

145. One respondent noted that the feasibility of deploying certain LMTs depends on the fund's characteristics. Swing pricing, for instance, suits open-ended funds investing in assets like equities or fixed income, where large inflows/outflows generate transaction costs. In contrast, money market funds use redemption fees as an anti-dilution measure since they meet redemptions through cash balances. For ETFs, share prices naturally fluctuate based on secondary market conditions, which generates premiums or discounts relative to NAV, making swing pricing irrelevant in that context.

146. Additionally, one respondent pointed out that ESMA's draft Guidelines suggested that swing pricing is suitable for funds with actively traded assets and information on trading costs is regularly updated. However, it is not suitable for funds investing in illiquid assets, as these funds cannot accurately estimate transaction costs.

147. Several stakeholders would see no merit in differentiating the characteristics. However, some of them claimed that fund managers shall have an appropriate level of discretion to decide the best approach.

148. In particular, one respondent argued that for AIFs with multiple share classes and varying liquidity profiles, managers should be allowed to apply different swing factors on a case-by-case basis. Another respondent agreed with this approach but only for AIFs investing in private assets.

ESMA's response:

149. Considering the feedback received, ESMA did not introduce any difference between investment strategies or between UCITS and AIFs for swing pricing.

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.

150. Respondents expressed mixed views on this question. Several respondents agreed that the same swing factor must be applied to all share classes. One of these respondents argued that this was because it must reflect the transaction costs which are common to all share classes. However, there could be exceptions, for instance for funds that offer retail and institutional share classes with different swing factors. Furthermore, two stakeholders explained that having the same swing factor was a guarantee of fair treatment for all unitholders and was easier to implement.

151. However, according to several other respondents the swing factor may differ among share classes, as they may represent different strategies and assets with the specific dilution costs that should only affect the relevant share class. In particular, for AIFs with share classes having different liquidity profiles, the fund manager should have the discretion to apply different swing factors on a case-by-case basis.

152. Also, one respondent explained that if a share class for institutional investors is hedged, resulting in higher costs than an unhedged retail share class, the swing factor for the unhedged retail share class should not include the costs of the hedged share class.

153. One respondent argued that where funds have multiple share classes, the NAV of the fund was the sum of the net assets of the different share classes, which differed in terms of expenses, distribution policies, currencies or minimum holdings. In addition, as new types of hedged share classes (e.g., currency-hedged) are developed, transaction costs may increasingly be incurred at the share class level. Hence, it could be appropriate to consider an additional swing factor at the share class level. When the fund swings in one direction and the share class in the opposite direction, 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.

However, implementing this would be more complex than with fund-level-only swing factors, and it is not currently market practice.

ESMA's response:

154. ESMA concluded that the mandate of the RTS did not empower ESMA to determine the level of application of LMTs to share classes and consequently removed the requirement for AIFMs and management companies to apply the same swing factor to all share classes.

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

155. Several respondents agreed with the description and characteristics of dual pricing. One consumer association agreed with the description but emphasized caution to protect investors. The first method of implementation might overestimate liquidity costs, while the "adjustable spread" method was preferred if based on a rigorous methodology that considers market conditions. Hence, dual pricing should be limited to experienced fund managers. Moreover, they urged ESMA to require clear explanations for investors on how dual pricing affects redemption values.

156. Few respondents noted that, as dual pricing was not widely used in Member States, managers should have a high degree of flexibility.

157. Another respondent disagreed with the description of dual pricing, stating that both calculation methods in Article 6 of the RTS did not specify the characteristics of dual pricing and omit explicit transaction costs. Dual pricing protects against dilution but could lead to concentration, artificially increasing fund performance.

158. Two respondents argued that Article 6 of the draft RTS should align with the definitions in AIFMD and UCITS, focusing on two key aspects of dual pricing: 1) it allows to charge transaction costs to subscribers and redeemers as if they were buying or selling assets directly, and 2) it creates different prices for subscriptions and redemptions at the same dealing point, based on ask and bid prices.

159. One stakeholder recommended that the first method of calculation (two NAVs) allow for adjustments to reflect additional costs of liquidity. They noted that the spread in dual pricing is typically applied by the transfer agent, not in the published NAV. Additionally, not all funds using the second method are priced on a mid-market basis; some are priced at the bid price. Therefore, the RTS wording should be amended to reflect this.

160. One respondent disagreed with the proposed dual pricing mechanism, as it would require significant IT developments, causing high costs also for end investors. The introduction of dual pricing would also complicate performance calculations, portfolio valuation and tax

reporting. Additionally, investors making identical subscription and redemption orders would face different NAVs, having to pay a liquidity cost, although the orders do not impact the fund's liquidity.

161. Few stakeholders argued that this LMT is not suited for some funds, in particular for real estate AIFs and for semi-liquid, private market funds.

ESMA's response:

162. ESMA took note that dual pricing was not a LMT widely used by market participants that may not be suitable for some funds in particular for funds investing in less or illiquid assets.

163. Considering one comment made, ESMA added one provision in both draft RTS that dual pricing shall impose on redeeming and subscribing investors the explicit and implicit estimated costs of portfolio transactions caused by subscriptions or redemptions, including any estimated significant market impact of assets purchases or sales to meet those subscriptions or redemptions.

164. Consistently with the other LMTs, ESMA removed from the draft RTS under the AIFMD and the UCITS Directive the provision on the application of dual pricing because the mandate of the RTS did not empower ESMA to determine the level of application of LMTs to share classes.

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

165. Many respondents were not aware of any other calculation methods for dual pricing.

166. Due to limited experience with dual pricing, a couple of respondents cautioned against provisions in the draft RTS that would restrict managers' ability to develop alternative calculation methods. To reduce concentration issues and align pricing with net flows, the spread between subscription and redemption prices could be reduced, hence sharing the benefit of dual pricing fairly between existing and trading investors. If the spread is reduced to zero, this mechanism would function as full swing pricing.

167. Finally, one respondent noted that not all the investment fund industry was structured to implement "dual pricing" across all fund ranges. Some members have single priced funds with spreads, rather than using two separate NAVs.

ESMA's response:

168. Based on the feedback received, ESMA concluded that no further calculation methods for dual pricing were necessary.

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?

169. Several respondents argued that different strategies or legal structures had no influence on the calculation methodology for dual pricing.

170. Some respondents emphasised the importance of providing fund managers with sufficient flexibility and discretion to use LMTs optimally, in line with the fund's assets and investors' best interests.

ESMA's response:

171. Considering the feedback received, ESMA did not introduce any difference between investment strategies and between AIFs and UCITS for the characteristics of dual pricing.

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

172. A few respondents simply agreed, while others provided more specific feedback.

173. Many stakeholders suggested that RTS should always, and especially in Article 7(1) of the draft RTS under the AIFMD, refer to estimated transaction costs (in particular for market impact), calculated when relevant and on a best effort basis.

174. Additionally, some respondents proposed removing the words "in advance" from Article of 7(4) of the draft RTS to allow asset managers to adjust thresholds based on market conditions. Furthermore, one of them argued that anti-dilution levy shall be defined in the RTS as a fee paid by unitholders / shareholders at subscription, repurchase, or redemption, as in the revised AIFMD and UCITS Directive.

175. Some stakeholders argued that an anti-dilution levy was unsuitable for semi-liquid, private market funds, or real estate funds as they hold mostly illiquid assets, making it difficult to apply a pre-determined NAV adjustment mechanism. They suggested allowing anti-dilution levies even when applied only to specific share classes.

176. One investor protection association noted that the description of anti-dilution levy was broad and could apply to various market practices. According to this respondent, ESMA should set clear criteria to ensure levies are controlled, in particular that they reflected actual costs and are applied only when there are significant net flows.

177. In addition, some respondent would support calculating anti-dilution levies based on individual investor inflows/outflows to ensure equal treatment, avoiding small orders

subsidising large ones. Lastly, anti-dilution tools should be used only by funds with a proven ability to assess liquidity costs accurately, similar to swing and dual pricing.

178. Some respondents pointed out that an anti-dilution levy reflected estimated liquidity costs, not exact transaction costs, and mitigated dilution from capital flow-induced transaction costs. Additionally, the draft provision that referred to exact transaction costs, was unfeasible as trades cannot be attributed to individual investors. According to them, it should be clarified that the anti-dilution levy can be applied to individual or groups of investors, not all transacting investors. Moreover, it should be calculated separately for subscriptions and redemptions, as a percentage of NAV, and may include market impact costs. The RTS should support this definition, allowing for tiered levies and thresholds to protect remaining investors from dilution.

179. One stakeholder pointed out that in their jurisdiction anti-dilution levy was seen as a complex variant of swing pricing, with full or partial swing pricing being preferred. Moreover, the approach, including market impact, was too broad, and practical implementation is unclear.

ESMA's response:

180. In line with the feedback from some stakeholders, ESMA aligned the provisions between the two draft RTS and included the word 'estimated' which was missing in one paragraph of the draft RTS under the AIFMD. However, ESMA did not include any reference to estimations made on a 'best effort basis' because this was not in scope of the mandate of the draft RTS.

181. ESMA took note of the comments made by some respondents that anti-dilution levies may not be appropriate for some funds. However, ESMA did not include any provision of that nature in the final draft RTS as there was no mandate for ESMA to include this kind of provision.

182. For the same reasons, ESMA did not include in the final draft RTS any provisions regarding the governance of anti-dilution levies.

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

183. Many respondents could not think of any other methods, and two stakeholders argued that anti-dilution levy can be calculated in the same way as swing factors.

184. According to one respondent, for semi-liquid strategies, managers may apply a fixed early repurchase deduction on the NAV for redemptions within a set period to protect non-redeeming investors as the fund grows.

185. One respondent explained that the current method was to apply anti-dilution levy only to subscribing or redeeming investors, but not to both. This respondent suggested to apply anti-dilution levies to both on a given dealing day. In the same manner, to ensure that transaction costs are shared by both subscribing and redeeming investors, another respondent argued that anti-dilution tools could be calculated and applied on a pro-rata basis.

186. One stakeholder highlighted that anti-dilution levies are also used when exposure to assets is gained synthetically, like through total return swaps. In this case, "swap fees" charged by the counterparty and covering hedging, rebalancing, and other costs, need to be considered. Managers should factor these fees into the anti-dilution levy calculation.

187. Finally, one respondent objected the provisions requiring managers to include both explicit and implicit estimated transaction costs, like market impact, in liquidity estimates. This forces subjective judgments, in particular when data is unavailable, potentially penalising investors. Additionally, presuming pro-rata sales of portfolios could overstate costs and wrongly assume a preferred management approach.

ESMA's response:

188. In light of the broad support from stakeholders, ESMA did not include any other calculation method for anti-dilution levy in the draft RTS under the AIFMD and the UCITS Directive.

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.

189. Many respondents agreed that in the case of funds with multiple share classes different anti-dilution levies could be applied. For AIFs with share classes having different liquidity profiles or targeting different types of investors (e.g. retail and institutional) the fund manager should have the discretion to apply different swing factors on a case-by-case basis.

190. One consumer association highlighted that orders placed by retail investors were generally small compared to those of institutional investors and generate smaller liquidity costs, hence funds may apply ADLs only to institutional investors.

191. On the contrary, a few respondents would not see the possibility for different anti-dilution levies depending on share classes but a couple of them acknowledged that there may be rare exceptions to rule.

ESMA's response:

192. Consistently with the other liquidity management tools, ESMA did not include any provision on the application and calibration of anti-dilution levies at the level of share classes in the final draft RTS under the AIFMD and the UCITS Directive.

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?

193. For several respondents there was no merit in introducing a difference between investment strategies and between AIFs and UCITS and others added that fund managers shall have an appropriate level of discretion to decide the best approach.

194. One respondent pointed out that the characteristics of AIFs investing in private assets compared to public markets may differ due to different liquidity-raising processes, less frequent dealing dates, and more significant variations in trading costs. Therefore, there could be merits for the characteristics of anti-dilution levy to differ between AIFs and UCITS.

195. Another respondent wondered whether this complex measure should apply to UCITS for retail investors as it may be difficult to understand and may restrain private client participation in capital markets.

ESMA's response

196. While ESMA acknowledged that anti-dilution levy might not be suitable for all investment strategies, ESMA did not introduce any differences in the characteristics of anti-dilution levy between UCITS and AIFs and between investment strategies.

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

197. Stakeholders provided limited feedback on the draft characteristics of redemptions in kind. However, some respondents commented that the way the Level 1 provision on redemption in kind was drafted could be detrimental to the normal functioning of ETFs and in particular to the primary market of ETFs. According to these respondents there was a need to recognise or confirm that when authorised participants use redemptions in kind for the purpose of creation/redemption of units/shares of ETFs, this should not qualify as LMT, and therefore the rule on the pro-rata approach shall not apply to them when the ETF is not replicating an index.

198. Other respondents commented that some flexibility should be introduced when redemption in kind was used and that fund managers shall not be obliged to apply the same method to all professional investors that redeem at the same time.

ESMA's response:

199. ESMA agreed with the comment made by several respondents on the potential impact of the pro-rata rule for the functioning of ETFs. ESMA therefore included a new provision clarifying that the pro-rata approach did not apply to authorised participants and market makers operating on the primary market of ETFs.

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

200. Respondents generally could not think of any other characteristics for redemptions in kind and most of them reiterated the same comments as for Question 36.

ESMA's response:

201. ESMA did not include any further characteristic beyond the one on authorised participants and market makers mentioned in the response to Question 36 above.

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?

202. The majority of respondents did not see the merit for the characteristics of redemption in kinds to differ between different investment strategies and between AIFs and UCITS.

ESMA's response:

203. Considering the feedback, ESMA did not include in any differences between investment strategies and between AIFs and UCITS for the provisions on redemption in kind.

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

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.

204. Most respondents agreed with the constituting elements of the characteristics of side pockets. Most of the comments received were on the creation of side pockets via physical separation in the case of UCITS and on the obligation for fund managers to manage side pockets with the sole objective of being liquidated.

205. The majority of respondents did not 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. According to these respondents, leaving the assets for which there are problems in the original UCITS would not transform the

original UCITS into a non-UCITS, hence there would be no breach of Article 1(5) of the UCITS Directive. These respondents were of the view that such approach as presented by ESMA was not intended by the EU legislators and otherwise, the co-legislators would not have included a new provision in Article 84(2)(a) of the UCITS Directive which allows for separated assets to be excluded from the calculation of limits laid down in Chapter VII on investment policies of UCITS.

206. In addition, respondents pointed out that the approach proposed by ESMA would create a significant change to the current practice which will also have further consequences such as (i) additional operational complications, (ii) additional transaction costs that would be borne by the fund and as a result by investors, (iii) potential tax implications.

ESMA's response:

207. While cognizant of the constraints for management companies, ESMA remained convinced that Article 1(5) of the UCITS did not allow management companies to create side pockets via physical separation with the creation of a new fund where assets for which there are problem are placed. Therefore, the final draft RTS under the UCITS Directive include only one scenario for the creation of side pockets via physical separation.

208. Considering the feedback received, ESMA did not include any other characteristics of side pockets and did not introduce any other difference between UCITS and AIFs than the creation of side pockets via physical separation of the assets.

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.

209. Apart from the issue on the creation of side pockets via physical separation in the case of UCITS and the provision to manage side pockets with the sole objective of being liquidated, respondents generally could not think of any other characteristics that ESMA should consider. In addition, respondents were of the opinion that there was no need for the characteristics of side pockets to differ between UCITS and AIFs.

ESMA's response:

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?

210. Respondents did not report any information on possible legal constraints in their jurisdictions that may limit the use of side pockets via asset segregation.

ESMA's response:

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.

211. The majority of respondents did not agree with this characteristic. According to them, side pockets can be created for assets that are no longer liquid due to geopolitical events such as the closing of a stock exchange, or sanctions being imposed on particular assets. Such circumstances can change. In the first example, assets will remain not listed until the reopening of the stock exchange. Once this happens, assets could become liquid again and be reintegrated in the fund, among other assets.

212. Side pockets inevitably include assets whose transferability has been compromised (mostly by unexpected legal or market developments) and where it is impossible to assess upfront the time horizon for such assets to become transferable again. Given the complexity and cost involved in managing a side pocket, the fund manager should be able to write down the value of the relevant investments to zero or transfer the relevant assets to an affiliated entity, if this reflects at that point a fair market price. This should be allowed, especially where the weight of the relevant position(s) in the overall portfolio is below 1%. The existence of robust governance around valuation of assets and the overall fiduciary duty of the fund manager towards its investors should be sufficient safeguards against the abuse of such possibility.

ESMA's response:

213. ESMA concluded there was no mandate within the empowerment of the draft RTS to specify how side pockets shall be managed. As a consequence, ESMA did not include any provisions in the final draft RTS under the AIFMD and UCITS Directive relating to the management of side pockets. However, ESMA kept the requirement that side pockets created via physical separation in the case of UCITS shall be put into liquidation, as otherwise it would mean that management companies would be allowed to manage a UCITS that is in violation of the UCITS rules.

214. For the same reason, ESMA removed from the final draft RTS the obligation for AIFMs and management companies to place cash within side pockets created via physical separation to manage any potential liabilities.

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?

215. Many respondents did not provide any comments on this question.

216. One respondent agreed 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.

217. Some stakeholders argued that a strong level of prescriptiveness could have negative impacts on the adoption of LMTs across Member States. Fund managers should have enough flexibility to define and adapt the characteristics of these tools. Therefore, they would support minimal standards that avoid any type of overregulation.

218. Regarding the costs, few respondents argued that the use of anti-dilution tools was expensive, particularly when implicit costs have to be included, and it should be kept in mind when choosing such LMT.

219. One respondent highlighted that it was very difficult to determine ex-ante future costs, however they are expected to be significant. Another stakeholder pointed out that the anticipated costs will be produced by various factors, such as implementing LMT, training and learning, prospectus review and information to investors and IT developments.

220. Another stakeholder argued that increasing the use of the proposed mechanisms, which are rarely used, could necessitate high IT development costs and, therefore, heavy implementation costs on the CSD model in their jurisdiction. Ultimately, these costs will be passed to investors. Moreover, regarding compliance costs, they noted that only asset manager impact is addressed, but custodian/asset servicer adaptations should also be taken into account.

ESMA's response:

221. Considering the feedback received, ESMA did not modify the overall approach taken in the final draft RTS on the UCITS Directive and where needed remove provisions that were not addressing characteristics of LMTs.

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

222. One respondent commented that ESG related aspects were not relevant for liquidity management rules. Another stakeholder believed that the implementation of the new rules in the RTS were an opportunity for innovation and reiterated the importance of allowing

flexibility for fund managers to implement the LMTs, which will encourage more efficient liquidity management practices to evolve.

ESMA's response:

223. Considering the feedback received, ESMA did not include any ESG and innovation-related aspect in the draft 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?

224. One respondent agreed with the proposed analysis in relation to the possible costs and benefits of the option proposed by ESMA as regards the characteristics of LMTs set out in Annex V of the AIFMD.

225. Several stakeholders argued that a strong level of prescriptiveness could have negative impacts on the adoption of LMTs across Member States. Fund managers should have enough flexibility to define and adapt the characteristics of these tools. Therefore, they would support minimal standards that avoid any type of overregulation, as they are beneficial for investors and for comparability of the funds industry.

226. One respondent focused on semi-liquid private equity funds, encouraging ESMA to draft its rules keeping them in mind. In fact, they argued that ESMA should ensure the application of appropriate rules so that the features of specific fund strategies are acknowledged.

227. Regarding the costs, few respondents argued that the use of anti-dilution tools was expensive, particularly when implicit costs have to be included, and it should be kept in mind when choosing such LMT.

228. One respondent highlighted that it is very difficult to determine ex-ante future costs, however they are expected to be significant.

229. Another stakeholder argued that increasing the use of the proposed mechanisms, which are rarely used, could necessitate high IT development costs and, therefore, heavy implementation costs on the CSD model in their jurisdiction. Ultimately, these costs will be passed to investors. Moreover, regarding compliance costs, they noted that only asset manager impact is addressed, but custodian/asset servicer adaptations should also be taken into account.

230. Finally, two stakeholders commented that the implementation of anti-dilution tools for systematically non relevant funds has a negative cost/benefit balance, thus it should be avoided.

ESMA's response:

231. Considering the feedback received ESMA introduced where possible some flexibility to reflect existing market practices and removed from the draft RTS any provision that would not address characteristics of LMTs.

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

232. One respondent commented that ESG related aspects were not relevant for liquidity management rules. Another stakeholder believed that the implementation of the new rules in the RTS were an opportunity for innovation and reiterated the importance of allowing flexibility for fund managers to implement the LMTs, which will encourage more efficient liquidity management practices to evolve.

ESMA's response:

233. Considering the feedback received, ESMA did not include any ESG and innovation-related aspect in the draft RTS under the AIFMD.

3.2 Annex II – Legislative mandate to develop technical standards

- Article 16(2)(g) of AIFMD

“ESMA shall develop draft regulatory technical standards to specify the characteristics of the liquidity management tools set out in Annex V.

When developing those draft regulatory technical standards, ESMA shall take account of the diversity of investment strategies and underlying assets of AIFs. Those standards shall not restrict the ability of AIFMs to use any appropriate liquidity management tool for all asset classes, jurisdictions and market conditions”.

- Article 18a (3) of the UCITS Directive

“ESMA shall develop draft regulatory technical standards to specify the characteristics of the liquidity management tools set out in Annex IIA.

When developing those draft regulatory technical standards, ESMA shall take account of the diversity of investment strategies and underlying assets of UCITS. Those standards shall not restrict the ability of UCITS to use any appropriate liquidity management tool for all asset classes, jurisdictions and market conditions.”

3.3 Annex III – Cost-benefit analysis

1. Introduction

The revised UCITS Directive and the AIFMD establish a list of Liquidity Management Tools that shall be available to UCITS and AIFs. The list of LMTs and their definitions are the same in both Directives.

This draft cost-benefit analysis (CBA) is qualitative by nature.

2. Technical options on the characteristics of LMTs

The following options were identified and analysed by ESMA to address the policy objectives of the RTS under the UCITS Directive and the AIFMD.

In identifying the options set out below and choosing the preferred ones, ESMA was guided by the relevant rules of the UCITS Directive and the AIFMD.

- Draft RTS under Article 18a (3) of the UCITS Directive

Policy objective	
Baseline scenario	The baseline scenario should be understood for this CBA as the application of the requirements set out in the UCITS Directive (i.e. the provision on LMTs) without any further specification. This would leave NCAs and also management companies complete discretion to determine the precise characteristics of LMTs. This could clearly lead to a lack of harmonisation in the application of a key provision in the UCITS Directive. The main benefit of the RTS is to establish harmonised characteristics of the LMTs listed in Annex IIA of the UCITS Directive. Such harmonisation will contribute to the uniformed application of the legislation by management companies and to supervisory convergence between NCAs. This will ultimately also participate to increasing investor protection and financial stability in the EU.
Options	The RTS aim to promote the objectives of the Level 1 Directive by setting out the exact characteristics of LMTs. This should contribute to the creation of a level playing field across member States, which will help ensure that LMTs are used in a consistent manner by management companies. This should reduce the scope for regulatory arbitrage, which could otherwise hamper the key objectives of the Level 1 Directive.

Option 1	Do not develop RTS and rely only on the requirements set out in the UCITS Directive.
Option 2	The RTS would provide high level characteristics for each LMT and would leave to national legislations and/or market practices to determine the exact characteristics.
Option 3	The RTS would provide detailed characteristics, distinguishing, if applicable, between investment strategies and UCITS and AIFs. Option 3 was the option in which the level of prescriptiveness of the characteristics of LMTs is high, ensuring a high level of convergence and harmonisation, in the context of the requirements set in the UCITS Directive and the corresponding RTS empowerments for ESMA
Preferred option	ESMA consulted on Option 3 and discarded Option 1 and 2. After having taken into account the feedback received from the public consultation, ESMA decided to develop detailed characteristics while introducing at the same time some flexibility where needed to account for different market practices.

- Draft RTS under Article 16(2)(g) of AIFMD

Policy objective	
Baseline scenario	The baseline scenario should be understood for this CBA as the application of the requirements set out in the AIFMD (i.e. the provision on LMTs) without any further specification. This would leave NCAs and also AIFMs complete discretion to determine the precise characteristics of LMTs. This could clearly lead to a lack of harmonisation in the application of a key provision in the AIFMD. The main benefit of the RTS is to establish harmonised characteristics of the LMTs listed in Annex V of AIFMD. Such harmonisation will contribute to the uniformed application of the legislation by management companies and to supervisory convergence between NCAs. This will ultimately also participate to increasing investor protection and financial stability in the EU.

Option 1	Do not develop RTS and rely only on the requirements set out in the AIFMD.
Option 2	The RTS would provide high level characteristics for each LMT and would leave to national legislations and/or market practices to determine the exact characteristics.
Option 3	The RTS would provide detailed characteristics, distinguishing, if applicable, between investment strategies and between UCITS and AIFs. Option 3 was the option in which the level of prescriptiveness of the characteristics of LMTs is high, ensuring a high level of convergence and harmonisation, in the context of the requirements set in the AIFMD Directive and the corresponding RTS empowerments for ESMA.
Preferred option	ESMA consulted on Option 3 and discarded Option 1 and 2. After having taken into account the feedback received from the public consultation, ESMA decided to develop detailed characteristics while introducing at the same time some flexibility where needed to account for different market practices.

3. **Assessment of the impact of the various options on the characteristics of LMTs**

- Draft RTS under Article 18a(3) of the UCITS Directive

Options	Qualitative description
Benefits	The main benefit of the proposed option is to provide a great level of harmonization and prescriptiveness for the characteristics of LMTs, contributing to the creation of a level playing field across Member States.
Costs	Based on the feedback to the consultation ESMA concluded that the draft RTS were unlikely to lead to significant additional costs to the extent that they do not impose substantive additional obligations beyond those already set by the UCITS Directive in relation to the use of LMTs.
Costs to regulator	The draft RTS will lead to additional costs for regulators, in particular with respect to the ongoing supervision of the liquidity management of UCITS but the benefits of such tasks, in terms of mitigation of any

	investor protection and financial stability issues related to UCITS, clearly outweigh these costs.
Compliance costs	Based on the feedback to the consultation, ESMA concluded that, compared with the current framework, the draft RTS will add certain compliance costs for management companies, in particular in relation to the supervision of their liquidity management, but the benefits of such duties, in terms of mitigation of any investor protection and financial stability issues related to UCITS, clearly outweigh these costs.
ESG-related aspects	Based on the feedback to the consultation, ESMA concluded that ESG-related aspects are not of direct relevance to the specific nature of the draft RTS on the characteristics of LMTs.
Innovation-related aspects	Based on the feedback to the consultation, ESMA concluded that innovation-related aspects are not of direct relevance to the specific nature of the proposed RTS on the characteristics of LMTs.
Proportionality-related aspects	Based on the feedback to the consultation, ESMA concluded the identified benefits outweigh the comparably limited costs, hence no proportionality-related aspects are expected to be impacted by the draft RTS.

- Draft RTS under Article 16(2)(g) of AIFMD

Options	**Qualitative description**
Benefits	The main benefit of the proposed option is to provide a great level of harmonization and prescriptiveness for the characteristics of LMTs, contributing to the creation of a level playing field across Member States.
Costs	Based on the feedback to the consultation, ESMA concluded that the draft RTS were unlikely to lead to significant additional costs to the extent that they do not impose substantive additional obligations beyond those already set by the AIFMD in relation to the use of LMTs.
Costs to regulator	The draft RTS will lead to additional costs for regulators, in particular with respect to the ongoing supervision of the liquidity management of AIFs but the benefits of such tasks, in terms of mitigation of any investor protection and financial stability issues related to AIFs, clearly outweigh these costs.

Compliance costs	Based on the feedback to the consultation, ESMA concluded that, compared with the current framework, the draft RTS will add certain compliance costs for management companies, in particular in relation to the supervision of their liquidity management, but the benefits of such duties, in terms of mitigation of any investor protection and financial stability issues related to AIFs, clearly outweigh these costs.
ESG-related aspects	Based on the feedback to the consultation, ESMA concluded that ESG-related aspects are not of direct relevance to the specific nature of the proposed RTS on the characteristics of LMTs.
Innovation-related aspects	Based on the feedback to the consultation, ESMA concluded that innovation-related aspects are not of direct relevance to the specific nature of the proposed RTS on the characteristics of LMTs.
Proportionality-related aspects	Based on the feedback to the consultation, ESMA concluded that the identified benefits outweigh the comparably limited costs, hence no proportionality-related aspects are expected to be impacted by this option.

4. Conclusions

Considering what has been illustrated above, ESMA believes that the overall supervisory and compliance costs associated with the implementation of these Regulatory Technical Standards are justified by the objectives described above and will be largely compensated by the benefits for all stakeholders and, particularly, for NCAs, managers and investors.

While in fact having the benefit of providing a harmonised framework at EU level for the characteristics of LMTs, the RTS will not only participate to convergent application of EU legislation, but also financial stability and investor protection.

3.4 Annex IV – Draft regulatory technical standards under the AIFMD

COMMISSION DELEGATED REGULATION (EU) …/..

of […]

supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the characteristics of liquidity management tools

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty of the Functioning of the European Union,

Having regard to Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [4], and in particular Article 16(2i), second subparagraph, thereof,

Whereas:

(1) To ensure a consistent use of suspensions of subscriptions, repurchases and redemptions, suspensions of subscriptions should apply simultaneously to suspensions of repurchases and redemptions and for the same period of time.

(2) A redemption gate is a partial and temporary restriction that does not entirely suspend redemptions but limits the amount or proportion of units or shares that shareholders can redeem within a given period.

(3) To ensure a consistent use of redemption gates by AIFMs, the characteristics of redemption gates should address the method for determining the activation threshold and the treatment of the non-executed part of redemption orders resulting from the use of redemption gates. To account for the diversity of investment strategies of AIFs, the method for determining the activation threshold should consist of considering net or gross

[4] OJ L 174, 1.7.2011, p. 1–73.

redemption orders at the level of the AIF for a given dealing date and the activation threshold could be expressed as a percentage of the net asset value of the AIF or in a monetary value or as a combination of both, or as percentage of liquid assets.

(4) When AIFMs activate redemption gates, the non-executed part of redemption orders should be treated according to predefined conditions disclosed to investors under Article 23(h) of Directive 2011/61/EU and, if any, according to national rules of the AIF home Member State. These conditions and rules may include the automatic transfer of the non-executed part of redemption orders to the following dealing date (with or without priority over redemption orders posted for the following dealing date) or their cancellation.

(5) Extension of the notice period should not have any impact on the redemption frequency of the fund. This means that when an AIFM extends the notice period of an AIF, the AIFM should not modify the redemption frequency, and AIFs should continue to offer the same redemption frequency to their investors.

(6) The extension of notice period should be the period of time that is added to the minimum notice period that investors should respect when placing their redemption orders. When this liquidity management tool is activated, the redemption orders should be executed at the end of the extended notice period.

(7) The notice period should not include the settlement process that is not controlled by the AIFM. For instance, the time necessary for post-settlement by the distributor should not be included even though reimbursement to the investors may take additional time.

(8) The notice period may be defined as a specific number of days, weeks, or months, or as a fixed date preceding the redemption date, which is also called the cut-off date.

(9) To ensure a consistent use of redemption fees, the range of redemptions fees should take into account the estimated explicit and implicit costs of portfolio transactions caused by redemptions, including any estimated significant market impact of assets sales to meet those redemptions.

(10) Explicit transaction costs should include costs that are explicitly charged to an AIF for its acquisition or disposal of assets. These costs would typically include brokerage fees, trading levies, taxes and settlement fees. These costs are generally stable in amount and quantifiable in advance of the transactions.

(11) Implicit transaction costs should be costs incurred indirectly upon acquisition or disposal of assets by an AIF (with the bid-ask spread and market impact being the key component). These costs may vary depending on, among other things, the type of underlying asset and the market conditions.

(12) Redemption fees should be based on gross redemption orders and should be deducted from the amount of money paid to redeeming investors for the benefit of the fund.

(13) Swing pricing should be composed of a swing factor whose purpose should be to impose on redeeming and subscribing investors the estimated explicit and implicit costs of portfolio transactions caused by subscriptions or redemptions, including any estimated significant market impact of assets purchases or sales to meet those subscriptions or redemptions.

(14) When AIFMs use swing pricing, they should adjust the net asset value of the AIF by incorporating the swing factor in the net asset value of the AIF. The net asset value published by the AIFM should be the net asset value with the application of the swing factor.

(15) AIFMs that select swing pricing should have the right to adjust the net asset value of the fund on every dealing date for which there is a net activity of any size between redemptions or subscriptions (commonly referred to as "full swing") or only when the net redemptions or subscriptions are greater than a predetermined swing threshold (commonly referred to as "partial swing").

(16) Under both types of swing pricing, the direction of the swing (i.e., whether the swing factor is added to or deducted from the net asset value) should be determined by the net capital activity of the dealing date. Therefore, for a given dealing date, if the net difference between redemptions and subscriptions results in net subscriptions, the swing factor should be added to the net asset value that will be adjusted upward. On the contrary, for a given dealing date, if the net difference between redemptions and subscriptions results in net redemptions, a swing factor should be deducted from the net asset value that will hence be adjusted downward. Under both types of swing pricing, a fund manager may decide to have either a single swing factor or apply progressively increasing swing factors depending on the net capital activity (commonly referred to as "tiered approach") or apply other possibilities such as mixed approaches.

(17) To ensure a consistent use of dual pricing, the characteristic of dual pricing should address the calculation methodology. The characteristics of dual pricing should enable two methods of dual pricing. One method should consist of calculating one net asset value which incorporates assets' ask prices and the other net asset value which incorporates assets' bid prices. Subscribing investors should pay the net asset value calculated using ask asset prices and redeeming investors should receive the net asset value calculated using bid asset prices. The other method should consist in setting an 'adjustable spread' around the fund's net asset value under which assets are priced on a mid-market basis, with a bid price at which the fund redeems shares and an offer price at which the fund issues new shares. The difference between these two prices is known as

the spread as estimated by the fund manager, which could be dynamic to reflect the liquidity costs in prevailing market conditions.

(18) To ensure a consistent use of anti-dilution levies, anti-dilution levies should impose on redeeming and subscribing investors the estimated explicit and implicit costs of portfolio transactions caused by subscriptions or redemptions, including any estimated significant market impact of assets purchases or sales to meet those subscriptions or redemption. Anti-dilution levies should be charged to redeeming investors in the case the number of redemptions exceed the number of subscriptions, or vice-versa, to subscribing investors in case the number of subscriptions exceed the number of redemptions, resulting in a change in the net assets of the funds.

(19) Regarding redemptions in kind, the rules set out in this Regulation should be without prejudice to the specific rules set out in Article 18(5) of Regulation (EU) 2023/606 of the European Parliament and of the Council5 allowing redemptions in kind for retail investors in ELTIFs.

(20) Redemptions in kind should only be available for redemption orders placed by professional investors and executed on a pro rata basis of their assets held by the AIFs. AIFMs may derogate from the obligation to execute redemptions in kind on a pro rata basis only if the AIF is solely marketed to professional investors or if the aim of the AIF's investment policy is to replicate the composition of a certain stock or debt securities index and that the AIF is an exchange-traded fund as defined in Article 4(1), point (46), of Directive 2014/65/EU.

(21) Regarding redemptions in kind, there is a need to account for the essential functions performed by authorised participants or market makers related to ETF's day-to-day operations and eco-system, in particular in relation to the primary and secondary market dealings. Their role includes acquiring or selling AIF ETF shares or units in the secondary market and assisting the AIF ETF in executing orders on assets resulting from these transactions. When, in the normal course of regular dealing activities relating to the direct redemption of shares in a AIF ETF by an authorised participant or market-maker, the delivery in whole or in part of underlying securities held by, or on behalf of, an AIF ETF to authorised participants and market makers to satisfy such dealing requests should not be considered as an activation of the redemption-in-kind mechanism in the context of Annex V of Directive 2011/61/EU as this does not relate to the liquidity management of the portfolio of AIF ETF.

[5] Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023 amending Regulation (EU) 2015/760 as regards the requirements pertaining to the investment policies and operating conditions of European long-term investment funds and the scope of eligible investment assets, the portfolio composition and diversification requirements and the borrowing of cash and other fund rules

(22) Side pockets may be used through physical separation or accounting segregation.

(23) For side pockets created with physical separation, assets for which economic or legal features have changed significantly or become uncertain due to exceptional circumstances should either be transferred into a new fund or remain in the original AIF. For side pockets created with accounting segregation, assets for which economic or legal features have changed significantly or become uncertain due to exceptional circumstances should be allocated to a dedicated share class of the AIF.

(24) To ensure a consistent use of the side pockets, side pockets should be closed for subscriptions and redemptions.

(25) AIFMs may be allowed to use other tools than the ones referred to in Annex V of Directive 2011/61/EU to manage the liquidity of the AIFs they manage but these other tools should not be considered as liquidity management tools for the purpose of complying with the obligation to select at least two liquidity management tools under Article 16(2)(b) of Directive 2011/61/EU. These additional tools may include for example so-called ‘soft closures’ that consist in suspending only subscription or only repurchases or redemptions of the AIF.

(26) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA) in accordance with Article 10 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council6.

(27) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council,

HAS ADOPTED THIS REGULATION:

Article 1

Subject matter

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[6] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

1. This Regulation specifies the characteristics of the liquidity management tools available to AIFs managing open-ended AIFs set out in Annex V of Directive 2011/61/EU.

Article 2
Suspension of subscriptions, repurchases and redemptions

1. For the purposes of the liquidity management tool referred to in Annex V, point 1, of Directive 2011/61/EU, a suspension of subscriptions, repurchases and redemptions shall apply simultaneously, for the same period of time and to all investors of the AIF. The liquidity management tool does not permit a suspension of subscriptions, repurchase or redemptions without providing for a suspension of all of them.

2. In the case of an AIF with multiple share classes, the suspension of subscriptions, repurchases and redemptions shall apply to all the share classes of that AIF.

Article 3
Redemption gates

1. For the purposes of the liquidity management tool referred to in Annex V, point 2, of Directive 2011/61/EU, a redemption gate shall include an activation threshold below which the redemption gate shall not be activated and shall apply to all investors of the AIF.
2. The activation threshold shall be based on the total net or gross redemption orders for an AIF received for a given dealing date and shall be expressed in one of the following ways:
   (a) in proportion to the net asset value of the AIF or in a monetary value, or as a combination of both;
   (b) as a percentage of liquid assets in accordance with Article 50(1) of Directive 2009/65/EC.
3. A redemption gate for a given dealing date shall be applied in one of the following ways:
   (a) execute the redemption orders from all investors for that dealing date in accordance with the redemption arrangements of the fund for an amount that corresponds at least to the level of the activation threshold in proportion to the total amount of those redemption orders; or
   (b) set a predefined redemption amount, of individual redemption orders below or equal to which orders from all investors for that dealing date will be executed in full, with the redemption applied only to the portion of the redemption order that exceeds the predefined redemption amount.

Article 4
Extension of notice periods

1. For the purposes of the liquidity management tool referred to in Annex V, point 3, of Directive 2011/61/EU, the extension of notice periods shall be the period of time that AIFMs add to the minimum notice period that investors shall give to the AIFM when placing their redemption order.
2. The extension of the notice period shall not have any impact on the redemption frequency of the AIF.

Article 5
Redemption fees

1. For the purposes of the liquidity management tool referred to in Annex V, point 4, of Directive 2011/61/EU, the predetermined range of redemption fees shall take into account the estimated explicit and implicit costs of redeeming units or shares, including any estimated significant market impact of asset sales to meet those redemptions.
2. Redemption fees shall be expressed either as a percentage of the redemption orders or as a monetary value. They may be applied at different levels based on the size of the redemption orders.

Article 6
Swing pricing

1. For the purposes of the liquidity management tool referred to in Annex V, point 5, of Directive 2011/61/EU, the swing factor in swing pricing shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of assets purchases or sales to meet those subscriptions or redemptions.
2. The swing factor shall be expressed as a percentage of the net asset value of the AIF.
3. Swing pricing may be applied where there is a difference between the redemption orders and the subscription orders (full swing) or if the difference exceeds a predefined activation threshold (partial swing). In either case:
   (a) if the difference between the redemption orders and the subscription orders for a given dealing date results in net redemptions, the swing factor shall be deducted from the net asset value of the AIF;
   (b) if the difference between the redemption orders and the subscriptions orders for a given dealing date results in net subscriptions, the swing factor shall be added to the net asset value of the AIF.
4. Swing pricing may include different swing factors corresponding to different activation thresholds.

Article 7
Dual pricing

1. For the purposes of the liquidity management tool referred to in Annex V, point 6, of Directive 2011/61/EU, dual pricing shall use one of the following calculation methods:

   (a) the AIF has two net asset values with one net asset value for subscribing investors calculated using the ask prices of the assets in which the AIF is invested and one net asset value for redeeming investors calculated using the bid prices of the assets in which the AIF is invested;

   (b) the AIF has one net asset value for subscribing and redeeming investors.

2. For both calculation methods referred to in paragraph 1, the costs of liquidity by which the net asset value per unit or share is adjusted shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.

Article 8
Anti-dilution levy

1. For the purposes of the liquidity management tool referred to in Annex V, point 7, of Directive 2011/61/EU, anti-dilution levies shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.

2. Anti-dilution levies shall be expressed either as a percentage of the redemption orders or subscription orders or as a monetary value.

3. Anti-dilution levies may be applied where the difference between redemption orders and subscription orders for a given dealing date exceeds a predefined activation threshold. Where the activation threshold is exceeded:

   (a) if the difference between redemption orders and subscription orders for a given dealing date results in net redemptions, an anti-dilution levy shall be deducted from the amount paid to redeeming investors;

   (b) if the difference between redemption orders and subscription orders for a given dealing date results in net subscriptions, an anti-dilution levy shall be charged to subscribing investors.

Article 9
Redemptions in kind

1. For the purposes of the liquidity management tool referred to in Annex V, point 8, of Directive 2011/61/EU, redemptions in kind shall prevent the sale of sizable blocks of securities of the AIF in response to redemption requests where those sizeable blocks would be likely to create significant transaction costs and market price impacts to shareholders or unit-holders of that AIF.

2. Where in the normal course of regular dealing activities relating to the direct redemption of shares in an AIF ETF by an authorised participant or market-maker, the delivery in whole or in part of underlying securities held by, or on behalf of, an AIF ETF to authorised participants or market-makers to satisfy such dealing requests shall not be considered an activation of the liquidity management tool of redemptions in kind.

Article 10
Side pockets

1. For the purposes of the liquidity management tool referred to in Annex V, point 9, of Directive 2011/61/EU, side pockets for assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances may take the form of one of the following:
   (a) a specific share class of the AIF created specifically for those assets (*accounting segregation*);
   (b) a separate fund to separate those assets from the other assets of the AIF created specifically for the purpose of that operation (*physical separation*).
2. For side pockets referred to in paragraph 1, point (a), new subscriptions, redemptions and repurchases shall be executed on the basis of the net asset value of the AIF from which the assets of the side pockets are excluded.
3. For side pockets referred to in paragraph 1, point (b), the separate fund may include one of the following:
   (a) the assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances;
   (b) all other assets of the AIF.
4. By way of derogation from paragraph 1, point (b), the assets for the separate fund referred to in paragraph 3, point (b), may be transferred through a merger into an existing AIF.
5. Investors shall receive shares or units of the side pocket pro rata in relation to their holdings in the AIF.
6. Side pockets shall be closed-ended and no subscriptions shall be accepted for them.

Article 11
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union.*

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

3.5 Annex V – Draft regulatory technical standards under the UCITS Directive

COMMISSION DELEGATED REGULATION (EU) …/..

of […]

supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the characteristics of liquidity management tools

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty of the Functioning of the European Union,

Having regard to Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)[7], and in particular Article 18a(5), second subparagraph, thereof,

Whereas:

(1) To ensure a consistent use of suspensions of subscriptions, repurchases and redemptions, suspensions of subscriptions should apply simultaneously to suspensions of repurchases and redemptions and for the same period of time.

(2) A redemption gate is a partial and temporary restriction that does not entirely suspend redemptions but limits the amount or proportion of units or shares that shareholders can redeem within a given period.

(3) To ensure a consistent use of redemption gates by management companies, the characteristics of redemption gates should address the method for determining the activation threshold and the treatment of the non-executed part of redemption orders resulting from the use of redemption gates. The method for determining the activation threshold should consist of considering net or gross redemption orders at the level of the

[7] OJ L 302, 17.11.2009, p. 32–96

UCITS for a given dealing date. The activation threshold should be expressed as a percentage of the net asset value of the UCITS to reflect the dynamic nature of the net asset value.

(4) When management companies activate redemption gates, the non-executed part of redemption orders should be treated according to predefined conditions disclosed to shareholders or unit-holders in the prospectus and, if any, according to national rules of the UCITS home Member State. These conditions and rules may include the automatic transfer of the non-executed part of redemption orders to the following dealing date (with or without priority over redemption orders posted for the following dealing date) or their cancellation.

(5) Extensions of the notice period should not have any impact on the redemption frequency of the fund. This means that if the notice period of a fund is extended, the redemption frequency of the UCITS should not be modified, and the UCITS should continue to offer the same redemption frequency to their shareholders or unitholders.

(6) The extension of notice period should be the period of time that is added to the minimum notice period that investors should respect when placing their redemption orders. When this liquidity management tool is activated, the redemption orders should be executed at the end of the extended notice period.

(7) The notice period should not include the settlement process that is not controlled by the management company. For instance, the time necessary for post-settlement by the distributor should not be included even though the reimbursement to the shareholders or unit-holders may take additional time.

(8) The notice period may be defined as a specific number of days, weeks, or as a fixed date preceding the redemption date, which is also called the cut-off date.

(9) To ensure a consistent use of redemption fees, the range of redemptions fees to be charged to redeeming shareholders or unitholders should include the estimated explicit and implicit costs of portfolio transactions caused by redemptions, including any estimated significant market impact of asset sales to meet those redemptions.

(10) The explicit transaction costs should include costs that are explicitly charged to an UCITS for its acquisition or disposal of assets, such as brokerage fees, trading levies, taxes and settlement fees, which are generally stable in amount and quantifiable in advance of the transactions. The implicit transaction costs should include the costs incurred indirectly upon acquisition or disposal of assets by an UCITS with the bid-ask spread and market impact as key components. These costs may vary depending on, among other things, the type of underlying asset and the market conditions.

(11) Redemption fees should be based on gross redemption orders and should be deducted from the amount of the money paid to redeeming shareholders or unit-holders for the benefit of the UCITS.

(12) The purpose of the swing factor in swing pricing is to charge redeeming and subscribing shareholders or unit-holders for the costs of transactions caused by subscriptions or redemptions. These costs should include the estimated explicit and implicit costs of those transactions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.

(13) The use of swing pricing should result in the adjustment of the net asset value of the UCITS by incorporating the swing factor in the net asset value of the UCITS. The net asset value published by the management company should be the net asset value with the application of the swing factor.

(14) Management companies that select swing pricing should be allowed to adjust the net asset value of the UCITS on every dealing date for which there is a net activity of any size between redemptions or subscriptions (commonly referred to as “full swing”) or only when the net redemptions or subscriptions are greater than a predetermined swing threshold (commonly referred to as “partial swing”).

(15) Under both types of swing pricing, the direction of the swing (whether the swing factor is added to or deducted from the net asset value) should be determined by the net capital activity of the dealing date. Therefore, for a given dealing date, if the net difference between redemptions and subscriptions results in net subscriptions, the swing factor should be added to the net asset value that will be adjusted upward. Similarly, for a given dealing date, if the net difference between redemptions and subscriptions results in net redemptions, a swing factor should be deducted from the net asset value that will be adjusted downward. Both types of swing pricing may use either a single swing factor or apply progressively increasing swing factors depending on the net capital activity (commonly referred to as “tiered approach“) or use mixed approaches.

(16) To ensure a consistent use of dual pricing the characteristic of dual pricing should address the calculation methodology. The characteristics of dual pricing should enable two methods of dual pricing. One method should consist of calculating one net asset value which incorporates assets’ ask prices and the other net asset value which incorporates assets’ bid prices. Subscribing shareholders or unit-holders should pay the net asset value calculated using ask asset prices and redeeming shareholders or unit-holders should receive the net asset value calculated using bid asset prices. The other method should consist of setting an ‘adjustable spread’ around the fund’s net asset value under which assets are priced on a mid-market basis, with a bid price at which the UCITS redeems shares and an offer price at which the UCITS issues new shares. The difference between these two prices is known as the spread as estimated by the management

company, which could be dynamic to reflect the liquidity costs in prevailing market conditions.

(17) To ensure a consistent use of anti-dilution levies, anti-dilution levies should result in a charge on redeeming and subscribing shareholders or unit-holders for the estimated explicit and implicit costs of transactions caused by subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemption after considering the net redemptions for a given dealing date.

(18) Redemptions in kind should only be available for redemption orders placed by professional investors and executed on a pro rata basis of their assets held by the UCITSs. Management companies may derogate from the obligation to execute redemptions in kind on a pro rata basis only if the UCITS is solely marketed to professional investors or if the aim of the UCITS' investment policy is to replicate the composition of a certain stock or debt securities index and that the UCITS is an exchange-traded fund as defined in Article 4(1), point (46), of Directive 2014/65/EU.

(19) Regarding redemptions in kind, there is a need to account for the essential functions performed by authorised participants or market makers related to ETFs, in particular in relation to the primary and secondary market dealings. Their role includes acquiring or selling UCITS ETF shares or units in the secondary market and assisting the UCITS ETF in executing orders on assets resulting from these transactions. When, in the normal course of regular dealing activities relating to the direct redemption of shares in a UCITS ETF by an authorised participant or market-maker, delivery is made in whole or in part of underlying securities held by, or on behalf of, an UCITS ETF to authorised participants and market makers to satisfy such dealing requests, this should not be considered an activation of the redemption-in-kind mechanism in the context of Annex IIA of the UCITS Directive as this does not relate to the liquidity management of the portfolio of UCITS ETFs.

(20) Side pockets may be used through physical separation or accounting segregation.

(21) According to Article 1(5) of Directive 2009/65/EC of the European Parliament and of the Council, Member States shall prohibit UCITS which are subject to that Directive from transforming themselves into collective investment undertakings which are not covered by that Directive. This means that for side pockets created with physical separation, it should not be possible to create side pockets via physical separation by placing the assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances in a new fund created for the purpose of the side pocket. In that case, the assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances should be kept in the

original UCITS, which becomes a side pocket, and manage the side pocket with the sole objective of being liquidated.

(22) To ensure a consistent use of side pockets, side pockets created with accounting segregation, the assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances should be allocated to a dedicated share class of the UCITS.

(23) To ensure a consistent use of side pockets, side pockets should be closed for subscriptions and redemptions.

(24) Management companies may be allowed to use other tools than the ones referred to in Annex IIA of Directive 2009/65/EC to manage the liquidity of the AIFs they manage but these other tools should not be considered as liquidity management tools for the purpose of complying with the obligation to select at least two liquidity management tools under Article 18a(2) of Directive 2009/65/EC. These additional tools may include for example so-called 'soft closures' that consist in suspending only subscriptions or only repurchases or redemptions of the UCITS.

(25) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA) in accordance with Article 10 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[8].

(26) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council,

HAS ADOPTED THIS REGULATION:

Article 1

Suspension of subscriptions, repurchases and redemptions

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 1, of Directive 2019/65/EC, a suspension of subscriptions, repurchases and redemptions shall apply simultaneously, for the same period of time and to all shareholders or unitholders of the UCITS. The liquidity management tool does not permit a suspension of

[8] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

subscriptions, repurchase or redemptions without providing for a suspension of all of them.

2. In the case of an UCITS with multiple share classes, the suspension of subscriptions, repurchases and redemptions shall apply to all the share classes of that UCITS.

Article 2

Redemption gates

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 2, of Directive 2011/61/EU, a redemption gate shall include an activation threshold below which the redemption gate shall not be activated and shall apply to all investors of the UCITS.
2. The activation threshold shall be based on the total net or gross redemption orders for a UCITS received for a given dealing date and shall be expressed in proportion to the net asset value of the UCITS.
3. A redemption gate for a given dealing date shall be applied in one of the following ways:

   (a) execute the redemption orders from all shareholders or unit-holders for that dealing date received in accordance with the redemption arrangements of the fund for an amount that corresponds at least to the level of the activation threshold in proportion to the total amount of those redemption orders; or

   (b) set a predefined redemption amount of individual redemption orders below or equal to which redemption orders from all unit-holders or shareholders for that dealing date will be executed in full, with the redemption gate being applied only to the portion of the redemption order that exceeds that predefined redemption amount.

Article 3

Extension of notice periods

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 3, of Directive 2009/65/EC, the extension of notice periods shall be the period of time that management companies add to the minimum notice period that shareholders or unit-holders shall give to management companies when placing their redemption order.
2. The extension of the notice period shall not have any impact on the redemption frequency of the UCITS.

Article 4

Redemption fees

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 4, of Directive 2009/65/EC, the predetermined range of redemption fees shall take into account the estimated explicit and implicit costs of redeeming units or shares, including any estimated significant market impact of asset sales to meet those redemptions.
2. Redemption fees shall be expressed either as a percentage of the redemption orders or as a monetary value. They may be applied at different levels based on the size of the redemption orders.

Article 5
Swing pricing

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 5, of Directive 2009/65/EC, the swing factor in swing pricing shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.
2. The swing factor shall be expressed as a percentage of the net asset value of the UCITS.
3. Swing pricing may be applied where there is a difference between the redemption orders and the subscription orders (full swing) or if the difference exceeds a predefined activation threshold (partial swing). In either case:

   (a) if the difference between the redemption orders and the subscription orders for a given dealing date results in net redemptions, the swing factor shall be deducted from the net asset value of the UCITS;

   (b) if the difference between the redemption orders and the subscriptions orders for a given dealing date results in net subscriptions, the swing factor shall be added to the net asset value of the UCITS.
4. Swing pricing may include different swing factors corresponding to different activation thresholds.

Article 6
Dual pricing

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 6, of Directive 2009/65/EC, dual pricing shall use one of the following calculation methods:

   (a) the UCITS has two net asset values with one net asset value for subscribing shareholders or unit holders calculated using the ask prices of the assets in which the UCITS is invested and one net asset value for redeeming shareholders or unit holders calculated using the bid prices of the assets in which the UCITS is invested;

   (b) the UCITS has one net asset value for subscribing and redeeming shareholders or unit holders.

2. For both calculation methods referred to in paragraph 1, the costs of liquidity by which the net asset value per unit or share is adjusted shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.

Article 7
Anti-dilution levy

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 7, of Directive 2009/65/EC, anti-dilution levies shall include the estimated explicit and implicit costs of subscriptions or redemptions, including any estimated significant market impact of asset purchases or sales to meet those subscriptions or redemptions.
2. Anti-dilution levies shall be expressed either as a percentage of the redemption orders or subscription orders or as a monetary value.
3. Anti-dilution levies may be applied where the difference between redemption orders and subscription orders for a given dealing date exceeds a predefined activation threshold. Where the activation threshold is exceeded:

   (a) if the difference between redemption orders and subscription orders for a given dealing date results in net redemptions, an anti-dilution levy shall be deducted from the amount paid to redeeming shareholders or unit-holders;

   (b) if the difference between redemption orders and subscription orders for a given dealing date results in net subscriptions, an anti-dilution levy shall be charged to subscribing shareholders or unit holders.

Article 8
Redemptions in kind

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 8, of Directive 2009/65/EC, redemptions in kind shall prevent the sale of sizable blocks of securities of the UCITS in response to redemption requests where those sizeable blocks would be likely to create significant transaction costs and market price impacts to shareholders or unit-holders of that UCITS.
2. Where in the normal course of regular dealing activities relating to the direct redemption of shares in a UCITS ETF by an authorised participant or market-maker, the delivery in whole or in part of underlying securities held by, or on behalf of, a UCITS ETF to authorised participants or market-makers to satisfy such dealing requests shall not be considered an activation of the liquidity management tool of redemptions in kind.

Article 9
Side pockets

1. For the purposes of the liquidity management tool referred to in Annex IIA, point 9, of Directive 2009/65/EC, side pockets for assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances may take the form of one of the following:

   (a) specific share class of the UCITS created specifically for those assets (*accounting segregation*);

   (b) the UCITS with all other assets transferred to another UCITS (*physical separation*).

2. For side pockets referred to in paragraph 1, point (a), new subscriptions, redemptions and repurchases shall be executed on the basis of the net asset value of the UCITS from which the assets of the side pockets are excluded.

3. The side pockets referred to in paragraph 1, point (b), shall have the following characteristics:

   (a) the assets whose economic or legal features have not changed significantly or have not become uncertain due to exceptional circumstances shall be transferred into a new UCITS created specifically for the purpose of this operation;

   (b) the original UCITS which contains only the assets whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances shall suspend subscriptions and redemptions and be put into liquidation;

   (c) the new UCITS shall be authorised and managed according to the investment strategy of the original UCITS.

4. By way of derogation from paragraph 3, points (a) and (c), the assets whose economic or legal features have not changed significantly or have not become uncertain due to exceptional circumstances may be transferred through a merger into an existing UCITS provided the merger complies with the requirements set out in Chapter VI of Directive 2009/65/EC.

5. Shareholders or unit-holders shall receive shares or units of the side pocket pro rata in relation to their holdings in the UCITS.

6. Side pockets shall be closed-ended and no subscriptions shall be accepted for them.

Article 10
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union.*

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,