Reply form

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

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **8 October 2024.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

Instructions

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

• Insert your responses to the questions in the Call for Evidence in this reply form.

• Please do not remove tags of the type < ESMA\_QUESTION\_GLMT\_0>. Your response to each question has to be framed by the two tags corresponding to the question.

• If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.

• When you have drafted your responses, save the reply form according to the following convention: ESMA\_CP1\_GLMT\_nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA\_CP1\_GLMT \_ABCD.

• Upload the Word reply form containing your responses to ESMA’s website (**pdf**  **documents will not be considered except for annexes**). All contributions should be submitted online at <https://www.esma.europa.eu/press-news/consultations/consultation-liquidity-management-tools-funds> under the heading *‘Your input -*  *Consultations’.*

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘[Data protection](https://www.esma.europa.eu/about-esma/data-protection)’.

**Who should read this paper?**

This document will be of interest to alternative investment fund managers, AIFs, management companies, UCITS, and their trade associations, depositories and their trade associations, as well as professional and retail investors investing into UCITS and AIFs and their associations.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | Irish Funds Industry Association (“Irish Funds”) |
| Activity | Irish Funds Association |
| Country / Region | Ireland |

# Questions

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

<ESMA\_QUESTION\_SLMT\_1>

Irish Funds would note that there may be circumstances whereby a fund manager (“manager”) requires the flexibility to suspend redemptions without also having to suspend subscriptions. Therefore Article 1(1) appears to be overly restrictive. For example, in the case of a fund operating a capital commitment and call mechanism there may be existing contractual commitments for investments within the fund (e.g. for a property) and as such the manager may choose to suspend redemptions but call on the committed capital to meet the funds contractual commitments for the benefit of the funds’ investors.

While we would generally envision the activation of suspension of subscriptions, repurchases, and redemptions in tandem as standard practice, in cases of a fund suspension — such as when a valuation is unavailable to produce the fund's Net Asset Value (NAV) — there are situations, as our example highlights, where this may not be appropriate. Therefore, we request that ESMA remove the blanket requirement to suspend subscriptions, repurchases, and redemptions as a single action.

Regardless of the approach, it is critical for managers to ensure that those LMTs selected are clearly documented in the funds offering documentation, in a way that is easily understood by investors.

Additionally, should the non-exhaustive list of ‘exceptional circumstances’ in the ESMA Guidelines consultation[[1]](#footnote-2) be retained for the activation of suspensions we would caution against any consideration of limiting or narrowing this definition in the final draft as a.) the circumstances around a suspension can be wide-ranging and not known in advance, and b.) this could have the unintended consequence of reducing the manager’s discretion to apply a suspension at the most appropriate time for the investors in the fund. It is critical that should any definition be retained it should be sufficiently high-level to allow the manager to retain the discretion to define what they deem ‘exceptional circumstances’ on a case-by-case basis. It should also be noted that this is the most exceptional LMT in a manager’s liquidity management toolkit (as recognised in the consultation) given its reputational impact and therefore the decision to activate a suspension by any manager is not one that is taken lightly and would be subject to the most stringent of governance processes.

Finally, it is also worth acknowledging that in the rare instances of a fund activating a suspension there is already good cooperation and communication between the National Competent Authorities (“NCAs”) and managers, with managers obliged to report any fund suspensions directly to their regulator.

<ESMA\_QUESTION\_SLMT\_1>

1. 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.

<ESMA\_QUESTION\_SLMT\_2>

In principle we would agree with this as it would prevent first mover advantage (noting this is taken to mean in the context of the element(s) that are suspended). As covered within the non-exhaustive list referenced in question 1 the reason for suspending a fund can be wide ranging but as an example, where a fund receives large redemption requests and there is valuation uncertainty within the fund, the suspension mechanism affords the manager the ability to navigate this situation in an effective way that is fair to all investors within the fund.

<ESMA\_QUESTION\_SLMT\_2>

1. 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?

<ESMA\_QUESTION\_SLMT\_3>

Acknowledging again that the manager is best placed to manage their fund, we would caution against mandating an overly prescriptive approach. However, the standard approach would be to manage the execution of all outstanding redemption orders placed before the fund was suspended to ensure that all investors are treated fairly. However, depending on the size of the redemption orders the manager may need to activate a gate at this point to ensure the orderly execution of those redemption orders.

<ESMA\_QUESTION\_SLMT\_3>

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

<ESMA\_QUESTION\_SLMT\_4>

Yes, Irish Funds believes there may be circumstances where subscriptions, repurchases and redemptions are not re-opened simultaneously as highlighted in question 1.

Another example might be where a decision is taken to wind down or liquidate a fund, and for only redemption orders to be filled without opening the fund for subscriptions/repurchases.

It is worth highlighting that often the circumstances that would lead to a fund suspension can be ‘black swan’ events and therefore difficult to predict. As such the manager needs to retain the discretion and flexibility to adapt to the liquidity situation as it arises.

<ESMA\_QUESTION\_SLMT\_4>

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

<ESMA\_QUESTION\_SLMT\_5>

Apart from the elements referenced in our response to the previous question regarding simultaneous suspensions of subscriptions, repurchases and redemptions, the characteristics provided should be sufficiently broad and comprehensive, without being overly prescriptive, allowing managers the appropriate flexibility to activate a suspension in the best interests of investors.

<ESMA\_QUESTION\_SLMT\_5>

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

<ESMA\_QUESTION\_SLMT\_6>

Irish Funds does not believe there is merit in differentiating characteristics between either investment strategies or funds vehicles (UCITS and AIFs). The fund terms and available tools selected for each fund are done to ensure that they are fit for purpose in terms of the fund strategy, investor base, dealing frequency etc… In the case of suspension, all funds are required to have this within their liquidity management tool kit. To the extent that the activation of a suspension is deemed necessary due to “exceptional circumstances”, what those circumstances constitute could be very different based on strategy, investor base and dealing frequency. However, its function as a mechanism is the same regardless of strategy or vehicle.

As referenced in question 1, ultimately it is for the manager / fund Board to exercise their judgement as to what types of trigger events constitute exceptional circumstances for their fund range. The manager will give due credence to the associated fund terms, investment strategies followed, and asset classes held, in addition to retaining discretion over what is determined to be in the best interests of their investors. Therefore, we do not see a need to create separate characteristics for the suspension of UCITS and AIFs (or across different strategies), and instead advocate for these characteristics to remain broad-based and not overly prescriptive.

Finally, it is worth reiterating that the decision to activate a suspension by any manager is not one that is taken lightly and would be subject to the most stringent of governance processes.

<ESMA\_QUESTION\_SLMT\_6>

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

<ESMA\_QUESTION\_SLMT\_7>

Caution should be exercised in terms of being overly prescriptive when it comes to the practical application of the gating mechanism by managers and their Boards.

Consideration should also be given to re-drafting the text in Article 2(6) as this might be read as giving priority to the non-executed orders. This could be expanded on to capture the additional context provided in paragraph 36 and 39 which provides discretion to the manager/Board as to the processing order of redemptions; “*The fund manager/fund Board shall specify in advance, whether the part of redemption orders that have not been executed, as a result of the activation of the redemption gate, and that have been carried forward to the next dealing date, shall have any priority or not over redemption orders submitted for execution at the next dealing date*”.

Additionally, there are a number of aspects to the characteristics of gates that should be re-considered and are highlighted in our answers (to the gating questions) below.

<ESMA\_QUESTION\_SLMT\_7>

1. 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.

<ESMA\_QUESTION\_SLMT\_8>

Article 2(1) considers the threshold only as a percentage of the NAV, and while this is a commonly used method, particularly in UCITS, another approach that may be used is determining a threshold based on an ‘absolute monetary’ amount. This is the case when it may be more appropriate to link a threshold to the size of a market rather than a fund for certain asset classes. For example, where a fund is invested in specific real estate markets, the manager may be able to determine the absolute size of a transaction that a market would be unable to absorb without a significant negative impact and set the threshold below that.

Finally, Article 2(2) references net redemption orders for a “given dealing date”. ESMA should also give due consideration to managers using a ‘rolling period’ which would be based on redemptions over a set cumulative period (possibly calibrated to the dealing frequency and notice period) breaching the threshold.

<ESMA\_QUESTION\_SLMT\_8>

1. 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?

<ESMA\_QUESTION\_SLMT\_9>

As an overarching position, Irish Funds believes that the selection and activation of LMTs should be at the discretion of the manager and considered on a case-by-case basis with the manager being best placed to exercise judgement to ensure the best outcome for their investors. Irish Funds would advocate that the activation threshold of any gate should be determined by the manager and that the activation of a gate should also be at the discretion of the manager/fund Board.

Irish Funds would note that gates would be a common LMT within an Irish UCITS toolkit. However, as it is deemed a more ‘exceptional’ LMT in the case of UCITS it is not widely used and the decision to activate a gate is typically taken at the manager/fund Board level.

<ESMA\_QUESTION\_SLMT\_9>

1. 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.

<ESMA\_QUESTION\_SLMT\_10>

As mentioned in our response to question 9, Irish Funds holds the overarching position that the selection and activation of LMTs should be at the discretion of the manager and considered on a case-by-case basis with the manager being best placed to exercise judgement to ensure the best outcome for their investors.

<ESMA\_QUESTION\_SLMT\_10>

1. 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.

<ESMA\_QUESTION\_SLMT\_11>

To treat all investors fairly, the activation threshold should not be set at the level of the single redemption order.

We would strongly oppose the suggested approach within the ESMA Guidelines Consultation[[2]](#footnote-3) that appears to propose the mandating of a pan-European minimum activation threshold for all funds. The setting of an appropriate minimum threshold for any fund should be retained by the manager.

<ESMA\_QUESTION\_SLMT\_11>

1. 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?

<ESMA\_QUESTION\_SLMT\_12>

Irish Funds does not believe that investors should automatically have the right to cancel the non-executed part of their redemption orders given that fund strategies, investments, liquidity profile etc… will vary and therefore a ‘one-size-fits-all’ approach is not appropriate in this regard. For example, in some circumstances, investors that are expecting liquidity constraints may place a larger redemption in the knowledge that they can cancel the part of their order that is not executed. This results in an artificially high level of redemptions which are subsequently cancelled. It is very difficult for portfolio managers to manage a fund on this basis. Therefore, Irish Funds would advocate that investors should have the ability to request the cancellation of non-executed orders, but this request can only be executed with the approval of the manager.

There should be no difference in approach in this regard between UCITS and AIFs.

<ESMA\_QUESTION\_SLMT\_12>

1. 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?

<ESMA\_QUESTION\_SLMT\_13>

Irish Funds does not believe there to be merit in differentiating characteristics between either investment strategies or fund vehicles (UCITS and AIFs), save for what the consultation highlights in relation to the European Long-Term Investment Fund (ELTIF). The fund terms and available tools selected for each fund are chosen to ensure they are fit for purpose in terms of the fund’s strategy, investor base, dealing frequency etc… To the extent that the activation of a redemption gate is deemed necessary, the mechanism and the core of what it is intended to do (i.e. gate redemptions) is the same regardless of strategy or vehicle. The only point of difference, though not related to the mechanism of the LMT itself, is that the threshold applied may vary depending on the strategy and asset types held within the vehicle, but the characteristics of the gate remain the same regardless of the threshold set.

<ESMA\_QUESTION\_SLMT\_13>

1. 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.

<ESMA\_QUESTION\_SLMT\_14>

Managers should have the flexibility to select and activate the LMTs that are in the best interest of their investors. Affording the manager sufficient flexibility in how they apply LMTs allows them to meet their fiduciary duties to their investors. Irish Funds would not be in favour of overly restrictive and prescriptive rules governing the application of LMTs, and while we would expect the standard approach to be that LMTs are applied to all share classes, there may be limited circumstances where this is not the case. It would therefore seem appropriate to afford managers flexibility to apply LMTs on a share class basis where it is deemed in the best interests of all investors and clearly stated in the funds offering documents.

<ESMA\_QUESTION\_SLMT\_14>

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

<ESMA\_QUESTION\_SLMT\_15>

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<ESMA\_QUESTION\_SLMT\_15>

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

<ESMA\_QUESTION\_SLMT\_16>

In general, although Irish Funds broadly agrees with the description of extension of notice periods, there are aspects of the characteristics that need to be considered, as highlighted in our responses to the extension of notice period questions below, to ensure the manager has sufficient flexibility to always be able to act in the best interest of their investors.

Additionally, it is worth noting that if the primary goal of implementing an LMT is to minimize the adverse impact on the market due to a redemption request, opting for an extended settlement period could offer a viable alternative to an extended notice period. For example, opting for an extended settlement period which could allow for the realisation of value within for example, a T+5 settlement, as opposed to a shorter period, for example T+3, is likely to allow the manager to manage market impact leading to lower implicit costs. While the value of positions being sold would experience daily gains and losses, executing trades over a more extended timeframe can likely curtail overall market impact costs for investors. Moreover, in these scenarios, it could be argued that an extended settlement period would be operationally simpler. Shifting the settlement date for cash distribution to investors is seemingly less intricate than dynamically altering a notification period. It is worth noting that fund prospectuses commonly include a provision stating that “settlement cycles will be X, but under certain circumstances, they may extend beyond”. In this context, an elongated settlement period leverages an existing clause in the fund prospectus to adapt to specific situations.

However, the abovementioned scenario largely assumes the overall market is stable during the settlement period. This means the manager can engage in trading over several days following the NAV date, allowing the manager to trade in potentially smaller lot sizes which reduces potential market impact and therefore transaction costs for investors.

Conversely, during periods of heightened market stress when concerns about market impact and liquidity are significantly intensified, the situation changes. In such stressed market environments, the remaining investors might encounter more substantial losses than they would in ordinary circumstances due to increased market exposure. Accordingly, in such a scenario, it may be more optimal to consider lengthening the notice period to enable the manager to plan appropriately for the proposed redemption.

These examples are presented as potential abstract scenarios; however, we believe that highlighting these scenarios is constructive as they underscore the significance of relevant facts and specifics (in the current conditions) in determining the appropriateness of implementing a specific LMT. Therefore, akin to the preceding considerations, it remains crucial for the manager to retain the discretion to employ an extended settlement or notice period.

<ESMA\_QUESTION\_SLMT\_16>

1. 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.

<ESMA\_QUESTION\_SLMT\_17>

Managers should have the flexibility to select and activate the LMTs that are in the best interest of their investors. Affording the manager sufficient flexibility in how they apply LMTs allows them to meet their fiduciary duties to their investors. Irish Funds would not be in favour of overly restrictive and prescriptive rules governing the application of LMTs, and while we would expect the standard approach to be that LMTs are applied to all share classes, there may be limited circumstances where this is not the case. It would therefore seem appropriate to afford managers flexibility to apply LMTs on a share class basis where it is deemed in the best interests of all investors and clearly stated in the funds offering documents.

<ESMA\_QUESTION\_SLMT\_17>

1. 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.

<ESMA\_QUESTION\_SLMT\_18>

Yes, however as referenced throughout our response to this consultation a ‘one-size-fits-all’ approach is not appropriate and therefore sufficient flexibility (governed by a robust framework) allows the manager to most effectively manage any liquidity stress that arises. We are supportive of the approach, as outlined in the consultation in *Article 3(5)*, that a manager‘***may*** *apply to a pre-defined number of dealing days’*’. That allows the manager to **either** set a fixed number of dealing days when extending a notice period or extend the notice period for an unspecified period of time, whatever approach, in the view of the manager, allows for the optimum outcome for their investors.

This would also be our view where a manager determines the selection of an extended settlement cycle as more appropriate for their investors under particular circumstances.

<ESMA\_QUESTION\_SLMT\_18>

1. 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?

<ESMA\_QUESTION\_SLMT\_19>

While Irish Funds do not believe there is a need to differentiate the characteristics of notice period extension between fund types and strategies, we would like to point out that AIFs typically focus on more complex asset types, often investing in less liquid or illiquid assets like private equity and real estate. These funds will often cater to professional investors with higher risk tolerances and may require specialised valuation processes. UCITS, on the other hand, target more liquid securities, with stricter regulations, including the degree of exposure to certain asset types, to protect retail investors. In addition, UCITS typically have daily dealing dates whereas AIFs are typically less frequent (monthly, quarterly, annually). Since there is often a correlation between the notice period and dealing frequency, the option to extend a notice period may require additional consideration for more illiquid strategies that have longer dealing frequency. Regardless, the characteristics and principles are the same i.e. the manager will determine if an extension of notice period is appropriate for the specific liquidity situation impacting their funds and investors at the design stage of the fund and review its appropriateness throughout the lifecycle of the fund.

<ESMA\_QUESTION\_SLMT\_19>

1. 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?

<ESMA\_QUESTION\_SLMT\_20>

From a fair treatment of shareholders perspective, redemption orders that have been placed but not executed before the notice period is extended would be executed under the original notice period. However, if certain criteria were met in extreme circumstances such as market liquidity events, then these may need to be deferred to the next dealing day. Therefore, it is important that the manager has sufficient flexibility and discretion to make a determination on a case-by-case basis to ensure the best outcome for the fund’s investors.

<ESMA\_QUESTION\_SLMT\_20>

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

<ESMA\_QUESTION\_SLMT\_21>

The existence of an extension of notice period, which would only be put into effect if required to manage liquidity in a fund, should be stated in the fund prospectus as one of the funds LMTs. In addition, managers should use reasonable endeavours to inform investors of the extension as soon as possible. All investors should be treated fairly on deactivation and be aware of the procedures that will apply, similar to those applied on activation. LMTs are activated to manage specific liquidity events, and once this liquidity event has been managed the LMT is deactivated, and the fund liquidity provisions return to normal. The key to ensuring fair treatment of investors is to have an appropriate liquidity management framework that helps guide the approach at both the activation and deactivation points, as well as disclosure and communication to investors when both activating and deactivating the LMT.

<ESMA\_QUESTION\_SLMT\_21>

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

<ESMA\_QUESTION\_SLMT\_22>

Irish Funds would like to highlight that redemption fees are not always utilised as an anti-dilution tool; instead, they can be used to encourage investors to hold the investment in line with the recommended holding period. For example, they may take the form of contingent deferred costs or part of a fund lock-up mechanism whereby an investor is charged for redeeming before a certain timeframe.

We would also like to highlight that estimating implicit costs is not a straightforward process and market impact presents significant complexity and difficulties in some cases, for example, in stressed market conditions for certain asset classes (e.g., fixed income). During market stress, liquidity can deteriorate rapidly, and transaction costs may become highly unpredictable, making accurate estimation challenging. The calculation of implicit costs should be considered estimate on a ‘best efforts’ basis. The risk of overestimation of costs should be considered and the materiality of the implicit costs including market impact should also be a consideration. Where the manager deems these costs not material (e.g. a large cap fund) there should be no requirement to include them in the redemption fee when considered on a cost/benefit basis.

We note that there seems to be an inconsistency in the following characteristics outlined in the consultation of the redemption fees: as per section 2.2.5 paragraph 49, redemption fees are predetermined fixed fees while paragraph 51 states they can be expressed as a range to consider that transaction costs might increase in stressed market conditions. We would note that fees may decrease gradually in line with the length of the period that the investor remains in the fund. To that point, redemption charges can be 0% in our view in certain situations (for example, post completion of the lock-up period charges may be shown as 0% in fund documents).

Similarly, as per paragraph 55 it is stated that “*redemption fees correspond to transaction-based costs which are fixed or have low variation”*. At the same time the paragraph states that “*redemption fees shall impose [..] the explicit and implicit estimated costs of portfolio transactions caused by redemptions, including any estimated significant market impact [..]”*. As such, the recognition that during stress periods implicit costs can increase significantly does not seem to align with the stated characteristic of predetermined, fixed or low variation costs.

Given the arguments above, we would suggest removing the term ‘*predetermined*’ from Annex 3.4 IV - Article 4(1) to allow for sufficient flexibility – noting this is already not included in Article 4(1) for UCITS.

<ESMA\_QUESTION\_SLMT\_22>

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

<ESMA\_QUESTION\_SLMT\_23>

Per our response to question 22 redemption fees are not always linked to dilution costs e.g. contingent deferred costs, redemption charges during lock-up periods and other distribution redemption fees.

<ESMA\_QUESTION\_SLMT\_23>

1. 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?

<ESMA\_QUESTION\_SLMT\_24>

No, we don’t believe the characteristics of a redemption fee should differ between different investment strategies and between AIFs and UCITS. Ultimately, the manager will set a fee or range that is appropriate for their fund. However, as referenced in question 22 and 23 the purpose of a redemption fee will not always be to act as an anti-dilution tool.

<ESMA\_QUESTION\_SLMT\_24>

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

<ESMA\_QUESTION\_SLMT\_25>

Irish Funds generally agree with the description and corresponding characteristics (including the use of full, partial and tiered swings) and welcome the recognition that the liquidity costs are estimated and as such, different managers may derive different estimates. However, we would like to highlight that estimating implicit costs is not straightforward, and market impact presents significant complexity and difficulties in some cases, for example in stressed market conditions for certain asset classes (e.g., fixed income). During market stress, liquidity can deteriorate rapidly, and transaction costs may become highly unpredictable, making accurate estimation challenging. The calculation of implicit costs should be considered an estimate on a ‘best efforts’ basis. The risk of overestimation of costs should also be considered.

As such, the statement that “*the swing factor shall impose [..] the explicit and implicit estimated costs of portfolio transactions costs caused by subscriptions or redemptions, including any significant market impact of assets purchases”* does not fully appreciate, in our view, the complexity and practical challenges of measuring dilution impact and updating the swing factors (including from an operational and governance perspective). Therefore, materiality of the implicit costs, including market impact, should be a consideration and where the manager deems these costs not material (e.g. a large cap fund) there should be no requirement to include in the swing factor when considered on a cost/benefit basis.

Additionally, we would also highlight our response to question 28 in relation to the application of swing factors per share class.

<ESMA\_QUESTION\_SLMT\_25>

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

<ESMA\_QUESTION\_SLMT\_26>

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<ESMA\_QUESTION\_SLMT\_26>

1. 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?

<ESMA\_QUESTION\_SLMT\_27>

We do not believe it is necessary to differentiate between UCITS and AIFs regardless of the investment strategy, and although investment strategy is a key consideration when deciding if swing pricing is a suitable LMT for a fund, the characteristics of swing pricing does not need to vary across strategies or fund type.

<ESMA\_QUESTION\_SLMT\_27>

1. 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.

<ESMA\_QUESTION\_SLMT\_28>

Managers should have the flexibility to select and activate the LMTs that are in the best interest of their investors. Affording the manager sufficient flexibility in how they apply LMTs allows them to meet their fiduciary duties to their investors. Irish Funds would not be in favour of overly restrictive and prescriptive rules governing the application of LMTs, and while we would expect the standard approach to be that LMTs are applied to all share classes, there may be limited circumstances where this is not the case. It would therefore seem appropriate to afford managers flexibility to apply LMTs on a share class basis where it is deemed in the best interests of all investors and clearly stated in the funds offering documents.

<ESMA\_QUESTION\_SLMT\_28>

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

<ESMA\_QUESTION\_SLMT\_29>

Irish Funds agree with the description of dual pricing and the corresponding characteristics.

<ESMA\_QUESTION\_SLMT\_29>

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

<ESMA\_QUESTION\_SLMT\_30>

Irish Funds are not aware of other calculation methods.

<ESMA\_QUESTION\_SLMT\_30>

1. 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?

<ESMA\_QUESTION\_SLMT\_31>

No, Irish Funds does not see merit in the characteristics of dual pricing differing between different investment strategies and between AIFs and UCITS. The characteristics of the LMT are the same regardless of the strategy or vehicle. Its suitability and when and why it is applied will be determined by the manager.

<ESMA\_QUESTION\_SLMT\_31>

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

<ESMA\_QUESTION\_SLMT\_32>

Irish Funds agree with the description of the anti-dilution levy (“ADL”).

In terms of characteristics, we note the same concerns highlighted in questions 22 and 25 around the challenges of calculating implicit costs and particularly market impact and the need to consider the materiality of the implicit costs including market impact before mandating their inclusion within the ADL.

In addition, ADL can also be calculated and applied on a pro-rata basis so that transaction costs are borne by both subscribing and redeeming investors.

Irish Funds also notes its response to question 34 below.

Finally, there also appears to be a typo that causes a difference between the calculation of market impact in Article 7 of both the AIF and UCITS text. The first bullet of the UCITS text includes the term “estimated” significant market impact, whereas the term “estimated” is missing in the AIF text. Given the calculation of market impact is widely recognised as a ‘best effort’ estimate, we request Article 7 of the AIF text to be updated accordingly.

<ESMA\_QUESTION\_SLMT\_32>

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

<ESMA\_QUESTION\_SLMT\_33>

As per the previous question, ADL can also be calculated and applied on a pro-rata basis so that transaction costs are borne by both subscribing and redeeming investors.

<ESMA\_QUESTION\_SLMT\_33>

1. 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.

<ESMA\_QUESTION\_SLMT\_34>

Managers should have the flexibility to select and activate the LMTs that are in the best interest of their investors. Affording the manager sufficient flexibility in how they apply LMTs allows them to meet their fiduciary duties to their investors. Irish Funds would not be in favour of overly restrictive and prescriptive rules governing the application of LMTs, and while we would expect the standard approach to be that LMTs are applied to all share classes, there may be limited circumstances where this is not the case. It would therefore seem appropriate to afford managers flexibility to apply LMTs on a share class basis where it is deemed in the best interests of all investors and clearly stated in the funds offering documents.

<ESMA\_QUESTION\_SLMT\_34>

1. 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?

<ESMA\_QUESTION\_SLMT\_35>

No, Irish Funds does not see merit in the characteristics of ADLs differing between different investment strategies and between AIFs and UCITS. The characteristics of the LMT are the same regardless of the strategy or vehicle. Its suitability and when and why it is applied will be determined by the manager.

<ESMA\_QUESTION\_SLMT\_35>

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

<ESMA\_QUESTION\_SLMT\_36>

See response to question 38.

<ESMA\_QUESTION\_SLMT\_36>

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

<ESMA\_QUESTION\_SLMT\_37>

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<ESMA\_QUESTION\_SLMT\_37>

1. 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?

<ESMA\_QUESTION\_SLMT\_38>

Irish Funds note that in the case where passive Exchange Traded Funds (“ETFs”) opt to use in-kind redemptions as one of its two nominated forms of Liquidity Management Tools (i.e. dictates to the investor precisely what securities it will return in exchange for ETF shares), the pro-rata requirement shall not be applied. We would also like to take the opportunity to clarify an important point in respect of ETFs generally (whether passive or active), namely that the requirements in relation to RIK shall only apply where a UCITS ETF is using RIK as one of its two nominated LMTs and not where it is using it as part of its business-as-usual redemption process. It is important that this point is clarified.

As noted by both the FSB**[[3]](#footnote-4)** and IOSCO**[[4]](#footnote-5)** in their respective Reports of December 2023, ETFs have an operational structure which is distinct from other UCITS and consequently both the FSB and IOSCO explicitly state that their respective guidance of December 2023 is not applicable to ETFs. They also indicate that the operation and structure of ETFs have been subject to significant review including as outlined in the IOSCO (2021) Exchange Traded Funds Thematic Note – Findings and Observations during Covid-19 induced market stresses[[5]](#footnote-6) and the IOSCO Final Report on Good Practices Relating to the Implementation of the IOSCO Principles for Exchange Traded Funds (May 2023)[[6]](#footnote-7).

ETFs trade in two distinct yet interconnected markets: ‘primary’ (ETF share creation and redemption between ETF issuers and Authorised Participants (APs)), and ‘secondary’ (exchange of ETF shares amongst investors, facilitated by market-makers operating on public trading venues). In the primary market, APs are authorised to transact (by creating and/or redeeming ETF shares) directly with the ETF issuer, in exchange for cash proceeds or a proportionate share of the underlying assets that make up the benchmark tracked by the ETF. APs typically undertake such primary market activity in response to ETF investors’ demand for liquidity in the secondary market. This liquidation feature of ETFs is distinctly different from other forms of UCITS funds such as Open-Ended Funds. With respect to the use of RIK by an ETF issuer, it is important to acknowledge two structural drivers:

1. RIK are regularly used by ETF issuers, enabling APs to facilitate liquidity, efficient pricing and effective arbitrage for the benefit of ETF investors. As such, redemptions-in-kind constitute a regular liquidity transmission tool for UCITS ETFs and restricting their use as an LMT will significantly disrupt the efficient functioning of the UCITS ETF market.
2. APs are specialised financial institutions such as banks and specialist ETF market makers.APs are therefore operationally prepared to receive redemptions-in-kind in exchange for ETF shares. In contrast, most ETF investors cannot receive the custody of underlying securities.

We would highlight that the ability for an ETF issuer to enter into in-kind arrangements with the APs is a key ‘business as usual’ structural feature which is used to facilitate an efficient and effective arbitrage mechanism. While this arrangement is entered into with sophisticated professional investors (i.e. APs), the UCITS ETFs may be sold to retail investors on the secondary market who will benefit from an effective arbitrage mechanism. This arrangement is supported by the transparency of the ETF’s portfolio holdings and dedicated capital markets personnel who assist with its operation and oversight. This is acknowledged by IOSCO (in its May 2023 report**[[7]](#footnote-8)**) which notes that “*The arbitrage mechanism is the defining feature of the ETFs structure as it provides the means to maintain a close tie between market price and NAV per share of the ETF. This in turn helps to ensure that different ETF investors are treated equitably when buying and selling ETF shares*”*.*

It should also be noted that in the case of European Long-Term Investment Funds (“ELTIFs”) there are prescriptive rules on when an investor in an ELTIF can receive assets in-kind and the ELTIF rules should take precedence over any AIFMD rules.

<ESMA\_QUESTION\_SLMT\_38>

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

<ESMA\_QUESTION\_SLMT\_39>

In Article 9(1b) for UCITS and AIFs, we feel the term “*Assets for which there are valuation issues or legal uncertainty*” is too narrow of a description. What may be useful is to expand the definition to include manager discretion, “*Assets for which there are valuation issues, legal uncertainty or that the manager deems necessary to move to a side pocket*”. This definition provides for sufficient flexibility to include the full scope of assets that may be considered for a side pocket, including illiquid assets, which aligns with the criteria for activation and calibration within the ESMA Guidelines consultation[[8]](#footnote-9).

Finally, we understand the bullet in paragraph 94 of the consultation “*The fund manager shall allocate a proportion of liquid assets to the side pocket in order to fulfil any possible liabilities arising from the management of the side pocket*” to mean that these liquid assets are transferred directly from the fund that the side pocket was created from.

<ESMA\_QUESTION\_SLMT\_39>

1. 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.

<ESMA\_QUESTION\_SLMT\_40>

Irish Funds would generally support the approach that the problematic assets should remain in the UCITS, with the liquid assets being transferred to a new UCITS. This ensures that the related parties (fund administrator, depositary, legal, audit etc) are familiar with any historical issues/events leading to the side pocket. It also avoids issues around the transfer of problematic assets to a new fund due to sanctions or other uncertainties. However, it is worth noting that the physical separation of assets is not a straightforward process and can take a significant period of time to implement, with additional costs also being borne through operating a separate vehicle versus an accounting segregated side pocket. It is worth highlighting also that in Ireland the Central Bank of Ireland only permit the method outlined in the ESMA consultation for UCITS[[9]](#footnote-10).

Finally, Irish Funds is also of the opinion that the text of Article 9(2) in the UCITS RTS should be amended to afford the manager sufficient flexibility to allow for the efficient management of their fund for the benefit of all investors; “*1. For side pockets referred to in paragraph 1 b) of this Article, management companies ~~shall~~* ***may*** *suspend the subscriptions and redemptions of the UCITS and transfer the assets for which there are no valuation issues or legal uncertainty in a new UCITS created specifically for the purpose of this operation (or via a merger into an existing UCITS in so far as the merger complies with the requirements set out in Chapter VI of Directive 2009/65/EC).*”

<ESMA\_QUESTION\_SLMT\_40>

1. 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.

<ESMA\_QUESTION\_SLMT\_41>

We do not believe that the characteristics of side pockets should differ, beyond that of the example in the consultation, between UCITS and AIFs.

<ESMA\_QUESTION\_SLMT\_41>

1. 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?

<ESMA\_QUESTION\_SLMT\_42>

Yes, it may be useful to highlight accounting segregation as a timelier and cost-effective setup relative to physical segregation. Accounting segregation may be agreed with Fund Administrators as a straightforward solution to set up closed-ended share classes on an ongoing basis (e.g. for illiquid investments), where fees are factored in up front. This offers more flexibility in the investment universe for open ended AIF’s.

The Central Bank of Ireland issued a “Notice of Intention[[10]](#footnote-11)” in May 2022 regarding the creation of side pockets in UCITS to address the increased sanctioning of assets resulting from the Russian invasion of Ukraine. Currently in Ireland you can only create a side pocket through ‘physical separation’ for Irish domiciled UCITS.

<ESMA\_QUESTION\_SLMT\_42>

1. 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.

<ESMA\_QUESTION\_SLMT\_43>

The manager shall *“manage the side pockets with the sole objective of being liquidated” (Article 9(4) – AIFM and Article 9(6) - UCITS)* could be read to mean that the side pocket shall ultimately be liquidated which ignores the potential for the manager to move assets from the side pocket back to the main fund once the liquidity/legal/valuation issues are resolved. In exceptional circumstances, where specific criteria such as a constant/single investor base are met, it may be beneficial to investors to reintegrate side-pocketed assets into the portfolio. In situations where sanctions are lifted and positions are liquid/tradable once more, it may be in the best interest of investors to hold the asset as part of the wider portfolio, reducing transaction costs etc, to achieve optimal returns. However, discretion should be afforded to managers to make informed decisions based on the best interests of their investors.

<ESMA\_QUESTION\_SLMT\_43>

1. 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?

<ESMA\_QUESTION\_SLMT\_44>

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<ESMA\_QUESTION\_SLMT\_44>

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

<ESMA\_QUESTION\_SLMT\_45>

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<ESMA\_QUESTION\_SLMT\_45>

1. 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?

<ESMA\_QUESTION\_SLMT\_46>

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<ESMA\_QUESTION\_SLMT\_46>

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

<ESMA\_QUESTION\_SLMT\_47>

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<ESMA\_QUESTION\_SLMT\_47>

1. https://www.esma.europa.eu/sites/default/files/2024-07/ESMA34-1985693317-1097\_CP\_on\_LMTs\_of\_UCITS\_and\_open-ended\_AIFs.pdf [↑](#footnote-ref-2)
2. https://www.esma.europa.eu/sites/default/files/2024-07/ESMA34-1985693317-1097\_CP\_on\_LMTs\_of\_UCITS\_and\_open-ended\_AIFs.pdf [↑](#footnote-ref-3)
3. [Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds (fsb.org)](https://www.fsb.org/uploads/P201223-1.pdf) [↑](#footnote-ref-4)
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5. https://www.iosco.org/library/pubdocs/pdf/IOSCOPD682.pdf [↑](#footnote-ref-6)
6. [FR07/23 Good Practices Relating to the Implementation of the IOSCO Principles for Exchange Traded Funds](https://www.iosco.org/library/pubdocs/pdf/IOSCOPD733.pdf) [↑](#footnote-ref-7)
7. [FR07/23 Good Practices Relating to the Implementation of the IOSCO Principles for Exchange Traded Funds](https://www.iosco.org/library/pubdocs/pdf/IOSCOPD733.pdf) [↑](#footnote-ref-8)
8. https://www.esma.europa.eu/sites/default/files/2024-07/ESMA34-1985693317-1097\_CP\_on\_LMTs\_of\_UCITS\_and\_open-ended\_AIFs.pdf [↑](#footnote-ref-9)
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10. [Notice of Intention - UCITS Side-Pocket Arrangements (centralbank.ie)](https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/industry-communications/notice-of-intention-ucits-side-pocket-arrangements.pdf) [↑](#footnote-ref-11)