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ELTIF 2.0 RTS: EU Commission Formally Adopts Its RTS and Takes Flexible Approach to Liquidity

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Key Takeaways

- On 19 July 2024, the EU Commission formally adopted its delegated regulation supplementing the ELTIF Regulation. The delegated regulation seeks to set out the regulatory technical standards specifying when derivatives will be used solely for hedging purposes, the requirements for an ELTIF's redemption policy and liquidity management tools, the circumstances for the matching of transfer requests of units of an ELTIF, certain criteria for the disposal of ELTIF assets and certain elements around costs disclosure.
- Most notably, the EU Commission has rejected ESMA's one-size fits all approach to liquidity and has provided managers of ELTIFs with the discretion to determine the most appropriate liquidity provisions for their ELTIFs (within certain parameters). In particular, (semi-) open-ended ELTIFs will not be required to always hold a minimum percentage of liquid assets nor to have a minimum holding period.

Regulation (EU) 2023/606 amending the ELTIF Regulation (**ELTIF 2.0**)[1] mandated ESMA[2] to develop regulatory technical standards (**RTS**), to, amongst other points, set out the requirements around liquidity for open-ended ELTIFs. The development of these RTS has involved a significant amount of back-and-forth between the European Commission (**EU Commission**) and ESMA, primarily due to the EU Commission's desire to ensure the success and flexibility of ELTIF 2.0 and its view that ESMA should take a more "proportionate approach" to the RTS and take into consideration the variety of potential ELTIFs and their investment strategies.

This ultimately led to the EU Commission, on 19 July 2024, finalising the RTS and formally adopting its delegated regulation supplementing the ELTIF Regulation[3]. In adopting its final RTS, the EU Commission has rejected ESMA's more conservative proposals on liquidity[4] and adopted a form of RTS which provides managers with the flexibility to determine the liquidity requirements that work best for a particular open-ended ELTIF, given its investment strategy (within defined parameters).

In particular:

- **Determination of the maximum redemption amount[5]:** Consistent with its previous position, the EU Commission did not agree with ESMA's proposal that open-ended ELTIFs must always hold a minimum percentage of liquid assets. The EU Commission's final RTS reintroduce flexibility and provide that the manager of an ELTIF may determine, in its discretion, the maximum percentage of liquid assets that can be used for redemption requests on the basis of either:

(1) the redemption frequency and the notice period of the ELTIF (in line with Annex I to the RTS (copied below)). This option does not mandate a minimum percentage of liquid assets that must be held by an ELTIF. As an example, if an ELTIF permitted redemptions on a quarterly basis (i.e. every 3 months) and required that investors give 3 months' notice of redemptions, then the ELTIF can redeem a maximum of 33.3% of the liquid assets held by it on the relevant redemption day; or

Notice Period / Redemption Frequency	No Notice Period	2 weeks Notice Period	1 month Notice Period	3 months Notice Period	6 months Notice Period	9 months Notice Period	12 months Notice Period
12 months	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
6 months	50.0%	52.2%	54.5%	66.7%	100.0%	100.0%	100.0%
3 months	25.0%	26.1%	27.3%	33.3%	50.0%	100.0%	100.0%
2 months	16.7%	17.4%	18.2%	22.2%	33.3%	66.7%	100.0%
1 month	8.3%	8.7%	9.1%	11.1%	16.7%	33.3%	100.0%
Bi-weekly	4.2%	4.3%	4.5%	5.6%	8.3%	16.7%	100.0%
Weekly	1.9%	2.0%	2.1%	2.6%	3.8%	7.7%	100.0%

(2) on the basis of the redemption frequency and the minimum percentage of liquid assets held by the ELTIF (as set out in Annex II to the RTS (copied below)). Here the ELTIF must hold a minimum percentage of liquid assets and the amount of such assets that can be redeemed on any redemption day is determined by how often investors can redeem.

Annex II (Gating)

Redemption frequency	Minimum percentage of liquid assets	Maximum percentage of liquid assets that can be redeemed (gating)
12 months, and less frequent	10%	100%
6 months	15%	67%
3 months	20%	50%
1 month or more frequent	25%	20%, applied on a monthly aggregate basis

In each case, when determining the maximum size of redemption on a given redemption day the manager of the ELTIF shall apply the maximum percentage to the sum of: (1) the assets categorised as liquid assets at that redemption date; and (2) the expected cash flow, forecasted on a prudent basis over 12 months[6].

- **Minimum holding period:** Contrary to the ESMA's view that an open-ended ELTIF must have a minimum holding period, the final RTS reiterates the EU Commission's previous position that open-ended ELTIFs do not need to have a mandatory minimum holding period. Instead, managers of open-ended ELTIFs can choose to provide for one if they determine that a minimum holding period would assist the ELTIF in completing the investment of its capital contributions.

If the manager of an ELTIF chooses to put a minimum holding period in place, it must consider the criteria set out in the RTS in determining the appropriate minimum holding period.

- **Redemption notice periods:** The EU Commission's RTS confirms that it is only where less than three months' notice of redemptions is required of investors that the manager of the ELTIF need inform the competent authority of the ELTIF of such notice period (and the reasons for such shorter notice period) and explain how that shorter notice period is consistent with the individual features of the ELTIF. This amendment brings the RTS in line with market standard practice and is an improvement on ESMA's earlier proposal (which required managers to justify to the relevant competent authority where the notice period was less than six months).
- **Notification obligations to the competent authority:** ESMA's draft RTS proposed that if there was a material change to any of the information provided to the competent authority on the ELTIF's redemption policy and related liquidity items, then the ELTIF's manager would need to provide written notice to the competent authority of the ELTIF of such change as soon as possible, and at least one month before implementing the change. The EU Commission's final RTS narrows the scope of this obligation however and provides that the manager of an ELTIF need only provide the relevant competent authority with such prior notice[7] in the case of the following changes:

(1) a change in the periodicity and the duration of the redemptions;

(2) a change in the available liquidity management tools and the conditions for their activation (if any);

(3) a change in the approach used by the manager of the ELTIF to determine the maximum redemption percentage; and

(4) a material change in the conditions and procedures for requesting redemptions and for processing the redemption requests received.

The EU Commission's final RTS also provides that where that competent authority does not react to such a notification within 20 calendar days, it shall be deemed to have agreed to such change.

- **Disclosure of the redemption policy / transfer matching mechanism:** The EU Commission's RTS have also removed the onerous requirements (1) that the redemption policy must be set out in an ELTIF's prospectus and on the manager's website, and (2) that the transfer matching mechanism must be set out in an ELTIF's instrument of incorporation and its prospectus. Where these policies and mechanisms are disclosed is now up to the manager.

These changes in respect of open-ended ELTIFs represent material improvements on ESMA's proposals and are anticipated to meet industry expectations as regards open-ended ELTIFs.

The EU Parliament and Council now have three months to object to the EU Commission's RTS, following which the RTS will be published in the EU's Official Journal (likely in October 2024) and enter into force the day following publication.

Footnotes

1. For a summary of ELTIF 2.0, please refer to our *OnPoint* ELTIF 2.0: retailization of private funds – the gateway to heaven or a storm in a teacup?
2. European Securities Market Authority, the EU's financial markets regulator and supervisor.
3. The EU Commission RTS dated 19 July 2024 are available here.
4. For a summary on the key points of the amendments from the ESMA’s April 2024 Opinion, please refer to our *OnPoint* ELTIF 2.0 RTS: Focus on Liquidity - ESMA Proposes Further Changes to EC Amendments
5. Article 18(2), first paragraph, point (d) of ELTIF 2.0.
6. For the purposes of point (2), the manager of the ELTIF shall only take into account those expected positive cash flows for which the ELTIF manager can demonstrate that there is a high degree of certainty that they will materialise. The manager of the ELTIF shall not consider as expected positive cash flows the possibility that the ELTIF can raise capital through new subscriptions.
7. Or provide the competent authority with notice immediately after an unforeseeable change beyond the control of the manager of the ELTIF has occurred.