What You Should Know About ETF Share Classes

Molly Landes and Holly Swan discuss this important evolution in fund structure—how ETF share classes blend mutual fund strategies with ETF efficiencies, expanding investor choice, boosting tax efficiency, and reshaping how advisors access portfolios.

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Key takeaways

- Exchange-traded fund (ETF) share classes expand investor choice by offering ETF and mutual fund shares from a single pooled portfolio with a common investment strategy.
- Advisors and investors who prefer the ETF vehicle can gain access to established mutual fund strategies combined with the structural efficiencies of ETFs.
- In-kind creation and redemption through the ETF share class can reduce realized capital gains within the shared portfolio, enhancing tax efficiency for all shareholders.
- Portfolio transaction activity is shared across ETF and mutual fund share classes, with in-kind transactions reducing reliance on portfolio trading and associated costs.
- ETF and mutual fund share classes have the same gross performance, though net performance may differ depending on share class fee structure.

The rise of ETF share classes in mutual fund structures

The success of ETFs has fueled sustained interest in extending their distinctive features, particularly tax efficiency and intraday tradability, to a broader range of investment strategies. A major regulatory development supporting this evolution is the U.S. Securities and Exchange Commission's (SEC) grant of exemptive relief allowing a mutual fund to offer both an exchange-traded share class and traditional mutual fund share classes within the same pooled portfolio.

While ETF share classes can provide access to more investment strategies for investors and financial advisors who utilize ETFs, operational implementation challenges may delay the adoption of these products on certain platforms.

What is an ETF share class?

An ETF share class is an additional share class of a mutual fund in which the ETF class and the mutual fund classes share a single pooled portfolio of assets. Both classes offer the same underlying investment strategy and, importantly, have the same gross performance. They differ only in the "wrapper" through which investors access the strategy and how transactions are executed.

In this structure, the ETF class operates using ETF mechanics, including in-kind creation and redemption through Authorized Participants (APs) and intraday trading on an exchange. The mutual fund classes continue to transact, typically with cash, at end-of-day net asset value (NAV) through traditional mutual fund processing.

This differs from a standalone ETF, which maintains its own separate pool of assets. Standalone ETFs may be structured as a “clone,” replicating an existing mutual fund; as a “cousin,” which is a related but not identical strategy; or as a new strategy built specifically for the ETF wrapper.

How ETF share classes can improve tax efficiency of mutual funds

In a mutual fund structure that includes an ETF share class, portfolio activity and costs are shared across a single pooled portfolio, and in-kind transactions executed through the ETF share class can help insulate investors from taxable events.

ETFs are known for their tax efficiency largely because of their in-kind creation/redemption mechanism. APs typically exchange pro-rata baskets of securities rather than cash when creating or redeeming ETF shares to satisfy client demand. Additionally, when a portfolio manager needs to rebalance the exposures, they may also use this same process to execute the rebalance. In doing so, the in-kind process will not trigger capital gains within the fund, unlike a market trade, which can immediately create a taxable event.

While mutual funds technically have the ability to transact on an in-kind basis, they rarely do so due to structural and operational limitations. However, when a mutual fund offers an ETF share class, the entire portfolio gains access to the ETF structure’s scalable, tax-efficient in-kind mechanism.

The ability to transact in-kind can serve as a powerful portfolio management tool, potentially reducing realized capital gains and related tax impact within the shared portfolio. This benefits all shareholders across both ETF and mutual fund classes.

Example: Same strategy, one structural difference

Consider two mutual funds with similar tax lot structures, pursuing the same strategy:

- **Fund A**: A mutual fund with no ETF share class
- **Fund B**: A mutual fund that offers an ETF share class

Fund A will generally meet redemptions with cash. To do so, it may need to sell appreciated securities, realizing gains that must be distributed to remaining shareholders.

If **Fund B** experiences ETF redemptions, the portfolio manager can use those in-kind redemptions to remove low-basis securities. Over time, Fund B may maintain a higher average cost basis for the shared portfolio and therefore distribute fewer capital gains. As a result, even with identical before-tax performance, the two funds may produce meaningfully different after-tax outcomes.

Even during periods of heavy mutual fund redemptions, ongoing ETF activity may create opportunities for the portfolio manager to use in-kind transactions, maintain a higher cost basis, and reduce the need to sell appreciated securities. Another example would be if a mutual fund with an ETF share class experiences a mutual fund redemption, cash could potentially be raised to meet the redemption with an offsetting ETF creation rather than by selling securities and subjecting shareholders to capital gains.

In effect, the ETF share class can act as a *pressure valve*, mitigating the traditional mutual fund problem of tax consequences for remaining shareholders.

Comparing redemptions and rebalancing across fund structures with in-kind eligible holdings:

Feature	Traditional mutual fund	Standalone ETF	Mutual fund with ETF share class
Redemption method	Typically cash	In-kind, but depends on underlying securities	Utilizes both methods (cash and in-kind)
Manager rebalancing options	Typically relies on market trades to implement desired changes in position weights, with in-kind transactions used on a more limited basis	Often utilizes in-kind transactions to remove or rebalance positions with capital gains when needed	Can utilize in-kind transactions to remove or rebalance positions with capital gains when needed
Capital gains management	Mainly use traditional tax loss harvesting methods and tools, less frequent use of in-kind rebalances	Can use both in-kind and traditional tax loss harvesting methods	Can use both in-kind and traditional tax loss harvesting methods
Impact on remaining shareholders	Gains more frequently passed through	Infrequent cap gains distribution	Less likely to pass through capital gains than a mutual fund with no ETF share class, but more likely than a standalone ETF

For existing mutual fund shareholders, the introduction of an ETF share class may improve the fund's long-term tax efficiency by reducing or potentially eliminating capital gains distributions for all share classes, which in turn may also help improve performance.

For shareholders who prefer holding an ETF, they now have access to previously exclusive mutual fund strategies, but with enhanced tax efficiency and the ability to trade intraday.

Inter-class exchanges

Many investors naturally ask whether they can move from a mutual fund share class to an ETF share class within the same fund without triggering a taxable event. The short answer is generally yes, but this capability requires the build out of substantial operational infrastructure across custodians, broker-dealers, and intermediary platforms. Although these capabilities are being developed, this may be platform and product dependent, so confirmation of availability is needed.

Additionally, advisors and shareholders may want to question if exchanging between classes is necessary. When exchanging from a mutual fund share class to ETF shares, investors typically retain potential benefits such as tax efficiency and holdings transparency. However, unlike mutual fund shares, ETF shares trade intraday and may incur transaction-related costs, such as bid/ask spreads and potential commissions.

While the intraday trading component of ETF share classes may be of particular interest to some, including firms that manage tactical model portfolios, it may be of less interest to financial advisors and investors who tend to be longer term holders.

Will all mutual funds have ETF share classes?

Not all mutual fund strategies are suitable for an ETF class. Domestic equity strategies tend to be the strongest fit because they are fully in-kind eligible. Developed international equity strategies and certain fixed income strategies may also benefit, though their viability can vary by market structure. Tax efficiency is not the only consideration, but it is an important one where applicable.

Examples from a tax efficiency standpoint:

- In domestic equities, active strategies may be well positioned to use in-kind redemptions frequently and effectively.
- Within U.S. fixed income, particularly credit and Treasuries, active strategies may also be able to implement in-kind redemptions on a regular basis.
- In single-country emerging market equities, benefits may be limited because many holdings are not eligible for in-kind transactions.

Additional considerations may include commercial viability and investor demand. Fund capacity is also a key factor in determining whether a given strategy is suitable for this structure. In cases where in-kind transfers of securities are not permitted, cash creations can also play an important role by helping to fund redemptions or dividend distributions. Ultimately, each strategy should be evaluated on a case-by-case basis.

How advisors can help prepare clients

For financial advisors, the addition of ETF share classes to existing mutual funds expands the range of available investment options without requiring clients to wait for a new standalone ETF to accumulate scale or build a track record. Because the ETF share class leverages the mutual fund's full performance history, clients who prefer the ETF structure can access a strategy with an established track record from day one.

From a mutual fund perspective, the added ETF share class may reduce the need for clients to move from mutual funds to standalone ETFs solely for tax management purposes.

Advisors are increasingly shifting client assets from mutual funds to ETFs to improve tax efficiency. However, moving from a mutual fund to a standalone ETF requires selling mutual fund shares, which can trigger taxable gains. Introducing an ETF share class within an existing mutual fund may help address the tax inefficiencies of traditional mutual funds while potentially avoiding the need to sell mutual fund holdings.

Advisors may want to help clients understand:

- The mechanics of the shared portfolio model

- Conditions under which tax efficiency may improve
- Scenarios in which capital gain distributions may persist
- Operational limitations and expectations around share class exchanges

This will help ensure expectations are realistic and that clients understand both potential benefits and limitations. Allspring is here to help financial intermediaries navigate these client communications.

A balanced view of ETF share classes

ETF share classes can offer potential benefits like improved tax efficiency and access to established strategies, but they are not a universal solution and may not address all tax considerations.

Their effectiveness depends on strategy characteristics, market conditions, and investor behavior and preferences across share classes.

In our view, ETF share classes can deliver meaningful benefits to both advisors and investors, but they should be viewed as just one of several tools used in constructing and managing portfolios. They expand investor choice and can address specific objectives like tax efficiency or vehicle preference, but we don't consider them to be a universal replacement for traditional mutual funds or standalone ETFs—each of which continues to serve distinct investment and investor needs.

Allspring's approach to ETF share classes

We received SEC relief to use the ETF share class structure in January 2026.

We continue to work with our funds' Board of Trustees to identify the appropriate candidates for ETF share classes and will provide more details on our plans as they become available. We are excited about the opportunity to deliver our expansive investment capabilities in this new share class structure and believe adding ETF share classes to existing mutual funds may bring important benefits to both ETF and traditional mutual fund investors, including:

- ***Access to investment strategies with well-established track records***: An ETF share class could leverage the scale and history of an existing mutual fund, enabling investors to access investment strategies with well-established track records.
- ***Greater tax efficiency for the whole portfolio***: ETF share classes give an existing mutual fund's portfolio managers an additional tool that could help them manage tax liabilities more effectively.
- ***Added operational efficiency***:The ETF share class structure may help reduce portfolio trading costs relative to standalone mutual funds. These funds may also experience more efficient portfolio rebalancing as cash flow through mutual fund share classes can be used to reposition the portfolio.
- ***Tax-free exchange from mutual fund classes to an ETF class***: Investors in existing mutual fund share classes are expected to be able to move tax-free to the fund's corresponding ETF share class, a vehicle with intraday trading flexibility and the ability to trade shares without the frequent trading restrictions imposed by many mutual funds.

For additional details or inquiries, Allspring is here to assist. Contact your Allspring ETF sales professional at **1-866-701-2575** or visit Allspring Active ETFs | Allspring Global Investments.

The ETF creation/redemption mechanism is a primary market process where authorized participants (APs) exchange underlying securities directly with ETF issuers for large blocks of shares ("creation units") to balance market supply and demand. Redemptions work in reverse order with APs exchanging large blocks of ETF shares (“redemption units”) in exchange for underlying securities. This helps to keep the ETF's share price aligned with its net asset value (NAV) and enhances liquidity.

Authorized Participants (APs) are specialized financial institutions, typically large banks, or broker-dealers—that hold an exclusive agreement with an ETF issuer to create and redeem ETF shares in the primary market. They help to ensure market liquidity and keep the ETF’s price aligned with its NAV by trading underlying securities for "creation units".

A multi-class investment structure allows a single fund or company to issue multiple types of shares or interests, often with different fee structures, voting rights, or dividend priorities to suit various investor needs.

SEC exemptive relief for ETF share classes is a U.S. Securities and Exchange Commission (SEC) order permitting mutual funds to add an exchange-traded fund (ETF) share class to their existing structure, allowing both to operate within one portfolio.

Tactical ETF model portfolios are actively managed investment strategies that shift asset allocation to capitalize on short-term market trends, sector rotations, or economic shifts.

Allspring ETFs are not available for distribution outside of the United States.

Carefully consider a fund’s investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus, containing this and other information, visit allspringglobal.com. Read it carefully before investing.

Investing involves risk, including the possible loss of principal. It is possible that an active trading market for ETF shares will not develop, which may hurt your ability to buy or sell shares, particularly in times of market stress. Shares may trade at a premium or discount to their net asset value (NAV) in the secondary market. These variations may be greater when markets are volatile or subject to unusual conditions. There can be no assurance that active trading markets for the shares will develop or be maintained by market makers or authorized participants. Shares of the ETFs are not redeemable with the ETF other than in creation unit aggregations. Instead, investors must buy or sell the ETF shares in the secondary market at market price (not NAV) through a broker-dealer. In doing so, the investor may incur brokerage commissions and may pay more than NAV when buying and may receive less than NAV when selling. Investing involves risk, including the possible loss of principal. Consult a fund’s prospectus for additional information on these and other risks.

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