ESMA RELEASES FINAL DRAFT RTS AND GUIDELINES ON LIQUIDITY MANAGEMENT

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ESMA GUIDELINES AND FINAL DRAFT RTS ON LIQUIDITY MANAGEMENT TOOLS OF UCITS AND OPEN-ENDED AIFS

Pursuant to the revised Directive 2011/61/EU (AIFMD) and Directive 2009/65/EC (UCITS Directive), the European Securities and Markets Authority (ESMA) was tasked with developing guidelines on the selection and calibration of liquidity management tools (LMTs) and developing regulatory technical standards (RTS) to determine the characteristics of LMTs available to managers of alternative investment funds (AIFs) (AIFMs) and of undertakings for collective investment in transferable securities (UCITS) (UCITS ManCos). On the back of this mandate, ESMA published a consultation paper (CP) on the draft guidelines and RTS.

The consultation period closed on 8 October 2024, with ESMA receiving 33 responses. Taking into account this stakeholder feedback, on 15 April 2025, ESMA published (i) itsfinal report on the Guidelines on LMTs of UCITS and open-ended AIFs (the Guidelines) and (ii) its final report on the draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive.

FINAL REPORT ON GUIDELINES ON LMTS OF UCITS AND OPEN-ENDED AIFS

On the back of feedback received during the consultation, ESMA made a number of changes to the Guidelines, deleting several sections that were previously included in the CP and amending other sections to provide more flexibility to AIFMs and UCITS ManCos. The Guidelines were also streamlined to avoid any overlaps with the RTS and the text contained in the AIFMD and UCITS Directive. Notable deletions from the Guidelines include:

- The guideline on governance principles, which previously stated that fund managers should develop an LMT policy which should document the conditions for the selection, activation and calibration of LMTs, and an LMT plan.

ESMA noted that the majority of stakeholder feedback highlighted that the LMT policy should be kept as an internal guidance document, and on the basis that the AIFMD and UCITS Directive already contain provisions mandating the implementation of policies and procedures for the activation and deactivation of LMTs and operational and administrative arrangements, ESMA deleted the sections of the Guidelines dedicated to the governance principles.

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- The guideline on disclosure to investors, which mandated managers to provide disclosure to investors on the selection, activation and calibration of LMTs in the fund documentation, rules or instruments of incorporation, prospectus or periodic reports.

ESMA noted that notwithstanding the fact that the majority of stakeholders supported the principle of improving transparency to investors, they stressed the importance to strike the balance between appropriate disclosure, investor protection and unintended consequences. On the back of this, ESMA decided not to retain these sections of the Guidelines, but noted that managers should nonetheless be cognisant of the LMT disclosure obligations set down in the AIFMD and UCITS Directive for example, that a description of the AIF's liquidity risk management shall be made available to investors by the AIFM.

- Certain other restrictive guidelines, including those that imposed more restrictive obligations on the selection, activation and calibration of LMTs, as it was noted that these guidelines limited the sole responsibility of the manager as prescribed by the AIFMD and UCITS Directive.

In contrast, ESMA retained certain guidelines that had previously been pushed back on by stakeholders including the guideline whereby managers should consider, where appropriate, the merit of selecting at least one quantitative LMT and at least one anti-dilution tool. While retaining this guideline, ESMA stressed that it is without prejudice to the ultimate responsibility of the manager for the selection of LMTs, including, where appropriate, redemptions in kind.

In light of the consultation feedback, ESMA noted that it has opted against a restrictive approach in the final Guidelines, instead emphasising the manager's sole responsibility for selecting and implementing LMTs.

DRAFT REGULATORY TECHNICAL STANDARDS ON LIQUIDITY MANAGEMENT TOOLS UNDER THE AIFMD AND UCITS DIRECTIVE

As was the case with ESMA's final report on the Guidelines, ESMA, on the back of feedback received from stakeholders, made a number of updates to the draft RTS, in particular to make several changes and clarifications with regard to redemption gates, and also to remove the requirement to apply the same rules to all share classes.

Taking into account feedback from stakeholders, ESMA introduced flexibility in the way in which the activation threshold for redemption gates of AIFs can be expressed. The RTS for AIFs now stipulate that the thresholds can be expressed: (i) as a percentage of the net asset value (NAV) of the AIF, (ii) in a monetary value (or a combination of both), or (iii) as a percentage of liquid assets. For UCITS however, ESMA retained the existing language regarding activation thresholds in that they shall only be expressed as a percentage of the NAV of the UCITS. In addition to this, ESMA introduced an alternative method for the application of redemption gates for AIFs and UCITS under which redemption orders below or equal to a pre-determined redemption amount can be fully executed while redemption orders above this amount are subject to the redemption gate. This mechanism, ESMA explained, should serve to avoid small redemption orders being affected by large orders that drive the amount of redemptions above the activation threshold.

In addition, the draft RTS previously included provisions requiring the same level of LMTs to be applied to all share classes, however, given that the mandate of the RTS did not support the development of specific and comprehensive application of LMTs to share classes, these provisions have been removed.

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Finally, stakeholder feedback alerted ESMA of the unintended consequences of the rules on redemption in kind for the functioning of the primary market of exchange-traded funds (ETFs). On the back of this, ESMA included a new provision in the UCITS RTS clarifying that the rule on 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.

WHAT COMES NEXT?

In terms of next steps, the final draft RTS have been submitted to the European Commission (the EC) for adoption and the EC have three months (which can be extended by one further month), to make a decision. The Guidelines shall start to apply on the date of entry into force of the RTS. Funds that existed before the entry into force of the RTS shall have 12 months to comply with the Guidelines.

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