



ADVISORY | INDUSTRY INFORMATION

## **AIFMD II 101: Part 2 – A new EU Framework for Liquidity Management Tools**



On 15 April 2024, Directive [2024/927/EU](#) amending AIFMD (2011/61/EU) and the UCITS Directive (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 ("AIFMD II") entered into force. The entry into force of AIFMD II marks a significant milestone for the European asset management industry.

Our advisory series considers a number of key changes for the asset management industry introduced by AIFMD II. The [first part of our advisory series](#) focused on the key changes for managers pursuing loan origination strategies, in light of the new harmonised framework for loan originating activities across the European Union ("EU").

In the second part of our AIFMD II advisory series we focus on the new legal framework under AIFMD II in relation to the use of liquidity management tools ("LMTs"). The new rules on LMTs apply to undertakings for collective investment in transferable securities ("UCITS") and to authorised EU alternative investment fund managers ("AIFMs") of open-ended alternative investment funds ("AIFs"). As such, all UCITS, open-ended AIFs, UCITS management companies and AIFMs will need to pay specific attention to the relevant requirements.

Please also refer to our other recent AIFMD II publications "[AIFMD II – A closer look](#)" and "[AIFMD II: Timeline to Implementation](#)".

In this advisory we provide an overview of the new LMT requirements and their practical implications for both open-ended AIFs and UCITS and their fund management companies.

## A new European framework for LMTs

The new harmonised approach to LMTs set out in AIFMD II reflects the wider global focus on the macroprudential framework for investment funds, and follows on from various consultations, guidance papers and regulatory surveys issued by the Financial Stability Board ("FSB")<sup>1</sup>, IOSCO<sup>2</sup>, the European Commission (the "Commission")<sup>3</sup> and the Central Bank of Ireland<sup>4</sup> (the "Central Bank").

AIFMs (acting on behalf of open-ended AIFs) and UCITS are primarily responsible for liquidity risk management, as well as for the selection, calibration, activation and deactivation of LMTs. Notwithstanding the ability to utilise LMTs, ESMA in its recent [consultation](#) on LMTs has emphasised that "LMTs should not be seen as a backstop for the purpose of addressing liquidity issues

stemming from inadequate fund structuring, poor investment decisions, inappropriate risk management or other management failings".

From a regulatory perspective, the activation and deactivation of LMTs will not provide an exemption from any existing obligations under current UCITS and AIFMD requirements in relation to asset eligibility, liquidity risk management, best execution, fair valuation procedures or fair treatment of investors. Furthermore, AIFMs (acting on behalf of open-ended AIFs) and UCITS will need to continue to ensure consistency between the investment policy, the liquidity profile and the redemption policy of funds under management.

<sup>1</sup>FSB consultation report, "[Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB's 2017 Policy Recommendations](#)".

<sup>2</sup>The IOSCO consultation report "[Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes](#)" (the "IOSCO Guidance") was published in July 2023. In December 2023, IOSCO published its final report "[Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes Final Report](#)" after considering the feedback from the IOSCO Guidance to support the greater use of anti-dilution LMTs to mitigate investor dilution and potential first-mover advantage arising from structural liquidity mismatch provided certain guidance to responsible entities.

<sup>3</sup>On 22 May 2024, the Commission published its targeted consultation on "[Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation \("NBFIs"\)](#)".

<sup>4</sup>On 18 July 2023, the Central Bank issued its "[Discussion Paper, An approach to macroprudential policy for investment funds](#)" and on 23 July 2024, published a [Feedback Statement](#) to the Discussion Paper.

## Liquidity management tools

LMTs are mechanisms which allow the AIFM or UCITS to effectively match redemption requests or other types of distributions out of a fund, with available liquid assets in the fund, to support the fund and its management company in dealing with redemption pressures under normal and stressed market conditions.

In light of the increasing focus on liquidity risk and its management in open-ended funds, AIFMD II prescribes on a legislative basis certain rules governing the availability and use of three categories of LMTs, in respect of both

open-ended AIFs and UCITS, which can broadly be divided into three cohorts:

- i. quantitative LMTs;
- ii. anti-dilution tools ("ADT"); and
- iii. other LMTs.

Please see the table below for the full range of LMTs and their descriptions.

LMT	Description	Anticipated Scope of ESMA LMT Guidelines <sup>5</sup>		
		Selection	Calibration	Activation and, where appropriate, deactivation
Available to UCITS and AIFMs managing open-ended AIFs				
Quantitative LMTs	1. Suspension of subscriptions, repurchase and redemptions		✓	Minimum expectations/ examples
	2. Redemption gate	✓	✓	
	3. Extension of notice periods	✓	✓	
Anti-Dilution Tools	4. Redemption fee	✓	✓	
	5. Swing pricing	✓	✓	
	6. Dual pricing	✓	✓	
	7. Anti-dilution levy	✓	✓	
Other LMTs	8. Redemption in kind	✓	✓	
	9. Side pockets		✓	

<sup>5</sup> The LMT Guidelines detail expectations for the selection and calibration of the LMTs under AIFMD II. The Directive refers to the activation and deactivation of side pockets only. While not specifically mandated by the Directive, ESMA also recommends minimum expectations, as well as examples, in order to identify instances that may lead to the activation of all LMTs

## General principles

AIFMD II sets out certain requirements in respect of LMTs for both UCITS and AIFMs of open-ended AIFs and also for national competent authorities ("NCAs")

The requirements, broadly the same for UCITS and AIFMs managing open-ended AIFs, include:

Requirement	Description of Relevant Obligation
Selection of at least two appropriate LMTs	AIFMs managing UCITS and open-ended AIFs need to select and include in the fund's rules or instruments of incorporation at least two (2) appropriate LMTs from points 2-8 in the table at page 3 above (except in the case of money market funds ("MMFs"), which will need to select at least 1 LMT from points 2-8 above as noted below), after assessing the suitability of those LMTs in relation to the pursued investment strategy, the liquidity profile and the redemption policy of the fund. UCITS and AIFMs managing open-ended AIFs are precluded from selecting LMTs only from points 5 and 6 in the table at page 3 above.
Selection of at least one LMT for MMFs	UCITS that are authorised as a MMF and an AIFM that manages an AIF authorised as a MMF must select at least one of the LMTs referred to at points 2-8 in the table at page 3 above. The Directive provides a derogation for MMFs in this regard.
Activation or Deactivation of LMTs Suspension of Dealing Procedures and Use of Side Pockets	<p>UCITS and AIFMs managing open-ended AIFs may, in the interest of investors or shareholders:</p> <ul style="list-style-type: none"> <li>i. temporarily suspend subscription, repurchase and redemption of shares or units in the UCITS or AIFs; or</li> <li>ii. where those LMTs are included in the constitutional documents of the fund, activate or deactivate any of the LMTs from points 2-8 in the table at page 3 above; or</li> <li>iii. activate side pockets. LMTs in (i) and (iii) above must be available to UCITS and AIFMs without the need to pre-select them.</li> </ul> <p>Suspension of dealing procedures and the implementation of side pockets may be used for exceptional cases where circumstances so require and where justified having regard to the interests of the investors in the fund.</p> <p>In addition, an NCA may, in the interest of investors, in exceptional circumstances and after consulting the UCITS or AIFM, require the activation or deactivation of the suspension of subscriptions repurchase and redemptions, where there are risks to investor protection or financial stability that, on a reasonable and balanced view, necessitate such activation or deactivation.</p>
Redemptions in kind	Redemptions in kind can only be activated upon the request of a professional investor <sup>6</sup> and if the redemption in kind corresponds to a pro rata share of the assets held by the fund. By way of derogation from the above, a redemption in kind need not correspond to a pro rata share of the assets held by the fund if that fund is solely marketed to professional investors, or if the aim of that fund's investment policy is to replicate the composition of a certain stock or debt securities index and that fund is an exchange-traded fund <sup>7</sup> .
Requirement for Detailed Policies and Procedures	UCITS and AIFMs managing open-ended AIFs shall implement detailed policies and procedures for the activation and deactivation of any selected LMTs and the operational and administrative arrangements for the use of such LMTs.
Notifications to NCAs	<p>The selection of at least two LMTs from points 2-8 in the table at page 3 (or at least one LMT in the context of MMFs) and the detailed policies and procedures for the activation and deactivation must be communicated to the NCA of the home EU member state of the UCITS or the AIFM fund, as appropriate.</p> <p>UCITS and AIFMs managing open-ended AIFs funds must, without delay, notify the NCA of its home EU member state of the following:</p> <ul style="list-style-type: none"> <li>i. upon the activation or deactivation of the suspension of subscriptions repurchase and redemptions; and</li> <li>ii. upon the activation or deactivation of any of LMTs from points 2-8 in the table at page 3 above in a manner that is not in the ordinary course of business, as envisaged in the fund's rules or instruments of incorporation.</li> </ul> <p>UCITS and AIFMs managing open-ended AIFs funds must, within a reasonable timeframe, before it activates or deactivates the use of side pockets, notify the NCA of its home EU member state of such activation or deactivation.</p> <p>As part of its regular reporting the UCITS management company must, for each of the UCITS it manages, provide to the NCA of the UCITS home member state the arrangements for managing the liquidity of the UCITS, including the current selection of liquidity management tools from points 2-8 in the table at page 3, as well as any activation or deactivation thereof.</p>

<sup>6</sup>A "professional investor" means an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to Directive 2014/65/EU of the European Parliament and of the Council.

<sup>7</sup>An exchange traded fund for this purpose is a fund as defined in Article 4(1), point (46), of Directive 2014/65/EU (MiFID II).



## ESMA consultations on LMTs

AIFMD II mandates ESMA to:

- a) develop guidelines on the selection and calibration of LMTs by UCITS and AIFMs for liquidity risk management and for mitigating financial stability risks; and
- b) draft and submit to the Commission draft regulatory technical standards on LMTs.

In this regard on 8 July 2024, ESMA [published](#) two consultations on "[Guidelines on Liquidity Management Tools of UCITS and open-ended AIFs](#)" (the "Draft LMT Guidelines") and "[Draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive](#)" (the "Draft RTS").

The Draft RTS and the Draft LMT Guidelines are designed to be read together and to promote convergent application of AIFMD II for both UCITS and open-ended AIFs and to ensure that UCITS and AIFMs are better equipped to manage the liquidity of such funds, in preparation for stressed market situations. Additionally, they intend on clarifying the functioning of specific LMTs, such as the use of side pockets, a practice that currently varies significantly across the EU.

### Draft RTS

In the Draft RTS, ESMA defines the constituting elements of each LMT, such as calculation methodologies and activation mechanisms. Importantly, the Draft RTS do not address the conditions under which the LMTs selected by the UCITS or AIFM shall be activated because the scope of the Draft RTS is limited to the characteristics of each LMT. There is no empowerment for ESMA to determine the circumstances according to which the selected LMTs shall be activated (except for side pockets), however, ESMA identifies its expectations and instances that may lead to the activation of all LMTs.

UCITS and AIFMs may also decide to use tools other than the LMTs referred to in AIFMD II to manage the liquidity of a fund. However, if used, these other tools shall not be considered as LMTs for the purpose of complying with AIFMD II. One example of these other tools would be the so-called "soft closure", where a fund is closed to new subscriptions when the size of the fund exceeds a pre-determined level, while still allowing investors to redeem.

In its report on the draft RTS, ESMA expects that in most instances, the characteristics of the LMTs should be the same under both legal frameworks and that only in limited circumstances these characteristics would differ. In this regard ESMA notes that, for the time being, the only differences that it has identified between UCITS and AIFs relate to one of the characteristics of redemption gates (applicable to AIFMs managing ELTIFs) and the provisions on side pockets.

### Draft LMT Guidelines

In the Draft LMT Guidelines, ESMA provides guidance on how AIFMs and UCITS should select and calibrate LMTs, in light of their investment strategy, their liquidity profile and the redemption policy of the fund. In this case selection refers to LMTs from points 2-8 in the table at page 3 only, as funds need to always be able to implement suspension of dealing procedures and side pockets without pre-selecting those.

The Draft LMT Guidelines note that LMTs should be considered as an essential element of a fund's overall liquidity management framework, but funds and fund management companies should not solely rely on LMTs to manage a fund's liquidity risk. The Draft LMT Guidelines also propose that, in the selection of the two minimum mandatory LMTs from points 2-8 in the table at page 3, UCITS and AIFMs should consider, where appropriate, the merit of selecting at least one quantitative-based LMT (i.e., redemption gates and extension of notice period) and at least one ADT (i.e., redemption fees, swing pricing, dual pricing, anti-dilution levy), taking into consideration the investment strategy, redemption policy and liquidity profile of the fund and the market conditions under which the LMT could be activated. In this context, UCITS and AIFMs may consider whether to select one LMT to use under normal market conditions and one LMT to be used under stressed market conditions (for instance, one ADT to use for normal market conditions and one quantitative LMT to be used under stressed market conditions). The activation of a specific LMT or its calibration should not in any way alter or change a fund's investment objectives, policy, profile or characteristics as stated in the fund's rules, offering documents or instruments of incorporation.

In respect of governance principles, and following IOSCO's recommendations for liquidity risk management for collective investment schemes, the Draft LMT Guidelines note that the internal governance arrangements should at least include the following elements.

- i. objective criteria (e.g., activation thresholds) for the application of LMTs;
- ii. methodology, including calibration;
- iii. parties involved (e.g., senior management, risk management, etc);
- iv. source of information and data used;
- v. controls;
- vi. documentation of decisions made;
- vii. escalation processes; and
- viii. oversight by the governing body.

The Draft LMT Guidelines also note that depositaries should set up appropriate verification procedures to check that documented procedures are established in relation to the use of LMTs.

### Investor disclosure

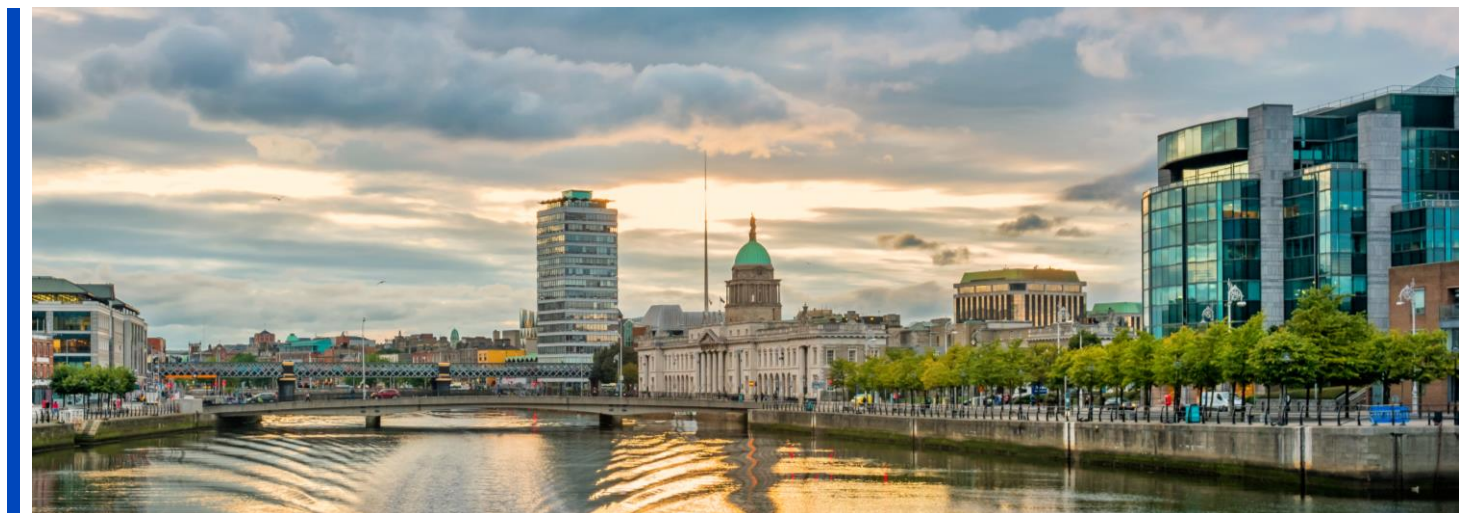
The Draft LMT Guidelines emphasise appropriate disclosure of available LMTs in the fund documentation, and/or periodic reports (e.g. a periodic report would provide an ex-post overview of activation whereas fund rules and prospectuses would state the conditions for activating an LMT). The implications of LMTs in terms of liquidity costs or access to their capital should also be disclosed. ESMA has noted that such disclosures should help to normalise the use of LMTs and increase the understanding of their functioning by investors, while the timing and detail of disclosure should balance any unintended consequences such as preventing any first mover advantage. ESMA also suggests that it may be helpful for funds to disclose periodic ex-post information on the historical use of LMT to investors via the fund's financial statements or via a website.

The consultations will remain open to responses from stakeholders until 8 October 2024. ESMA will deliver final reports outlining the final RTS and LMT Guidelines to the Commission by 16 April 2025.

## Timing considerations

As outlined above, AIFMD II entered into force on 15 April 2024 and will need to be transposed by EU member states into their national law by 16 April 2026, at the latest. Transposition into national law in Ireland and other EU member states can, in theory, be implemented earlier than the above deadline. However, it is not expected that national legislatures will transpose AIFMD II in advance of the RTS on LMTs.

AIFMD II requires that EU member states apply any transposed legislation from **16 April 2026**. In any case, impacted UCITS and open-ended AIFs, together with their AIFMs and UCITS management companies will need to be prepared both operationally and legally in advance of implementation of AIFMD II to ensure that their constitutional documents, offering documents, material contracts and policies and procedures are updated to comply with the new LMT requirements set out in AIFMD II.



## Further information

We practice Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Irish and Jersey law from an international network of ten offices across Europe, the Americas, Asia and the Middle East. For more information, please get in touch with your usual contact at Walkers or any of the contacts in your region listed below.



### Nicholas Blake-Knox

Partner and head of Asset Management and Funds  
Ireland

+353 1 470 6669

[nicholas.blake-knox@walkersglobal.com](mailto:nicholas.blake-knox@walkersglobal.com)



### Damien Barnaville

Partner  
Ireland

+353 1 863 8529

[damien.barnaville@walkersglobal.com](mailto:damien.barnaville@walkersglobal.com)



### Eimear Keane

Partner  
Ireland

+353 1 470 6622

[eimear.keane@walkersglobal.com](mailto:eimear.keane@walkersglobal.com)



### Aongus McCarthy

Partner  
Ireland

+353 1 470 6624

[aongus.mccarthy@walkersglobal.com](mailto:aongus.mccarthy@walkersglobal.com)



### Emmet Quish

Partner  
Ireland

+353 1 470 6652

[emmet.quish@walkersglobal.com](mailto:emmet.quish@walkersglobal.com)



### Jennifer Brady

Of Counsel  
Ireland

+353 1 470 6647

[jennifer.brady@walkersglobal.com](mailto:jennifer.brady@walkersglobal.com)



### Michael Dyulgerov

Of Counsel  
Ireland

+1 345 470 6683

[michael.dyulgerov@walkersglobal.com](mailto:michael.dyulgerov@walkersglobal.com)



### Claire Winrow

Of Counsel  
Ireland

+353 1 863 8539

[claire.winrow@walkersglobal.com](mailto:claire.winrow@walkersglobal.com)



### Eimear O'Flynn

Of Counsel  
Ireland

+353 1 863 8516

[eimear.oflynn@walkersglobal.com](mailto:eimear.oflynn@walkersglobal.com)



### Joseph Mitchell

Senior Associate  
Ireland

+353 1 470 6649

[joseph.mitchell@walkersglobal.com](mailto:joseph.mitchell@walkersglobal.com)



### Grainne Denihan

Associate  
Ireland

+353 1 863 8504

[grainne.denihan@walkersglobal.com](mailto:grainne.denihan@walkersglobal.com)