15 April 2025
ESMA34-1985693317-1160

Final Report

Guidelines on LMTs of UCITS and open-ended AIFs

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1 Executive Summary

Reasons for publication

The revised AIFMD and UCITS Directive[1] provide that ESMA shall develop guidelines on the selection and calibration of liquidity management tools (LMTs) by UCITS and AIFMs of open-ended AIFs for liquidity risk management and for mitigating financial stability risks. Those guidelines shall recognise that the primary responsibility for liquidity risk management remains with the UCITS and AIFM. Furthermore, they shall include indications as to the circumstances in which side pockets can be activated and allow adequate time for adaptation before they apply, in particular for existing UCITS and open-ended AIFs.

On 8 July 2024, ESMA published a Consultation Paper (CP) on the proposed draft guidelines. The public consultation closed on 8 October 2024. This final report includes the revised guidelines developed taking into account the feedback received to the consultation.

Contents

Section 2 contains the legislative mandates to develop draft guidelines, as well as the main amendments following the public consultation.

Annex I summarises the feedback received to the consultation that ESMA carried out and explains how ESMA has taken this feedback into account.

Annex II sets out the cost-benefit analysis related to the draft guidelines.

Annex III contains the full text of the draft guidelines.

Next Steps

The Guidelines in Annex III of this report will be translated into the official EU languages and published on the ESMA website. The publication of the translations will trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the guidelines.

The Guidelines will apply upon the application date of the RTS on the characteristics of the Liquidity Management Tools (LMTs).[2]

Managers of funds existing before the date of application of these guidelines should apply these guidelines in respect of those funds after twelve months from the application date of the RTS.

[1] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 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 (europa.eu)
[2] See ESMA34-1985693317-1259.

2 Overview

2.1 The AIFMD and UCITS Directive review

1. Article 18a (4) Directive 2009/65/EC (UCITS Directive) provides that "By 16 April 2025 ESMA shall develop guidelines on the selection and calibration of liquidity management tools by UCITS for liquidity risk management and for mitigating financial stability risks. Those guidelines shall recognise that the primary responsibility for liquidity risk management remains with UCITS. They shall include indications as to the circumstances in which side pockets, as referred to in Annex IIA, point 9, can be activated. They shall allow adequate time for adaptation before they apply, in particular for existing UCITS".

2. Similarly, Article 16(2h) Directive 2011/61/EU (AIFMD) provides that "By 16 April 2025 ESMA shall develop guidelines on the selection and calibration of liquidity management tools by AIFMs for liquidity risk management and for mitigating financial stability risks. Those guidelines shall recognise that the primary responsibility for liquidity risk management remains with AIFMs. They shall include indications as to the circumstances in which side pockets, as referred to in Annex V, point 9, can be activated. They shall allow adequate time for adaptation before they apply, in particular for existing AIFs".

2.2 Public consultation

3. On 8 July 2024, ESMA published a CP on the proposed draft guidelines on Liquidity Management Tools under the AIFMD and UCITS Directive. The consultation closed on 8 October 2024.

4. ESMA received 33 responses, from asset managers (and their associations), industry associations, one consumer association and one public authority. The Securities and Markets Stakeholder Group (SMSG) did not provide any advice. The non-confidential responses are available on ESMA's website[3].

5. Following the feedback received from stakeholders, ESMA saw merit in making some modifications to the guidelines presented in the consultation paper. These are described in the below Section 2.3 and are reflected in the revised text of the guidelines. More detailed feedback from ESMA on how the comments made by respondents in response to the

[3] Consultation on Liquidity Management Tools for funds

consultation were addressed is included in the Feedback Statement in Annex I, question by question.

2.3 Amendments to the guidelines following feedback to the consultation paper

6. In order to describe the main changes compared to the consultation paper, it is necessary to first to summarise some of the proposals in the draft guidelines that were consulted on:

   A. Selection of LMTs:

      In the selection of the two minimum mandatory LMTs, managers should consider, where appropriate, the merit of selecting at least one quantitative-based LMT (i.e.: redemption gates, extension of notice period) and at least one ADT (i.e.: redemption fees, swing pricing, dual pricing, ADL), 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.

   B. Governance principles:

      Managers should develop an LMT policy, which should form part of the broader fund liquidity risk management process policy document, and should document the conditions for the selection, activation and calibration of LMTs.

      Managers should develop an LMT plan, that should be in line with the LMT policy, prior to or immediately after the activation of suspensions of subscriptions, repurchases and redemptions and prior to the activation of a side pocket.

   C. Disclosure to investors:

      Managers should provide disclosure to investors on the selection, activation and calibration of LMTs in the fund documentation, rules or instruments of incorporation, prospectus and/or periodic reports.

   D. Depositaries

      Depositaries should set up appropriate verification procedures to check that managers have in place documented procedures for LMTs.

   E. Other guidelines that imposed more restrictive obligations on the selection, activation and calibration of LMTs

Those guidelines included restrictions on:

a) preventing the systematic activation of redemption gates for funds marketed to retail investors[4];

b) providing that an independent third party (e.g.: the auditor, the depositary) should value the assets in case of the activation of redemptions in kind[5];

c) the simultaneous selection and activation of ADTs (e.g.: swing pricing and ADL)[6].

7. The main modifications to the guidelines following the feedback received from stakeholders are described below.

Guideline on considering the merit of selecting at least one ADT and at least one quantitative LMT

8. ESMA has decided to retain the guideline whereby managers should consider, where appropriate, the merit of selecting at least one quantitative LMT and at least one ADT, but has further stressed, at the beginning of this guideline, that the primary responsibility for liquidity risk management and for the selection of the appropriate LMTs remains with the manager. ESMA also notes that this is without prejudice to the ultimate responsibility of the manager for the selection of LMTs, including, where appropriate, redemptions in kind.

Deletion of the guideline on the governance principles

9. ESMA has decided not to retain the sections of the guidelines dedicated to the governance principles in light of the feedback received.

10. In this context, it is to be noted that the UCITSD and AIFMD already include provisions on organisational requirements[7], including requiring UCITS and AIFMs to "*implement detailed policies and procedures for the activation and deactivation of any selected liquidity management tool and the operational and administrative arrangements for the use of such tool*". Therefore, the Level 1 already contains provisions mandating the implementation of policies and procedures for the activation, deactivation of LMTs and the operational and administrative arrangements. For this reason, while ESMA reminds managers of the

[4] See CP on the Guidelines on LMTs of UCITS and open ended AIFs, ESMA34-1985693317-1097, Section 6.5.3.2, paragraph 37.
[5] *Ibidem*, paragraph 48.
[6] *Ibidem*, paragraph 51.
[7] Including Article 18 AIFMD and Article 57 Commission Delegated Regulation (EU) No 231/2013 and, most importantly, Article 18a(2) UCITS and Article 16(2b) of the AIFMD.

importance of implementing detailed policies and procedures on the use of LMTs, as provided by the Directives, ESMA has decided not to produce guidelines in this respect, and to remove all draft guidelines that included governance and/or organisational obligations from the final guidance

Deletion of the guideline on the disclosure to investors

11. ESMA has decided not to retain the guidelines on disclosure to investors in light of the feedback received.

12. In this context, the revised AIFM Directive[8] provides that AIFMs shall make available to investors, inter alia, a "description of the AIF's liquidity risk management, including the redemption rights, both in normal and in exceptional circumstances, of the existing redemption arrangements with investors, and of the possibility of, and conditions for, using liquidity management tools selected in accordance with Article 16(2b)". It is also to be noted that the activation and deactivation of LMTs are part of the redemption policy of the fund, which is laid down in the fund rules or the instruments of incorporation or the prospectus, which imposes disclosure obligations to the manager.[9] Therefore, while ESMA reminds managers of the importance of ensuring a proper disclosure on the use of LMTs, as provided by the Directives, ESMA has decided not to produce guidelines in this respect, and to remove all draft guidelines that included disclosure obligations from the final guidance.[10]

Guideline addressed to depositaries

13. ESMA decided not to retain the guideline addressed to depositaries in light of the lack of a legal mandate and the fact that the obligations of depositaries are already established under UCITS and AIFMD, including on risk management and liquidity risk management.

Deletion of other guidelines that imposed more restrictive obligations on the selection, activation and calibration of LMTs

14. In some instances, the draft guidelines included recommendations that would impose restrictions on the selection, activation and calibration of LMTs, thus limiting the sole responsibility of the manager as prescribed by Level 1 provisions.

[8] Article 23(1)(h) AIFMD.
[9] Article 40(4) of Commission Directive 2010/43/EU (i.e. "UCITS Level 2 Directive").
[10] This included disclosing the activation thresholds for redemption gates in the fund's rules, offering document and instruments of incorporation (see CP on the Guidelines on LMTs of UCITS and open-ended AIFs, ESMA34-1985693317-1097, Section 6.5.3.2, paragraph 38) and the relevant details governing the activation of swing pricing for normal and stressed market conditions (*Ibidem*, paragraph 67).

15. Therefore, taking into account the feedback received from the consultation, ESMA has decided to refrain from taking a restrictive approach in the final guidance and to better recognise the manager's sole responsibility on the selection, activation and calibration of LMTs in light of the specific situation and the market conditions.

16. In this context, ESMA would however stress the importance of ensuring that managers do not use LMTs 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, and even more so for funds marketed to retail investors which need a higher level of protection.

17. Lastly, the guidance was streamlined to avoid any overlaps with the RTS on the characteristics of LMTs[11] and the Level 1 text.

[11] See ESMA34-1985693317-1259.

3 Annex I: Feedback Statement

THE SELECTION OF LMTs

Q1. Do you agree with the list of elements included under paragraph 17 of Section 6.5.1 of the draft guidelines that the manager should consider in the selection of LMTs? Are there any other elements that should be considered?

18. While some respondents agreed with the proposed criteria for the selection of LMTs, the majority of respondents considered that the manager's discretion should be better recognised and suggested that the list of selection criteria should be non-exhaustive and exemplary.

19. Some respondents suggested including some additional elements to the list, such as: operational barriers and complexity; structural characteristics of the fund; availability of other LMTs that are not listed under Annex V AIFMD and Annex IIA UCITS (e.g.: soft closures); distribution policy of the fund; lack of data on the distribution side.

20. Lastly, a consumer association suggested adding the characteristic of the fund's investor base.

ESMA response:

21. ESMA takes note of stakeholders' feedback. ESMA notes that the list of selection criteria provided by the Guidelines is non-exhaustive and that managers may consider any other element which is deemed relevant for the purpose of the selection of LMTs.

22. ESMA has further integrated the list of selection criteria in light of the suggestions provided by stakeholders, including the fund's structural characteristics, as well as operational barriers and complexity, data availability on the distribution side and the characteristics of the fund's investor base.

23. Lastly, the Guidelines recognise that managers have the discretion to also use additional liquidity measures that were not defined in the Annexes.

Q2. Should the distribution policy of the fund be considered in the selection of the LMTs? What are the current practices in relation to the application of anti-dilution levies by third party distributors (e.g.: whether the third party corrects the price by adding the anti-dilution levy to the fund NAV)?

24. Several respondents agreed that the distribution policy should be one of the factors considered in the selection of LMTs and one consumer association emphasised that the distribution policy is crucial in this context.

25. On the contrary, few stakeholders highlighted that the distribution policy of the fund should not necessarily and always be considered in the selection of the LMTs, but only when it is relevant.

ESMA response:

26. ESMA takes note of stakeholders' feedback and has retained the distribution policy as one of the elements to be considered in the selection of LMTs.

Q3. Do you agree that among the two minimum LMTs managers should consider the merit of selecting of at least one quantitative LMT and at least one ADT, in light of the investment strategy, redemption policy and liquidity profile of the fund?

27. Almost all respondents, including a consumer association, disagreed with the proposed guideline arguing that managers should be given sufficient flexibility to select the most suitable LMT, as mandated by the Level 1. In this context, one respondent cautioned against a hard requirement to select one ADT and one quantitative LMT, as this would undermine the primary responsibility of the manager for liquidity risk management. Other respondents argued that it is unclear how the proposed guidance would apply to redemptions in kind, which are neither an ADT, nor a quantitative-based LMT, but are permitted to be selected as one of the two minimum LMTs.

ESMA response:

28. ESMA takes note of the feedback provided by stakeholders. ESMA believes that it is important to ensure that managers consider the merit of selecting both types of LMTs and, in general, select as many LMTs as possible to face different market conditions and/or liquidity issues. This is why ESMA, while stressing that the primary responsibility for liquidity risk management and for the selection of the appropriate LMTs remains with the manager, has nevertheless retained the guideline whereby managers should consider, where appropriate, the merit of selecting at least one quantitative LMT and at least one ADT. ESMA notes that this is without prejudice to the ultimate responsibility of the manager for the selection of LMTs, including, where appropriate, redemptions in kind.

DEPOSITARIES

Q4. Do you see merit in developing further specific guidance on the depositaries' duties, including on verification procedures, with regards to LMTs?

29. The majority of respondents highlighted that the obligations of depositaries are already established under UCITS and AIFMD, including on risk management and liquidity risk management.[12]

ESMA response:

30. ESMA acknowledges that the obligations of depositaries are already established under UCITS and AIFMD, including on risk management and liquidity risk management and has decided not to include any specific guidance addressed to depositaries in the final guidelines.

THE LMT POLICY

Q5. Do you agree with the list of elements included under paragraph 28 of Section 6.5.2 of the draft guidelines to be included in the LMT policy? Are there any other elements that, in your view, should be included in the LMT policy?

Q6. In your view, what are the elements of the LMT policy that should be disclosed to investors and what are the ones that should not be disclosed? Please provide reasons for your answer.

31. The majority of respondents highlighted that the elements included in the list are too far reaching and should be indicative and not prescriptive and that, in any case, the LMT policy should be kept as an internal guidance document and not be public.

32. Other respondents broadly agreed with the list, but two of them proposed that it should be emphasised that the LMT policy is a guidance document and that managers should be given flexibility to adapt the LMT policy as needed.

ESMA response:

33. ESMA takes note of the feedback provided by stakeholders and has decided not to retain the section of the guidelines dedicated to the governance principles.

[12] Reference was made by one respondent of UCITS and Article 95 of Commission Delegated Regulation 231/2013, which require depositaries to perform ex post controls and verifications of processes and procedures that are the responsibility of the management company.

34. In this context, it is to be noted that the UCITSD and AIFMD already include provisions on organisational requirements13, in particular, under the revised Directive the UCITS and the AIFM are required to "implement detailed policies and procedures for the activation and deactivation of any selected liquidity management tool and the operational and administrative arrangements for the use of such tool". Therefore, the Level 1 already contains provisions mandating the implementation of policies and procedures for the activation, deactivation of LMTs and the operational and administrative arrangements.

35. Against this background, ESMA has decided not to retain the guidance on the governance principles in the final guidance.

THE DEFINITION OF "EXCEPTIONAL CIRCUMSTANCES"

Q7. Do you agree with the above definition of "exceptional circumstances"? Can you provide examples of additional exceptional circumstances, not included under paragraph 30 of Section 6.5.3.1 of the draft guidelines, that would require the manager to consider the activation of suspension of subscriptions, repurchases and redemptions, having regard to the interests of the fund's investors?

36. The majority of respondents disagreed with the attempt of defining exceptional circumstances. While not being fully supportive, other respondents broadly agreed with the proposed list, recognising that it has the benefit of being a non-exhaustive one.

ESMA response:

37. ESMA takes note of the feedback provided by stakeholders. ESMA believes that providing a definition of exceptional circumstances is important in order to harmonise practices among Member States on when it is considered appropriate to activate a suspension of redemptions, repurchases and subscriptions. ESMA has therefore included the definition of exceptional circumstances in the definition section of the guidelines. Lastly, ESMA notes that the list of examples of exceptional circumstances is non-exhaustive.

SUSPENSIONS OF SUBSCRIPTIONS, REPURCHASES AND REDEMPTIONS

Q8. Do you agree with the elements of the LMT plan included under paragraph 32 of Section 6.5.3.1 of the draft guidelines to be included in the LMT plan? Is there any other element that should be considered?

[13] Including Article 18 AIFMD and Article 57 Commission Delegated Regulation (EU) No 231/2013 and, most importantly, Article 18a(2) UCITS and Article 16(2b) of the AIFMD.

38. While the majority of respondents cautioned that the preparation of the LMT plan would be burdensome and some elements be difficult to be know beforehand, others broadly agreed with the implementation of an LMT plan and praised the possibility of formalising it not necessarily before but also immediately after the activation of the LMT(s).

39. In any case, the majority of respondent agreed that the LMT plan should not be disclosed.

ESMA response:

40. ESMA takes note of the feedback provided by stakeholders and has decided not to retain the section of the guidelines dedicated to the governance principles, including the one on the LMT plan.[14]

Q9. Do you agree with the above list of elements to calibrate the suspensions of subscriptions, repurchases and redemptions? Is there any other element that should be considered?

41. The majority of respondents were generally against a fixed threshold for the activation of LMTs, including for suspensions of redemptions and suggested removing the reference to the “activation threshold” for a suspension.

42. In this context, one respondent indicated that establishing a threshold could create an anchor for decision making and increase the predictability of activating suspensions thus implementing the mechanistic approach that the guidelines want to avoid.

ESMA response:

43. ESMA acknowledges broad support for removing the reference to an activation threshold for suspensions of subscriptions, repurchases and redemptions and has implemented this suggestion in the final guidance in order to avoid the risk, highlighted by stakeholders, of an “automatic” activation of suspensions.

REDEMPTION GATES

Q10. Do you agree with the proposed criteria for the selection of redemption gates? Is there any other criteria that should be considered?

[14] For additional details please refer to the ESMA response to Q5 – Q6.

Q11. What methodology should be used and which elements should be taken into account when setting the activation threshold of redemption gates?

Q14. In order to ensure more harmonisation on the use of redemption gates, a fixed minimum activation threshold, above which managers could have the option to activate the redemption gate, could be recommended. Do you think that a fixed minimum threshold would be appropriate, or do you think that this choice should be left to the manager?

Q15. If you think that a fixed minimum threshold should be recommended, do you agree that for daily dealing funds (except ETFs and MMFs) it should be set as follows:

a) at 5% for daily net redemptions; and

b) at 10% for cumulative net redemptions received during a week?

44. Several respondents argued that redemption gates are being used by less liquid funds on a day-to-day basis in light of the less liquid nature of their assets and challenged the guideline whereby redemption gates should only be used in case of significant liquidity issues. In this context, some respondents did not agree with the draft guidelines aimed at restricting the possibility to use redemption gates systematically for funds marketed to retail investors.

45. All respondents, but two, were strongly against setting a unique methodology and/or a harmonised activation threshold for redemption gates, highlighting that managers should have the flexibility to choose the best approach according to the specific situation. To this respect, a consumers' association argued that a fixed minimum threshold risks being too low for some funds and too high for others. The two respondents that expressed their support for a harmonised fixed threshold stressed the discretionary nature of the activation, which should remain with the manager and that for funds invested in less liquid assets the activation of redemption gates should not be necessarily linked to specific circumstances.

ESMA response:

46. ESMA takes note of the feedback received by stakeholders. ESMA notes that, in light of the Level 1, redemption gates should not necessarily be activated under exceptional circumstances (as suspensions and side pockets), but under any circumstances under the discretion of the manager. Therefore, in line with the Level 1 provisions, ESMA has decided not to retain the guideline whereby, for funds marketed to retail investors, redemption gates should not be systemically activated to manage the fund's liquidity on a day-to-day basis. In the same spirit, in light of the suggestions provided by stakeholders and of the limitations

provided by the Level 1 rules, ESMA has decided not to retain the guideline whereby redemption gates should be activated only in case of significant liquidity calls, as LMTs can be activated both under normal and stressed market conditions.

47. Lastly, ESMA acknowledges stakeholders' preference not to set harmonised activation thresholds for redemption gates and had decided not to issue any guidance in this respect.

Q12. Do you agree that the use of redemption gates should not be restricted in terms of the maximum period over which they can be used? Do you think that any differentiation should be made for funds marketed to retail investors? Please provide concrete cases and examples in your response.

Q13. What is the methodology that managers should use to calibrate the activation threshold of redemption gates to ensure that the calibration is effective so that the gate can be activated when it is needed? Do you think that activation thresholds should be calibrated based on historical redemption requests and the results of LSTs?

48. The majority of respondents agreed that redemption gates should not be restricted in terms of the maximum period over which they can be used, nor the number of times that they can be activated. Several reasons were provided, including that managers may have to wait to have sufficient liquidity in order to honour redemptions and, in most cases, the timeline cannot be defined upfront.

49. Several respondents highlighted that there is no reason to distinguish retail and institutional investors. In the view of one respondent, in fact, while it is true that redemption gates are less suited for retail investors, it is also likely that a manager of those funds would simply not select or activate them in the first place.

50. On the calibration methodology for redemption gates, in line with their answers to questions 11, 14 and 15, the majority of respondents cautioned against being too prescriptive, highlighting that this choice should be left to the manager.

51. In the view of some respondents, the calibration should also consider factors other than historical redemptions and LSTs, for instance current market conditions, as well as the expected cash flows, to help identify a potential liquidity mismatch and if this can be mitigated.

ESMA response:

52. ESMA has considered the feedback received and has decided not to change the proposed draft guidance on the use of redemption gates, which should not be restricted in terms of the maximum period over which they can be used (maximum duration of redemption gates), or the maximum number of times that redemption gates can be activated (maximum use of redemption gates), as long as the activation of redemption gates remains temporary in nature.

53. In light of the suggestions provided by stakeholders, ESMA has not provided a specific calibration methodology for redemption gates and has rather further integrated the list of elements to be taken into consideration in the calibration, which now includes the current market conditions and the expected cash flows, as suggested by stakeholders.

EXTENSION OF NOTICE PERIOD

Q16. Do you agree with the proposed criteria for the selection of the extension of notice period? Are there any other criteria that should be considered?

Q17. According to the revised AIFMD and UCITS Directive, the extension of notice periods means extending the period of notice that unit-holders or shareholders must give to fund managers, beyond a minimum period which is appropriate to the fund. In your view, for RE and PE funds: i) what would be an appropriate minimum notice period; and ii) would the extension of notice period be an appropriate LMT to select?

Q18. Do you think the length of the extension of notice periods should be proportionate to the length of the notice period of the fund? Do you think a standard/ maximum extended notice period should be set for UCITS?

Q19. Do you agree with the above criteria for the activation of the extension of notice period? Are there any other criteria that should be considered?

Q20. Do you have any comments on the guidance on the calibration of the extension of notice periods?

54. Stakeholders broadly agreed with the proposed selection criteria for the extension of notice periods and a number of them agreed that this LMT, as well as longer notice periods, would be more suited for funds invested in less liquid assets. However, some of the stakeholders suggested to delete the reference to RE and PE funds, as well as the reference to the fact that AIFs invested in less liquid assets and, particularly, RE and PE funds, should already have in place a notice period which is in line with the level of liquidity of their assets.

55. Furthermore, the majority of stakeholders advised against setting a minimum notice period, although some of them recognised that funds invested in less liquid assets should in principle have “longer” notice periods. Those stakeholders argued that a minimum notice period would be an arbitrary choice given the heterogenous universe of funds and that this assessment should be made on a case-by-case basis. Those respondents argued that there cannot be a one size fits all approach and that the assessment should be made by the manager only and on a case-by-case basis.

56. A public authority proposed to go beyond the proposed guidance and provide that funds invested in less liquid assets should have a minimum 12-month notice period.

57. Lastly, stakeholders were broadly in favour of the proposed criteria for the activation of the extension of notice period, and while agreeing that this LMT could be activated under both normal and stressed market conditions, they highlighted that ultimately the decision belongs to the manager.

ESMA response:

58. ESMA takes note of the feedback received from stakeholders. ESMA notes that the applicable rules under the AIFMD already provide that AIFMs shall ensure that, for each AIF that they manage “the investment strategy, the liquidity profile and the redemption policy are consistent”[15]. In this context, as already indicated in previous occasions[16], ESMA would like to stress the importance of ensuring ongoing supervision of the alignment between the funds’ investment strategy, liquidity profile and redemption policy.

59. On the proposal made by a public authority to set out that funds invested in less liquid assets should have a minimum 12-month notice period, ESMA notes that this requirement is beyond the scope of the guidelines and would potentially be better addressed by a Level 1 change.

60. Against this background, ESMA has decided not to substantially modify the proposed guidance on the extension of notice period.

REDEMPTIONS IN KIND

[15] See Article 16(2) of the AIFMD.
[16] See the 2020 ESMA Report in response to the May 2020 ESRB Recommendation and the ESMA Final Report on the 2022 CSA on valuation, available, respectively at esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf and ESMA34-45-1802_2022_CSA_on_Asset_Valuation_-_Final_Report.pdf .

Q21. Do you agree with the above criteria for the selection of redemptions in kind? Are there any other criteria that should be considered?

Q22. Do you agree with the above criteria for the activation of redemptions in kind? Are there any other criteria that should be considered?

Q23. Do you think that redemptions in kind should only be activated on the NAV calculation dates?

Q24. What are the criteria to be followed by the managers for the selection of the assets to be redeemed in kind in order to ensure fair treatment of investors?

Q25. How should redemptions in kind be calibrated?

61. Stakeholders broadly agreed with the criteria for the selection of Redemptions in Kind (RiK) and one of them suggested considering additional factors, for instance, the structure of the fund, the number of investors and the asset types.

62. Some stakeholders asked whether it would be possible for managers to select RiK as one of the two minimum LMTs, in light of the fact that redemptions in kind are neither a quantitative LMT nor an ADT.

63. A number of respondents suggested clarifying that for ETFs RiK should not be considered as an “activation” of LMTs for the purpose of the guidelines, arguing that RiK are not a mechanism for the liquidity management of ETFs, in light of the fact that Authorized Participants (APs) are affiliated with the ETFs, and retail investors do not interact with the ETF directly.

64. Several stakeholders suggested deleting the requirement to perform the valuation of the assets by an external third party as they considered this requirement to be unjustified and costly, arguing that that the manager is already required to calculate a fair price at each valuation and redemption date, as reviewed by the auditor (or the depositary), in line with legal and regulatory requirements.

65. As to the criteria to be followed by the managers for the selection of the assets to be redeemed in kind, some stakeholders pointed out that the selection of the assets will depend on the strategy and the asset composition of the fund, hence it should be left to the manager's discretion. The same argument for raised for the calibration of RiK, where the majority of stakeholders argued that this should be determined on a case-by-case basis in light of the agreement between the manager and the investors.

ESMA response:

66. ESMA takes note of the suggestions provided by stakeholders and has further integrated the criteria for the selection of RiK by adding the structure of the fund, the number of investors, as well the asset types.

67. As already highlighted in the ESMA response to Question 3, ESMA confirms that it is possible for the manager to select RiK as one of the minimum LMTs. On the question regarding the applicability of RiK to ETFs, ESMA points stakeholders to the ESMA response provided for Question 36 of the Feedback Statement of the Final Report on the RTS on the characteristics of LMTs.[17]

68. Following the comments received by stakeholders, ESMA has also decided to delete the reference to a "third party valuer" for the valuation of assets in case of the activation of RiK, as the applicable rules on valuation are already set out in the relevant legislations. In this context, the references to the depositary and the auditor, which were presented as examples of entities that could perform the independent valuation, were also deleted.

ANTI-DILUTION TOOLS (ADTs)

Q26. Do you agree that managers should consider the merit of avoiding the simultaneous activation of certain ADTs (e.g.: swing pricing and anti-dilution levies)? Please provide examples when illustrating your answer.

Q27. Do you agree with the list of elements provided under paragraph 56 of Section 6.5.4 of the draft guidelines? Is there any other element that should be included in the estimated cost of liquidity?]

Q28. Do you have any other comments on the proposed general guidance on ADTs?

69. While several respondents, including a consumer association, agreed that managers should avoid activating at the same time several ADTs, as this could create duplicative impacts, some respondents argued that managers should have the flexibility to select different ADTs and to activate them simultaneously, especially when market conditions are particularly stressed.

70. On the elements to be considered in the estimated cost of liquidity, several respondents highlighted the difficulty of determining implicit transaction costs, and many other argued

[17] See ESMA34-1985693317-1259, Section 3.1, Question 36.

that there should not be a requirement to systematically include implicit costs, due to the potential lack of data. A few respondents pointed out that the list of cost elements should not be considered exhaustive, as explicit costs may also include other factors.

71. Other comments were provided on disclosure, where two respondents agreed that the thresholds for activation should not be disclosed to investors, in order to prevent taking advantage from this information.

ESMA response:

72. ESMA takes note of the responses provided by stakeholders. ESMA believes that while the cost of liquidity cannot be precisely determined ex ante – which is why the guidelines refer to the "estimated" cost of liquidity – it should be ensured that it includes all the potential costs in the most transparent way. On this point, ESMA also notes that the lists provided in the guidelines of potential explicit and implicit costs are non-exhaustive and can therefore be further integrated by the manager on a case-by-case basis.

73. Following the comments made by some stakeholders, ESMA has decided not to retain the guidelines preventing the simultaneous selection and activation of ADTs, as not prohibited under the Level 1 rules.

74. Lastly, in the final guidance ESMA has not retained the definitions of the explicit and implicit transaction costs to avoid any overlaps with the RTS on the characteristics of LMTs.[18]

REDEMPTION FEES

Q29. Do you agree with the above criteria for the selection of redemption fees? Is there any other criteria that should be considered?

Q30. Do you have any views on how to set the activation thresholds for redemption fees?

Q31. Do you have any comments the calibration of redemption fees?

75. The majority of stakeholders agreed with the criteria for the selection of redemptions fees but highlighted that the activation thresholds would depend on many parameters (e.g.: size of the redemption, impact of the costs on remaining investors) and should be defined on a case-by-case basis, considering also market conditions. In this context, they reiterated the

[18] See ESMA34-1985693317-1259.

view that managers should have the final decision on the selection of the most appropriate LMT.

76. On the calibration of redemptions fees, several stakeholders reiterated their view that transaction costs should be estimated on a best effort basis and one respondent cautioned against the mandatory application of estimated implicit costs, noting it may be very challenging.

ESMA response:

77. ESMA takes note the feedback provided by stakeholders. ESMA would like to highlight that the guidelines recognise the manager's discretion in the selection of the most appropriate LMT. On the estimation of implicit costs, ESMA reiterates the view already expressed in its response to the previous Question.

SWING PRICING

Q32. Do you agree with the above criteria for the selection of swing pricing? Is there any other criteria that should be considered?

Q33. Under which circumstances should the manager consider the activation of swing pricing?

Q34. Do you agree with the above principles that a manager should follow in order to recalibrate the swing factor? Is there any other criteria that should be considered?

Q35. Do you have any comments on the proposed guidance on the calibration of swing pricing?

78. Stakeholders broadly agreed with the selection criteria of swing pricing.

79. On the activation of swing pricing, most respondents agreed that the activation thresholds should not be disclosed in order to avoid the first move advantage and market manipulation.

80. Some respondents discouraged prescribing specific swing pricing models or minimum swing factors, as this would require expert judgment across asset management functions.

ESMA response:

81. ESMA takes note of the responses provided by stakeholders and, as suggested by some of them, has decided to refer to the "estimated" cost of liquidity for swing pricing, in order to ensure consistency with the other ADTs.

DUAL PRICING

Q36. As dual pricing is a LMT which is not particularly used in most Member States, stakeholders' feedback on the selection, activation and calibration of this LMT is especially sought from those jurisdictions where this is used.

82. The majority of respondents concurred that dual pricing is either not used or permitted in their jurisdictions and therefore they have no experience on this LMT. Against this background, some respondents referred to their comments on swing pricing, due to the similarity between these two LMTs. In this context, stakeholders suggested that the Guidelines should not limit managers' discretion and should grant maximum flexibility to the manager.

83. One respondent highlighted that dual pricing is generally used by funds where the costs are mainly made up by the bid-ask spread or driven by investor preferences.

ESMA response:

84. ESMA takes note of stakeholders' feedback on dual pricing and has decided not to amend the proposed guidance.

ANTI-DILUTION LEVIES (ADL)

Q37. Do you agree with the above criteria for the selection of ADL? Is there any other criteria that should be considered?

Q38. Do you agree with the above criteria for the activation of ADL? Is there any other criteria that should be considered?

Q39. Do you agree that ADL should be calibrated based on the same factor used to calibrate swing factors?

Q40. Do you have any comments on the selection, activation and calibration of ADL?

85. Respondents broadly agreed with the criteria for the selection and activation of ADL.

86. While some respondents agreed that ADL should be calibrated based on the same factor used to calibrate swing factors, others did not have a strong opinion on the topic.

ESMA response:

87. ESMA takes note of stakeholders' feedback and has decided not to substantially modify the proposed guidance.

SIDE POCKETS

Q41. Do you agree with the above definition of "exceptional circumstances"? Can you provide examples of additional exceptional circumstances, not included under the above paragraph?

88. All respondents referred to their answer to Question 7 and/or provided the same answer.

ESMA response:

89. Please refer to the ESMA response already provided under Question 7.

Q42. In your view, how the different types of side pockets (physical segregation vs. accounting segregation) should be calibrated and in which circumstances one should be chosen over the other? Please provide examples including on whether the guidance should be different for UCITS and AIFs.

Q43. Do you have any comments on the calibration of side pockets?

90. The majority of respondents reiterated the view that the manager is best placed to make the choice between accounting and physical segregation.

91. On whether the guidance should be different for UCITS and AIFs, the majority of the respondents highlighted that there should be no differences, in order to allow managers to take a flexible approach and take the relevant decisions in the best interest of investors and in light of the specific circumstances.

92. Three stakeholders highlighted that the determination of the calibration criteria should be at the discretion of the manager and that the notion of an "activation threshold" is not compatible with this LMT and should be based on the specific circumstance and not triggered by a specific threshold.

93. Some stakeholders expressed a preference for allowing the possibility of reversing the side pocket decision without necessarily liquidating the fund, thus endorsing a more flexible approach than the one whereby side pockets should be managed with the sole objective of being liquidated.

94. ESMA takes note of the feedback provided by stakeholders and confirms that no activation threshold is provided by the guidelines on side pockets.

95. On whether or not to liquidate the fund following the activations of side pockets, please refer to the ESMA responses provided to Question 43 of the Final Report on the RTS on the characteristics of LMTs.[19]

96. Similarly to suspensions, ESMA has decided not to retain the guidelines regarding an LMT plan prior to the activation of a side pocket.[20]

DISCLOSURE TO INVESTORS

Q44. Do you have any comment on the proposed guidance on disclosure to investors?

Q45. Do you agree that investors should be informed of the fact that the manager can activate selected and available LMTs and that this information should be included in the fund's rules and instruments of incorporation?

Q46. Which parts of the LMT policy, if any, should be disclosed to investors?

97. The majority of stakeholders supported the principle of improving transparency to investors but stressed the importance to strike the right balance between appropriate disclosure, investor protection and unintended consequences, in order to balance the benefits against potential drawbacks, such as increased operational costs, risk of information overload, inadvertent disclosure of sensitive information and the suitability of a uniform approach for a diverse investment fund universe.

98. More specifically, several stakeholders cautioned against overly prescriptive or granular disclosure requirements which may be counterproductive due to the more sophisticated investors could "game" these disclosures for the benefit.

[19] See ESMA34-1985693317-1259, Section 3.1, Question 43.
[20] For additional details please refer to the ESMA response to Q5 – Q6 and Q8.

99. Lastly, the large majority of the stakeholders were of the view that the LMT policy is an internal document and should not be disclosed to investors for the same reasons provided under their responses to Q6 and Q44.

ESMA response:

100. ESMA has decided not to retain the section of the guidelines on disclosure to investors.

101. The revised AIFM Directive provides for a "description of the AIF's liquidity risk management, including the redemption rights, both in normal and in exceptional circumstances, of the existing redemption arrangements with investors, and of the possibility of, and conditions for, using liquidity management tools selected in accordance with Article 16(2b)". It is also to be noted that the activation and deactivation of LMTs are parts of the redemption policy of the fund, which is laid down in the fund rules or the instruments of incorporation or the prospectus, which imposes disclosure obligations to manager. [21] Therefore, the Level 1 contains already provisions on disclosure to investors.

APPLICATION OF THE GUIDELINES

Q47. In your view, how much time would managers need for adaptation before they apply the guidelines, in particular for existing funds?

102. Stakeholders proposed a wide range of implementation periods. Some of them were of the view that a longer implementation period should be given to existing funds (i.e. 12 month-period to existing funds and a 24 month-period for new funds), while others that the same period should be granted to both new and existing funds (this varying from a 24-month to a 36-month implementation period).

103. In view of stakeholders, sufficient time should be given in order to: i) amend governance rules, as well disclosure to investors; ii) calibrate the use of ADTs; iii) set up the technical infrastructures (IT, monitoring systems); and iv) take the appropriate arrangements with external entities (e.g.: the depositary, custodians, distributors).

ESMA response:

104. ESMA takes note of the view expressed by stakeholders on the application of the guidelines and agrees that sufficient time should be granted to managers in order to ensure compliance with the recommended practices. Furthermore, ESMA believes that it is

[21] Article 40(4) of Commission Directive 2010/43/EU (i.e. "UCITS Level 2 Directive").

important to coordinate the entry into force of the guidelines with the adoption of the RTS on the characteristics of LMTs[22] by the European Commission (i.e.: avoid the risk that the guidelines become applicable before the RTS).

105. Therefore, ESMA has decided that the Guidelines will apply upon the application date of the RTS on the characteristics of the LMTs and that managers of funds existing before the date of application of these guidelines should apply these guidelines in respect of those funds after twelve months from the application date of the RTS. This is also in light of the Level 1 mandate requiring that the guidelines "shall allow adequate time for adaptation before they apply" in particular for existing funds.[23]

COST-BENEFIT ANALYSIS (CBA)

Q48. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the technical proposal develop by ESMA as regards the policy objecting of achieving a set of minimum standards by which all managers across Member States should select, activate and calibrate LMTs? Which other types of costs or benefits would you consider in that context?

Q49. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the technical proposal develop by ESMA as regards the policy objecting of achieving a set of minimum standards by which all managers across Member States should provide disclosure to investors on the selection, activation and calibration of LMTs? Which other types of costs or benefits would you consider in that context?

Q50. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the technical proposal develop by ESMA as regards the policy objecting of achieving a set of minimum standards by which all managers across Member States arrange their governance for the selection, activation and calibration of LMTs? Which other types of costs or benefits would you consider in that context?

106. While some stakeholders agreed with the proposed CBA, others stressed that the implementation of the guidelines will add significant costs.

107. Three respondents stressed that while harmonising LMTs can be in the interest of investors, excessive regulation limiting the discretion of the manager would not be

[22] See The Final Report on the RTS of the characteristics of LMTs, ESMA34-1985693317-1259.
[23] See Article 18a (4) of the UCITSD and Article 16(2h) of the AIFMD.

beneficial. The same stakeholders indicated that, in terms of costs, the use of ADT may be prohibitively expensive, especially where implicit costs such as significant market impact have to be included and that this element should be taken into account when selecting LMTs, especially for those funds that are not systemically relevant.[24]

108. One stakeholder stressed the impact of operational costs coming from the implementation of the guidelines, especially in relation to the whole chain of external entities (e.g.: depositaries, custodians, IT infrastructures) that are involved in the process.

ESMA response:

109. ESMA takes note of the feedback received and note that stakeholders have not precisely quantified the cost of compliance with the requirements. As already highlighted in its response to previous questions, ESMA has decided not to retain the sections of the guidelines related to corporate governance principles and disclosure which will make the implementation of the guidelines less costly for stakeholders.

[24] One stakeholder provided some examples of administrative costs billed by fund administrator to fund managers, i.e. 500 Euro per year for gates and 3000 Euro year for swing pricing.

4 Annex II: Cost-benefit analysis

4.1 Introduction

The revised UCITS Directive and the AIFMD establish a list of LMTs that shall be available to UCITS and AIFs. The list of LMTs and their definitions are the same in both Directives.

The Directives also provide that, by 16 April 2025, ESMA shall develop guidelines on the selection and calibration of LMTs by UCITS and AIFMs of open-ended AIFs for liquidity risk management and for mitigating financial stability risks. Those guidelines shall recognise that the primary responsibility for liquidity risk management remains with UCITS and the AIFM. Furthermore, they shall include indications as to the circumstances in which side pockets can be activated and allow adequate time for adaptation before they apply, in particular for existing UCITS and AIFs.

This cost-benefit analysis (CBA) is qualitative by nature. No data was received by ESMA through the consultation process.

The following table summarises the potential costs and benefits resulting from the implementation of the guidelines.[25]

4.1.1 Providing guidelines on the selection, activation and calibrations of LMTs

Policy objective	To achieve a set of minimum standards by which all managers across Member States should select, activate and calibrate LMTs
Baseline scenario	The baseline scenario should be understood for this CBA as the application of the requirements set out in the AIFMD and UCITS Directive without any further specification. This would leave managers complete discretion on how to select, activate and calibrate the LMTs referred to in Annex IIA of the UCITSD and in Annex V of the AIFMD (hereafter "the Annexes").

[25] ESG and innovation related aspects are not of direct relevance to the specific nature of the guidelines, as well as to RTS on the characteristics of LMTs under AIFMD and UCITS Directive. As the sections on governance principles and disclosure were not retained in the final guidance, the respective CBAs have been deleted from the analysis.

Technical proposal	To provide guidelines on how managers should select, activate and calibrate the LMTs listed in the Annexes.
Benefit	ESMA expects that these guidelines will benefit managers, investors and NCAs by providing clarity and guidance on expected practices. The introduction of these guidelines aims at contributing to the creation of a level playing field across Member States, reducing the scope for regulatory arbitrage, which could otherwise hamper investor protection and financial stability.[26] The main benefit of the guidelines is therefore to establish harmonised practices on the selection, activation and calibration of the LMTs listed in the Annexes. Such harmonisation will contribute to the uniformed application of the legislation by managers and to supervisory convergence between NCAs. This will ultimately also participate to increasing investor protection and financial stability in the EU.
Compliance costs	While there is significant variation in the availability of LMTs across EU jurisdictions, depending on national rules, suspension of redemptions is already available for UCITS in all jurisdictions, as shown by the mapping published in the 2020 ESMA response to the ESRB recommendation on liquidity risks in investment funds[27]:

Availability of LMTs for UCITS

	AT (1)	BE (2)	BG (3)	CY (4)	CZ (5)	DE (6)	DK (7)	EE (8)	ES (9)	FI (10)	FR (11)	GR (12)	HR (13)	HU (14)
Gates	NO	YES	NO	YES	NO	YES	NO	NO	NO	YES	YES	NO	*	NO
Side pockets	NO	NO	NO	YES	NO	NO	NO	NO	YES	NO	YES	NO	*	NO
Anti-dilution levy	NO*	YES	NO	NO	NO	NO	NO	NO	YES	NO	YES	NO	*	NO
Redemption fees	YES	YES	NO	NO	YES	YES	YES	NO	YES	YES	YES	YES	*	YES
Redemption in kind	NO	NO	NO	NO	NO	YES	YES	NO	YES	YES	YES	NO	*	NO
Suspension redemptions /subscriptions	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Swing pricing	NO**	YES	NO	NO	NO	YES	NO	NO	YES	YES	YES	NO	*	NO
Mandatory liquidity buffers	NO	NO	NO	NO	NO	NO	NO	NO	YES	NO	NO	NO	*	NO
Side letters	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	*	NO

	IE (15)	IS (16)	IT (17)	LI (18)	LT (19)	LU (20)	LV (21)	MT (22)	NL (23)	NO (24)	PL (25)	PT (26)	R (2
Gates	YES	NO	NO	NO	YES	YES	NO	YES	YES	YES		YES	Y
Side pockets	NO	NO	NO	YES	NO	YES*	NO	NO	YES	YES		NO	N
Anti-dilution levy	YES	NO	NO	NO	NO	YES	NO	YES	YES	YES		NO	N
Redemption fees	YES	NO	YES	YES	YES	YES	YES	YES	YES	YES		YES	Y
Redemption in kind	YES	YES	NO	YES	NO	YES**	NO	YES*	YES	NO		YES	N
Suspension redemptions /subscriptions	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES		YES	Y
Swing pricing	YES	NO	NO	YES	NO	YES	NO	YES**	YES	YES		NO	N
Mandatory liquidity buffers	YES	NO	NO	NO	NO	NO	NO	YES	NO	NO		NO	N
Side letters	NO	NO	NO	NO	NO	NO	NO	YES	YES	NO		NO	N

[26] See FR15/23 Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes (iosco.org), p. 22.
[27] See esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf (europa.eu), p. 36.

	Furthermore, in the majority of Member States a selection of LMTs is already available and managers are therefore already familiar with the possibility to select and activate LMTs. As such, while having the benefit of providing a harmonised framework at EU level for the selection, activation and calibration of LMTs, these guidelines may not add significant costs to managers, other than compliance costs linked to the update of the relevant policies and procedures regarding LMTs. Furthermore, the guidelines will not impose any strict obligations on the managers as, ultimately, the primary responsibility for liquidity risk management, as well as for the selection, calibration, activation and deactivation of LMTs is of the manager.
Proportionality-related aspects	The identified benefits outweigh the comparably limited costs, hence no proportionality-related aspects are expected to be impacted by this option.

4.1.2 Conclusions

Considering what has been illustrated above, ESMA believes that the overall supervisory and compliance costs associated with the implementation of these guidelines are justified by the objectives described above and will be largely compensated by the benefits for all stakeholders and, particularly, for NCAs, managers and investors.

While in fact having the benefit of providing a harmonised framework at EU level for the selection, activation and calibration of LMTs, the Guidelines will participate to increasing not only investor protection, but also financial stability.

5 Annex III: Guidelines on Liquidity management tools (LMTs) of UCITS and open-ended AIFs

1. Scope

Who?

1. These guidelines apply to competent authorities and fund managers

What?

2. These guidelines apply in relation to Article 18a(2) of the UCITS Directive and Article 16(2b) and (2c) of the AIFMD.

When?

3. These guidelines apply on the date of application of the RTS referred to in Article 18a(3) of the UCITS Directive and Article 16(2g) of the AIFMD.

4. By way of derogation from the first subparagraph, in respect of a fund existing before the date of application referred to in that subparagraph, these guidelines apply twelve months from that date.

2. Legislative references, abbreviations and definitions

Legislative references

UCITSD	Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)[28]
AIFMD	Directive 2011/65/EU on Alternative Investment Fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010[29]
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC[30]

Abbreviations

UCITS	Undertaking in Collective Investment in Transferable Securities
AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
LMT	Liquidity Management Tool
NAV	Net Asset Value
ADT	Anti-Dilution Tool
ADL	Anti-Dilution Levy

[28] OJ L 302, 17.11.2009, p. 32.
[29] OJ L 174, 1.7.2011, p.1.
[30] OJ L 331, 15.12.2010, p. 84.

Definitions

fund manager	a) a management company as defined in Article 2(1)(b) of the UCITS Directive; b) an investment company that has not designated a management company authorised pursuant to the UCITS Directive referred to in Article 30, first subparagraph, of the UCITS Directive; c) an AIFM as defined in Article 4(1)(b) of the AIFMD that manages an open-ended AIF
ADTs	redemption fees, swing pricing, dual pricing, ADLs
selected LMTs	the LMTs selected by the fund manager among those included in Annex IIA, points 2 to 8, of the UCITSD and in Annex V, points 2 to 8, of the AIFMD, i.e.: redemption gate, extension of notice periods, redemption fee, swing pricing, dual pricing, anti-dilution levy, redemption in kind
exceptional circumstances	unforeseen events, operational environments or regulatory environments that materially impact the fund's ability to carry out normal business functions which would temporarily prevent the fund manager from meeting the funding obligations arising from the liabilities side of the balance sheet

3. Purpose

5. These guidelines are published under mandates set out in the amending Directive of the AIFMD and UCITS Directive (Directive (EU) 2024/927 of the European Parliament and of the Council31). More specifically, the mandates in Article 18a, paragraph 4, of the UCITS Directive and Article 16, paragraph 2h, of the AIFMD provide that ESMA shall develop

[31] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 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 (OJ L, 2024/927, 26.3.2024).

guidelines on the selection and calibration of liquidity management tools by UCITS and AIFMs for liquidity risk management and for mitigating financial stability risks.

6. These guidelines are also based on Article 16(1) of the ESMA Regulation.

7. Whilst the primary responsibility for LMTs remains with the UCITS and AIFMs, the purpose of these guidelines is to establish consistent, efficient and effective supervisory practices and to ensure the common, uniform and consistent application of Union law, in particular of Article 18a(2) of the UCITS Directive and Article 16(2b) and (2c) of the AIFMD in relation to the selection, activation and calibration of LMTs.

4. Compliance and reporting obligations

Status of the guidelines

8. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.

9. Competent authorities to which these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

Reporting requirements

10. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication by ESMA. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.

11. Financial market participants are not required to report whether they comply with these guidelines.

5. Guidelines on LMTs of UCITS and open-ended AIFs

5. 1 Guidelines on general principles

12. The primary responsibility for liquidity risk management, as well as for the selection, calibration, activation and deactivation of LMTs, remains with the fund manager. In the selection of the appropriate LMTs, fund managers should give due consideration that the selected LMTs will allow to effectively manage the fund's liquidity risk under both normal and stressed market conditions and that the selection is as comprehensive as possible to address different circumstances.

13. In accordance with Article 18a(2) of the UCITSD and Article 16(2b) of the AIFMD, when selecting LMTs from Annex IIA of the UCITS Directive and Annex V of the AIFMD, fund managers should assess the suitability of those tools in light of all relevant factors, including at least the following:

    a) the fund's legal structure and any specific features associated with the manner in which it is structured (e.g. ETFs, master-feeder structure);

    b) the fund's investment strategy and investment policy;

    c) the dealing terms of the fund including, *inter alia*, the minimum duration of the notice period, lock up period, settlement period, redemption policy and dealing frequency;

    d) the liquidity profile of the fund and its underlying assets, including any anticipated liquidity demands, taking into account investors' redemptions and other potential sources of liquidity risk from the liability side of the fund's balance sheet (e.g.: margin calls) under normal and stressed market conditions and the impact on the liquidity profile of the fund of the activation of the LMTs;

    e) the results of liquidity stress testing;

    f) the characteristics of the fund's investor base;

    g) the fund's distribution policy;

    h) any other relevant operational barriers and complexities that may impact on the feasibility of implementing certain LMTs.

14. While the UCITSD and AIFMD require the selection of at least two appropriate LMTs from the lists contained in Annex IIA of the UCITS Directive and Annex V of the AIFMD,

managers may choose to select more than two LMTs as well as additional liquidity measures, in order to ensure the fund's overall resilience and ability to manage its liquidity during both normal and stressed market conditions. In selecting additional LMTs or liquidity measures, fund managers should assess their suitability in light of all relevant factors, including at least the factors referred to in the previous paragraph.

15. In the selection of the two minimum mandatory LMTs, fund managers should consider, where appropriate, the merit of selecting at least one quantitative-based LMT (i.e.: redemption gates, extension of notice period) and at least one ADT (i.e.: redemption fees, swing pricing, dual pricing, ADL), 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, fund managers may consider whether to select one LMT to use under normal market conditions and one LMT to be used under stressed market conditions.

16. When considering the activation of LMT(s), fund managers should assess whether to activate LMTs individually or in combination with additional LMTs or other liquidity measures.

17. Fund managers should be able to demonstrate, at the request of the competent authority, that the activation and calibration(s) of the selected LMTs are in the best interest of all investors and are appropriate and effective in light of market conditions and the relevant characteristics of the fund (e.g.: the liquidity profile, the type of underlying assets, the investor base).

18. Fund managers should ensure that the level of subscription and redemption orders received is treated in a manner which avoids that some investors benefit from information on the probability that LMTs may be activated (e.g.: activation thresholds may be reached in case of redemption gates).

5.2 Guidelines on quantitative-based LMTs

5.2.1 Guidelines on suspension of subscriptions, repurchases and redemptions ("suspensions")

19. Fund managers should consider the activation of suspensions only in exceptional circumstances and where justified having regard to the interests of its investors. A non-exhaustive list of exceptional circumstances under which a fund manager may consider activating suspensions includes: asset valuation difficulties; severe liquidity issues (e.g.: due to margin calls, significant withdrawal) where executing the sale of underlying assets

could cause liquidity issues for the fund (e.g.: large discounts in asset sales, large dilution of remaining investors); critical cyber incident that impacts on the fund, the fund manager and/or fund's services provider capacity to operate; unforeseen market closures, trading restrictions, closure of trading venues; severe financial and/or political crisis; identification of significant fraud; natural disaster.

20. The suspensions may include the suspension of the NAV calculation, particularly in case of uncertain valuation and where it is not possible to compute the NAV of the fund(s). In other cases, and whenever possible, the fund manager should continue to value the assets in the fund and publish a NAV to ensure proper information is provided to investors, including the fact that the fund is closed for subscriptions, repurchases and redemptions.

21. Whilst suspensions, in some cases, may be activated while the fund manager is deciding whether to liquidate the fund, fund managers should ensure that suspensions are activated only on a temporary basis (i.e.: with the view not to permanently suspend the fund, but to re-open it, or liquidate it or activate side pockets, if necessary, at a certain point in time).

22. Fund managers should consider relevant calibrations for suspensions to include:

    a) the criteria for assessing and monitoring the conditions that prompted their activation;

    b) the criteria for reviewing and potentially revising the decision to suspend and the change in circumstances that would warrant this.

5.2.2 Guidelines on redemption gates

23. Fund managers should consider the selection of redemption gates for all funds, as all assets could potentially suffer from liquidity issues during stressed market conditions and the activation of this LMT may be useful to avoid the activation of suspensions.

24. The selection of redemption gates should be considered especially by:

    a) fund managers of funds with a concentrated investor base, where a redemption of a significant size could cause liquidity issues to the fund and affect investors, particularly the remaining ones;

    b) fund managers of funds whose assets might be less liquid, inherently illiquid, or might become illiquid during stressed market conditions and/or assets that might take longer time to sell.

25. Fund managers should consider the activation of redemption gates in cases of redemption requests when the threshold is exceeded. The activation of redemption gates may be less

suited where a fund has valuation issues, in which case the manager may consider the use of other LMTs (e.g.: suspensions together with the suspension of the NAV).

26. Fund managers should calibrate the activation threshold in order to ensure that it operates effectively, so that a redemption gate can be activated whenever the manager needs to limit redemptions in the best interest of investors. In calibrating such threshold, managers should give due consideration to:

    a) the NAV calculation frequency;

    b) the investment objective of the fund;

    c) the liquidity of the underlying assets;

    d) the current market conditions;

    e) the expected cash flows.

27. Fund managers should not restrict the use of redemption gates in terms of the maximum period over which they can be used (maximum duration of redemption gates) or the maximum number of times that redemption gates can be activated (maximum use of redemption gates), as long as the activation of the gate remains temporary in nature. These matters should be determined by the fund manager on a case-by-case basis.

5.2.3 Guidelines on the extension of notice periods

28. Fund managers should consider the selection of extension of notice periods for all funds but, as this LMT provides additional time to liquidate the underlying assets, particular consideration should be given to this LMT in respect of:

    a) funds whose liquidity is particularly susceptible to deterioration in times of market stress;

    b) AIFs invested in less liquid assets and, particularly, for real estate and private equity funds, which should already have an appropriate redemption frequency in line with the level of liquidity of their assets under normal market conditions.

29. Fund managers should consider the activation of extension of notice periods both under normal and stressed market conditions, taking into account that it may be particularly useful in certain circumstances, for instance, in case of redemption pressures.

30. Fund managers should carefully assess whether the activation of the extension of notice periods is appropriate for UCITS under normal market conditions, taking into consideration the liquidity of their assets and the best interest of investors.

31. In order to avoid prompting an increase of redemptions requests, fund managers should carefully calibrate the length of the extension of notice periods, considering the time necessary for the orderly liquidation of the underlying instruments in the best interests of the investors.

5.2.4 Guidelines on Redemptions in Kind (RiK)

32. In the selection of RiK, fund managers should consider:
    a) the structure of the fund;
    b) the investor concentration;
    c) the asset types; and
    d) the applicable restrictions that apply to the use of RiK to professional investors only, in accordance with Article 18a(2) of the UCITS Directive and Article 16(2b) of the AIFMD.

5.3 Guidelines on Anti-Dilution Tools (ADTs)

33. Fund managers should consider the selection of ADTs for all types of funds to mitigate material investor dilution and potential first mover advantage.

34. Fund managers should carefully assess the different levels for the activation of ADTs at fund level and should set in advance and regularly review appropriate and prudent activation thresholds so as to avoid any material dilution impact on investors, in both normal and stressed market conditions and depending on the investment strategy, assets under management, size and portfolio characteristics, estimated cost of liquidity, investor profile, liquidity profile of each fund and historical fund flows.

35. Fund managers should consider that the activation of ADTs may be more challenging in certain circumstances, for example, when there is limited market liquidity and/or in cases of valuation uncertainty. In those cases, fund managers may consider the use of other LMTs in addition to ADTs (e.g.: quantitative-based LMTs).

36. Fund managers should ensure that the activation of ADTs does not affect the fund manager’s duty to value all assets fairly and appropriately at all times.

37. Fund managers should activate ADTs both under normal and stressed market conditions to impose the estimated costs of liquidity on subscribing and/or redeeming investors. The estimated cost of liquidity should:

a) include both explicit and implicit transaction costs of subscriptions, repurchases or redemptions, including any significant market impact of asset purchases or sales. A reasonable input for the estimation of the market impact could be to analyse previous transactions under similar market conditions to compare the difference between the price when the order was placed and the final executed price;

b) be based, as a starting point, on costs associated with transacting a pro-rata slice of all assets in the portfolio (i.e. “pro-rata approach”), unless this does not represent a fair estimate of the true liquidity cost. Where the pro-rata approach does not represent a fair estimate of the liquidity cost, the estimation can be adjusted to reflect more accurately the expected cost of liquidity when transacting in selected single holdings of the portfolio. Managers may consider using the pro-rata cost in stressed times, when it is most relevant for mitigating the potential dilution impact on the remaining investors.

38. In order to ensure that the calibration of ADTs effectively reflects the estimated costs of liquidity, the fund manager should regularly review the calibration and adjust it when needed.

39. Fund managers should be able to demonstrate, at the request of the relevant NCA, that the calibration of ADTs is fair and reasonable for both normal and stressed market conditions, taking into account the best interests of investors.

5.3.1 Guidelines on redemption fees

40. Fund managers may consider the selection of redemption fees for all types of funds, but redemption fees may be most useful in respect of the following funds:

a) funds that invest in assets which have fixed, transparent and/or foreseeable transaction costs, such as real estate agency fees or notary fees, and/or that have low-variation transaction costs (e.g.: fixed taxes and levies on real estate transactions);

b) funds that are invested in less liquid assets where other ADTs, such as swing pricing, might be challenging or impossible to implement due to infrequent and limited pricing sources.

41. When calibrating the predetermined range of redemption fees, fund managers should apply a methodology that, if static, allows for review and adjustment, to reflect the higher cost of liquidity or stressed market conditions.

5.3.2 Guidelines on swing pricing

42. Fund managers should consider the selection of swing pricing for funds whose underlying assets are actively traded and information on trading costs (bid/ask) is available and frequently updated, particularly where the funds invest mainly in assets with market contingent liquidity costs. Fund managers should consider that swing pricing may be less appropriate when trading costs are not readily available

43. Fund managers should base a decision to activate a specific swing pricing model (i.e.: full, partial with a single or tiered swing factor), and the calibration of the swing factor, on market conditions, based on a methodology determined by the fund manager.

44. When calibrating swing pricing, fund managers should ensure that the estimated cost of liquidity, in light of the market conditions, is incorporated in the swing factor, including any significant market impact of the trades.

45. Fund managers may set a maximum swing factor. In case the swing factor adjustment goes beyond the maximum swing factor, the fund manager should be able to justify, if required by the competent authority, on an ex-post basis the swing factor applied.

46. Fund managers should ensure that a decision to recalibrate the maximum swing factor is justified and made in the best interest of the investors.

5.3.3 Guidelines on dual pricing

47. Fund managers should consider the selection of dual pricing as potentially appropriate for funds that invest mainly in assets whose liquidity costs are reflected primarily by a bid-ask spread.

48. While dual pricing may be more suitable for funds that invest in assets whose liquidity costs are mainly comprised of the bid-ask spread, fund managers should account separately by additional adjustment to the NAV any significant market impact or explicit transaction costs.

5.3.4 Guidelines on Anti-Dilution Levy (ADL)

49. Fund managers should consider ADL to be especially appropriate for funds:

a) with a high investor concentration (i.e.: a small number of investors), to address the risk that one or more investors could fully redeem their shares at a short notice;

b) with significant levels of subscription and/or redemption activity that could negatively impact the fund's existing investors (e.g.: smaller funds in terms of NAV could be more impacted by the cost of liquidity caused by large redemptions);

c) that invest in less liquid assets (e.g.: high yield bonds, small cap equities);

d) where information on trading costs (bid/ask) is generally available (e.g.: funds that invest in assets with market contingent liquidity costs).

50. Fund managers should note that ADL can be activated on an ongoing basis or dynamically based on pre-defined triggers and thresholds.

51. While the ADL may be implemented consistently during normal market conditions, fund managers should review its calibration in relation to changing market conditions to ensure its effectiveness in preserving the fund's liquidity.

52. Fund managers should calibrate ADL based on the same factors used to calibrate swing factors, i.e.: the calibration of ADL should include all estimated explicit and estimated implicit transaction costs and it should be reviewed and, where needed, adjusted to ensure that the levy can evolve on a regular basis in light of the market conditions.

5.4 Guidelines on side pockets

53. Fund managers should consider the activation of side pockets only in exceptional circumstances and where justified having regard to the interests of its investors. A non-exhaustive list of exceptional circumstances under which a fund manager may consider activating side pockets includes:

a) significant valuation uncertainty and/or illiquidity of a specific portion of the portfolio of the fund for which there is no active market and/or for which trading is prohibited (e.g. due to sanctions) and/or for which fair valuation is temporarily unavailable with the view of segregating it from the rest of the fund (to enable this part to remain open for investors);

b) fraud, financial crisis or war affecting a particular sector or region.

54. In the calibration of side pockets, managers should consider:

a) determining the circumstances for activating a side-pocket and defining when such conditions no longer exist;

b) setting criteria for assessing and monitoring the conditions that prompted the use of the side-pocket;

c) consider the merit of placing some cash to manage the potential liabilities of the side pockets;

d) the criteria for reviewing and potentially revising the side-pocket decision and the changing circumstances that would warrant this.