

# Explanatory note accompanying the public consultation on the exercise of the Member State discretions provided for in 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

## 1.Introduction

The present explanatory note ('the **Note**') is issued in relation to the Consultation launched by the Ministry of Finance on 13.06.2025 ('the **Consultation**'). The Consultation seeks stakeholder views as to the exercise of the Member State discretions provided for in 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 ('the **Amending Directive**'). The Amending Directive amends:

- 1) Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 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 ('the **AIFMD**'); and
- 2) Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ('the **UCITS**').

The AIFMD has been transposed into Cypriot Law by means of Law 56(I) of 2013 on Alternative Investment Fund Managers ('the **AIFM Law**'), whereas the UCITS has been transposed into Cypriot Law by means of Law 78(I) of 2012 on Open-Ended Undertakings for Collective Investment ('the **UCI Law**'). Both the AIFM Law as well as the UCI Law will have to be amended as a result of the changes brought by the Amending Directive. Some of those amendments are already prescribed in the Amending Directive and will be effected in the context of the transposition process. Some others require the prior exercise of Member State ('**MS**') discretions provided for in the Amending Directive. As regards the latter, the Ministry of

Finance (‘the **Ministry**’) seeks through the Consultation the views of stakeholders as to the exercise of the MS discretions provided for in the Amending Directive.

## **2. Addressees**

The Note and the Consultation are addressed to a wide array of stakeholders, including but not limited to fund managers, investment fund service providers and delegates, advisors, competent authorities, fund reporting and other IT solution providers as well as other financial services entities, which may consider that the Amending Directive will have an impact on their business activities.

## **3. Content and structure of the Note**

The Note provides certain background information in relation to those provisions of the Amending Directive, where MS discretions are laid down. The aim is to describe the applicable context and facilitate stakeholder input. It also includes the Ministry’s initial approach as well as the input sought from stakeholders.

The content of the Note is limited to those provisions of the Amending Directive that involve the exercise of MS discretions in relation to the AIFMD, and subsequently the AIFM Law, and the UCITSD, and subsequently the UCI Law.

By means of a preliminary clarification in relation to the AIFMD, the said EU Directive primarily regulates the alternative investment fund manager (**‘AIFM’**) as its title suggests. However, it also indirectly impacts the investment funds under the AIFM’s management, namely alternative investment funds, within the meaning of the AIFMD (**‘AIFs’**)<sup>1</sup>. This is why as regards amendments to the AIFMD, references to the depositary, being a service provider to the AIF<sup>2</sup>, or to loan-originating AIFs are made under the Amending Directive, since the AIFM is also responsible for ensuring the AIF’s compliance with the AIFMD<sup>3</sup>. Conversely, the UCITSD is primarily dedicated to the regulation of the investment fund, i.e. of an Undertaking for Collective Investment in Transferable Securities (**‘UCITS’**). A UCITS can be managed by a UCITS Management Company, within the meaning of the UCITSD (**‘UCITS ManCo’**).

Where the provisions of the Amending Directive relate to the exercise of a MS discretion on a matter that is common<sup>4</sup> to both the AIFMD as well as the UCITSD, the information on and the approach as to the said discretion will be presented jointly.

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<sup>1</sup> The term AIF in this context is broader than the homonymous term employed in the context of Part II of Law 124(I) of 2018 on Alternative Investment Funds (‘the **AIF Law**’). Practically, the term AIF as defined herein, includes but is not limited to the investment funds falling under Title II of the AIF Law. Thus, from a Cyprus perspective the term AIF in the present context also encompasses AIFLNs (Part VII of the AIF Law) and RAIFs (Part VIII of the AIF Law).

<sup>2</sup> Recital nr.(11) of the AIFMD.

<sup>3</sup> Art.5(1) of the AIFMD.

<sup>4</sup> E.g. liquidity management tools under section 4.4 below herein.

## 4. The MS discretions for which stakeholder views are sought

### 4.1 Deviation from the AIF depositary localisation requirement (AIFMD-related discretion only)

While the AIFMD<sup>5</sup> currently requires the depositary of an EU AIF to be established in the same MS as such AIF, the Amending Directive<sup>6</sup> introduces a MS discretion for deviation from the said localisation requirement. More specifically, MS may provide that a credit institution established in another MS will be able to be appointed as the depositary of an AIF established within their territory. However, it needs to be clarified in advance that the said deviation does not constitute a so-called ‘depositary passport’. Furthermore, the granting of such deviation will be subject to strict conditions, including firstly the submission of a reasoned request by the AIFM concerned. Secondly, the existence of a depositary market of a certain size, a condition which applies to Cyprus. Thirdly, a regulatory case-by-case basis assessment of such request<sup>7</sup>.

Regarding the MS discretion in question, the initial approach of the Ministry is to make use thereof and allow a credit institution established in another MS to be the depositary for an AIF of the Republic<sup>8</sup>. Within this context, the Ministry seeks stakeholders views, including how the term ‘reasoned request’ should be further specified.

There is another depositary-related issue, which, although not involving a discretion, is worth mentioning and applies to both AIF and UCITS depositaries. As per the Amending Directive, a central securities depositary, within the meaning of Regulation (EU) 909/2014 (**‘CSD Regulation’**), shall be considered a delegate of the AIF<sup>9</sup>/UCITS<sup>10</sup> depositary when acting in the capacity of an ‘investor CSD’<sup>11</sup>. However, the AIF<sup>12</sup>/UCITS<sup>13</sup> depositary shall be exempted from the relevant delegate due diligence requirements, when entrusting custody of financial instruments to such a central securities depositary. This amendment regarding the role of

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<sup>5</sup> Art.21(5)(a) of the AIFMD.

<sup>6</sup> New paragraph 5a of Art.21 of the AIFMD laid down in Art.1(10)(a) of the Amending Directive.

<sup>7</sup> Points (a)-(b) of new paragraph 5a of Art.21 of the AIFMD laid down in Art.1(10)(a) of the Amending Directive.

<sup>8</sup> Within the meaning of section 42(1)(a) of the AIFM Law.

<sup>9</sup> New fifth subparagraph of paragraph 11 of Art.21 of the AIFMD laid down in Art.1(10)(c)(ii) of the Amending Directive.

<sup>10</sup> New paragraph 4 of Art.22a of the UCITSD laid down in Art.2(8)(b) of the Amending Directive.

<sup>11</sup> European Central Bank, Glossary available at

<https://www.ecb.europa.eu/services/glossary/html/glossi.en.html> : ‘investor CSD...A term used in the context of central securities depository (CSD) links. An investor CSD – or a third party acting on behalf of the investor CSD – opens an account in another CSD (the issuer CSD) so as to enable the cross-system settlement of securities transactions’.

<sup>12</sup> New point (c) of the second subparagraph of paragraph 11 of Art.21 of the AIFMD laid in Art.1(10)(c)(i) of the Amending Directive.

<sup>13</sup> New point (c) of paragraph 2 of Art.22a of the UCITSD laid down in Art.2(8)(a) of the Amending Directive.

CSDs in the custody chain, comes after this capacity had been initially negated in the AIFMD<sup>14</sup> and an ambiguous formulation was adopted in Directive 2014/91/EU amending the UCITSD ('UCITS V')<sup>15</sup>. Conversely, the provision of services by a central securities depository acting in the capacity of an 'issuer CSD'<sup>16</sup> shall not be considered as a delegation of the depository's custody functions.

## 4.2 Extending the list of top-up services for AIFMs/UCITS ManCos (Discretion in relation to both the AIFMD and the UCITSD)

Under the current framework both AIFMs as well as UCITS ManCos may 'top-up' their sectoral license to also provide the services laid down in Art. 6 para.4 of the AIFMD/Art.6 para.3 of the UCITSD respectively. However, UCITS Mancos may currently not provide the 'top-up' service of Reception and Transmission of orders ('RTO'), while AIFMs can. The Amending Directive rectifies this imbalance and provides for an alignment in this respect<sup>17</sup>.

Where the 'top-up services' of RTO, portfolio management, investment advice and safe-keeping and administration of fund units are provided, AIFMs<sup>18</sup> and UCITS Mancos<sup>19</sup> will have to comply with certain provisions of Directive 2014/65/EU (**MiFID II**). By means of a further

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<sup>14</sup> Recital Nr. 41 of the AIFMD: 'Entrusting the custody of assets to the operator of a securities settlement system as designated for the purposes of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems or entrusting the provision of similar services to third-country securities settlement systems should not be considered to be a delegation of custody functions.'

<sup>15</sup> Recital Nr. 21 of the UCITS V: 'When a Central Securities Depository (CSD), as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council, or a third-country CSD provides the services of operating a securities settlement system as well as at least either the initial recording of securities in a book-entry system through initial crediting or providing and maintaining securities accounts at the top tier level, as specified in Section A of the Annex to that Regulation, the provision of those services by that CSD with respect to the securities of the UCITS that are initially recorded in a book-entry system through initial crediting by that CSD should not be considered to be a delegation of custody functions. However, entrusting the custody of securities of the UCITS to any CSD, or to any third-country CSD should be considered to be a delegation of custody functions.'

<sup>16</sup> European Central Bank, Glossary available at <https://www.ecb.europa.eu/services/glossary/html/glossi.en.html> : 'issuer CSD (issuing CSD)...A central securities depository (CSD) in which securities are issued (or immobilised). The issuer CSD opens accounts allowing investors (in a direct holding system) and/or intermediaries (including investor CSDs) to hold these securities'; also at Banque de France, Chapter 12 Central securities depositories, Updated on 30 September 2020, available at [https://www.banque-france.fr/system/files/2023-04/livre\\_chapitre\\_12\\_en.pdf](https://www.banque-france.fr/system/files/2023-04/livre_chapitre_12_en.pdf) p.2 : 'The CSDs are also active participants in the integration of financial markets, in particular by establishing links between CSDs: these links are one of the ways for participants in a given market to be able to access securities issued in other jurisdictions. The establishment of a link from a CSD (called the "investor CSD") to another CSD (the "issuer CSD") means that the investor CSD becomes a participant of the issuer CSD, i.e. in practice opens a securities account in its name with the issuer CSD (which is in fact nearly always established in another country, as there are very few countries nowadays with more than one CSD). The investor CSD thus enables its participants to access securities other than those for which it itself performs the notary function'

<sup>17</sup> New point (iii) in the first subparagraph of point (b) of paragraph 3 of Art.6 of the UCITSD laid down in Art.2(2)(a)(i) of the Amending Directive.

<sup>18</sup> New paragraph 6 of Article 6 of the AIFMD as laid down in Art.1(2)(d) of the Amending Directive.

<sup>19</sup> New paragraph 4 of Article 6 of the UCITSD as laid down in Art.2(2)(b) of the Amending Directive.

amendment under the Amending Directive, AIFMs<sup>20</sup> and UCITS ManCos<sup>21</sup> will no longer be required to be authorised for the ‘top-up’ service of individual portfolio management, as a prerequisite for the provision of the non-core ‘top-up services’.

In addition, the list of non-core ‘top-up’ services that AIFMs<sup>22</sup>/UCITS Mancos<sup>23</sup> can provide is extended under the Amending Directive to also encompass ‘*any other function or activity which is already provided*’ by them in relation to their fund management activities; or in relation to the ‘top-up’ services they provide. The term ‘*any other function or activity*’ is to be perceived broadly. For instance, it is not limited to providing fund administration for AIFs/UCITS under the management of another AIFM/UCITS Manco pursuant to a delegation arrangement; it can also be associated with IT services for portfolio management and risk management, e.g. the sale of an in-house developed relevant software.

AIFMs<sup>24</sup> and UCITS Mancos<sup>25</sup> will also be able to provide as a ‘top-up’ service administration of benchmarks in accordance and compliance<sup>26</sup> with Regulation (EU) 2016/1011 (**‘Benchmark Regulation’**). However, administration of benchmarks, which are used in the AIFs<sup>27</sup>/UCITS<sup>28</sup> that the said entities manage is excluded therefrom, for obvious conflicts of interest purposes.

Regarding AIFMs only, the Amending Directive<sup>29</sup> allows them to be authorised to also provide the top-up service of credit servicing activities in accordance with Directive (EU) 2021/2167 (**‘Credit Servicing Directive’**). In the interest of clarity, it needs to be pointed out that despite being excluded from the scope of application of the Credit Servicing Directive<sup>30</sup>, AIFMs still need to comply therewith under the Amending Directive<sup>31</sup>. The reason therefore being that, for AIFMs, the Amending Directive is *lex specialis vis-a-vis* the Credit Servicing Directive, so that the Amending Directive requirement for compliance with the Credit Servicing Directive prevails. More specifically, AIFMs are generally exempted from the scope of the Credit Servicing Directive in accordance with Article 2(5) thereof, unless they provide the credit servicing activity as part of the top-up services referred to in the revised Article 6(4)(d) of AIFMD. In such a case they will be subject to the provisions of the Credit Servicing Directive, including the relevant authorisation requirement in the absence of a clear carve-out<sup>32</sup>.

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<sup>20</sup> Point (b) of paragraph 5 of Art.6 of the AIFMD will be deleted laid down in Art. 1(2)(c)(i) of the Amending Directive.

<sup>21</sup> New second subparagraph of paragraph 3 of Art.6 of the UCITSD laid down in Art. 2(2)(a)(iii) of the Amending Directive.

<sup>22</sup> New point (iv) of point(b) of paragraph 4 of the AIFMD laid down in Art.1(2)(a) of the Amending Directive

<sup>23</sup> New point (iv) in the first subparagraph of point (b) of paragraph 3 of Art.6 of the UCITSD laid down in Art.2(2)(a)(i) of the UCITSD.

<sup>24</sup> New point (c) of paragraph 4 of Article 6 of the AIFMD as laid down in Art.1(2)(b) of the Amending Directive.

<sup>25</sup> New point (c) in the first subparagraph of paragraph 3 of Article 6 of the UCITSD laid down in Art.2(2)(a)(ii) of the Amending Directive.

<sup>26</sup> Recital nr.(4) of the Amending Directive.

<sup>27</sup> New point (e) in paragraph 5 of Article 6 of the AIFMD laid down in Art.1(2)(c)(ii) of the Amending Directive

<sup>28</sup> New second subparagraph of paragraph 3 of Art.6 of the UCITSD laid down in Art. 2(2)(a)(iii) of the Amending Directive.

<sup>29</sup> New point (d) of paragraph 4 of Article 6 of the AIFMD laid down in Art.1(2)(b) of the Amending Directive.

<sup>30</sup> Art. 5 point(a) point(ii) of the Credit Servicing Directive.

<sup>31</sup> Recital nr.(4) of the Amending Directive.

<sup>32</sup> As per the current state of things.

However, given the complexity of this topic, further clarifications and guidance are expected from the European Commission thereupon.

Where delegation of any of the ‘top-up services’ takes place, the AIFMD<sup>33</sup>/UCITS<sup>34</sup> delegation rules will apply.

The approach of the Ministry as regards the extension of the ‘top-up services’ that AIFMs/UCITS ManCos can provide is to fully avail of the discretions provided for in the Amending Directive. Within this context, stakeholders are invited to provide their views, as to whether the discretion in question should be fully availed of or not or to what extent.

#### **4.3 Loan-origination by AIFs and loan-originating AIFs (Discretion in relation to the AIFMD only)**

By way of a preliminary clarification, the term ‘*loan-origination*’ or ‘*originating a loan*’, within the meaning of the Amending Directive, has to be distinguished from the term of a ‘*loan originating AIF*’, within the meaning of the Amending Directive. This distinction is necessary, in order to understand the mechanics of the provisions of the Amending Directive on loan-origination, on the one hand, and loan-originating AIFs, on the other hand. More specifically, the provisions of the Amending Directive on loan origination apply to any AIF engaged in loan origination, irrespectively of whether it qualifies as a loan-originating AIF or not. Conversely, a loan originating AIF is only an AIF: ‘(i) *whose investment strategy is mainly to originate loans; or (ii) whose originated loans have a notional value that represents at least 50 % of its net asset value;*’<sup>35</sup>, so that the relevant provisions of the Amending Directive apply only to such AIFs. This practically means that the provisions of the Amending Directive referring to AIFs that engage in loan origination, include loan-originating AIFs but are not limited thereto. Conversely, the provisions of the Amending Directive that refer to loan-originating AIFs apply only vis-a-vis those AIFs that satisfy the requirements of the relevant definition. Within the context of the said definition, the term ‘*mainly*’ has to be perceived in a relative sense, i.e. the loan origination strategy being primary vis-a-vis other investment strategies of the AIF in question, even if none thereof exceeds 50% of the AIF’s NAV. Besides, the term ‘**mainly**’ has to be perceived in a ‘substance over form’ sense, i.e. irrespectively of the primary investment strategies laid down in the constitutive documents of the AIF.

Furthermore, the provisions on ‘loan origination’<sup>36</sup> apply to primary market operations only, to the exclusion of secondary market operations. The first limb of the relevant definition, namely that the loan be granted directly or indirectly by the AIF, confirms this. As regards the reference in the second limb of the said definition to ‘*defining or pre-agreeing its* [the loan’s]

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<sup>33</sup> New first subparagraph of paragraph 1 of Art.20 of the AIFMD laid down in Art.1(9)(a)(i) of the Amending Directive.

<sup>34</sup> New paragraph 1 of Article 13 of the UCITS laid down in Art.2(4)(a)(i) of the Amending Directive.

<sup>35</sup> New point (at) of paragraph 1 of Article 4 of the AIFMD laid down in Art.1(1)(b) of the Amending Directive

<sup>36</sup> New point (ar) of paragraph 1 of Article 4 of the AIFMD laid down in Art.1(1)(b) of the Amending Directive: “‘*loan origination*” or “*originating a loan*” means the granting of a loan: (i) directly by an AIF as the original lender; or (ii) indirectly through a third party or special purpose vehicle which originates a loan for or on behalf of the AIF, or for or on behalf of an AIFM in respect of the AIF, where the AIFM or AIF is involved in structuring the loan, or defining or pre-agreeing its characteristics, prior to gaining exposure to the loan;”.

*characteristics, prior to gaining exposure to the loan'* this is not to be understood as bringing secondary market operations within the AIFMD's regulatory perimeter. This provision serves rather as an anti-avoidance/anti-bypassing provision. More specifically, even if the AIF in question gains exposure to loans in the secondary market, it will still be considered as having originated the loan, i.e. a primary market operation, where '*...the AIFM or AIF is involved in structuring the loan, or defining or pre-agreeing its characteristics, prior to gaining exposure'* thereto.

Based on the aforesaid distinction, the amendments brought by the Amending Directive to the AIFMD as regards loan-origination and loan-originating AIFs should be understood to apply as follows:

- 1) The new point (d) of paragraph (3) of Article 15 of the AIFMD<sup>37</sup> will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 2) The new second subparagraph of paragraph (3) of Article 15 of the AIFMD<sup>38</sup> will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 3) The new paragraph (4a) of Article 15 of the AIFMD<sup>39</sup>, and consequently the new paragraphs (4c) and (4d) of Article 15 of the AIFMD respectively, will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 4) The new paragraph (4b) of Article 15 of the AIFMD<sup>40</sup> will apply only to AIFMs managing loan-originating AIFs;
- 5) The new paragraph (4e) of Article 15 of the AIFMD<sup>41</sup> will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 6) The new paragraph (4f) of Article 15 of the AIFMD<sup>42</sup>, will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 7) The new paragraph (4g) of Article 15 of the AIFMD<sup>43</sup>, will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;

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<sup>37</sup> Laid down in Art.1(7)(a)(i) of the Amending Directive.

<sup>38</sup> Laid down in Art.1(7)(a)(ii) of the Amending Directive.

<sup>39</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>40</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>41</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>42</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>43</sup> Laid down in Art.1(7)(b) of the Amending Directive.

- 8) The new paragraph (4h) of Article 15 of the AIFMD<sup>44</sup>, will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 9) The new paragraph (4h) of Article 15 of the AIFMD<sup>45</sup>, will apply to AIFMs managing AIFs engaging in loan origination, including thus AIFMs managing loan-originating AIFs;
- 10) The new paragraph (2a) of Article 16 of the AIFMD<sup>46</sup>, will apply only to AIFMs managing loan-originating AIFs; and
- 11) The new paragraph (2f) of Article 16 of the AIFMD<sup>47</sup> refers to guidelines that will apply only to AIFMs managing loan-originating AIFs.

The new paragraph (4g) of Article 15 of the AIFMD introduces a MS discretion. More specifically, *‘Without prejudice to other instruments of Union law, a Member State may prohibit AIFs that originate loans from granting loans to consumers as defined in Article 3, point (a), of Directive 2008/48/EC of the European Parliament and of the Council in its territory, and may prohibit AIFs from servicing credits granted to such consumers in its territory. Such prohibition shall not affect the marketing in the Union of AIFs granting loans to consumers or servicing credits granted to consumers.’* At this point it needs to be clarified that the discretion in question relates to not permitting such AIFs to seek borrowers in Cyprus, not investors. The AIFMD marketing passport, i.e. the marketing of such AIFs to investors in Cyprus remains fully applicable, as is also the case with the AIFMD management passport. What is consulted herewith is the restriction for such AIFs to deploy their investment activities, i.e. provide consumer credit, within the territory of the Republic.

The Ministry’s initial approach is to allow the granting of such credit by AIFs engaging in loan origination, including loan-originating AIFs. The Ministry seeks stakeholder views as to whether a restriction should be introduced as well as the extent thereof, i.e. granting of credit and servicing of credit.

By way of clarification, the provisions of the Amending Directive that are applicable to AIFMs that manage AIFs that originate loans should not prevent Member States from laying down national product frameworks that define certain categories of AIFs (excl. European Long-Term Investment Funds (**ELTIFs**), which are regulated under the ELTIF Regulation<sup>48</sup>) with more

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<sup>44</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>45</sup> Laid down in Art.1(7)(b) of the Amending Directive.

<sup>46</sup> Laid down in Art.1(8) of the Amending Directive.

<sup>47</sup> Laid down in Art.1(8) of the Amending Directive.

<sup>48</sup> Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023 amending Regulation (EU) 2015/760 as regards the requirements pertaining to the investment policies and operating conditions of European long-term investment funds and the scope of eligible investment assets, the portfolio composition and diversification requirements and the borrowing of cash and other fund rules



restrictive rules. This practically means that any relevant national product frameworks<sup>49</sup> will continue to apply; provided there is no overlap with the respective provisions of the Amending Directive or the said national provisions are stricter or the AIF in question is not under the management of an authorised AIFM.

Finally, the functions constituting management of AIFs have been amended pursuant to the Amending Directive<sup>50</sup> to also comprise of the activities of originating loans on behalf of an AIF and of servicing securitisation special purpose entities.

#### **4.4. Liquidity management tools (Discretion in relation to both the UCITSD and the AIFMD)**

The provisions of the Amending Directive on liquidity management tools ('LMTs') apply to open-ended investment funds, i.e. open-ended AIFs<sup>51</sup> and UCITS<sup>52</sup>. LMTs are, in essence, limitations of the investor's redemption right, hence their application in the context of open-ended investment funds only. LMTs were common contractual practice both for open-ended AIFs as well as for UCITS, being embedded in their constitutive and offering documentation. Pursuant to the Amending Directive, they have become a statutory 'must' as well.

The intensity of LMTs varies. There is the LMT of extension of notice periods<sup>53</sup>, which could be considered rather as a condition than as a limitation, the LMT of a 'redemption gate'<sup>54</sup> leading to a partial restriction of the possible redemption amount, up to the total restriction of the investor's redemption right, when a suspension of redemptions applies<sup>55</sup>. The suspension of redemptions is the most onerous LMT for an investor, as its redemption right is fully neutralised. The LMT of suspension of redemptions must always be at the disposal of the fund manager in exceptional circumstances as a last resort mechanism. For this reason it does not form part of the (minimum two) LMTs to be selected, as is also the case with the so-called 'side-pockets'<sup>56</sup>.

When deciding to select the (minimum number of two) LMTs, a fund manager must consider the pursued investment strategy, the liquidity profile and the redemption policy of the fund

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<sup>49</sup> E.g. the Cyprus Securities and Exchange Commission Directive 131-2014-03 on the categorisation of AIFs of the Republic.

<sup>50</sup> New points (d) and (e) of point 2 in Annex I to the AIFMD as laid down in Annex I to the Amending Directive.

<sup>51</sup> New paragraph 2b of Article 16 of the AIFMD as laid down in Art.1(8) of the Amending Directive

<sup>52</sup> Paragraph 2 of new Article 18a of the UCITSD as laid down in Art.2(6) of the Amending Directive

<sup>53</sup> Point 3 in the new Annex V to the AIFMD laid down in Annex II to the Amending Directive regarding AIFs and Point 3 in the new Annex IIA to the UCITSD laid down in Annex IV to the Amending Directive regarding UCITS

<sup>54</sup> Point 2 in the new Annex V to the AIFMD laid down in Annex II to the Amending Directive regarding AIFs and Point 2 in the new Annex IIA to the UCITSD laid down in Annex IV to the Amending Directive regarding UCITS.

<sup>55</sup> Point 1 in the new Annex V to the AIFMD laid down in Annex II to the Amending Directive regarding AIFs and Point 1 in the new Annex IIA to the UCITSD laid down in Annex IV to the Amending Directive regarding UCITS. It seems, from the employment of a cumulative formulation that the suspension of redemptions also leads to a suspension of subscriptions.

<sup>56</sup> New paragraph 2c of Article 16 of the AIFMD laid down in Art.1(8) of the Amending Directive regarding AIFs and new paragraph 2 of Article 84 of the UCITSD laid down in Art.2(13) of the Amending Directive regarding UCITS.

in question. Swing pricing and dual pricing<sup>57</sup> cannot be cumulatively chosen, since this might lead to a duplicating effect<sup>58</sup>. In addition, the LMT of redemption in kind can be applied for professional investors only<sup>59</sup>. The said provision implies that both the UCI Law<sup>60</sup> as well as the AIF Law<sup>61</sup> may have to be amended, in order to be aligned with the said requirement of the Amending Directive.

The obligation to select two LMTs as a minimum is reduced to one, in case of AIFs<sup>62</sup> or UCITS<sup>63</sup> which qualify as money-market funds, within the meaning of the EU Money-Market Funds Regulation (**Regulation (EU) 2017/1131**).

The Amending Directive provides that Member States shall ensure that the LMTs available to fund manager are ‘at least’<sup>64</sup> those set out in Annex II to the Amending Directive in respect of AIFs and Annex IV to the Amending Directive in respect of UCITS. Given the aforesaid, the Ministry seeks stakeholder views as to if and which additional LMTs could be included in the list of LMTs available to fund managers (e.g. redemption gate not only at investor level, but also at investment fund level).

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<sup>57</sup> New paragraph 2b third sentence of Article 16 of the AIFMD laid down in Art.1(8) of the Amending Directive regarding AIFs and paragraph 2 third sentence of new Article 18a of the UCITS laid down in Art.2(6) of the Amending Directive

<sup>58</sup> **Financial Conduct Authority**, Swing Pricing and Fragility in Open-end Mutual Funds, by Dunhong Jin et al. Occasional Paper 48, May 2019, available at <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-48.pdf> p.4: ‘Alternative pricing rules (known as swing or dual pricing)...’

<sup>59</sup> Fourth subparagraph of new paragraph 2b of Article 16 of the AIFMD laid down in Art.1(8) of the Amending Directive regarding AIFs and fourth subparagraph of paragraph 2 of new Article 18a of the UCITS laid down in Art.2(6) of the Amending Directive regarding UCITS

<sup>60</sup> See section 18(4) second sentence of the UCI Law: ‘(4) Η αξία των μεριδίων του ΟΣΕΚΑ που εξαγοράζονται, καταβάλλεται σε μετρητά μέσα σε τέσσερις (4) εργάσιμες ημέρες από την ημερομηνία αποτίμησης η οποία λαμβάνεται υπόψη για τον υπολογισμό της τιμής εξαγοράς των μεριδίων. Ανεξάρτητα από το παρόν εδάφιο, επιτρέπεται η καταβολή αξιών, ως προϊόντος εξαγοράς μεριδίων διαπραγματεύσιμου ΟΣΕΚΑ κατά το οριζόμενο στο άρθρο 45, σε αντιστοιχία με τη σύνθεση του αναπαραγόμενου στο χαρτοφυλάκιο του ΟΣΕΚΑ δείκτη, εφόσον υφίσταται σχετική πρόβλεψη στον κανονισμό ή τα καταστατικά έγγραφα του ΟΣΕΚΑ.’

<sup>61</sup> See section 42(3) of the AIF Law, given in particular that ‘well-informed investors’ under the said Law do not qualify as ‘professional investors’: ‘Η αξία των εξαγοραζόμενων μεριδίων ΟΕΕ καταβάλλεται σε μετρητά ή σε είδος, εάν προβλέπεται στον κανονισμό ή στα καταστατικά έγγραφα του ΟΕΕ ή, εφόσον πρόκειται για διαπραγματεύσιμο ΟΕΕ, σε αξίες σε αντιστοιχία με τη σύνθεση του αναπαραγόμενου στο χαρτοφυλάκιο του ΟΕΕ δείκτη και η καταβολή διενεργείται εντός του χρονικού διαστήματος που προβλέπεται στον κανονισμό ή στα καταστατικά έγγραφα του ΟΕΕ.’

<sup>62</sup> Second subparagraph of new paragraph 2b of Article 16 of the AIFMD as laid down in Art.1(8) of the Amending Directive

<sup>63</sup> Second subparagraph of paragraph 2 of new Article 18a of the UCITS as laid down in Art.2(6) of the Amending Directive.

<sup>64</sup> New paragraph 2e of Article 16 of the AIFMD as laid down in Art.1(8) of the Amending Directive regarding AIFs and paragraph 1 of new Article 18a of the UCITS as laid down in Art.2(6) of the Amending Directive regarding UCITS.

