BlackRock

8th October 2024

European Securities and Markets Authority (ESMA)
201-203 Rue de Bercy
72012 Paris

Submitted online via: www.esma.europa.eu

RE: Consultation Paper: Draft Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive.

BlackRock[1] is pleased to have the opportunity to respond to the consultation paper on draft regulatory technical standards on liquidity management tools under the AIFMD and UCITS Directive.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation and will continue to contribute to the thinking of ESMA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Maria Ging
Managing Director,
EMEA UCITS Chief Financial Officer
maria.ging@blackrock.com

Martin Parkes
Managing Director,
Co-Head of EMEA Public Policy
martin.parkes@blackrock.com

Helen Davies,
Director, International Product
Oversight Group
helen.davies@blackrock.com

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

BlackRock

Responses to Questions

Suspension of Subscriptions, Repurchases and Redemptions:

1. **Do you agree with the proposed characteristics of suspension of subscriptions, repurchases and redemptions? If not, please justify your position.**

   The characteristics define suspension of subscriptions, repurchases and redemptions as "temporarily disallowing the subscription, repurchase and redemption of the fund's units or shares" and suggest that "the fund cannot be closed for redemptions and repurchases and continue to accept subscriptions (and vice versa)".

   Fund documentation provided to investors outlining the circumstances under which subscriptions would be suspended does not usually assume that suspending redemptions will automatically trigger the suspension of subscriptions. Introducing such a rule would be a change to existing market practice. In our view those three things should all be able to function independently of each other and the RTS should be amended to reflect that. See our response to Q. 4.

   Secondly, with reference to section 2.2.1.16 (which defines a 'soft closure'), we would like to emphasise that 'soft closure' can go beyond just closing the fund to new subscriptions. Often, a soft close will involve agreeing an amount that can be divided up between investors seeking to transact. We recommend allowing a broader definition of a 'soft close', with a sliding scale of measures including maximum subscriptions, which will determine whether you temporarily gate subscriptions, or suspend them entirely.

2. **Do you agree that orders that have been placed but not executed before the fund manager suspends shall not be executed until the suspension is lifted? If not, please explain why these orders shall be executed.**

   This approach may present a number of operational and cross-border issues for a typical mutual fund. As a general principle for a regular dealing fund, if the order has been placed in good faith before the relevant dealing cut off time, it should be honoured. There should be flexibility for funds distributed via straight through processing (STP) procedures to account for time zone challenges.

   For example, investors from Asian markets using STP notification processes to European funds will send their orders during Asian working hours - which are before the European markets open. These investors could be disadvantaged for having chosen European funds over Asian ones if their orders are not executed. This is far from an anecdotal issue given the success of European funds in Asian markets. Managers are contractually obliged to honour those orders and enable them to go automatically to the transfer agent, per the terms of business.

   It would be a very complex process to reverse these types of deal flows without losing confidence in the European fund structure. In this case it would be preferable to suspend dealing at the final cut off point for orders on the relevant dealing day, so that all future trades on subsequent days are suspended.

3. **Once the fund is reopened for subscriptions, repurchases and redemptions, what would be your approach to redemption orders that have not been executed before the fund was suspended?**

   Assuming liquidity has improved prior to re-opening, we would resume orders chronologically. Those who placed redemption orders first before the suspension would have their orders executed first and so on, until all orders are completed.

4. **Do you think there are circumstances where subscriptions, repurchases and redemptions may not be reopened simultaneously? If yes, what are these circumstances?**

   Yes, subscriptions, repurchases and redemptions can function independently from each other so long as the NAV can still be priced. For example, an illiquid fund may still be able to buy assets whilst not being able to sell and vice versa. This happened on several occasions during the COVID-19 pandemic, where funds could either buy but not sell, sell but not buy, or in some instances could neither sell nor buy.

   Ultimately. this is a decision that should be guided by the liquidity needs of the investor, the liquidity profile of the assets and the liquidity strategy of the fund. If a suspension was introduced to address redemption pressures, reopening subscriptions before redemptions - where viable - could help the overall liquidity position of the fund and be beneficial to the remaining investors.

   Separately, some investors may be pursuing investment strategies that involve regular savings via subscriptions to a fund. These subscriptions should be facilitated to the greatest extent possible to minimise disruption for these investment strategies.

5. **Can you think of any further characteristics of suspension of subscriptions, repurchases and redemptions?**

   No.

6. **Do you think there is merit for the characteristics of suspension of subscriptions, repurchases and redemptions gates to differ between different investment strategies and between AIFs and UCITS? If yes, how?**

   While we do not believe there is a need to prescriptively differentiate the characteristics of suspension of subscriptions, repurchases and redemptions between fund types and strategies, we do see some differences in how they're used in practice, so it is important not to make them overly prescriptive.

   Generally, in a UCITS fund a redemption gate is used as an exceptional circumstances tool when redemptions exceed a threshold and where the fund has liquidity concerns about being to realise the assets in the underlying markets.

   In more illiquid funds, e.g. ELTIF or other institutional vehicles with periodic redemption periods, it is likely that gates will be used more systematically. For example, the final RTS for ELTIF permit AIFMs to use gates on a systematic basis at each dealing point, e.g. no more than 5% redemptions on any one dealing day depending on the fund's overall expected liquidity.

   We would see a similar approach being of value to other AIFs with similar limited redemption characteristics. It is important that the use of gates and the liquidity profile of the fund are clearly disclosed to both regulators and investors to ensure liquidity expectations are well understood.

Redemption Gates:

7. **Do you agree with the description of redemption gates and their characteristics? If not, please justify your position.**

   It should not be mandatory for redemption gate thresholds to be expressed as a percentage of the NAV. While this is one way to think about gates, it is not the only one.

It should also be possible for a portfolio manager to express the threshold as a currency amount (e.g. in € or $ depending on the dealing currency of the fund) that they think the market can sustain.

Secondly, section 2.2.3.31 would disallow gating mechanisms under which redeeming investors placing redemption orders below the redemption threshold would be allowed to have their redemption order fully executed, while redeeming investors placing orders above the threshold would get their orders only partially executed. ESMA considers this would be discriminatory. We disagree – by applying a maximum amount that investors can redeem, fund managers are acting fairly and in the best interest of all investors. Where unlimited redemptions are not feasible, we consider it fairer that investors should be able to have the same maximum amount redeemed. While some investors may wish to redeem more, it would be unfair to meet their full request and leave little or nothing for others.

Lastly, the characteristics state that the fund manager/fund board "shall specify in advance whether the part of redemption orders that have not been executed, as a result of activation of the redemption gate, and that have been carried forward to the next dealing date, shall have any priority or not over redemption orders submitted for execution the following day." This potentially brings an element of unfairness, the gated redeemers, - or subscribers (!) – should always get priority over those submitting a new redemption or subscription request.

8. **The draft RTS provides that the redemption gate threshold shall be expressed as a percentage of the NAV of the fund considering the net redemption orders for a given dealing day. Are you aware of any other method that ESMA should consider in the RTS? If yes, please explain.**

   It should be possible for a portfolio manager to express the threshold as a currency amount (e.g. in €, $ or other dealing currency of the fund) that they think the market can sustain. In this scenario, all redeeming/subscribing investors would be entitled to an equal share of that amount, with minimum and maximum limits applied.

9. **Do you agree that redemption gates may be either activated automatically when the activation threshold is exceeded or that the fund manager/ fund boards may decide whether or not to activate the redemption gate? Do you believe that automatic activation of redemption gates could create a first mover advantage?**

   Irrespective of whether gates are activated automatically or by the fund manager when activation thresholds are surpassed, liquidity mechanisms should always allow flexibility for managers and/or fund boards to adjust to different and unexpected market conditions in the best interest of investors. Ultimately, if a fund is subject to a high volume of redemptions, but that same fund is still experiencing inflows there may not be a need to gate the fund; the decision should be determined by the fund's overall liquidity position.

   Managers should not be forced to implement a gate in the event of a threshold being exceeded if it would not be in the best interest of investors. There would also be a risk of first mover advantage in such a scenario because investors would be aware that orders are limited once an activation threshold is reached and could be incentivised to redeem from the fund when they otherwise would not have. We saw these dynamics play out in money market funds (MMFs) in March 2020 when the direct link between a breach of the 30% weekly liquidity threshold and the triggering of a decision-making process around imposing redemption fees and gates caused procyclical behaviour by investors.

10. **Do you think that the automatic activation of redemption gates shall not be permitted for some types of funds? If yes, please explain your position.**

No, we think all funds should at least have the option to automatically activate redemption gates. The fund manager is then best-placed to decide if such a tool would be appropriate for the fund in question, taking into account the investor profile, underlying assets and investment strategy etc.

11. Do you agree that the activation threshold shall not be expressed at the level of the single redemption order? If not, please justify your position.

Yes, the activation threshold should not be expressed at the level of a single redemption order, but at the fund level – either as a % of the NAV **or** as a total amount in the dealing currency of the fund.

12. In the case of activation of redemption gates, do you agree that investors should have the right to cancel the non-executed part of their redemption orders? In particular, should there be a different approach between UCITS and AIFs?

If redemption risk is proving to be a cause for concern, then providing investors with the **option** (but not right) to cancel the non-executed part of the redemption orders may alleviate some of that risk. Therefore, it should be possible - but **only** so long as there would be no material negative impact for remaining investors.

The decision to grant that request therefore must be at the discretion of the manager on a case-by-case basis. For example, it would not be appropriate for one big investor to effectively block the entire fund by making a large redemption request, only to subsequently cancel if markets improved later.

Less-liquid funds by nature of their underlying assets may require additional time to complete sales to meet redemption requests. In the interest of remaining investors, fund managers will seek to avoid scenarios in which asset sales are commenced to fund redemptions, and then subsequently withdrawn. This is especially the case for less-liquid funds where this would be very disruptive to the fund's overall liquidity risk management and strategy.

Otherwise, BlackRock sees no need for differentiated approaches for UCITS and AIFs.

13. Do you think there is merit in having different characteristics of redemption gates for different investment strategies and between AIFs and UCITS? If yes, how?

No, the characteristics should be the same, although the thresholds themselves could of course be different. Either way, the gating mechanism should work the same way.

14. In the case of funds with multiple share classes, do you agree that the same redemption gate shall apply to all share classes? If not, please justify your position.

In most cases, yes. All share classes in a UCITS funds should certainly be treated the same. However, there may be some AIFs with concentrated investor bases, where a redemption of significant size could generate a trade that cannot be executed without having an adverse market impact on other fund investors. Typically, this type of investor will hold a different class of fund shares to other investors. To enhance the effectiveness of gates, policymakers could explore the possibility of refining the tool to allow application to specific share classes (e.g. those limited to institutional investors), or even specific investors.

15. Can you think of any further characteristics of redemption gates?

Gates are less suited to funds with retail client bases or those distributed through intermediaries and platforms. The distribution architecture for these funds is increasingly automated and would not lend itself to such ad-hoc interventions. For these types of funds swing pricing is a more appropriate way to manage dilution risk.

We would also reiterate that per our response to Q. 7, the characteristics of gates should be widened to cover soft closures as well, to account for the fact that liquidity issues can also arise from subscriptions, not just redemptions.

Extension of Notice Periods:

16. Do you agree with the description of extensions of notice period and their characteristics? If not, please justify your position.

Yes.

17. Do you agree that the same extension of notice period shall apply to all investors or different extensions of notice periods per share class/unit shall be allowed? Please justify your position.

Yes, generally speaking all investors should be subject to the same notice period extension in keeping with the principle of equal treatment of investors. However, the RTS should not preclude AIFs from setting different lock-in periods for professional investors, provided this has been agreed in advance and has been clearly laid out in the offering documents. AIFs with illiquid investments will generally need different approaches to extension of notice periods when compared to UCITS. Allowing for the rules to differ based on the nature of the fund would allow for more appropriate rules in each case.

18. Do you agree that extensions of notice period may be applied for a pre-defined period of time (for a pre-defined number of dealing dates)? If not, please justify your position.

Yes, extensions of notice periods may be applied for a pre-defined period of time, but this should not be mandatory. In other words, we support wording that suggests notice periods **may be** extended for a pre-defined period of time, but not that they **must be** extended for a pre-defined period of time. In most cases, a fund manager cannot predict with any certainty when the situation necessitating the extension of the notice period in the first place will be resolved.

19. Do you think there is merit for the characteristics of extensions of notice period to differ between different investment strategies and between AIFs and UCITS? If yes, how?

No.

20. How would you execute redemption orders that have been placed but not executed before the notice period is extended? Would you execute them under the original notice period, or would you execute them at the following dealing day?

They would be executed under the original notice period, unless extreme circumstances e.g. a severe liquidity strain, made this unfeasible, in which case the order might need to be deferred to the next dealing day.

21. How would you ensure fair treatment of investors when deactivating the extension of notice period?

We would resume orders chronologically. Those who placed orders first before the extension of the notice period would have their orders executed first and so on, until all orders are completed. Managers should be obliged to keep investors informed when activating and deactivating notice period extensions.

Redemption Fees:

22. Do you agree with the description of redemption fees and the corresponding characteristics? If not, please justify your position.

No. Firstly, as noted for other tools in the RTS, the RTS assume that costs only arise when a fund is trying to sell assets, but costs can equally arise when the fund is trying to buy assets. The characteristics as written fail to recognise that transaction costs may also be generated from subscriptions, and they should be widened to reflect this possibility.

Secondly, the RTS state that the fee cannot be zero. We disagree with this approach, especially because the swing factor is allowed to be zero elsewhere in the RTS. If thresholds are allowed, and the cost of liquidity is negligible, then we see no reason for a fixed fee to be applied in that scenario.

The RTS are inconsistent in that the characteristics suggest the fee must impose on transacting investors the estimated explicit and implicit costs of their transaction, but equally the fee must be fixed or have low variation, and that it should be 'pre-defined'. We consider these obligations to be contradictory because the cost of liquidity is variable and suggest removing the 'pre-defined' obligation.

The draft characteristics say the redemption fees should be paid to the fund "to the benefit" of the remaining investors – this is misleading. It would be more accurate to say "redemption fees are paid to the fund with a view to mitigating any potential disadvantage to remaining investors from the transacting investor's actions".

Lastly, the characteristics stipulate that "investors placing redemption orders that correspond to a certain redemption fee level shall all be charged the same redemption fee". In practice this is problematic. Trading and market impact are calculated at the sub-fund level where the result of all dealing is calculated based on overall redemptions from the fund, not just smaller pieces of it. Therefore, it is harder to justify charging smaller transactions less. This approach would not be followed with other anti-dilution tools because it could potentially mean there could be a slice of the overall cost not picked up by any shareholder.

In general, we encourage flexibility in how managers adopt these tools, subject to the core principle of mitigating material dilution of investors being upheld. We would note as a reminder that in general, funds with significant dealing volumes may be better served by an anti-dilution LMT applied at the fund level (e.g., swing pricing) rather than a tool that is applied at individual deal level like a redemption/subscription fee.

23. Can you think of any other redemption fee mechanism than the ones described above? If yes, please provide examples.

Subscription fees described above should be included.

24. Do you think there is merit for the characteristics of redemption fees to differ between different investment strategies and between AIFs and UCITS? If yes, how?

No.

Swing Pricing:

25. Do you agree with the description of swing pricing and the corresponding characteristics? If not, please justify your position.

We agree with the description but would emphasise that swing pricing is not just a tool to be used in stressed conditions - it is frequently used on a day-to-day basis through all market conditions. In fact, the ongoing use of swing pricing in normal market conditions where there are significant net capital flows means that it can be deployed without a stigma effect in extreme market conditions. Swing pricing can be deployed for as long as assets can be fairly and appropriately valued and transacted. If underlying market conditions are so adverse that they do not support the use of fair value pricing mechanisms, swing pricing ceases to be an appropriate tool, and managers will instead use mechanisms such as gating or suspension until market conditions stabilise.

Secondly, we agree that the swing factor should reflect the **estimated** cost of liquidity and would add that this should be done on a best-efforts basis. We note that there is some inconsistency in the wording throughout the RTS, in that it says 'estimated cost of liquidity' in some places, but just 'cost of liquidity' in others. It should say estimated throughout in recognition of the fact that the ability to set an appropriate swing factor relies on the ability of the manager to assess the expected costs of transacting and accessing liquidity. However, this is dependent on accurate on-screen prices which are not always available.

For example, during March 2020 screen prices and bid-ask spreads did not always represent actionable prices. In these circumstances, the transaction cost models used to determine swing factors should be supplemented by input from other sources, including trading, portfolio management and risk teams to determine an adjustment that appropriately reflects the cost of reaching a transactable price prices.

So, while swing pricing frequently utilises modelling and automated data feeds, it is not automated from start to finish. It requires human governance and oversight, including the combined judgement and expertise from a range of asset management functions when setting swing pricing thresholds and factors. As such, flexibility for managers in operationalising this ADL remains paramount.

For further details on the operation of swing pricing see our Policy Spotlight – *Raising the Bar*.[2]

26. Can you think of any characteristics of swing pricing that the ones described above?

While not a characteristic per se, we would like to take this opportunity to reemphasise the difference between first mover advantage (FMA) in funds and first mover advantage in markets.

Swing pricing's goal is to remove FMA in funds, but crucially, not in markets. Even when swing pricing is applied, investors can still choose to redeem for other reasons – e.g., responding to broader market conditions, re-appraising an asset class' prospects, a desire to re-balance or re-allocate their portfolio, or to raise or invest cash balances. Swing pricing via adjustment to the fund NAV reflecting transaction size and market conditions provides a disincentive to transact, but it cannot and should not be used to prevent investors from redeeming altogether.

[2] https://www.blackrock.com/corporate/literature/whitepaper/spotlight-swing-pricing-raising-the-bar-september-2021.pdf

All investors, irrespective of vehicle, face incentives to transact opportunistically to take advantage of perceived or actual changes in market fundamentals (such as reallocating from bonds to equity), or in market-wide conditions (such as liquidity). The fact that some investors will be able to pre-empt these changes and transact ahead of others is an example of FMA in markets and is inherent in market functioning. This aligns with the FSB's observation that 'an investor who redeems solely in anticipation of further market deterioration is not considered as benefitting from first-mover advantage'.[3]

27. Do you think there is merit for the characteristics of swing pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

As previously noted, it may not be operationally feasible to deploy certain LMTs for a particular fund depending on the characteristics of the fund or asset class. For instance, less-liquid funds by nature of their underlying assets may be better served by an anti-dilution LMT applied at individual deal level (e.g., subscription/redemption fees).

Swing pricing is typically applied to open-ended investment funds which, while holding some cash balances (mainly to take advantage of investment opportunities), invest primarily in assets such as fixed income or equities. Swing pricing is appropriate for these funds because a sizeable inflow or outflow creates the need to transact in underlying assets, and in turn, can generate transaction costs.

By contrast, money market funds (MMFs) are designed specifically to meet redemptions through cash balances (and are required in most jurisdictions to hold a substantial portion of their portfolio in overnight liquidity to ensure that cash balances are sufficient to meet redemptions), which means redemptions do not generate transaction costs. Only in circumstances where net redemptions exceed these cash balances would an MMF need to sell assets in secondary markets. In these instances, redemption fees are a more suitable anti-dilution measure for MMFs than swing pricing, as they can be applied in a way that allows MMFs to continue pricing and dealing on an intraday basis.

In an exchange-traded fund (ETF) structure, investors hold shares whose value fluctuates as they are traded on secondary markets, which can generate premiums or discounts relative to the fund's NAV. Adjustments to the fund's price to reflect prevailing market conditions – including liquidity premia – are inherent in this process, as demonstrated by the performance of fixed income ETFs during the COVID-19 shock. However, the discount of an ETF's share prices relative to its NAV cannot be used as the appropriate swing factor for traditional mutual funds with a similar strategy and portfolio holdings as the ETF.

IOSCO's Thematic Note on the performance of ETFs during the COVID-19 shock is instructive here, noting that while "in general, the secondary market price of an ETF's shares should be at or close to its NAV as a result of an effective arbitrage mechanism [...] it may also reflect other inputs, such as increased transaction costs (e.g., bid-ask spread, commissions, taxes, fees charged in the creation or redemption process), increased uncertainty related to valuation of underlying assets [...] and higher hedging costs [for authorised participants] due to heightened uncertainty during periods of market stress'.[4]

[3] https://www.fsb.org/wp-content/uploads/P201223-1.pdf
[4] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD682.pdf

28. Do you agree that in the case of funds with multiple share classes, the same swing factor shall be applied to all share classes? If not, please justify your position.

Yes, the same swing factor should apply unless operating a hybrid model with different anti-dilution tools on different classes. However, if all share classes swing, then they should have the same swing factor because anti-dilution tools and trading are managed at a sub-fund level.

Dual Pricing:

29. Do you agree with the description of the dual pricing and the corresponding characteristics? If not, please justify your position.

Yes, however under both proposed calculation methods you could have a spread that relates to costs other than the cost of liquidity e.g. foreign exchange. Spreads may also incorporate market impact, in a similar fashion to swing pricing. Therefore, we would recommend that "Method A" (i.e., where 2 NAVs are calculated) also include the ability to adjust the NAV "by a factor that reflects the [additional] cost of liquidity."

We agree on the difference between swing pricing and dual pricing, i.e. that in swing pricing there is only one 'swung' NAV for all transacting investors, but that in dual pricing there are different NAVs for subscribing investors and redeeming investors. However, it is worth noting that typically the spread on the dual price is applied by the transfer agent, not necessarily in the published NAV. We would note that not all funds using "Method B" are priced on a mid-market basis, some are priced at the bid price. We would recommend the RTS wording is amended to reflect this reality.

30. Are there any other calculation methods for dual pricing that should be considered? If yes, please give example.

No.

31. Do you think there is merit for the characteristics of dual pricing to differ between different investment strategies and between AIFs and UCITS? If yes, how?

No.

Anti-Dilution Levy:

32. Do you agree with the description of the anti-dilution levy and the corresponding characteristics? If not, please justify your position.

Yes, but instead of saying anti-dilution levies should be charged to transacting investors **"<u>in the case of a change</u>** in the net capital activity of the fund (i.e. if the number of redemptions exceed the number of subscriptions or vice-versa), we recommend that the text simply states that the levy should be charged **<u>in keeping with</u>** the net capital activity of the fund.

Section 77 outlines the differences between anti-dilution levies and redemption fees by saying redemption fees are pre-determined, fixed fees while levies are variable and calibrated according to the fund's net flows. Again, as per response to Q.22, this is problematic because the fee cannot be fixed or have low variation if the cost of liquidity which must be accounted for is variable.

33. Are there any other calculation methods for anti-dilution levy that ESMA shall consider? If yes, please give example.

The anti-dilution levy could be calculated in the same way as swing factors.

34. In the case of funds with multiple share classes, would you see the possibility for different anti-dilution levies depending on share classes? Please justify your position.

No.

35. Do you think there is merit for the characteristics of anti-dilution levy to differ between different investment strategies and between AIFs and UCITS? If yes, how?

No.

Redemptions in Kind:

36. Do you agree with the description of redemptions in kind and the corresponding characteristics? If not, please justify your position.

No, the characteristics as written do not fully distinguish between the use of redemptions in kind (RIK) for liquidity management purposes in open-ended funds (OEFs) such as a traditional mutual fund, from its use as a BAU redemption mechanism in an exchange-traded fund (ETF).

As an LMT, we agree with limiting the use of RIK to funds marketed only to professional investors. RIK enable the fund to transfer the underlying assets to the redeeming investor, instead of their cash value. Only large, institutional or professional investors who possess their own dedicated custody accounts would be able to use RIK, and such investors would likely only find this tool useful if they have a similar portfolio on their own account to the one held in the fund.

We would not consider this a tool that can or should be a widely usable substitute for the normal OEF redemption process or as a means of easing pressure on market liquidity – few investors possess the capability to receive RIK, narrowing their practicality as an LMT to a limited number of scenarios.

However, as a redemption mechanism in ETFs, RIK are considered an integral feature of the structure of the fund. ETFs trade in both primary and secondary markets. Authorised Participants (APs), typically financial institutions such as banks, are authorised to transact with the ETF to create or redeem shares, in exchange for a proportionate share of the underlying assets that make up the benchmark tracked by the ETF. Other ETF investors, which aren't APs, do not interact directly with the ETF when buying or selling shares, but instead trade through brokers with other investors on an exchange, or other venues.

As specialised financial institutions, which are typically affiliated on an individual basis with specific ETFs and portfolio of assets they track, APs are operationally prepared to receive RIK in exchange for ETF shares. This should not be subject to a pro-rata slice as it would impact the ETF's ability to keep its price aligned with the value of its underlying securities, by removing the economic incentives of APs and market makers to trade with them.

When, in the normal course of regular dealing activities relating to the direct redemption of shares in a UCITS ETF by an authorised participant/market-maker, delivery in whole or in part of underlying securities held by, or on behalf of, the UCITS ETF to authorised participants/market makers in satisfaction of such dealing request should not be considered an activation of the RIK mechanism in the context of Annex IIA liquidity management tools.

Separately, Sections 83 and 84 outline conditions where the RIK do not need to correspond to a pro-rata share of the redeeming investors' holdings. Where RIK are used for liquidity management purposes, we think this is problematic. If the fund is tracking an index, then the RIK must be pro-rata to avoid excessive divergence from the index. Similarly, so far as is possible, if the fund is holding securities that do not replicate the index, it would be unfair for those securities to be offloaded onto redeeming investors without an assessment by the fund's depositary or auditors (depending on the provisions in relevant national law) as to the fairness of the allocation of assets to both remaining investors and redeeming investors (see response to Q. 37).

However, as stated previously, we do not consider the use of RIK in ETFs (by APs or market makers) as an 'activation' of the tool for liquidity risk management purposes. Section 83 notes the RIK does not need to correspond to a pro-rata share of assets held by the UCITS "if the aim of that UCITS' investment policy is to replicate the composition of a certain stock or debt securities index **and that UCITS is an ETF**". We would like to clarify that not all UCITS funds replicating an index are ETFs, and that pro-rata redemption requirements should not be applicable to any ETFs for the reasons outlined above.

37. Can you think of any other characteristics of redemptions in kind?

In some markets like Luxembourg, redemptions in kind require valuation by an external auditor. The costs of that report are borne by the shareholder requesting the redemption in kind, but if the manager decides to implement an RIK to avoid the sale of sizable blocks of securities in response to a redemption request, then it is unclear who would pay.

By contrast, in Ireland the depositary is responsible for signing off that an assessment of the assets chosen has been made, confirming they are a representative pro-rata share and secondly that the valuation of the assets is fair and does not disadvantage remaining investors.

38. Do you think there is merit for the characteristics of redemption in kinds to differ between different investment strategies between AIFs and UCITS? If yes, how?

Yes. AIFs often deal with more complex and illiquid assets such as private equity and real estate, requiring specialized processes and independent valuations to ensure fairness. These funds are typically marketed to professional investors who have a higher risk tolerance and better understanding of complex assets.

In contrast, UCITS invest in more liquid and transferable securities and are subject to stricter regulations designed to protect retail investors. Given their mixed investor base, UCITS require simpler and more transparent processes, ensuring that retail investors are not disadvantaged.

While some funds may offer RIK for institutional investor share classes in retail funds, RIK are not appropriate tools for retail investors themselves. Tailoring RIK characteristics to reflect these differences ensures that the unique needs and regulatory requirements of each fund type are appropriately addressed, benefiting both the funds and their investors.

Side Pockets:

39. Do you agree with the description of side pockets and the corresponding characteristics? If not, please justify your position.

Yes, though BlackRock encourages ESMA to take a flexible approach to allow fund managers a range of options to be used. Under certain circumstances, BlackRock believes that the side pocket through a new share class model may provide the best investor outcome in terms of minimal tax, transaction and other costs at the portfolio level as well as a quicker implementation time than alternative models such as the establishment of new authorised fund (or sub-fund of an umbrella) which would receive the non-affected investments. However, in other circumstances, a new authorised fund (or a sub-fund of an umbrella) may provide the best investor outcome.

40. Do you agree that in the case of UCITS, side pockets created by physical separation should only be done with the creation of a new UCITS where the assets for which there are no problems are placed? If not, please explain your position.

Yes. The alternative (i.e. moving the problem assets to a new UCITS) would not be possible given the assets in question would have become illiquid.

41. Can you think of any other characteristics of side pockets that ESMA should consider? In particular, do you think that the characteristics of side pockets shall differ between UCITS and AIFs (in addition to the creation of side pockets via physical separation of the assets)? If, yes please elaborate.

No.

42. Do you see merit in specifying further the characteristics that side pocket created by means of accounting segregation should have? If yes, can you please explain how you have created side pockets via accounting segregation? Have you encountered any legal constraints or are you aware of any legal constraints in your jurisdiction that may limit the use of side pockets via asset segregation?

No, we do not see a need for further specification. During the Ukraine crisis, FAQ from the CSSF for funds domiciled in Luxembourg allowed funds to create side pockets through either physical segregation i.e. creation of a new fund, or accounting segregation i.e. a new share class. This approach was also taken up outside the EU, by the UK's FCA for UK domiciled funds. However, the CBI did not allow for as much flexibility and so Irish domiciled funds were not permitted to put in place accounting segregation, only physical segregation.

Physical segregation is a costly process given the requirements to develop a new prospectus and all the administrative and legal costs that go with setting up a new fund, including the set-up of new custody accounts for the fund. In several non-EU countries this may be a time–consuming process and could defeat the objective of taking decisive action to protect investors' interests. In practice, the hurdles associated with physical segregation, combined with the fact that accounting segregation was not permitted, mean that no Irish domiciled fund has successfully created a side pocket. In Luxembourg, both options are allowed.

43. Do you agree that the assets in the side pocket should always be managed with the view to liquidate them? Or could there be circumstances, where a reintegration with the normal assets could be contemplated? Please explain.

Yes, in our experience side pockets tend to be managed with a view to liquidating them down the line. However, the crucial point is that it must remain at the discretion of the manager **when** the liquidation should take place. That decision will be based on an assessment of what is best for the original investors.

If the assets are valued at zero when the side pocket is created, there may come a time when the value of those assets begins to rise again (see some possible scenarios below). The assets will ultimately be sold at a point determined by the manager (e.g. when they regain X% of their value or even when they generate X% return). The proceeds should then be distributed on a pro-rata basis to the shareholders of the side pocket.

Those assets should not be reintegrated into the original fund because the ownership of that initial fund will likely have changed significantly since the side pocket was created, so the wrong investors would profit from the reintegration of the assets. In theory, the original fund could repurchase the side pocket assets, but given their questionable history they are unlikely to be seen as attractive, or indeed UCITS eligible assets.

Instances where side pocket assets may regain some value:

- **Sanctions:** While some fund managers may ultimately decide to close funds with exposures (where sanctioned securities account for a majority of fund assets, and it becomes unviable to continue managing the remaining exposure) we believe that side pockets should allow end-investors continued liquidity in non-sanctioned assets, while protecting them from speculative trading into the fund. Managers should also preserve the possibility of future returns if and when trading resumes in impacted assets.
- **Change of company status:** The legal or economic status of companies' debt instruments could also change. For example, Chapter 11 of the US Bankruptcy Code allows businesses to restructure their finances and operations while remaining in business. It is not uncommon for these companies' debt instruments, having been valued at zero and possibly side-pocketed, to restructure and re-emerge with a decent value.

Cost-Benefit Analysis:

44. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards the characteristics of LMTs set out in Annex IIA of the UCITS Directive? Which other types of costs or benefits would you consider in that context?

BlackRock supports the creation of these RTS and agrees they should help move towards a more harmonised and uniform application of the legislation by ManCos and supervisory convergence between NCAs. However, we would still urge ESMA to allow for a degree of flexibility in the application of tools to enable managers to respond to market dynamics, and to avoid the risk of unintended consequences from an overly prescriptive approach.

45. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the UCITS Directive?

No.

46. Do you agree with the above-mentioned reasoning in relation to the possible costs and benefits of the option taken by ESMA as regards the characteristics of LMTs set out in Annex V of the AIFMD? Which other types of costs or benefits would you consider in that context?

BlackRock supports the creation of these RTS and agrees they should help move towards a more harmonised and uniform application of the legislation by ManCos and supervisory convergence between NCAs. However, we would still urge ESMA to allow for a degree of flexibility in the application of tools to enable managers to respond to

market dynamics, and to avoid the risk of unintended consequences from an overly prescriptive approach.

47. Is there any ESG and innovation-related aspects that ESMA should consider when drafting the RTS under the AIFMD?

No.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by this consultation and will continue to work with ESMA on any specific issues which may assist in the finalisation of the draft regulatory technical standards on liquidity management tools under the AIFMD and UCITS Directive.

BlackRock

8th October 2024

European Securities and Markets Authority (ESMA)
201-203 Rue de Bercy
72012 Paris

Submitted online via: www.esma.europa.eu

RE: Consultation Paper: Guidelines on Liquidity Management Tools of UCITS and Open-Ended AIFs

BlackRock[1] is pleased to have the opportunity to respond to the consultation on the guidelines for liquidity management tools of UCITS and open-ended AIFs.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation and will continue to contribute to the thinking of the ESMA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Maria Ging
Managing Director,
EMEA UCITS Chief Financial Officer
maria.ging@blackrock.com

Martin Parkes
Managing Director,
Co-Head of EMEA Public Policy
martin.parkes@blackrock.com

Helen Davies,
Director, International Product Oversight Group
helen.davies@blackrock.com

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive Summary

BlackRock believes robust liquidity risk management is and has always been a critical part of fund managers' fiduciary duty to their investors. This includes the consideration and management of risks to the value of an investor's holdings being impacted in both normal and challenging market conditions.

We are very supportive of the harmonisation of the availability of liquidity management tools (LMTs) across the EU – having access to as broad a range of LMTs as possible provides fund managers with the ability to have flexibility and adaptability in responding to contractions in liquidity, particularly in challenging market conditions. Such harmonisation will raise the level of investor protection and financial stability in Europe, and once in place, will position this toolkit among the most advanced globally.

The LMTs discussed in this consultation are used in all aspects of a fund's 'life cycle'; they are embedded in the initial product design and used as part of ongoing portfolio management, but they are also used to manage extraordinary market conditions and protect investors in the run-up to fund closure. The decision to use an LMT and how to do so is informed by the assets a fund is invested in, market conditions for those assets, the fund's investor base, numerous other factors. These decisions are often highly time-sensitive and dependent on evolving market conditions.

This means there is no one-size-fits-all approach to deploying LMTs, and how to use them is a judgement that should sit primarily with asset managers and fund governance bodies, who have the best knowledge and information on developments within a fund, and are therefore best informed about how and when to deploy LMTs.

While some market events and conditions may affect groups of funds at the same time, variation in investment objectives, portfolio composition, and investor bases make it unlikely there will be a foreseeable 'right time' to use particular LMTs across some or all funds in a market, or a scenario in which one tool would be appropriate for multiple funds.

In stressed markets, regulators can play a critical role by issuing supervisory guidance on use of LMTs, informed by close engagement with industry on idiosyncratic or fund-specific issues. More generally, however, regulators can improve LMT uptake by monitoring asset managers' operational preparedness to use tools, engaging in dialogue with managers on their use, and setting standards and best practises that promote high quality application.

This is exemplified by the final recommendations issued by IOSCO in December 2023 on the use of anti-dilution LMTs, which recommend that fund managers "consider and use appropriate anti-dilution LMTs…to mitigate material investor dilution and potential first-mover advantage". Fund managers retain a level of interpretation and discretion in determining the appropriate course of action for the fund. This is an important consideration, as such discretion provides the requisite flexibility to evaluate whether the fund faces a risk of material dilution, and which LMT is most appropriate to deploy to address the specific risks and market conditions at play.

The use of LMTs should not be viewed solely as a means of crisis management measures: many ex-ante and ex post tools are business-as-usual mechanisms used as part of prudent fund management. To this point, in the case of redemptions in kind, it is important to distinguish between the use of redemptions in kind for liquidity management purposes in OEFs such as a traditional mutual fund, from its use as a redemption mechanism in an exchange-traded fund (ETF). As a redemption mechanism in ETFs, redemptions in kind are considered an integral BAU feature of the fund. While Authorised Participants (APs), typically financial institutions such as banks/brokers, are authorised to transact with the ETF to create or redeem shares, in exchange for a proportionate share of the underlying assets that make up the benchmark tracked by the ETF, other ETF investors, do not interact

directly with the ETF when buying or selling shares, but instead trade through brokers with other investors on an exchange, or other venues. Therefore, we do not consider the use of redemptions in kind in ETFs (by APs or market makers) as an ***activation*** of the tool for liquidity risk management purposes.

Much focus in the consultation is centred on how LMTs can manage redemptions, but it is also important to consider the effect of increased subscriptions on the ability of the fund to allocate capital, particularly for funds investing in assets with limited liquidity, where it can be more operationally challenging to find suitable investment opportunities which are aligned in quality and quantity with the existing portfolio. Soft closures for instance, refer to a sliding scale of measures which allow fund managers to restrict the level of subscriptions, allowing them to determine whether they will temporarily gate subscriptions, or suspend them entirely.

Responses to Questions

General Principles:

1. **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?**

   Yes, we broadly agree with the list of elements. In addition, other elements managers could also consider include:
   - **Structural considerations** outside of those listed, such as whether the fund has a master-feeder structure, or if it is an exchange traded fund (ETF). In the case of ETFs, for instance, it is important to take into account the ETF's trading mechanism which mean that anti-dilution tools used for traditional mutual funds may not always be appropriate.
   - **Availability of other LMTs.** Outside of those listed in the Guidelines, other LMTs may be available which would influence the selection of LMTs, such as the ability to activate a 'soft closure' of the fund, which can take the form or ceasing active marketing of the fund, or instituting a refusal of subscription, which in a similar way to redemption gates, prevents subscriptions of excessive size.
   - **Investor base.** The characteristics of the investor base should also be considered in the selection of the most appropriate tool. For example, 'funds of one', where a segregated mandate is wrapped in a fund structure, typically an AIF, there is only one shareholder in the fund, there is no likelihood of a dilutive effect of a subscription or redemption, so an anti-dilution tool would probably be inappropriate.
   - **Operational barriers and complexity.** It may not be operationally feasible to deploy certain LMTs for a particular fund, depending on the characteristics of the fund or asset class. For instance, funds with significant dealing volumes may be better served by an anti-dilution LMT that is applied at the fund level (e.g., swing pricing) rather than a tool that is applied at individual deal level (e.g,. subscription/ redemption fees).

2. **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)?**

   The distribution policy of the fund should be considered in the selection of the LMTs, as it will typically exist in the context of the broader regional or market specific

distribution infrastructure, which can impact how operationally feasible it is to implement a particular tool.

For instance, distribution through intermediaries and platforms would make the use of ad-hoc gates much more operationally challenging. The distribution architecture for these funds is increasingly automated and would not lend itself to ad-hoc interventions to gate a fund. On the other hand, European swing pricing models have been designed to align with these distribution models.

Funds which are managed in one jurisdiction, but which are distributed to investors in a jurisdiction with a different time zone will also need to factor in how this might impact the implementation of certain LMTs.

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?

Overall, we agree that managers should consider the merit of selecting of at least one quantitative LMT and at least one ADT for the two minimum LMTs.

Where possible, most open-ended funds can *benefit* from the ability of ADTs to assign transaction costs to the transacting investors, as it contributes to the protection of the remaining investors' holdings, upholding the principle of equal treatment of investors. Though ADTs can be better suited to funds which hold assets that trade daily, as there is more available data to calculate the cost of liquidity, the benefit can still extend to funds invested in less liquid or illiquid assets. For instance, a number of large subscriptions to such a fund would require large trades to buy these assets, in turn likely significantly impacting the asset price and raising transaction costs. The use of an ADT such as an anti-dilution levy would help to protect the existing investors from bearing the impact of these trading costs, and maintaining the performance of the fund.

The selection of two tools from those listed in the Guidelines should only mean that the fund is operationally prepared to activate the tool – the actual decision to activate the LMTs would remain at the discretion of the fund manager, and may include consideration of other LMTs not listed.

That being said, we would caution against a hard *requirement* to select one quantitative LMT and at least one ADT, as this would infringe upon the primary responsibility of the fund manager for liquidity risk management. The starting point for the selection of LMTs for a fund (as well as the decision to activate), is to analyse a number of factors to determine suitability, such as the assets a fund is invested in, historical or typical market conditions for those assets, the fund's investor base, the activity of those investors, and numerous other factors. This underscores the need for flexibility, as the specific circumstances of each fund will dictate the tools selected, which could potentially result in the selection of two ADTs, or two quantitative LMTs.

In certain fund types, dilution is structurally unlikely so selecting an ADT could be inappropriate. This includes 'funds of one', which have only one shareholder in the fund, meaning there is no dilutive effect of a subscription or redemption, or master/feeder structures, where dilution is less likely to occur at the feeder fund level, but rather would be a more relevant consideration at the master level.

It is also unclear how this requirement would apply to redemptions in kind, which are neither an ADT nor a quantitative-based LMT, as they fall into the 'other tools' category, but are permitted to be selected as one of the two mandatory LMTs.

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

The duties of depositaries are already well established in UCITSD and AIFMD, which include oversight and verification of the manager's compliance with regulatory requirements around risk and liquidity management processes. We do not see it necessary to develop further guidance.

Governance Principles:

5. 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?

We broadly agree with the list of elements to be included in the LMT policy. However, we would caution against the LMT policy prescribing the exact course of action concerning the activation of LMTs, as fund managers require a level of discretion in order to manage liquidity in varying circumstances.

The 'LMT playbook' in point (b), which requests setting out the "potential sequencing and interdependencies of selected and available LMTs" implies that fund managers always follow a predetermined deployment plan when activating LMTs. While it is important to prepare ahead, as part of a robust operational resiliency framework and good business continuity management, fund managers still require flexibility to tailor the activation of tools to address the specific market circumstances at the time, in the best interests of investors.[2]

Reflecting this case-by-case nature, it should be emphasised that the LMT policy is intended as guidance on the appropriate considerations to keep in mind, but managers should be provided the flexibility to adapt the LMT policy as needed.

We recommend that investment managers are given the discretion to decide how they structure and deliver the governance arrangements outlined in the Guidelines. Each investment manager is structured differently, and individual funds vary in their size and complexity and legal structure.

Concerning the governance of ADTs in the LMT policy, paragraph 29 of 6.5.2 requires a six-monthly review of the nature of the costs, the distribution of costs between unitholders, and the estimation methodology. We suggest that the six-monthly review should be limited to the estimation methodology i.e. reviewing the swing factors or threshold models in place on a particular fund to ensure these are still appropriate. The nature of the costs, which could include elements such as broker fees, share class-specific costs, and bid-ask spreads, may vary per fund but are likely to remain consistent within a six-month period for a specific fund, so an annual review would be better suited in this case.

Review of the distribution of costs would also benefit from an annual, rather than six-month period, as it would better align with the typical timeline for review of the fund's

---

[2] For further analysis of business continuity management practices and operational resilience, see our ViewPoint: [Lessons from COVID-19: Operational Risk and Resilience.]

overall performance, taking into account how the ADTs implemented have shielded the fund from dilution effects.

6. **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.**

Transparency and clarity of information is important for fund investors. Fund investors should have appropriate information in the prospectus on what LMTs are, why they are used, how the fund utilizes them, and, if appropriate, ex-post disclosure of how they have been used.

However, granularity beyond this should be avoided. The disclosure of thresholds and calibration practices, as referenced in point (p) could facilitate investors attempting to arbitrage the fund by trading just below the thresholds.

Funds with nominally similar investment strategies could justify using different parameters for their LMTs. Disclosure of these different parameters could, without clear disclosure and explanations, be incorrectly perceived as a cost difference between different types of funds - and unduly influence investors' fund selection decisions.

It is important that the disclosure also does not imply there is a 'standard' way that LMTs will be activated each time, given the variety of market scenarios that can arise. The LMT playbook in point (b), containing the potential sequencing and interdependencies of the fund's LMTs should not be disclosed for this reason. Decisions to activate LMTs are often highly time-sensitive and dependent on evolving market conditions, so may vary from the stated playbook on a case-by-case basis. Such disclosure could create false expectations for investors, who don't possess the same oversight or expertise of fund as the fund Board would, and as such, may lack the necessary context needed to understand the decisions taken in a particular scenario.

Other elements of the internal risk management and governance process in the LMT policy covered points (d) – (o) could be summarised in an overview addressing the key points, without delving into detail. Such internal risk management processes are not typically communicated to investors, given they are not considered to be material to their own decision making.

Suspension of Subscriptions, Repurchases and Redemptions:

7. **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?**

Overall, we agree with the definition, but would suggest to remove 'unforeseen' from the description, as it implies that suspensions should only be activated in novel circumstances, which we would disagree with.

Exceptional circumstances represent the extreme end of a sliding scale of severity, so while a fund manager may foresee a specific liquidity challenge could develop, based on emerging market conditions, it may not be appropriate to suspend subscriptions or redemptions until it becomes apparent that such conditions would materially impact the fund's ability to "carry out normal business functions…[or] meet the funding obligations arising from the liabilities side of the balance sheet."

By its nature, we would not see it appropriate to attempt to try to provide a list of what exceptional circumstances are, as these are difficult to predict in advance, and, even a non-exhaustive list may skew or limit the interpretation of the fund manager to determine the appropriate threshold at which to suspend the fund. Moreover, close engagement between NCAs and managers is typical in stressed market conditions, providing an opportunity for managers to justify their decision to suspend, where necessary.

A fund manager may also choose to activate a temporary suspension on non-dealing days, which may not necessarily fit neatly into the ‘exceptional circumstances’ definition. A non-dealing day would likely occur where a fund is marketed across several jurisdictions, but has exposure to an underlying local market that is closed or has historically low dealing volumes during a specific period, such as Lunar New Year, or Golden Week.

8. 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?

While we agree that suspensions should be temporary, including a tentative duration of the suspension, as mentioned in point (c) would be complex in such exceptional circumstances, and should be avoided as they could be misleading. Taking the outbreak of the COVID-19 pandemic in March 2020 as an example, it would not have been possible to estimate how long suspensions would last, or provide a “timeline to resume normal operations”, especially not immediately after activation of the suspension as is requested in the Guidelines, as no fund manager knew how long the health crisis and economic crisis was likely to persist for.

Providing a simulation of the liquidity profile of the fund following the market stress, while at the point of suspension, as in point (d) would similarly be speculative at best, as the accuracy of such a simulation would be hard to guarantee, making the information redundant.

Point (e), an assessment of the impact of the suspension on investors, is also challenging and potentially inappropriate. The decision to suspend is taken by the fund manager in order to fulfil their overarching fiduciary duty to act in best interest of investors, so assessing such an impact seems contradictory to this purpose. It may also be difficult to implement as it is often challenging to determine who the individual investor is with precision, such as when funds are distributed through intermediaries.

Point (i) also should not be included in the LMT plan as the decision to suspend should be based on what is in the best interests of fund investors, and factoring in increased regulatory scrutiny, or perceived legal risks could negatively influence the manager’s decision making.

The LMT Plan should be for internal use only, as it is essentially a contingency planning document.

9. 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?

An activation threshold for suspensions can act as a guide to inform the fund manager as to when it may be most appropriate to start having discussions around a potential suspension, but should not be a fixed requirement. As discussed, the type of exceptional

circumstances which might lead to a suspension can be unique, and a fixed threshold would be unlikely to cover all eventualities.

Redemption Gates:

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

We agree with the criteria, but not with the suggestion that redemption gates should be considered for all funds – the manager is best placed to decide which LMTs would be most appropriate for the fund in the fund design process, and discretion should be afforded to them regarding the weight of this criteria in their decision making.

While a concentrated investor base could indeed be a relevant consideration in choosing to activate a redemption gate, LMT selection is made at the fund design phase, where this would be unlikely to be known for certain.

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

As mentioned in our response to the draft RTS, irrespective of whether gates are activated automatically or at the discretion of the fund manager, we believe the activation threshold should always allow flexibility for managers and/or fund boards to adjust to different and unexpected market conditions in the best interest of investors.

We would also caution against redemption gates being understood as a tool for use only in severely stressed market conditions. Especially for AIFs invested in assets with limited liquidity, perhaps as part of a semi-liquid investment strategy, gates are an important and common tool, in normal and stressed market conditions alike. This approach has been recognised in the final draft of the ELTIF RTS.

The use of gates in Money Market Funds (MMFs) on the other hand, would typically indicate that the fund is likely to be wound down, as its primary purpose is to preserve capital and liquidity. Unlike most mutual funds, MMFs are designed to meet outflows using cash on hand, not by selling assets to fund redemptions. Gates, whilst an important LMT, should in this instance therefore be considered as a tool to be used in extreme scenarios. As such, the activation threshold would necessarily be higher.

Concerning regular dealing funds such as UCITS marketed to retail investors, we agree that gates should not be "systematically activated". However, provided there is appropriate disclosure in the fund prospectus about their function and purpose, gates structured as caps on available liquidity can be explained to retail investors.

While managers may disclose an indicative percentage of the level at which they may activate a gate, for the benefit of aiding investor understanding, it should be clear that this percentage is representative, rather than decisive.

This is for two reasons;

- It is important that the actual internal activation threshold, which may be lower than that published, is kept internal to avoid signalling investors as to when they could potentially arbitrage the fund.
- Additionally, publishing the precise activation threshold could remove the manager's flexibility to vary from the threshold as needed. Many managers do already disclose a threshold at which they are likely to defer such redemption requests.

Moreover, it is important to note that just as a fund manager may deem it appropriate to activate a gate on redemptions of the fund, a manager may also choose to activate a 'gate' on subscriptions to the fund, otherwise known as a 'soft closure' of the fund, in order to prevent a potential dilutive effect of a large subscription. This could range from ceasing active marketing of the fund, to restricting or deferring a certain level of subscriptions in a given period.

12. 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.

We agree that redemption gates should not be restricted by a maximum period over which they can be used. As discussed in Question 11, particularly in the case of AIFs invested in less liquid asset classes gates such as private debt or real estate, gates can be a common tool to manage liquidity, in normal and stressed market conditions alike.

While we do believe that gates are less suited to funds marketed to retail investors, as the distribution architecture for these funds is increasingly automated and would not lend itself to ad-hoc interventions to gate a fund, we do not see a need to differentiate the use of gates for such funds, as the manager likely simply wouldn't select or activate the tool if they don't deem it appropriate.

13. 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?

In addition to historical redemption requests and liquidity stress test results, the calibration methodology should also take into account the current market conditions, to assess whether there is enough liquidity in the market to meet the requisite redemptions for the underlying assets, and expected cashflow, which could help to identify whether there is a potential liquidity mismatch and if this can be mitigated.

The manager could also consider taking into account redemption coverage ratios at different horizons, which help to assess whether a fund has sufficient liquid assets to cover potential redemptions without significantly impacting its overall portfolio.

We would also recommend that access to such liquidity is determined on a pro rata basis on the relevant dealing day rather than on a first come first served basis to maintain fairness between investors.

14. 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?

The fund manager should determine the appropriate minimum threshold for activating redemption gates in a particular fund, taking into liquidity of the underlying assets, and the expected cash flow of the fund.

We do not believe NCAs or ESMA should attempt to achieve harmonisation in the use of gates, as a fixed minimum threshold is unlikely to be able to account for the variety

of cases that may warrant gating across the highly heterogeneous universe of UCITS & AIFs. Statutory imposition of any minimum threshold for the activation of gates can enhance procyclicality, by signalling investors as to when they could potentially arbitrage the fund, rather than leaving it to the manager's discretion.

15. 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?

As stated in Question 14, we believe that fixed minimum thresholds which apply across all fund types and asset classes will be arbitrary, so should be left to the discretion of the fund manager, who possesses the expertise and holistic overview of the fund.

When a fund manager is determining the appropriate minimum threshold for their fund, focusing solely on redemptions might provide a distorted view, and should be balanced with an assessment of the underlying liquidity of the asset class itself, and an assessment of the expected cashflows. For instance, if the percentage of overall redemptions is at 10% in a day, but the fund is invested in a highly liquid asset class such as large cap equities, and has consistent inflows or other cash flows like dividend payments, such level of redemptions might not trigger the activation of a gate.

It is expected that the threshold will be higher for funds invested in more liquid assets, and lower for those invested in illiquid assets, but the fund manager should decide on the specific threshold. Managers should, however, be prepared to justify their judgements to their local NCA and where relevant, their depositary.

Furthermore, calculating weekly outflows, as would be required for the suggested 10% threshold for cumulative net redemptions received during a week, presents many complexities. It is difficult to know where to draw the line for a particular week's calculation in an effective way, given there may be varying levels of both inflows and outflows which could vary the fund's proximity to the threshold.

Extension of Notice Periods:

16. 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?

Yes. Notice periods would typically be selected for funds investing in less liquid or illiquid assets, such as real estate and infrastructure, given the time often needed to plan and prepare for transactions. Where the assets invested in are inherently illiquid, we would agree that the notice period should be in line with the level of liquidity of their assets under normal market conditions.

17. 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?

RE and PE funds can possess different lifespans, even from the same fund manager, ranging from 7-10 years in RE, and 10-12 years in PE. For this reason, we would advise against defining a minimum notice period, which would be arbitrary given the differences, but would support fund managers aligning their minimum notice periods to the liquidity of the assets in normal market conditions, as already included.

For such funds, the extension of notice periods would be an appropriate LMT, but would be best placed for the fund manager to decide, as for instance, they could choose to also implement extended settlement periods, to provide additional time to sell the underlying assets in an orderly manner.

18. 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?

No. The length of the extended notice period should be at the discretion of the fund manager, and as stated previously, we do not believe setting standard minimum or maximum notice periods would be effective, given the highly heterogeneous universe of UCITS funds.

19. 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?

Yes, we agree with the activation criteria.

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

No comment.

Redemptions in Kind:

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

It is important to distinguish between the use of redemptions in kind for liquidity management purposes in OEFs such as a traditional mutual fund, from its use as a redemption mechanism in an ETF.

As an LMT, we agree with limiting the use of redemptions in kind to funds marketed only to professional investors. Redemptions in kind enable the fund to transfer the underlying assets to the redeeming investor, instead of their cash value. Only large, institutional or professional investors who possess their own dedicated custody accounts would be able to use redemptions-in-kind, and such investors would likely only find this tool useful if they have a similar portfolio on their own account to the one held in the fund.

We would not consider this a tool that can or should be a widely usable substitute for the normal OEF redemption process or as a means of easing pressure on markets liquidity – few investors possess the capability to receive redemptions in kind, narrowing their practicality as an LMT to a limited number of scenarios.

However, as a redemption mechanism in ETFs, redemptions in kind are considered an integral feature of the structure of the fund. ETFs trade in both primary and secondary markets. Authorised Participants (APs), typically financial institutions such as banks/brokers, are authorised to transact with the ETF to create or redeem shares, in exchange for a proportionate share of the underlying assets that make up the benchmark tracked by the ETF. Other ETF investors, which aren't APs, do not interact directly with the ETF when buying or selling shares, but instead trade through brokers with other investors on an exchange, or other venues.

As specialised financial institutions, which are typically affiliated on an individual basis with specific ETFs and portfolio of assets they track, APs are operationally prepared to

receive redemptions in kind in exchange for ETF shares. This should not be subject to a pro-rata slice as it would impact the ETF's ability to keep its price aligned with the value of its underlying securities, by removing the economic incentives of APs and market makers to trade with them.

To reflect this, we suggest making the following addition to the Guidelines:

"When, in the normal course of regular dealing activities relating to the direct redemption of shares in a UCITS ETF by an Authorised Participant / market-maker, delivery in whole or in part of underlying securities held by, or on behalf of, the UCITS ETF to authorised participants / market makers in satisfaction of such dealing request is not considered an activation of the redemption-in-kind mechanism in the context of Annex IIA liquidity management tools."

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

Broadly, yes.

Where redemptions in kind are used for liquidity management purposes, we would support the requirement for an independent third party to value the redemption in kind independently. This helps to ensure fairness of the allocation of assets to both remaining investors and redeeming investors, and can be fulfilled in different ways, as demonstrated by existing practices across the EU.

In some markets like Luxembourg, redemptions in kind require valuation by an external auditor. The costs of that report are borne by the shareholder requesting the redemption in kind, but if the manager decides to implement an RIK to avoid the sale of sizable blocks of securities in response to a redemption request, then it is unclear who would pay.

By contrast, in Ireland the depositary is responsible for signing off that an assessment of the assets chosen has been made, confirming they are a representative pro rata share and secondly that the valuation of the assets is fair and does not disadvantage remaining investors.

As stated in Question 21, we do not consider the use of redemptions in kind in ETFs (by APs or market makers) as an ***activation*** of the tool for liquidity risk management purposes. Typically, the individual AP redeeming is affiliated with the specific ETFs and portfolio of assets they track, and other ETF investors (such as retail investors) which aren't APs, do not interact directly with the ETF when buying or selling shares, so the same issues of fair treatment of investors do not arise. Therefore, we do not consider it appropriate or necessary to require an independent valuation of the assets.

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

Yes, activating the redemption in kind on the NAV calculation date will help to ensure that the amount and type assets transferred are based on the most recent and accurate valuation, providing fair value for both redeeming and remaining investors.

24. 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?

Apart from in the case of ETFs, the fund manager activating a redemption in kind should select assets in the fund on a pro-rata basis, in order to ensure fairness of the allocation of assets to both remaining investors and redeeming investors.

For use in ETFs, redemptions in kind should not be subject to a pro-rata slice as it would impact the ETF's ability to keep its price aligned with the value of its underlying securities, by removing the economic incentives of APs and market makers to trade with them.

25. How should redemptions in kind be calibrated?

Anti-Dilution Tools – General:

26. 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.

Fund managers should be afforded the flexibility to activate the LMTs they deem will best protect investors from material dilution, which may indeed include the simultaneous activation of two ADTs.

27. 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?

We agree that explicit (e.g., taxes, trading levies, broker fees) and implicit (indirect costs such as bid-ask spreads and market impact) transaction costs are the two main components of estimating the cost of liquidity. However, the underlying elements of each component, as described in the Guidelines, should not be seen as an exhaustive list. Further, for some securities, the distinction between the two components is less clear.

Explicit transaction costs may also include:

- Custody transaction charges on an actual or historical basis.
- Share class-specific costs, e.g., for currency hedged share classes.
- Any anti-dilution adjustments or spreads applied to underlying investment funds or derivative instruments.
- Bid-ask spreads – which are described in the Guidelines as implicit only, but may also be known in advance if managers have access to the relevant data.

Implicit transaction costs help to provide a more accurate estimate of the costs generated from the fund manager's actual trading activity in running their fund. The bid-ask spread represents the difference between the lowest ask price and the highest bid price, a cost that managers will likely incur in buying a security and selling it later. However, the quantity available to buy at the lowest ask price or to sell at the highest bid price is limited, and large orders will likely exceed the quantity available at the current best price. Market impact therefore typically reflects the influence of the order size on the trade execution, usually showing that larger orders will be executed at less advantageous prices than the best bid or offer for the fund manager.[3] The accuracy of the estimated market impact will depend on the calibre of market data available in a particular asset class. Access to complete fund flow data for each dealing day plays a large role in the ability to assess liquidity costs and fragmentation in certain markets across Europe may make this more challenging to obtain.

[3] For further discussion of implicit costs, please see our ViewPoint: Disclosing Transaction Costs - The need for a common framework.

It should be noted that while we believe that managers should be expected to calculate their estimates with a reasonable degree of confidence, there may be instances where even in light of all reasonable efforts taken by the investment manager to estimate the cost of liquidity, the actual transaction costs may still differ.

The degree to which both explicit and implicit costs can be incorporated for *all* of the listed ADTs will vary in certainty. For swing pricing and dual pricing both elements can typically be incorporated into liquidity cost estimates, again on a best-efforts basis, dependent on the asset class. Anti-dilution levies can in some cases incorporate these costs, although where fund distribution is significantly intermediated this may prove more difficult. For redemption fees, market impact would be more challenging to incorporate, as these are often structured as a static fee, requiring managers to estimate in advance one fee appropriate for normal conditions and a different fee for stressed conditions, based on a representative slice of the underlying assets.

For these reasons, we feel the manager should have discretion concerning the incorporation of market impact with appropriate evidence and perhaps a level of transparency, rather than market impact being always required.

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

Paragraph 60 of 6.5.4 states that "managers should not calibrate ADTs in a way that could help to artificially improve the performance of the fund."

While this is never the intention of the use of ADTs, shielding the fund from dilutive effect may influence performance to a degree. In the case of swing pricing for instance, in the event that a fund swings on the last day of a reporting period (i.e. month end), the swing effect will, to some extent, obscure underlying fund performance. The impact can be positive or negative, depending on the direction of the swing. Some mention of this impact may be made in commentaries should the effect be significant. This is an unavoidable consequence of a process which exists for the sole purpose of investor protection. This is not the same as leveraging ADT costs to manipulate what would otherwise have been the fund's expected performance.

To support investor understanding of this impact, managers could then provide investors, on request, with the swing factor applied to a fund on a day that the investor has subscribed or redeemed units of that fund.

Redemptions Fees:

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

As noted in our response to the ESMA RTS on LMTs, this LMT is intended to address the risk of opportunistic arbitrage of fund assets, and we believe it is important to note that this risk may arise from both subscriptions and redemptions.

We agree with the criteria, though would suggest removing references to RE assets specifically, which could skew the interpretation of both fund managers and NCAs as to which types of funds subscription or redemption fees should be selected for.

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

The activation thresholds should take into account the size of subscription orders above which a fee could be charged to transacting investors, as well as redemption orders.

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

Subscription or redemption fees are typically calculated as a percentage of the transaction size, meaning investment managers can estimate an average for market impact but cannot always make a full allocation of the liquidity costs.

Paragraph 64 of 6.5.4.1 which states that – “Managers should consider whether to calibrate the redemption fee as a single fee or whether it is adjusted based on a tiered approach corresponding to the amount of net fund flows (i.e. the larger the redemption order the higher the redemption fee)” – could contribute to making a more accurate allocation of the liquidity costs, however, depending on the number of intermediaries involved and the volume of orders and the level of technology in place within these networks, it could be challenging to make frequent and quick changes to the subscription/ redemption fee for a given volume of trades and still conduct the associated cash reconciliations.

Swing Pricing:

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

Overall, we agree with the selection criteria.

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

As with all of the anti-dilution tools, swing pricing is a means of attributing the cost of liquidity to the transacting investor. Swing pricing adjusts the NAV at which all investors’ transactions in a fund take place on a particular day, and is based on the cumulative total fund flows for the day, netting off purchases and sales, to arrive at a total net flow. The activation thresholds should reflect elements such as the fund size, dealing costs, investor base, liquidity of the underlying markets and investment universe in which the particular fund invests, among other factors.

Many swing pricing models adopt a tiered approach, which allows multiple thresholds to be set for the application of increasing swing factors. These thresholds are set according to the possible range of redemptions and adjust the NAV price by the different sizes of flows, e.g., from 0.25% to over 25%.

From a BlackRock perspective, our tiered threshold model takes account of the different levels of dilution incurred at varying shareholder flow sizes – that is, the differences between overall costs and dilution on small security deals (typically low spreads) and very large deals (typically with much larger spreads and where market impact occurs). For example, a 2% net inflow might trigger a 20-bps swing to offer, while a 10% net inflow could trigger a 40-bps swing to offer.

Ultimately, the setting and activation of such thresholds should remain at the discretion of the fund manager, taking into account the elements discussed. Detailed disclosure of the activation thresholds should not be made available, to avoid incentivising investor dealing just below the threshold, as well as protecting potentially commercially sensitive information.

Upon request, investors could however receive information regarding the size and direction of a pricing swing in relation to relevant investor transactions on any given valuation day, on an ex post event basis.

34. 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?

We agree that managers should have the flexibility to recalibrate the maximum swing pricing factor (which would have been set for normal market conditions) in stressed market conditions, and that such recalibration should be justifiable to the NCA if required, on the basis of the prevailing market conditions at the time. Paragraph 70 of 6.5.4.2 should be clear that it is solely the decision to recalibrate the *maximum* swing factor that needs to be justified, rather than just any of the swing factors.

Given there will have been a documented maximum swing factor in the prospectus, we agree that the recalibration of this should be communicated to investors, though not necessarily with detail of what the new maximum is, to again guard against the possibility of investors attempting to game the fund.

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

For most fund managers, it is not yet possible to ensure that the estimated cost of liquidity, including market impact, is incorporated into the swing factors for swing pricing. As previously stated, the level of precision to which market impact can be estimated varies per asset class, reflecting different market structures.

We strongly discourage any intervention that aims to prescribe specific swing pricing models or minimum swing factors: this process requires considered judgement drawing on the skill sets of different asset management functions and should not be prescriptive. Mandating the inclusion of specific market impact where underlying market data is not available could raise the risk of 'over' swing pricing, which risks a pricing error for which fund investors will require compensation; and disadvantages open-ended fund investors vis-à-vis those using other investment vehicles by creating an unlevel playing field in their respective abilities to access market liquidity.

Swing factors can instead take into account the following components, based on the observed transaction cost for each fund portfolio:

- An adjustment for the spread. Spread is the difference between the bid and offer price of a security. This needs to be captured because the funds calculate a single NAV price each day while the underlying securities held within the funds' portfolio are traded at bid and offer prices. This spread is not caught in a single NAV price, unless it is captured in the swing factor adjustment.

- An adjustment for broker fees and any other market charges.

- An adjustment for governmental taxes and duties payable on securities transactions (may or may not include capital gains tax and withholding tax).

- An adjustment for the market movement caused by the trading activity. This may be close to zero for liquid securities with large market capitalisation. When dealing in less liquid securities with lower daily trading volumes a trade can cause the securities' price to move (due to demand and supply),

therefore this movement is estimated and included in the swing factor for each fund.

Dual Pricing:

36. 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.

Dual pricing tends to be used for funds where the costs are mainly comprised of the bid-ask spread or can also be driven by investor preferences.

We observe two common approaches to calibrating dual pricing:

- The fund has two NaVs, valued on both a bid & offer basis, relying on the bid/offer prices quoted plus an estimate of dealing expenses.
- The fund has one NaV, valued at mid-price. A spread – including costs of liquidity such as the bid-ask difference, foreign exchange costs, and other dealing expenses – is applied to the mid NAV to derive the fund bid & offer prices.

The two-NaV method is considered more traditional, and typically relies on the touch spread, which can become less reliable in stressed conditions. However, this method can incorporate market impact by adjusting either the bid NaV or offer NaV (flow direction dependent) to incorporate market impact.

The single NaV method better enables the per-trade spread costs to incorporate the impact of investor dealing, allowing closer alignment to actual costs. In this method, either the bid or offer (flow direction dependent) spread, which is used to derive the bid / offer price of the fund, is adjusted to incorporate market impact, but the NaV itself is not adjusted.

Anti-dilution Levy (ADL):

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

Generally, we agree with the selection criteria. An additional consideration would be the distribution architecture of the fund, integrating ADL calculations into a distribution platform's systems, efficiently updating transaction records and communicating the levy details to investors can be operationally complex, and at times not possible for such intermediaries.

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

Yes, we agree with the activation criteria.

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

Please see our answer to Question 35.

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

No further comments.

Side Pockets:

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

Reflecting our answer to Question 7, we would suggest to remove 'unforeseen' from the description, as it creates the narrower assumption that side pockets should only be activated in completely novel circumstances, which is not always the case.

As previously stated, it may be difficult to predict the scenarios in which such exceptional circumstances may arise which may require the activation of side pockets, and a non-exhaustive list should not be interpreted by NCAs as a narrowing of the applicable conditions for activation.

42. 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.

BlackRock does not believe the guidance should be differentiated for UCITS and AIFs, to allow fund managers to be able to take a flexible approach to determining which type of side pocket will work in the best interests of investors, in the given circumstance.

Accounting segregation – through the creation of an additional share class in the same fund – may provide better investor outcomes where reducing costs, facilitating a faster implementation time, and minimising additional tax implications are the primary considerations. Physical segregation – creating a new fund or sub-fund – is often a costly process, given the requirements to develop a new prospectus and all the administrative and legal costs that go with setting up a new fund, including the set-up of new custody accounts for the fund. In several non-EU countries this may be a time–consuming process and could defeat the objective of taking decisive action to protect investors' interests.

However, there are circumstances where a manager may deem physical segregation more suitable. It may, for instance, lower the investment risk (by way of tracking error) associated with the problem assets potentially gaining value again, and could simplify the accounting and regulatory reporting and oversight processes through providing a simple and clear delineation.

Regarding the 'detailed plan' that should be formalised before the activation of a side pocket, point (d), which requires an estimated timeline of the side pocket's duration, is impractical. Prior to activating the side pocket, and indeed even during its activation, it would be difficult to know how long the side pocket might be necessary for. If this timeline is to be relied upon as part of the communications to investors addressed in paragraph 86, it may prove misleading, as it would be speculative.

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

We believe the approach taken to side pocket activation and calibration in Luxembourg provides an appropriate balance between maintaining manager discretion and a level of supervisory oversight.

Before determining which option is most appropriate to deal with the assets that became illiquid, the CSSF require the governing body of the fund to conduct a thorough analysis covering the following aspects:

- The governing body must be able to justify why the selected tool is the only possible/adequate tool to be implemented, taking into consideration the best interest of the investors.
- The analysis must cover legal aspects (e.g. potential breaches with respect to UCITS regulation) as well as fiscal and accounting aspects related to the proposed operation.
- It should be ascertained that the model is compliant with the sanction regime.
- It should be ascertained that the implementation of the tool is not contrary to the constitutional documents of the UCITS.
- It must be checked to what extent and under what conditions the approval of investors is required.
- The costs of the selected model must be assessed (e.g. avoidance of fees that are disproportionate for the investors or any duplication of fees due to an asset splitting).

The fund must then have permission from the CSSF to undertake the split. The following considerations, which are required to be included in the application, are pertinent from our perspective for managers to consider in calibrating a side pocket:

- Information on the illiquid assets (e.g. percentage of assets concerned, reason why they are illiquid)
- Description of the segregation option the governing body contemplate implementing and reason for choosing this option.
- Description of the additional fees to be charged in relation to the contemplated option.
- Information on measures taken to avoid unfair treatment of remaining investors.
- Information on the way the governing body will communicate to investors.
- Where applicable, information on the approval process of the operation by investors.
- Necessary update of the prospectus in case the investment strategy changes (to be assessed on a case-by-case basis)
- List of countries where the UCITS is eligible for marketing. Confirmation whether the supervisory authorities of such countries have been / will be informed, and if not, why such information procedure is not necessary.
- A statement from the governing body confirming the assessment of the legal and fiscal issues related to the proposed operation. That statement must be documented by a legal assessment/opinion duly endorsed by the governing body.

Disclosure to Investors:

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

BlackRock is supportive of providing transparency and clarity to fund investors. Investors should have appropriate information to aid their understanding and decision-making with regards to the fund, including what the LMTs are, why they are used, how the fund utilizes them, and, if appropriate, ex-post disclosure of how they have been used.

Granularity in such disclosure, however, such as regarding specific elements of how LMTs are calibrated and activated can have unintended adverse effects on the fund, so should be avoided.

As discussed in our answer to Question 11, disclosing the specific activation thresholds (for redemption gates or any other LMTs) could incentivise certain investors to redeem just under the threshold, voiding the intended function of LMTs, and potentially even creating a destabilising effect in the fund. Instead, if the intention is to provide investors with understanding of why a particular LMT could be or has been activated, managers may give a high-level qualitative indication of the conditions for activation, such as high subscription or redemption requests and market stress in the case of redemption gates.

Similarly, the range of adjustment factors used by a fund could constitute commercially sensitive information. Funds with nominally similar investment strategies could justify using different adjustment factors for their LMTs. Disclosure of these different parameters could, without clear disclosure and explanations, be incorrectly perceived as a cost difference between different types of funds - and unduly influence investors' fund selection decisions. The release of this information to trading counterparties may also lead to deterioration in dealing terms, at the expense of underlying investors.

Regarding ex-post disclosures, we agree this can be helpful for investors to understand the cost implications of LMTs on the fund, but would suggest that it be left to the manager's discretion as to whether this is provided as a summary or in a more granular format, as well as the timing of such disclosure.

In order to manage expectations, any disclosure should not imply that there is a singular way in which the LMTs will be applied, given the varying market scenarios that may arise. Therefore, we welcome the ability of the fund to exceed the range of adjustment factors, even where disclosed to investors. Decisions to activate LMTs are often highly time-sensitive and dependent on evolving market conditions, so may vary from the stated ranges on a case-by-case basis. Such disclosure could create false expectations for investors, who don't possess the same oversight or expertise of fund as the fund Board would, and as such, may lack the necessary context needed to understand the decisions taken in a particular scenario.

45. 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?

We would suggest that this disclosure be included in the fund's rules (or offering document / prospectus) ***or*** the instruments of incorporation, rather than being required for both. Instruments of incorporation can be complex and costly to amend, due to their legal nature, and are not typically the main reference point for investors.

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

Please see our answer to Question 6.

Application of the Guidelines:

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

Given the number of ongoing regulatory development changes currently in progress the time taken to build and test adaptations to existing processes typically requires a 12-to-18-month implementation timeline. We therefore recommend at least 18 months implementation for roll out of the changes.

Cost-Benefit Analysis:

48. 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?

49. 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?

50. 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?

Conclusion

We appreciate the opportunity to address and comment on the issues raised by this consultation and will continue to work with ESMA on any specific issues which may assist in the finalisation of guidelines on liquidity management tools of UCITS and open-ended AIFs.