Reply form

**On the Regulatory Technical Standards on Liquidity Management Tools under the AIFMD and UCITS Directive**

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **8 October 2024.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

Instructions

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

• Insert your responses to the questions in the Call for Evidence in this reply form.

• Please do not remove tags of the type < ESMA\_QUESTION\_GLMT\_0>. Your response to each question has to be framed by the two tags corresponding to the question.

• If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.

• When you have drafted your responses, save the reply form according to the following convention: ESMA\_CP1\_GLMT\_nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA\_CP1\_GLMT \_ABCD.

• Upload the Word reply form containing your responses to ESMA’s website (**pdf**  **documents will not be considered except for annexes**). All contributions should be submitted online at <https://www.esma.europa.eu/press-news/consultations/consultation-liquidity-management-tools-funds> under the heading *‘Your input -*  *Consultations’.*

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

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**Who should read this paper?**

This document will be of interest to alternative investment fund managers, AIFs, management companies, UCITS, and their trade associations, depositories and their trade associations, as well as professional and retail investors investing into UCITS and AIFs and their associations.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | BlackRock |
| Activity | Asset Management |
| Country / Region | International |

# Questions

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

<ESMA\_QUESTION\_SLMT\_1>

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.

<ESMA\_QUESTION\_SLMT\_1>

1. 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.

<ESMA\_QUESTION\_SLMT\_2>

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.

<ESMA\_QUESTION\_SLMT\_2>

1. 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?

<ESMA\_QUESTION\_SLMT\_3>

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.

<ESMA\_QUESTION\_SLMT\_3>

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

<ESMA\_QUESTION\_SLMT\_4>

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.

<ESMA\_QUESTION\_SLMT\_4>

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

<ESMA\_QUESTION\_SLMT\_5>

No.

<ESMA\_QUESTION\_SLMT\_5>

1. 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?

<ESMA\_QUESTION\_SLMT\_6>

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.

<ESMA\_QUESTION\_SLMT\_6>

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

<ESMA\_QUESTION\_SLMT\_7>

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.

<ESMA\_QUESTION\_SLMT\_7>

1. 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.

<ESMA\_QUESTION\_SLMT\_8>

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.

<ESMA\_QUESTION\_SLMT\_8>

1. 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?

<ESMA\_QUESTION\_SLMT\_9>

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.

<ESMA\_QUESTION\_SLMT\_9>

1. 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.

<ESMA\_QUESTION\_SLMT\_10>

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.

<ESMA\_QUESTION\_SLMT\_10>

1. 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.

<ESMA\_QUESTION\_SLMT\_11>

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.

<ESMA\_QUESTION\_SLMT\_11>

1. 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?

<ESMA\_QUESTION\_SLMT\_12>

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.

<ESMA\_QUESTION\_SLMT\_12>

1. 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?

<ESMA\_QUESTION\_SLMT\_13>

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.

<ESMA\_QUESTION\_SLMT\_13>

1. 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.

<ESMA\_QUESTION\_SLMT\_14>

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.

<ESMA\_QUESTION\_SLMT\_14>

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

<ESMA\_QUESTION\_SLMT\_15>

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.

<ESMA\_QUESTION\_SLMT\_15>

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

<ESMA\_QUESTION\_SLMT\_16>

Yes.

<ESMA\_QUESTION\_SLMT\_16>

1. 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.

<ESMA\_QUESTION\_SLMT\_17>

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.

<ESMA\_QUESTION\_SLMT\_17>

1. 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.

<ESMA\_QUESTION\_SLMT\_18>

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.

<ESMA\_QUESTION\_SLMT\_18>

1. 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?

<ESMA\_QUESTION\_SLMT\_19>

No.

<ESMA\_QUESTION\_SLMT\_19>

1. 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?

<ESMA\_QUESTION\_SLMT\_20>

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.

<ESMA\_QUESTION\_SLMT\_20>

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

<ESMA\_QUESTION\_SLMT\_21>

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.

<ESMA\_QUESTION\_SLMT\_21>

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

<ESMA\_QUESTION\_SLMT\_22>

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.

<ESMA\_QUESTION\_SLMT\_22>

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

<ESMA\_QUESTION\_SLMT\_23>

Subscription fees described above should be included.

<ESMA\_QUESTION\_SLMT\_23>

1. 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?

<ESMA\_QUESTION\_SLMT\_24>

No.

<ESMA\_QUESTION\_SLMT\_24>

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

<ESMA\_QUESTION\_SLMT\_25>

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*.[[1]](#footnote-2)

<ESMA\_QUESTION\_SLMT\_25>

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

<ESMA\_QUESTION\_SLMT\_26>

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’s 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.

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’.[[2]](#footnote-3)

<ESMA\_QUESTION\_SLMT\_26>

1. 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?

<ESMA\_QUESTION\_SLMT\_27>

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’.[[3]](#footnote-4)

<ESMA\_QUESTION\_SLMT\_27>

1. 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.

<ESMA\_QUESTION\_SLMT\_28>

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.

<ESMA\_QUESTION\_SLMT\_28>

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

<ESMA\_QUESTION\_SLMT\_29>

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.

<ESMA\_QUESTION\_SLMT\_29>

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

<ESMA\_QUESTION\_SLMT\_30>

No.

<ESMA\_QUESTION\_SLMT\_30>

1. 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?

<ESMA\_QUESTION\_SLMT\_31>

No.

<ESMA\_QUESTION\_SLMT\_31>

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

<ESMA\_QUESTION\_SLMT\_32>

Yes, but instead of saying anti-dilution levies should be charged to transacting investors **“in the case of a change** in the net capital activityof 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 **in keeping with** 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.

<ESMA\_QUESTION\_SLMT\_32>

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

<ESMA\_QUESTION\_SLMT\_33>

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

<ESMA\_QUESTION\_SLMT\_33>

1. 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.

<ESMA\_QUESTION\_SLMT\_34>

No.

<ESMA\_QUESTION\_SLMT\_34>

1. 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?

<ESMA\_QUESTION\_SLMT\_35>

No.

<ESMA\_QUESTION\_SLMT\_35>

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

<ESMA\_QUESTION\_SLMT\_36>

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.

<ESMA\_QUESTION\_SLMT\_36>

1. Can you think of any characteristics of redemptions in kind?

<ESMA\_QUESTION\_SLMT\_37>

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.

<ESMA\_QUESTION\_SLMT\_37>

1. 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?

<ESMA\_QUESTION\_SLMT\_38>

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.

<ESMA\_QUESTION\_SLMT\_38>

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

<ESMA\_QUESTION\_SLMT\_39>

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.

<ESMA\_QUESTION\_SLMT\_39>

1. 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.

<ESMA\_QUESTION\_SLMT\_40>

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.

<ESMA\_QUESTION\_SLMT\_40>

1. 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.

<ESMA\_QUESTION\_SLMT\_41>

No.

<ESMA\_QUESTION\_SLMT\_41>

1. 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 pocket 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?

<ESMA\_QUESTION\_SLMT\_42>

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.

<ESMA\_QUESTION\_SLMT\_42>

1. 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.

<ESMA\_QUESTION\_SLMT\_43>

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.

<ESMA\_QUESTION\_SLMT\_43>

1. 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?

<ESMA\_QUESTION\_SLMT\_44>

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.

<ESMA\_QUESTION\_SLMT\_44>

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

<ESMA\_QUESTION\_SLMT\_45>

No.

<ESMA\_QUESTION\_SLMT\_45>

1. 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?

<ESMA\_QUESTION\_SLMT\_46>

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.

<ESMA\_QUESTION\_SLMT\_46>

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

<ESMA\_QUESTION\_SLMT\_47>

No.

<ESMA\_QUESTION\_SLMT\_47>

1. <https://www.blackrock.com/corporate/literature/whitepaper/spotlight-swing-pricing-raising-the-bar-september-2021.pdf> [↑](#footnote-ref-2)
2. <https://www.fsb.org/wp-content/uploads/P201223-1.pdf> [↑](#footnote-ref-3)
3. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD682.pdf> [↑](#footnote-ref-4)