16 May 2022

Financial Conduct Authority
12 Endeavour Square
London
E10 1JN

Submitted via email to: **amfpolicy@fca.org.uk**

RE: Protecting investors in authorised funds following the Russian invasion of Ukraine CP 22/8

BlackRock[1] is pleased to have the opportunity to respond to the Consultation Paper "Protecting investors in authorised funds following the Russian invasion of Ukraine" [CP 22/8], issued by the Financial Conduct Authority.

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 Paper and will continue to contribute to the thinking of the FCA 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,

Nicholas Gibson
EMEA Head of Compliance

nicholas.gibson@blackrock.com

Martin Parkes
Managing Director, Global Public Policy Group

martin.parkes@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 encourages the FCA to take a flexible approach to allow AFMs a toolkit of liquidity management tools to be used in the best interests of funds and their investors. As such we believe that it is in investors' interests to include side pockets (both internal and external) alongside existing liquidity management tools, such as suspensions, allowing managers greater choice in tailoring their response to the specific circumstances of the fund and its underlying investments.

BlackRock generally supports the FCA's proposal to permit UK authorised retail funds to create share class side pockets for holding affected investments where this approach would be in the best interests of the relevant funds and their investors. BlackRock also encourages the FCA to consider alternative models such as establishing a new authorised fund (or sub-fund of an umbrella) which would have the same investment objective and policy as the existing fund and to which the non-affected investments would be transferred pursuant to a scheme of arrangement where this approach would be in the best interests of the relevant funds and their investors.

BlackRock also encourages the FCA to consider adopting rules allowing AFMs a wider use of side pockets (both internal and external) in authorised funds as permanent liquidity management tools in exigent circumstances. Equally applicable in the current situation and in similar future scenarios, BlackRock believes the appropriate implementation of such liquidity management tools, alongside existing liquidity management tools, will (i) protect UK authorised retail funds from a disorderly market opening, (ii) will discourage speculation on units in an affected fund; (iii) protect existing investors' interests in affected assets and (iv) permit investors that are unable to hold to affected investments to retain existing holdings in an affected fund.

Responses to questions

1: Do you have any comments on our assessment of the effects of our proposals on existing unitholders? If so, please provide details.

In certain circumstances, BlackRock believes the FCA's proposal for share class side pockets may provide the best outcome for existing unitholders in terms of minimal tax, transaction and other costs at the portfolio level.

We believe the proposals are consistent with the application of section 235(4) of the Financial Services and Markets Act 2000 ("FSMA"), as at the time of the creation of the side pocket class/transfer of affected investments, unitholders can be viewed as exchanging rights in the existing class containing both non-affected investments and affected investments for rights in the existing class and rights in the side pocket class. Additionally, upon the creation of the side pocket class, if the side pocket class is closed/put into winding up, section 235(4) of FSMA should no longer apply to the side pocket class as closed share classes do not necessarily permit / are not available for switching.

In relation to the application of section 236(3) of FSMA, it would be reasonable to read this requirement against the background that, prior to the establishment any side pocket, the affected investments would generally be valued at or near to zero. We note also the existing commentary in PERG 9.6 on the application of section 236(3), which indicates that this condition "should not be applied rigidly in relation to specific events such as particular issues of shares or securities or in relation to particular points in time" (PERG 9.6.3), and that "[s]ome shares or securities may clearly satisfy the condition whereas others may not" (PERG 9.6.4).

Where Russia has been removed from the index tracked by an index fund or from the asset allocation index and/or investment objective and policy of an active fund, without the availability of side pockets as a liquidity management tool, the fund may not have the flexibility to hold the affected investments for a sufficient period of time for the Russia affected investments to recover (either fully or partially). Side pockets can provide an investor with an opportunity to realise some form of recovery (albeit such recovery cannot be guaranteed) even though the timeframe may be uncertain. The alternative approach without side pockets would mean the investor receives a negligible amount / nothing if the affected investments are required to be sold when the local market reopens for trading by foreign investors but where market conditions continue to be impaired.

2: Do you consider our proposals adversely impact any groups with protected characteristics under the Equality Act 2010? Do you consider there are any issues which may be relevant to our obligations under the Equality Act (see paragraph 2.24)? If so, please provide details.

No comment.

3: Do you agree that the proposed unit class structure is a suitable way to create a side pocket in a retail fund? Are there any improvements that could be made to it?

BlackRock generally agrees that the proposed unit class structure is a suitable way to create a side pocket in a retail fund.

4: Do you agree that the proposed side pocket class could operate without causing prejudice to the interests of other investors in the fund?

BlackRock believes that in certain circumstances, the proposed side pocket class may provide the best outcome to both existing and new investors as it (i) permits the realisation of the affected assets in an orderly and managed way; (ii) protects existing investors' interests in the affected investments and avoids the dilution of those interests due to subscriptions by new investors into the fund; (iii) avoids speculation in the affected fund's units; (iv) preserves the ability of existing investors who suffered losses when the affected investments were written down to fully participate in any recovery of value; and (v) allows new investors to purchase units in the fund without exposure to the affected investments as well as providing a possible exit for existing investors who wish to continue to hold units in the affected fund without exposure to the affected investments.

5: Do you have any comments on the side pocket model set out above? Should the FCA take steps to enable AFMs of funds holding affected investments to use this alternative model?

Under certain circumstances, BlackRock believes that the side pocket 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. In other circumstances, however, a new authorised fund (or a sub-fund of an umbrella) may provide the best investor outcome and BlackRock encourages the FCA to take a flexible approach, similar to the approach taken by other regulators, to allow AFM's a range of options to be used as liquidity management tools.

BlackRock also encourages the FCA to consider adopting permanent rules allowing AFMs the wider use of side pockets (both internal and external) in authorised funds as permanent liquidity management tools (alongside existing liquidity management tools such as suspensions) for use by AFMs in other exigent situations where such approach is in the best interests of the fund and its investors.

See also response to question 4.

6: Do you agree with our proposals to define the scope of affected investments? If not, which other assets would you allow to be included in a side pocket (or require to be excluded) and why?

BlackRock generally agrees with the proposed scope of affected investments but suggests expanding the definition to include situations where an investment is impacted by an impairment of normal market conditions.

7: Do you agree with our proposed conditions for creating a side pocket class? If not, what conditions do you think should apply to the creation of a side pocket class and why?

BlackRock generally agrees with the proposed conditions for creating a side pocket class and would not seek to add any further conditions.

8: Do you agree that the AFM's governing body should be required to consider the matters set out above before deciding whether to approve the creation of a side pocket unit class? Are there any other matters the governing body should consider?

No comment.

9: Do you agree with our approach to amending the instrument constituting the fund and the prospectus? If not, what alternative approach would you recommend?

BlackRock generally agrees with the approach to amending the instrument constituting the fund and the prospectus. We would welcome the development of a fast-track approval process by the Fund Authorisations team for the review and approval of changes to the scheme documents required to effect the implementation of the side pockets.

10: Do you agree with our proposal to dispense with holding a unitholder meeting to approve the side pocket? If not, what benefit do you think holding a meeting would provide for unitholders in the current situation?

BlackRock generally agrees with the proposal to dispense with holding a unitholder meeting to approve the side pocket as such a meeting would incur avoidable expense and create further delays and thus would not be in the overall best interests of the unitholders given the current exigent circumstances.

11: Do you agree with our proposals for AFMs to notify investors about the creation of the side pocket? If not, what steps should the AFM be required to take?

BlackRock generally agrees with the proposal that if the AFM determines the creation of the side pocket classes should be treated as a significant change, the requirement under COLL 4.3.6R (3) should be disapplied and that the AFM should be given the flexibility to inform unitholders in a timely fashion either in advance or after the change has been implemented.

See also response to question 10.

12: Do you agree that AFMs should decide the best way of issuing units in new classes so that holdings are proportionate to the existing classes? If not, what alternative approach would you suggest?

BlackRock generally agrees with the proposal that the AFM should have the flexibility to decide the best way of issuing units in the new classes so that holdings in the side pockets are proportionate to existing holdings.

BlackRock notes that the FCA has suggested that it will be for the AFM to determine the mechanics of the unit issuance and the unit class structure for side pockets and BlackRock suggests it would be helpful for the FCA to include clarifications within COLL as to whether any existing distributing classes would need to be replicated as side pocket classes and for such side pocket classes to make on-going periodic distributions or if such distribution requirements may be curtailed or terminated.

13: Do you have any comments on how income property and capital property should be allocated to a side pocket class? What are your views on the allocation of uninvested capital cash and its use to carry out hedging transactions?

BlackRock generally agrees with the proposal that the AFM should have the flexibility to determine whether to allocate a portion of uninvested cash to cover costs and charges and whether to undertake derivative transactions attributable to only to the side pocket class, in order to hedge foreign currency exposures to the fund's base currency.

14: Do you agree with the proposed guidance on how costs and charges should be allocated where a side pocket class is created?

BlackRock generally agrees that a side pocket class should bear a proportionate share of the costs which arise and are incurred for the benefit of all unitholders, such as depositary expenses and fees, audit fees, and regulatory charges and generally agrees with the proposed guidance that the AFM should have flexibility in determining the best accounting for such expenses. BlackRock suggests that for clarity the list of costs and charges should include transaction-related costs from disposing of the affected investments.

See also response to question 24.

15: Do you agree that an AFM should not charge preliminary or exit fees, or a performance fee, when managing a side pocket class?

BlackRock generally agrees that an AFM should not charge preliminary or exit fees, or a performance fee, when managing a side pocket class.

16: Do you agree that our proposed rules and guidance will ensure unitholders receive adequate and timely information about the side pocket class structure? If not, what further steps should firms take to meet investors' information needs?

BlackRock generally agrees that the proposed rules and guidance will ensure unitholders receive adequate and timely information about the side pocket class structure.

17: Do you agree that the FCA should publish consumer-facing material to explain the use of side pockets? If so, what matters should it cover?

BlackRock agrees that the FCA should publish consumer-facing materials to cover the use of side pockets and include sufficient detail in plain language as to be helpful to investors and their advisors.

18: Do you agree that AFMs should be allowed to decide how to manage the transition process? Are there any other investor protection issues arising from the process of setting up a side pocket class, that we should address in rules or guidance?

BlackRock generally agrees that AFMs should be allowed to decide how to manage the transition process.

19: Do you have any comments on the implications of creating a side pocket for ISA managers and for investors holding units in an ISA?

No comment.

20: Do you have any comments on the implications of creating a side pocket for firms giving financial advice?

No comment.

21: Do you have any comments on the implications of creating a side pocket for platform service providers and other firms involved in fund distribution?

No comment.

22: Do you have any comments on the implications of creating a side pocket for providers of unit-linked life funds and for policyholders of those funds?

BlackRock believes that it is important for unit-linked funds to have the ability to use side pockets for the same reasons as authorised funds.

23: Do you have any comments on the implications of creating a side pocket for SIPP providers and for consumers holding fund investments in a SIPP?

No comment.

24: Do you agree that the AFM should continue to apply the assessment of value rules to side pocket classes?

BlackRock generally agrees that AFMs should continue to apply the assessment of value rules to side pocket classes and would appreciate the FCA providing clarification in COLL 6.6.21R that AFMs have the flexibility to carry out the assessment separately from the assessment of value on the rest of the fund. The assessment of value reporting could include disclosure on the proportionate share of costs allocated to the side pocket classes which are incurred for the benefit of all unitholders, specific costs of managing the side pocket classes as well as an on-going cost/benefit analysis of the side pocket affected investments.

25: Do you agree with our proposed rules and guidance on how investment and borrowing powers should apply to a fund with a side pocket class?

BlackRock generally agrees with the proposed rules and guidance on how investment and borrowing powers should apply to a fund with a side pocket class.

26: Do you have any comments on the process for valuing and pricing a fund with a side pocket class?

BlackRock generally agrees with the process for valuing and pricing a fund with a side pocket class and the flexibility to determine the appropriate valuation frequency.

27: Do you agree with our proposal to allow AFMs to choose whether to offer redemptions at zero / minimal value or to suspend dealing in units of the side pocket class? If not, what approach to redemption would you suggest?

BlackRock generally agrees with the proposal to allow AFM the flexibility to choose whether to offer redemptions at zero / minimal value or to suspend dealing in units of the side pocket class.

28: Do you agree that AFMs should decide the extent to which transfers of side pocket units to third parties may be allowed? If not, what approach would you recommend and why?

BlackRock generally agrees with the proposal to allow AFM the flexibility to decide the extent to which, if any, transfers of side pocket units to third parties may be allowed.

29: Do you agree that AFMs should be able to offer unitholders a choice of ways of exiting the class if future circumstances allow? Are the options described above appropriate and are there other options that could be offered?

BlackRock generally agrees with the proposal that AFMs should be able to offer unitholders a choice of ways of exiting the class if future circumstances allow. BlackRock generally agrees that AFM's require the flexibility to develop their plans in response to events as they unfold and should not be constrained from offering unitholders any particular option as and when such options materialise.

30: Are the information needs of investors over the life of the side pocket class adequately met by existing rules and guidance? Are there any other steps that AFMs or other firms should take to keep investors informed?

BlackRock agrees that AFMs should consider how best to provide sufficient regular and detailed communications to unitholders in side pocket classes and appreciates the FCA giving AFMs the flexibility to provide the information through various channels (direct communications, publishing on websites, etc) as the AFM's deem appropriate.

31: Are there any other matters not covered in this consultation, that the FCA should consider in making rules and guidance to allow side pocket unit classes?

No comment.

32: Do you have any comments on our cost benefit analysis?

No comment.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Consultation Paper and will continue to work with the FCA on any specific issues which may assist in the ongoing review of the proposals to permit side pockets in UK authorised retail funds that have affected investments (as defined in the Consultation Paper).