

4th September 2023

**Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland**

Submitted via email to: fsb@fsb.org

RE: Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB’s 2017 Policy Recommendations: Consultation report

BlackRock¹ is pleased to have the opportunity to respond to the Financial Stability Board’s consultation, *Addressing Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds – Revisions to the FSB’s 2017 Policy Recommendations*.

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 Financial Stability Board 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,

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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

We strongly support the liquidity risk management principles embedded in the fund categories proposed by the Financial Stability Board (FSB). The proposals recognise that fund structures, dealing terms, and the range of liquidity management tools (LMTs) used – including anti-dilution mechanisms – should reflect the tradability, liquidity, and trading costs of underlying fund assets.

We also broadly agree with the FSB's definition of 'liquid' assets as those that are readily convertible into cash without significant market impact in all market conditions. Similarly, we recognise that other assets may be readily convertible into cash with discounts (reflecting trading and liquidity costs) in certain market conditions – i.e. those defined by the FSB as 'less liquid'.

We therefore support the principle set out by the FSB that funds mostly invested in 'liquid' assets should be able to offer daily dealing, and those with significant investments in assets defined by the FSB as 'less liquid' should continue to offer daily dealing provided they can incorporate appropriate anti-dilution tools. Our response to [IOSCO](#) discusses the use of these tools in more detail.

However, **we have concerns that the proposed thresholds-based approach to classification could lead to adverse incentives or mis-categorisation of funds** as market conditions change, particularly with respect to the 'liquid' and 'less liquid' categories. There are two observations underpinning these concerns.

First, **assets captured in the 'liquid' and 'less liquid' categories exist on a spectrum of liquidity costs, and it is plausible that assets within both categories could see spikes in these costs as market conditions vary** (see examples in Annex). It is difficult to *a priori* distinguish assets that are 'readily convertible into cash without significant market impact in normal and stressed market conditions' from those where this is 'contingent on market conditions.'

Second, fund portfolios often contain a range of asset classes (for example multi-asset funds made up of equities, bonds, and other assets), or a range of assets within an asset class (for example mixed bond funds containing both sovereign and corporate bonds). Similarly funds that primarily hold 'liquid' assets may also make a certain allocation to 'illiquid' assets depending on fund mandates and regulatory requirements. **The share of a portfolio that a given type of asset represents may vary with market conditions, creating a risk that classification of funds based on hard thresholds will be unstable.**

In turn, **if hard thresholds are used to trigger different requirements with respect to the use of anti-dilution tools, and possibly other measures such as notice periods, there is a risk of adverse incentives being created** as the portfolio composition approaches the thresholds.

We therefore recommend that the FSB consider defining a global baseline standard of two broad fund categories: 'liquid' and 'illiquid'. In principle, 'liquid' funds should be permitted to use daily dealing and operationally prepared to use anti-dilution tools as appropriate; and 'illiquid' funds should have less frequent or longer dealing, notice, or settlement periods. Instead of hard-coding thresholds into regulation, the principles underpinning each category should be embedded in local regulatory frameworks. Since a variety of approaches to liquidity classification and liquidity risk management already exist across different jurisdictions, and existing definitions do not necessarily align with the FSB's proposed definitions, **we recommend that the final FSB**

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Recommendations are principles-based and made sufficiently flexible to allow existing local rulebooks to adapt to them.

In our view, **the first consideration for determining fund structures and dealing terms should be the frequency with which underlying assets trade. If assets trade daily, there is no liquidity mismatch for daily-dealing open-ended funds (OEFs).** This creates a clear and consistent distinction between assets in the ‘illiquid’ category and those in the ‘liquid’ or ‘less liquid’ categories proposed by the FSB.

That said, it is critical that funds offering daily dealing while investing in ‘less liquid’ assets (as defined by the FSB) have mechanisms in place to impose variable liquidity costs on investors and to mitigate potential first-mover advantage. **We recommend that all funds within the revised ‘liquid’ category incorporate at least one suitable anti-dilution tool**, and that managers are operationally prepared to deploy them to offset any material dilution.² **The set of tools available to managers will be shaped by local jurisdictional and ecosystem characteristics, for example in the US and Japan**, where fund distribution architectures constrain which tools can feasibly be implemented by managers, and how they are used. We welcome efforts to ensure managers have access to as broad a tool kit as possible.

Since the universe of OEFs is highly heterogenous, we believe **fund managers are best placed to make judgements about the liquidity of underlying assets, liquidity of the overall portfolio, and how funds should be structured.** There are a range of factors managers need to account for when determining which liquidity management (or anti-dilution) tools a fund should use. The FSB has rightly identified some of these as market depth and turnover, days to trade, efficiency and effectiveness of the price mechanism, price impact of large transactions, operational features and potential frictions, and valuation certainty. **Managers should be prepared to justify their judgements and to be challenged by their local supervisors.**

More generally, a principle we see underlying all of the FSB’s proposals is that financial stability is enhanced when OEF investors are able to buy and sell assets on the same terms as investors holding those assets directly – they should be no better or worse off in terms of trading costs or the time it takes to transact in an asset. The principle of equal treatment of investors is also a core tenet of investor protection, and, we believe, demonstrates that **enhancing OEF investor protection and enhancing financial stability are complementary objectives.**

We therefore **recommend that the FSB makes clear in its Recommendations that any policies that undermine OEF investor interests and protection are likely to in turn undermine financial stability objectives**, and that as policymakers look to enhance the use of liquidity management tools, investor protection should remain paramount.

Consideration of mandatory cash buffers demonstrates this principle: such measures would be discriminatory, both between investors in an OEF and versus investors using other investment vehicles. Relying on cash buffers to meet redemptions means that investors who ‘move first’ will not bear any liquidity risks, at the cost of remaining investors. This undermines investor protection by negating the principle of equal treatment of investors. And as the FSB suggests, cash buffers increase first-mover

² As noted in our response to IOSCO, we define ‘market impact’ as the level of costs imposed on the fund by transacting investors which, if not borne by those investors, change the incentives faced by other investors in the fund. The degree of acceptable dilution this implies will vary with the type of assets held by the fund, the typical bid/ask spread, its investment strategy, whether investors in the fund are retail or institutional, and market conditions. We believe the manager is best placed to determine this level for each fund as part of its normal governance process.

advantage within the fund, creating incentives to ‘run’ that do not otherwise exist, and therefore risk undermining financial stability.

Finally, **we recommend that the FSB’s revised Recommendations acknowledge the fact that market-wide outcomes – i.e., financial stability – cannot be delivered by focusing on individual entities or product types, such as OEFs, in isolation.** Prevailing market dynamics are, by definition, a product of the interaction between all market participants – encompassing the full range of asset owners, intermediaries, investment vehicles (direct investors, separate accounts, other funds and structured products), and market infrastructures.

The ability of markets to weather future crises depends on broad-based action that builds market resilience, and will not be enhanced if policy focuses solely on the functioning of OEFs. We therefore welcome the workstreams led by the FSB that look to develop a systemic, ecosystem-wide understanding of the non-bank system; and on the role intermediaries, market structure, and transparency have on the functioning of core fixed income markets. A holistic perspective on all of these issues is critical to enhancing financial stability.³

Responses to questions

1. Should “normal” and “stressed” market conditions be further described to facilitate the application of the bucketing approach? If yes, how would you propose describing such conditions?

We believe it is difficult to precisely specify ‘normal’ and ‘stressed’ market conditions. Transaction costs can vary in ‘normal’ market conditions for a variety of reasons: macro-economic news; changes in Central Bank overnight interest rates; the expected level of corporate defaults; and the level of inventory which dealers hold in over-the-counter (OTC) markets versus their desired level. The level of this ‘normal’ variance in costs differs by asset class and country, making it difficult to define a simple measure that coherently distinguishes normal and stressed conditions across all markets. And while, as noted in Question 2, there are a range of quantitative and qualitative factors that can be used holistically to assess asset liquidity – it is difficult to identify a specific threshold for any of them that could point to a ‘stressed’ market.

Rather, we think of market liquidity at any given time as being one point on a potentially wide spectrum of conditions. The Annex to this letter provides some evidence that this is as true for some of the most liquid markets, such as government bonds and large cap equities, as it is for corporate bonds. As such, we do not believe additional descriptions would be helpful for the ‘bucketing’ approach.

In our view, this set of Recommendations should aim to ensure fund managers and their supervisory authorities are focused on the principle that OEF liquidity risk management practises ensure each OEF is structured and managed appropriately with respect to the full spectrum of market conditions for assets in its portfolio.

2. Are the examples of the factors that should be considered in determining whether assets are liquid, less liquid or illiquid appropriate? Are there other factors which should be considered and, if yes, which ones and why?

³ For further discussion see our [Policy Spotlight: A holistic approach to bond market resilience](#).

Yes. The first consideration for aligning fund structures and dealing terms with portfolio liquidity should be the frequency with which underlying assets trade. Assets that trade daily ('liquid' and 'less liquid' in the FSB's categories) exist on a spectrum of liquidity costs, and judgements about liquidity are informed by a range of quantitative and qualitative factors. The FSB has rightly identified some of these as market depth and turnover, days to trade, efficiency and effectiveness of price mechanism, price impact of large transactions, operational features & potential frictions, and valuation certainty.

This is not an exhaustive list, however, and there are several other factors that can help to supplement judgements. For example, in some fixed income markets, daily volumes can have high variance, meaning Average Daily Volume (ADV) metrics represent a conservative or lower-bound estimate of what is tradable. This can be supplemented by daily posted inventory volumes ('dealer axes') to distinguish between the volume that typically trades and the volume that is tradable in the market, subject to variation in transaction costs.

The range of factors that need to be considered for each individual fund will vary significantly according to its portfolio, and the characteristics of underlying assets.⁴ Since the universe of OEFs is highly heterogenous, we believe fund managers are best placed to make judgements about the liquidity of underlying assets and of the overall portfolio – and should be challenged on these judgements by their local supervisors.

3. Is the use of specific thresholds an appropriate way to implement the bucketing approach? If yes, are the proposed thresholds for defining funds that invest mainly (i.e., more than 50%) in liquid or less liquid assets and funds that allocate a significant proportion (i.e., 30% or more) of their assets to illiquid assets appropriate? If not, which thresholds would be more appropriate and why?

We strongly support the principle that fund structures, dealing terms, and the range of liquidity management tools used – including anti-dilution mechanisms – should reflect the tradability, liquidity, and trading costs of underlying fund assets. However, we are concerned that in practise the use of hard thresholds in this 'bucketing' approach could lead to adverse effects or mis-categorisation of funds as market conditions change.

As noted above, frequently traded assets (those defined as 'liquid' and 'less liquid' by the FSB) exist on a spectrum of liquidity and transaction costs. Assets that trade with typically low liquidity costs can experience variation in those costs as market conditions change (see Annex). It is therefore difficult to *a priori* distinguish assets that are 'readily convertible into cash without significant market impact in normal and stressed market conditions' from those where this is 'contingent on market conditions.' Liquidity of all frequently traded assets is contingent on market conditions. Similarly, the share of a portfolio a given asset represents will vary as valuations change with market conditions.

This means the classification of assets and funds into Category 1 and Category 3, and the thresholds used to determine this (>50% in 'liquid' and 'less liquid' assets respectively), is likely to be unstable. If hard thresholds are used to trigger different

⁴ For example, some types of asset-backed securities are traded on a daily basis, but require investors to gather quotes over the course of a few days beforehand. These securities are therefore liquid enough to be held in a daily-dealing fund, but such funds should consider incorporating notice periods to allow the time needed to prepare trades.

requirements with respect to the use of anti-dilution tools, and possibly other measures such as notice periods, there is a risk of adverse incentives being created as the portfolio approaches this threshold.

There is also a scenario in which a fund invests in 'illiquid' assets, either directly or through a fund-of-funds structure, with a target allocation of <30%. With the thresholds proposed, this would qualify the fund for either Category 1 ('liquid') or 3 ('less liquid'). Again, there is a risk that the liquid segment of the fund's portfolio falls in value and pushes the illiquid portion over the threshold – creating similar adverse incentives.

To mitigate these risks, we recommend the FSB revise its proposals to include just two fund categories: 'liquid' and 'illiquid', distinguished by tradability of fund assets. If assets trade daily, there is no liquidity mismatch for daily-dealing OEFs. As such, 'liquid' funds should be permitted to use daily dealing; 'illiquid' funds should have less frequent or longer dealing, notice, and settlement periods.

For the revised 'liquid' category, funds will need a suitable mechanism in place to impose variable liquidity costs on transacting investors, and to mitigate potential first-mover advantage where there is risk of material dilution. We recommend that *all* funds within this category incorporate a suitable anti-dilution tool, and that managers should be operationally prepared to deploy them, as appropriate, to offset these risks. When overseeing the use of tools, local regulators should consider the characteristics of individual funds, market structure of underlying assets, and jurisdiction-specific considerations such as distribution infrastructure and data availability.

Further, managers intending to hold illiquid assets in an otherwise majority 'liquid' fund should have in place price-based and quantity-based controls to manage risks in scenarios where market fluctuations change the composition of a portfolio, and clearly disclose their intent to use the tools in this type of scenario.

Instead of hard-coding thresholds into regulation, we recommend embedding the liquidity management principles underpinning each category in regulatory frameworks, that fund managers adopt them as appropriate, and are prepared to justify their fund structuring and liquidity risk management decisions to their local supervisors, in accordance with any local liquidity risk management regulations. The choice of tools available to managers will be driven by characteristics of the local ecosystem – for example in the US and Japan, where fund distribution architectures constrain which tools can feasibly be implemented by managers. We welcome efforts to ensure managers have access to as broad a tool kit as possible.

- 4. Should the FSB consider recommending the use of a decreased redemption frequency (on a standalone basis), a longer notice period (on a standalone basis) or a longer settlement period (on a standalone basis) for OEFs investing in less liquid assets that do not meet the expectation on the implementation of anti-dilution LMTs? Or should these measures be used in combination, considering the risk of redemptions crowding around certain dates?**
- 5. Would additional guidance on factors to consider when setting the redemption frequency or notice or settlement period be helpful? If yes, in what respect?**

Questions 4 and 5 are answered together here.

For the reasons outlined above, we encourage the greatest possible flexibility in determining how liquidity management tools, anti-dilution tools, and fund structures are combined with one another. The appropriate combination will vary for each fund, depending on specific characteristics and market structure of its underlying assets – which in turn determines their liquidity and tradability.

However, additional guidance on setting redemption, notice, and settlement periods would be helpful. **In our view, fund redemption frequencies should be informed by how frequently underlying assets can be traded; while notice periods should reflect the planning and preparation needed to transact in underlying assets. If assets trade daily, there is no liquidity mismatch for daily-dealing OEFs.**

It is not necessarily the case that funds with longer notice periods should deal on a less frequent basis. For example, some types of asset-backed securities (ABS) are traded daily, and therefore funds investing in ABS can offer daily dealing. However, trading in these types of ABS requires portfolio managers to gather quotes over the course of a few days before the relevant dealing point. Notice periods give time for this process to take place, and would be an appropriate way of structuring the fund.

Similarly, managers of daily dealing funds can and do make provisions to accommodate disruption to trading in their funds' underlying assets. Many fund prospectuses give managers the right to temporarily cease dealing in fund shares in certain circumstances. This could include unexpected disruptions to markets from extreme weather events, or public or religious holidays. This illustrates the broader principle that fund redemption terms should reflect the frequency with which assets trade, but with flexibility to accommodate specific market characteristics.

6. Do the proposed changes to Recommendations 4 and 5, when read together with the proposed IOSCO guidance on anti-dilution LMTs, help achieve greater use and a more consistent approach to the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?

We agree that taken together the Recommendations and IOSCO guidance represent a valuable step forward in raising the bar in the use and operation of liquidity management tools. Our [response](#) to IOSCO's consultation provides further commentary.

7. Are there any obstacles (either universal or jurisdiction specific) to the implementation of the revised FSB Recommendations on the use of anti-dilution LMTs? If yes, what additional recommendations or guidance would help address such obstacles?

Yes. Our [response](#) to IOSCO's consultation provides more detail.

8. Would additional recommendations or guidance be helpful in clarifying the expectation that OEF managers have internal systems, procedures and controls enabling them to use anti-dilution LMTs as part of the OEFs' day-to-day liquidity risk management?

Yes. Our [response](#) to IOSCO's consultation provides more detail.

9. Do you agree with applying anti-dilution LMTs to subscribing investors as well as to redeeming investors? If not, why?

Yes. Liquidity costs can be incurred for both buy and sell transactions, and there is a risk of dilution regardless of the direction of net flows.

10. Would additional international guidance on the availability and use of quantity-based LMTs be useful? If yes, what aspects should such guidance focus on? If not, why?

Managers can be further assisted through standards, best practices, and guidance that promote high-quality application of LMTs. Such guidance could outline the characteristics of the LMTs, the corresponding liquidity risks they mitigate, and example scenarios for their use without seeking to restrict their use to specific asset classes, fund types, or market conditions.⁵

The primary responsibility to activate or de-activate an LMT is best placed with the fund manager or fund board. Managers are responsible for ex-ante and ongoing liquidity risk management; and have the most detailed and up-to-date information on a fund's investor base, portfolio composition, redemption and subscription activity, and market conditions for underlying assets. As part of their fiduciary duty, they are required to activate LMTs in line with investors' best interests.

Regulators, meanwhile, are responsible for making detailed assessments of LMTs at the fund authorization phase and on an ongoing basis, ensuring the full range of LMTs are available in local rulebooks, and ensuring managers are operationally prepared to use LMTs.⁶ They may also look to encourage activation of LMTs by fund managers where investor protection is at risk and/or in stressed markets.

11. Do the proposed changes to Recommendation 2, when read together with the proposed IOSCO guidance on disclosure to investors, help enhance disclosure to investors on the use of anti-dilution LMTs? If not, what changes should be proposed to the FSB Recommendations?

Yes. Our response to IOSCO's consultation provides more detail.

12. Should any other 2017 FSB Recommendations (Recommendations 1, 6, 7 or 9) be amended to enhance the clarity and specificity of the intended policy outcomes? If yes, which ones and why?

13. Are there any other aspects that should be considered in the revised FSB Recommendations to ensure that they are effective from a financial stability perspective?

Questions 12 and 13 are answered together here.

⁵ Our [Policy Spotlight: A European perspective on managing liquidity risk in investment funds](#) discusses a range of liquidity management tools, scenarios in which fund managers may deploy them, and the role regulation and regulators can play in enhancing their use.

⁶ As an example, in many jurisdictions, the use of 'side-pockets' is not allowed. With appropriate guidelines the wider use of side-pockets could contribute to financial stability by allowing funds holding assets which have become illiquid (due to changing market conditions) to side-pocket these assets, allowing them to continue to provide the fund's standard liquidity terms on the remaining assets. Without this ability many managers are likely to face a decision to suspend dealing in the fund. The recent allowance by several NCAs to allow side-pocketing of sanctioned Russian assets showed the value of this approach in allowing investors access to the remainder of the fund's liquid assets.

Footnote 18 of the FSB’s consultation paper discusses the possibility of cash or liquid asset buffers for OEFs. We strongly agree that such buffers would generate unintended consequences. As the FSB suggests, rather than contributing to fund resilience, cash buffers increase first-mover advantage *within funds* and create incentives to ‘run’ that do not otherwise exist.⁷

We also believe that proposals to impose cash buffers conflict with the objectives of the FSB’s revised Recommendations 3, 4, and 5. The FSB notes that revisions to Recommendation 3 look to “*provide greater clarity on the redemption terms that OEFs could offer to investors, based on the liquidity of their asset holdings*”. Revisions to Recommendations 4 and 5 aim to “*mitigate potential first-mover advantage arising from structural liquidity mismatch in OEFs by imposing on investors the costs of liquidity associated with fund redemptions and subscriptions ... anti-dilution LMTs should impose on redeeming and subscribing investors the explicit and implicit costs of redemptions and subscriptions, including any significant market impact of asset sales and purchases to meet those redemptions and subscriptions*”.

The implication of these statements is that financial stability is enhanced by ensuring investors in OEFs bear equivalent liquidity costs to an investor holding the same assets directly. It is therefore right that FSB and IOSCO are focused on ensuring the availability and operationalization of anti-dilution tools, which improve both investor protection (by preventing the actions of one set of investors leading to adverse impacts on another) and enhance financial stability (by negating first-mover advantage *within funds* and thereby negating any incentive to ‘run’ and take advantage of lower transaction costs).

Cash buffers, by contrast, are discriminatory: they create potential conflicts between sets of investors in an OEF and create an uneven playing field compared with investors using other investment vehicles. They would undermine both investor protection (by negating the principle of equal treatment of investors holding an equity stake in fund assets) and financial stability (by increasing incentives to ‘run’ and take advantage of redemptions being met from cash balances).

This illustrates the principle that enhancing OEF investor protection and enhancing financial stability are *complementary objectives*. We therefore recommend that the FSB makes clear in its Recommendations that any policies that undermine OEF investor interests and protection are likely to in turn undermine financial stability objectives, and that as policymakers look to enhance the use of liquidity management tools, investor protection should remain paramount.

Relatedly, it is important to recognize that prevailing market dynamics are, by definition, a product of the interaction between all market participants – encompassing the full range of asset owners, intermediaries, investment vehicles (direct investors, separate accounts, other funds and structured products), and market infrastructures. The ability of markets to weather future crises depends on broad-based action that builds market resilience and will not be enhanced if policy focuses solely on functioning of OEFs. Some other areas that should be addressed include:

⁷ Fund investors hold a redeemable equity stake in all of the funds’ assets, both cash and securities. To ensure all investors are treated fairly, fund managers generally aim to meet redemptions on a pro-rata or risk-constant basis by selling over time a representative ‘slice’ of portfolio assets. Relying on cash buffers to meet redemptions means that investors who ‘move first’ will not bear any liquidity risks, and receive their stake in the fund in cash, leaving an overall less liquid portfolio for other investors. There is also no guarantee that any buffer will be sufficient to prevent funds from having to sell securities onto the secondary market.

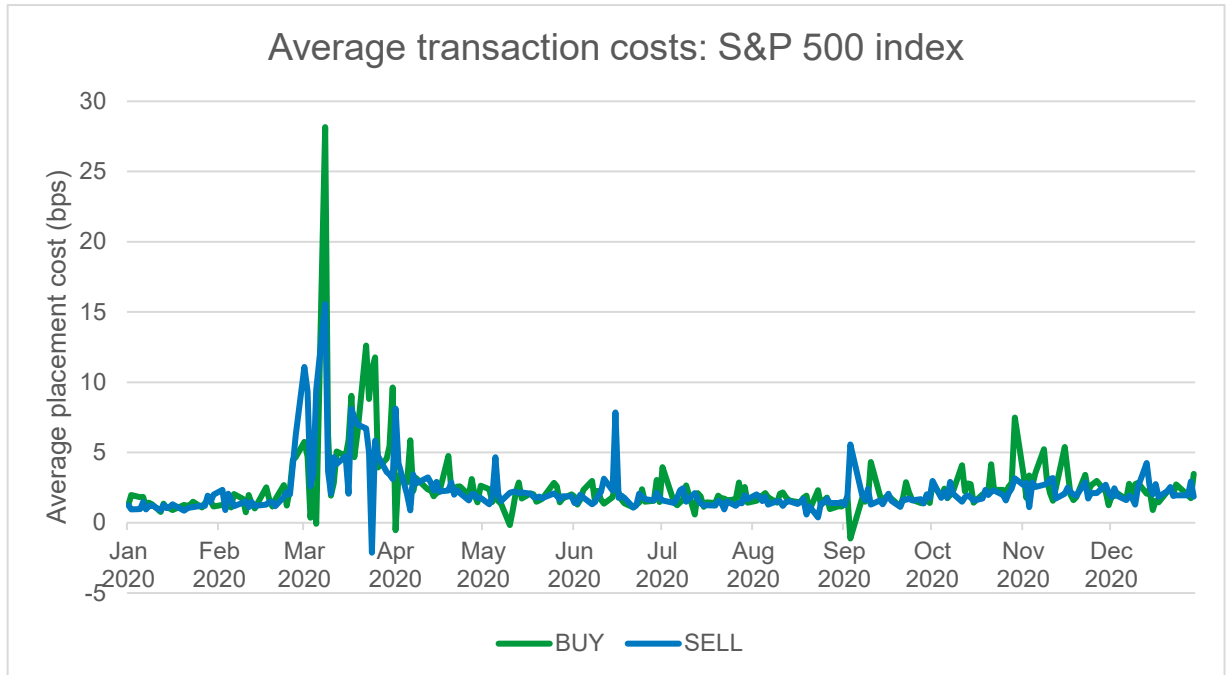
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- Closing persistent data gaps on portfolios and trading activity for vehicles other than open-ended funds;
- Recognizing the critical role that intermediaries, market structure, and transparency have in market resilience and financial stability;
- Facilitating access to information and resources, such as consolidated tapes of pre- and post-trade data – which enhance market transparency and efficiency.

The FSB has several workstreams that seek to address these issues – including efforts to develop a systemic, ecosystem-wide understanding of the non-bank system; and others on the functioning of core fixed income markets. We recommend that the FSB’s revised Recommendations acknowledge the fact that market-wide outcomes – i.e., financial stability – cannot be delivered by focusing on individual entities or product types, such as OEFs, in isolation.

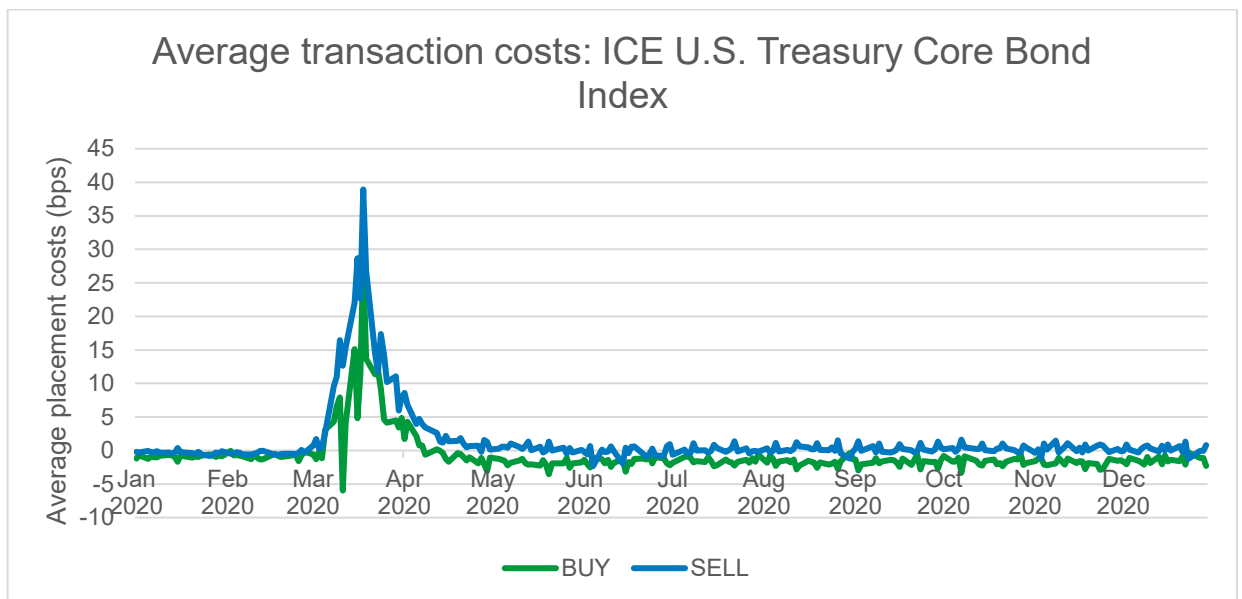
Annex: Transaction costs for liquid assets

Transaction costs for US equities



Source: BlackRock S&P, Thomson Reuters. Data shown is for BlackRock trades executed within 1-min of placement (approximately 230,000 trades over the course of 2020).

Transaction costs for US Treasuries



Source: BlackRock, ICE, IDC. Data shown is for BlackRock trades executed within 1-min of placement (approximately 70,000 trades over the course of 2020).

4th September 2023

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RE: Guidance for effective implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes

BlackRock¹ is pleased to have the opportunity to respond to the International Organisation of Securities Commissions' (IOSCO) consultation report on its guidance for the use of anti-dilution liquidity management tools.

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 report and will continue to contribute to the thinking of IOSCO on any issues that may assist in the outcome.

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

Yours faithfully,

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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

Robust liquidity risk management has always been a critical part of investment managers' fiduciary duty to their investors. This includes consideration of the risk that an investor's holdings could potentially be diluted by explicit or implicit trading costs generated by subscription or redemption requests, or that there may be difficulty in accurately valuing assets in challenging market conditions, and even trading them at all.

As discussed in our [response](#) to the FSB's Consultation Report on structural liquidity mismatch in open-ended funds, we believe that **all funds investing in assets that have variable liquidity costs while offering daily dealing should incorporate at least one suitable anti-dilution tool** into their liquidity risk management processes and be operationally prepared to deploy them when necessary.

As such, **we welcome the efforts of the FSB and IOSCO to ensure there is greater availability and uptake of a broad range of liquidity risk management tools (LMTs), particularly anti-dilution LMTs.** Increasing the availability and appropriate use of these tools will strengthen funds' liquidity risk management in all market conditions and address any 'first mover advantage' that may arise within open-ended fund (OEF) structures.²

We welcome IOSCO's recognition that **the choice of anti-dilution tool for a fund and whether it should be used are decisions best taken by investment managers.** Investment managers and fund boards possess the most detailed and up-to-date information on, and experience of, their funds, market conditions, and investor behaviour, in order to determine whether and which anti-dilution LMT should be deployed.

Indeed, **the set of tools available to managers will also be driven by local jurisdictional and ecosystem characteristics,** for example in the US and Japan, where fund distribution architectures constrain the set of tools that can feasibly be implemented by managers, and how they are used.

Deployment of anti-dilution tools should be further based on the investment manager's assessment of whether there is a risk of material dilution as a result of dealing activity. We view material dilution as the level of costs imposed on the fund by transacting investors which, if not borne by those investors, would materially change the incentives of other investors to remain invested or deal in fund shares.

The degree of acceptable dilution this implies will vary with the type of assets held by the fund, the typical bid/ask spread, its investment strategy, whether investors in the fund are retail or institutional, market conditions, and potentially other idiosyncratic factors that may be identified by the investment manager. We therefore believe that the investment manager is best placed to determine when to institute the application of a LMT for a fund as part of its normal governance and liquidity management processes.

Determining material dilution requires investment managers to make a judgment of the cost of liquidity – including likely market impact – based on the data available to them. It is important to note that **even with all reasonable efforts made, assessments of dilution, liquidity costs, and market impact are influenced by data availability,**

² While it is acknowledged that the use of anti-dilution LMTs can address the 'first mover advantage' in fund structures, they should not, and cannot be used to change opportunistic or pre-emptive positioning by investors to take advantage of changing market conditions, which we see as a broader first mover advantage in markets.

and may involve judgement. In certain jurisdictions such as the US and Japan there are significant regulatory or business practice barriers to accessing certain types of data, in particular the availability of same-day fund flow data – which is a function of the characteristics of the fund ecosystem in these jurisdictions. The ability to estimate liquidity costs with a high level of confidence will be influenced by these characteristics.

Local regulators should be cognisant of this challenge when interpreting the proposed Guidance, and make efforts to coordinate with all relevant market participants to assess which toolkit or sub-set of tools is appropriate for any given jurisdiction. **Regulators should also consider building in protections and flexibility into their respective regulatory regimes for investment managers and fund boards making and overseeing the determination of these estimates.**

Finally, we agree that strong governance processes should be in place to ensure effective liquidity risk management of open-ended funds, and recommend that managers be granted the discretion to structure the governance elements outlined in the Consultation Report in a way that is appropriate to their business. Each investment manager is structured differently, and individual funds vary in their size and complexity and legal structure; as such, a 'one-size fits all' approach is likely to be inappropriate.

Responses to questions

Proposed Guidance 1 – Overall Framework

- 1. To what extent does the proposed guidance 1 help responsible entities to better integrate the use of anti-dilution LMTs within their existing liquidity risk management framework? Have all the critical elements been captured?**

The proposed guidance is appropriately structured.

- 2. Do you agree with the proposed guidance 1 regarding the inclusion of anti-dilution LMTs within the daily liquidity risk management framework that OEF managers should have in place at all times?**

We agree that OEF managers should be operationally prepared to deploy an anti-dilution tool which can be used as appropriate as part of business-as-usual activities. Anti-dilution tools should be applied where it is determined that material dilution exists. Regulators can further support implementation of proposed Guidance 1 by ensuring that investment managers are operationally prepared to deploy anti-dilution tools and have appropriate contingency plans in place for managing extraordinary market conditions.

- 3. Is this proposed guidance appropriate for all types of OEFs in its scope, and proportionate for all types of responsible entities to implement? If not, please explain.**

All funds with a significant allocation to assets that have variable liquidity costs while offering daily dealing should incorporate at least one suitable anti-dilution tool into their liquidity risk management processes and be operationally prepared to deploy them.

Investment managers should retain the discretion to decide whether to activate an anti-dilution LMT, based on whether the subscription or redemption would result in material dilution. The judgment of what constitutes material dilution will differ from fund to fund, as it should represent the level of costs imposed on the fund by transacting investors which, if not borne by those investors, would materially change the incentives of other investors to remain invested or deal in fund shares. The degree of acceptable dilution this implies will vary with the type of assets held by the fund, the typical bid/ask spread, its investment strategy, whether investors in the fund are retail or institutional, and market conditions. We believe the manager is best placed to determine this level for each fund as part of its normal governance and liquidity management processes.

Further, how the guidance can be implemented in practise will vary according to local jurisdictional and ecosystem characteristics. Local regulators should be cognisant of these variations when interpreting the proposed Guidance, and make efforts to coordinate with all relevant market participants to assess which toolkit or sub-set of tools is appropriate for any given jurisdiction.

Proposed Guidance 2 – Types of Anti-Dilution LMTs

- 4. Has the proposed guidance identified all of the anti-dilution LMTs commonly used by responsible entities? Are there any other LMTs that share the same economic objective of passing on the liquidity cost to transacting investors, that could be included in this guidance? If so, please describe them.**
- 5. Are the identified anti-dilution LMTs described correctly? Do the features or characteristics of the different tools vary, or do they generally operate as described?**

In response to both questions 4 and 5:

Broadly speaking, the five anti-dilution LMTs listed – swing pricing, valuation at bid or ask prices, dual pricing, anti-dilution levies, and subscription / redemption fees – are the most commonly used tools. That said, how they are deployed in practise will reflect differences local fund structures and broader ecosystems. We encourage flexibility in how managers adopt these tools, subject to the core principle of mitigating material dilution of investors being upheld.

The description of the ‘anti-dilution levy’ could be expanded to also encompass single priced funds where the variable levy reflects the bid/ask spread.

The ‘valuation at bid or ask prices’ is described as the valuation switching from mid-price to the bid or ask price depending on the direction of net fund flows. The valuation at mid-price could also be adjusted by the estimated cost of liquidity.³

- 6. Do you support the proposed guidance 2? If not, in which cases do you think it could be justified not to adopt at least one anti-dilution LMT in OEFs (other than ETFs and MMFs)? What elements do you take into consideration to choose a specific anti-dilution LMT for your OEFs?**

³ It should also be noted that the cost of liquidity, particularly the market impact, can only partially be attributed to the transacting investor for both ‘valuation at bid or ask prices’ and ‘subscription / redemption fees’. We discuss this further in our answer to Question 9.

BlackRock is supportive of the proposal that investment managers be prepared to deploy at least one suitable anti-dilution LMT, for all funds, bar MMFs and ETFs, investing in assets that have variable liquidity costs while offering daily dealing.

The choice of tool should reflect the characteristics of the fund, market structure of underlying assets, and jurisdiction-specific considerations such as fund distribution infrastructures.

The decision to use one anti-dilution LMT over another will typically be based on an assessment of various factors that will inform how effective the tool will be. Relevant considerations include, but are not limited to:

- Whether net cash flows can be captured accurately and quickly enough to be incorporated into operational processes underpinning anti-dilution tools.⁴
- Operational ability to move valuation from bid-price to mid to offer price depending on net cash flows.
- 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)
- Consideration of the distribution platform requirements and fund client base – clients in some jurisdictions may have expressed a preference for certain types of anti-dilution LMTs; while others may not be operationally compatible – retail investors, for example, will not be able to pay liquidity fees directly, but can do so through price adjustments such as swing pricing.
- Other operational features of the fund distribution ecosystem, i.e., the set-ups of fund administrators, transfer agents, distributors, broker dealers among others.⁵

As discussed in Question 3, we believe this decision should be based on the manager's assessment of material dilution.

Where there is little to no estimated dilutive effect, it may not be necessary for an investment manager to activate anti-dilution LMTs, and we recommend a proportionate approach to the application of the Guidance. For example:

- A number of funds are structured as 'funds of one' with only one shareholder in the fund, meaning there is no dilutive effect of a subscription or redemption.
- The lack of dilutive effect is also relevant for highly liquid funds where any dilution would likely be very low e.g., 1 – 3bp, and the activation of an anti-dilution tool would not result in a different net asset value (NAV) per share / unit.
- For 'fund of funds' structures, dilution is less likely to occur at the feeder fund level, but rather would be a more relevant consideration at the master level.
- If there is no shareholder dealing, for instance where flow management tools such as the deferral of subscriptions / redemptions have been activated, an

⁴ We note that in certain jurisdictions such as the U.S., it is currently not possible to obtain this data due to the difference in timing between fund valuation and the receipt of fund flows data. As such, the potential implementation of anti-dilution tools will require a different approach to estimating liquidity and transaction costs. We discuss this further in our answer to Question 9.

⁵ For instance, in Japan, funds typically operate with a dual NAV, where the trust bank that safekeeps the assets calculates a NAV which is reconciled daily to the NAV calculated by the investment manager. Therefore, the choice of which anti-dilution tool to implement would need to factor in the capability of the trustee(s) to reflect the estimated cost of liquidity in the NAV, and may be especially challenging where investment manager use several trustees for their fund ranges.

anti-dilution tool would not be needed, as there would be no dealing and therefore dilution.

- Fund structures where delayed valuation and shareholder dealing cycles facilitate the incorporation of actual security trade prices into the dealing NAV per share.

In particular, it may not always be appropriate to use an anti-dilution tool for certain fund types or market events. In some circumstances, for example where other valuation adjustment or quantity-based LMTs such as flow management measures are used, it may not be necessary to deploy anti-dilution LMTs. We agree there are situations where market conditions may be so adverse that it is not possible for managers to confidently value the underlying assets in the fund fairly or to reasonably estimate the cost of liquidity, and in this case it would typically be more appropriate for managers to use alternative LMTs, such as flow management tools (for instance, gates or suspensions, where available) instead of anti-dilution tools, until market conditions stabilise. For instance, in the UK, the FCA requires open-ended funds to suspend dealing if the fund's standing independent valuer has expressed material uncertainty about the value of one or more of their assets under management and that material uncertainty applies to at least 20% of the value of the assets of the fund.⁶ This illustrates just one example that where shareholder dealing is closely controlled or if there is no shareholder dealing, then there is no dilution requiring anti-dilution LMTs.

For these reasons, it is important that the primary responsibility for selecting and activating anti-dilution LMTs, or at all, in OEFs should remain with the investment manager. The investment manager or its delegates should be prepared, where requested by supervisors, to evidence a full and robust justification for applying or not applying any anti-dilution tools, to maintain accountability.

Proposed Guidance 3 – Calibration of Liquidity Costs

7. Have the components of the cost of liquidity, as described above, captured all the relevant costs that should be considered when calibrating anti-dilution LMTs?

We agree that explicit (e.g., taxes, levies, broker fees) and implicit (indirect costs e.g., bid-ask spreads, market impact) transaction costs are the two main components of liquidity costs. However, the underlying elements of each component, as described in the Consultation Report, 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 Consultation Report as implicit only, but may also be known in advance if managers have access to the relevant data.

⁶ FCA Rulebook COLL 7.2.-3 R

8. How does the cost of liquidity vary across different funds? To what extent could we achieve a more consistent approach to calibrating anti-dilution LMTs for similar funds, and what is the best way to do so?

The cost of liquidity will vary primarily by the type and liquidity of securities in which the fund invests. Explicit costs vary by instrument depending on how brokers collect fees; while implicit costs such as bid-ask spreads are influenced by the size of the order placed.⁷ Costs can further vary by region, where both local policies (e.g., taxes and levies) and differences in local market structures influence trade execution. Liquidity costs can also vary due to market sentiment, government activity, or broker sentiment.

Funds with different investment strategies may also face different liquidity costs – index funds with very large numbers of holdings (or using synthetic replication) may be able to facilitate significant trading activity without incurring significant market impact. By contrast, active investment funds with a more focussed investment style could be more likely to incur significant market impact if trades are more concentrated.

Trading can also vary from investment manager to investment manager in terms of quality of execution, and trading terms used from trading desk to trading desk. Any one (or a combination) of these factors may result in a difference in costs from entity to entity, even in the same market conditions.

Given diverse fund structures, operating models, and regulatory environments, it is unlikely that liquidity costs faced even by similar types of funds will be consistent or comparable.

Standards and best practises are best suited to achieve greater consistency in approach. They should cover the principles and operations that underpin the use of anti-dilution tools, including, where relevant:

- A non exhaustive range of explicit and implicit costs to be included;
- The use of thresholds that reflect funds' investor base;
- Governance, oversight, and review / back-testing of any models used;
- Processes and communication channels to facilitate information flow;
- Disclosure to fund investors;
- Contingency and escalation procedures that have been robustly tested.

9. How can significant market impact be incorporated in the calibration of all of the proposed anti-dilution tools? Please provide examples.

Market impact can be incorporated in price-based tools (swing pricing, bid-ask valuation, and dual pricing) provided the fund accountant is able to adjust the published fund price for the expected dilution due to a subscription or redemption. It is also possible to apply the market impact to an anti-dilution levy, although there may be implementation issues depending upon distributor system limitations. Redemption fees are typically fixed in fund prospectuses and therefore may not be easily changed with changing market conditions.

⁷ For instance, for equities and futures, brokers collect a pre-determined execution commission; while fixed income commissions are incorporated into the final trade price – and can vary with market conditions.

It is important to note, however, that methodologies for assessing market impact vary by asset class, reflecting different market structures.⁸ A major input to market impact assessments is comprehensive fund flow data for each dealing day, which is not currently available in several jurisdictions, for example in the US and Japan. Accuracy of liquidity cost assessments in these jurisdictions are impacted by a lack of access to same-day flow data. Accessing this data on the day of the transacting investor's request would require significant change to the systems and processes of other entities such as intermediaries and retirement plan recordkeepers, especially in the context where regulators require a high degree of confidence of same-day subscription/redemption flow data.

We believe that managers should be expected to calculate their estimates based on a reasonable degree of confidence which would in turn greatly reduce the barrier to incorporate market impact. 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 differ. In light of the operational challenges outlined, we also recommend that regulators particularly in these jurisdictions, grant safe harbours to investment managers as long as they are considered as having made reasonable efforts to estimate the costs. This will be dependent on an investment manager having reasonably designed policies and procedures. Over the long term, we recommend that regulators consider how to enhance the availability of indicative flow information by consulting with all relevant stakeholders to address the barriers currently in place, with an appropriate transition period.

10. Can all of the components of the cost of liquidity (i.e., explicit and implicit transaction costs including any significant market impact) be incorporated in all five anti-dilution LMTs as set out in the discussion of Element (i) above? If not, what are the limitations to doing so and how would you suggest improving the effectiveness of these anti-dilution LMTs?

Subject to constraints imposed by local market ecosystems in some jurisdictions, as detailed in Question 9, we believe all liquidity and transaction costs can be incorporated in swing pricing, bid-ask pricing, and dual pricing. Anti-dilution levies can in some cases incorporate these costs, although where fund distribution is significantly intermediated this may prove more challenging.

The Consultation Report rightly recognises that it is more challenging to incorporate market impact into subscription and redemption fees, as they are often a static fee. Investment managers may need 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. This may not be an exact reflection of market impact, but could still perform an anti-dilutive function. See our answer to Question 11 for further discussion.

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 in some manner. Not all investment managers may have the current capability to include market impact (e.g., access to data, or the experience/expertise to apply it), however, not all fund types or situations would require/ benefit from the inclusion of market impact and the use of other solutions

⁸ Market impact calculations are often linked to best execution cost assessments such as slippage. While slippage can be used as a proxy to measure market impact, the concepts are not the same. See further discussion in our ViewPoint: [Disclosing Transaction Costs - The need for a common framework](#).

such as valuation or flow management solutions may provide satisfactory outcomes via different means.

11. To what extent can a subscription / redemption fee achieve the objective of addressing the investor dilution issue and financial stability concern of OEFs by attributing the liquidity costs to transacting investors? How could it be appropriately calibrated to achieve this objective?

Fixed 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. Depending on how subscription or redemption fees are defined in the prospectus, it could also restrict the ability to regularly update fees in response to changing market conditions. If the fee is managed by the fund's transfer agent, it may be more straightforward to incorporate this into the individual deal cash settlement notices. However, if it is charged at the level of broker dealer, distributor or platform through which investor orders are routed, operational considerations could be different. 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.

The frequency of the subscription or redemption requests can also impact how effectively the cost of liquidity can be incorporated. Portfolio managers trade on net cash flows, whereas subscription/ redemption fees are levied on gross cash flows.

12. Do you see benefits in a tiered approach to attributing the cost of liquidity by using different adjustment factors according to net fund flow, market conditions and characteristics of the funds? Are there any operational difficulties? Any further comments thereto?

In many swing pricing models, a tiered approach to attributing the cost of liquidity 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%.

This can result in a more frequent, but also more graduated application of swing factors, resulting in a more accurate adjustment for liquidity costs. This in turn benefits end-investors, who receive less pronounced NAV variation and impact on reported fund performance.

A multiple threshold model is operationally more complex, given the need to make regular adjustments to the fund NAV, which can be challenging for both the fund administrator to implement and for the investment manager to compute. Greater automation is required as a consequence. However, once the processes have been built out to accommodate a multiple threshold model it can be used as a business-as-usual tool.

Tiers and thresholds should be set and reviewed by the manager, as they should reflect the potential range of flows, which is a function of the funds' investor base.

13. How could guidance on LMT calibration achieve a fair balance between (i) ensuring investors have a clear expectation of the cost of liquidity they could be charged and (ii) ensuring responsible entities have enough flexibility to

attribute the overall cost of liquidity at all times, especially under stressed market conditions?

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

However, transparency on specific elements of how anti-dilution tools are calibrated should be avoided to mitigate any adverse effects on the fund. For example, disclosing the thresholds used to activate tools could allow some investors to arbitrage the fund by trading just below the threshold.

Similarly, the range of swing factors (for example) used by a fund could constitute commercially sensitive information. The release of this information to trading counterparties may lead to deterioration in dealing terms, at the expense of underlying investors.

14. Is the proposed approach regarding ranges of liquidity cost adjustment appropriate? If not, how could it be improved?

Yes. However, ranges may need to be very broad to encompass trading from small to large volumes.

15. Is the proposed expectation on the level of confidence and the sophistication of liquidity cost estimations appropriate? If not, how could it be improved?

We agree that estimates should be made on a 'reasonable efforts' basis. In jurisdictions that have less experience in applying anti-dilution LMTs, it will take time to develop access to historical transaction cost data, more sophisticated modelling and investment managers' experience/expertise – all of which impact the accuracy of liquidity cost estimates. As outlined previously, market structure characteristics in some jurisdictions, will necessarily limit the accuracy of estimates that can reasonably be made. It would not currently be appropriate to expect a high level of confidence of same-day subscription / redemption flow data in these jurisdictions.

We would recommend that regulators particularly in these jurisdictions take a multi-stage approach to addressing these limitations in partnership with investment managers and other relevant stakeholders (such as fund administrators, platforms, and other relevant record keepers). This could involve convening working groups of all relevant stakeholders to firstly identify where the gaps are, and secondly to propose potential solutions.

Proposed Guidance 4 – Appropriate Activation Threshold

16. What are the appropriate factors to consider in setting the activation threshold so that anti-dilution LMTs will be activated for any subscription/redemption activities with material dilution effect? How would you define 'material dilution effect'? Why and how could it vary across different funds?

The threshold for activating an anti-dilution LMT should reflect elements such as the fund size, investment policy, asset liquidity, investor base and concentration, historical fund flows and estimated cost of liquidity, among other factors.

Material dilution, as defined in our answer to Question 3, represents the level of costs imposed on the fund by transacting investors which, if not borne by those investors, would change the incentives of other investors to remain invested or deal in fund shares. The degree of acceptable dilution this implies will vary with the type of assets held by the fund, the typical bid/ask spread, its investment strategy, whether investors in the fund are retail or institutional, and market conditions.

We believe the responsible entity is best placed to determine this level for each fund as part of its normal governance process. Entities must strike a balance between investor protection, operational effectiveness, transparency, short-term NAV volatility and tracking error, board and investor expectations, and portfolio management considerations.

In our view, the factors responsible entities should consider when setting thresholds include, but are not necessarily limited to:

- Type of threshold (percentage, monetary or a combination) and whether single or multiple/tiered thresholds will be applied,
- Fund size, investor base, and investor composition;
- Type of and liquidity of securities held in the fund;
- Costs and dilution impact associated with the markets in which the fund invests;
- Consistency within a fund complex, and whether consistency of thresholds can be achieved without affecting the effectiveness of the anti-dilution tool;
- Acceptable level of client net capital activity for which transaction costs can be absorbed by the fund;
- Soft closure measures on capacity constrained funds, for example, a fund may be closed to one-off new subscriptions, but continue to accept small subscriptions from regular savings plans on the basis they do not have a materially dilutive effect and are known well in advance of the relevant dealing point;
- Frequency of the threshold review, and any specific triggers to review.

17. Does the use of an activation threshold introduce the risk of trigger / cliff-edge effects? How could trigger / cliff-edge effects be avoided? Could the tiered swing pricing address the trigger / cliff-edge effect?

Activation thresholds would only introduce 'cliff edge' effects if there has been detailed disclosure of what the thresholds are. As noted in Question 13, we believe that thresholds and calibration practices should not be disclosed, particularly ex-ante, for these reasons.

Proposed Guidance 5 – Governance

18. Do the proposed arrangements discussed above include all the essential elements regarding governance and oversight arrangements in relation to the use of anti-dilution LMTs? Are they proportionate to the differing size and complexity of responsible entities' fund ranges?

We agree with all the elements recommended for internal governance arrangements as described in the Consultation Report. In our view, strong governance processes should incorporate:

- Clear documentation of roles and responsibilities;
- Terms of reference or equivalent documentation to define the extent of powers delegated, membership of the governing body, frequency of meetings and nature and frequency of reporting responsibilities;
- Documentation of meetings and decisions, particularly of any variations from standard policies;
- Regular review (e.g., on a monthly or quarterly basis) of anti-dilution tools used, including calibration and thresholds, and back-testing where possible;
- Processes to mitigate operational risk in terms of how decisions are communicated from the governing body to the party charged with execution, which could be the fund accountant / transfer agent – in particular risk from manual processes;
- Review, escalation, and contingency processes to accommodate any significant changes in fund size, or adapt to changes in market conditions.

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

19. Please describe any material factors of the governance and oversight arrangements which have not been included.

While the input of fund portfolio managers can be an important source of market intelligence for governance and decision-making purposes, they should not be part of these processes, to avoid conflicts of interest.

Proposed Guidance 6 – Disclosure to Investors

20. Is the ex-ante information described above likely to be appropriate and effective in explaining the use of anti-dilution LMTs to investors? What other information about dilution, if any, might be helpful to investors before they invest in a fund?

In addition to including information about what the anti-dilution tool is, its purpose and how it works in the fund prospectus, it may be useful to have supplementary material in the form of a brochure or ‘flyer’ dedicated to explaining the anti-dilution tools, their related processes, and the funds they are applied to in accessible language. This could act as a concise but useful dedicated source for investors to reference information about anti-dilution tools separately to the broader prospectus.

We agree that the prospectus should allow for the possibility to go beyond the disclosed ranges of adjustment factors, in specific circumstances. In some jurisdictions the discretion for investment managers to exceed the disclosed swing factors is already permitted by the regulator, while other regulators require explicit permission to increase factors beyond those stated in the prospectus.⁹

⁹ During the COVID-19 Crisis, some investment managers, including BlackRock, sought this permission from the Luxembourg regulator, the Commission de Surveillance du Secteur Financier (“CSSF”). The CSSF in its COVID-19 FAQ allowed swing factors to be increased on a temporary basis, subject to appropriate investor

21. What information can (and should) be disclosed ex-post to investors or the public, and at what frequency, to enhance transparency without compromising the aims of the anti-dilution LMTs or creating unintended consequences? Further, how soon should this information be disclosed to investors?

We agree that it may also be helpful for managers to provide ex-post information on whether and to what extent anti-dilution tools have been used, to help investors understand the costs attributed to redeeming or subscribing they may have borne or could bear in future. Dynamic information should be disclosed outside of fund prospectus and articles which may be very infrequently amended. Historic ex-post disclosures could also be provided on investment manager websites as the volumes would be far too great to be accommodated in annual / semi-annual fund financial statements.¹⁰

Information about the amount of dilution cost adjustment applied, the direction of flows, and the date these were applied or the NAV per share before and after application of the anti-dilution adjustment should be disclosed to investors, but it should be at 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. To ensure these disclosures are effective in guiding decision-making, these could be published periodically on investment managers' websites, or also on request from a transacting shareholder.

22. Are there other risks than those described in this section attached to the disclosure of the parameters used for anti-dilution tools?

As outlined above, parameters used for anti-dilution tools will be highly specific to each fund depending on securities held, investment strategy, and investor base. Funds with nominally similar investment strategies could justify using different parameters for their anti-dilution tools. 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.

Overcoming Barriers and Disincentives

23. Do you agree with the list of barriers and disincentives identified? Do you consider there are others that are not covered?

We agree that these are the main barriers and disincentives.

24. In your view, what are the most significant barriers or disincentives to the implementation of anti-dilution LMTs? What are your suggestions for possible solutions to mitigate or overcome the barriers and disincentives to the implementation of anti-dilution LMTs?

notification, and allowed managers to include swing pricing provisions where they had not previously been operationalized. The CSSF has since permitted the increase of swing factors beyond the maximum level where already provided for in the prospectus, in its [2021 Swing Pricing FAQ](#). Other regulators, such as France's Autorité des Marchés Financiers (AMF), provided similar guidance to managers of French funds. These actions allowed the application of swing factors at a level consistent with underlying market spreads. See AMF, [Continuity of Management Activities During the Coronavirus Crisis](#), March 2020.

¹⁰ For an example of the type of documentation BlackRock provides to its clients see our paper: The dilution effects of investor trading activity on mutual funds available at: <https://www.blackrock.com/corporate/literature/whitepaper/swing-pricing-dilution-effects-of-trading-activity-on-mutual-funds-october-2020.pdf>

25. For those OEFs facing significant barriers, what are the implications for their ability to implement this guidance? Are adjustments needed to the guidance to account for this, bearing in mind the objective to mitigate dilution for investor protection?

In response to both Questions 24 and 25.

As discussed previously, certain jurisdictions face structural and operational challenges to implementing certain anti-dilution tools.

Calculating estimates of the cost of liquidity at the time of the subscription or redemption relies in large part on access to complete fund flow data for each dealing day, which is not currently available in several jurisdictions. Accessing this data on the day of the transacting investor's request would require significant change to the systems and processes of other entities such as intermediaries and retirement plan recordkeepers.

To address this, we recommend that regulators in these jurisdictions consider how to enhance the availability of indicative flow information by consulting with all relevant stakeholders to address the barriers currently in place. This should be accompanied by an appropriate transition period, to help investment managers and relevant third parties to build up the expertise and operational systems needed to accommodate implementation of anti-dilution measures. This transition period would also help to facilitate the significant education and engagement efforts needed to bring investors and distributors up to speed.

In the early stages of this implementation, we note that 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 differ. Expert knowledge and the availability of data will need to be built up in these jurisdictions, so in recognition of the differing states of maturity, regulators should grant protections to responsible entities as long as they are considered as having made all reasonable efforts to estimate the costs. This will be dependent on a robust justification to be provided by the investment manager.

Other questions

26. Do you have any other comments on any guidance proposed in this document?

The availability of timely and reliable market data is critical to properly assess market depth and transaction costs, which in turn inform assessments of asset liquidity and calibration of anti-dilution LMTs. While transparency has significantly increased in recent years, there is still room for improvement in many jurisdictions. In Europe, this could be further improved through a real-time consolidated tape for price and volume data, and a "Best Bid or Offer" metric, for equity and fixed income, and we welcome recent efforts from the European Commission and the FCA to introduce respective frameworks for this.

We appreciate the opportunity to address and comment on the issues raised by this consultation Paper, and will continue to work with IOSCO and the FSB on any specific issues which may assist in enhancing liquidity risk management.

BlackRock

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