2 August 2012

Mr. Mohamed Ben Salem
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain


Dear Mr. Ben Salem:

BlackRock is pleased to have the opportunity to respond to IOSCO’s Consultation Report on the Principles of Liquidity Risk Management for Collective Investment Schemes.

BlackRock is a leader in investment management, risk management and advisory services for institutional and retail clients worldwide. At 30 June, 2012, BlackRock’s AUM was $3.56 trillion (€2.81 trillion). BlackRock offers products that span the risk spectrum to meet clients’ needs, including active, enhanced and index strategies across markets and asset classes. Products are offered in a variety of structures including separate accounts, mutual funds, iShares® (exchange-traded funds), and other pooled investment vehicles. BlackRock also offers risk management, advisory and enterprise investment system services to a broad base of institutional investors through BlackRock Solutions®.

Our client base includes corporate, public funds, pension schemes, insurance companies, third-party and mutual funds, endowments, foundations, charities, corporations, official institutions, banks and individuals. BlackRock represents the interests of its clients and it is from this perspective that we engage on all matters of public policy. BlackRock supports regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analyses, preserves consumer choice.

BlackRock is a member of European Fund and Asset Management Association (“EFAMA”) and a number of national industry associations1 reflecting our pan-European activities and reach.

Key points

BlackRock welcomes the focus given by the principles set out in the Consultation Report and believes that they reflect best practice in many regulated structures such as those falling within the scope of EU Directives such as AIFMD and UCITS. As such, we agree that the principles on the whole adequately address regulatory issues raised by the valuation of CIS and bring out key principles for dealing with conflicts of interest. We do have a number of specific points on the following themes:

- Recognising the diversity of liquidity profiles of CIS
- Focus on the liquidity challenges faced by illiquid assets
- The role of liquidity risk management
- Liquidity policies need to focus not only on redemption restrictions but also on the life cycle of a CIS and the wider management context

1 Association of British Insurers (ABI), Association Française de Gestion (AFG), Assogestioni, Association française des Sociétés financières (ASF), Association suisse des institutions de prévoyance (ASIP), Bundesverband Investment and Asset Management (BVI), Dutch Fund and Asset Management Association (DUFAS), Eumedion, Financial Reporting Council (FRC), Irish Association of Pension Funds (IAPF), Irish Funds Industry Association (IFIA), Investment Management Association (IMA), Inverco, Alternative Investment Management Association (AIMA) and National Association of Pension Funds (NAPF).
Distinguishing between liquidity management for collateral as opposed to the CIS investment portfolio

Recognising the diversity of liquidity profiles of CIS

The Principles focus more generally on open-ended CIS with limited references to closed-ended CIS. In the past, the definition of a CIS has often focused on open-ended CIS but with recent legislative developments such as the Alternative Investment Fund Managers Directive in the EU (AIFMD), which includes both open and closed-ended vehicles in its scope, it is essential that the Principles look at both CIS types equally. There are, however, significant differences between the assets held within closed-ended and open-ended CIS. In many cases, closed-ended CIS are formed to hold illiquid assets and may have very limited redemption options until the life of the CIS has expired.

We would also recommend IOSCO taking further account of ESMA's technical advice to the European Commission on possible implementing measures of the AIFMD (pages 73-81) which offers a number of suggestions for applying common principles in a proportionate manner regardless of the liquidity profile of the CIS.

It is also key that liquidity policies are applied in a manner which is consistent with the fair treatment of investors taking into account the impact on underlying prices and/or spreads of the individual assets of the Alternative Investment Fund (AIF). In addition some closed-ended investment funds such as UK investment trusts offer indirect liquidity to investors by arranging for their shares to be listed and traded on recognised exchanges and in this case the fund’s aim is to ensure sufficient secondary market liquidity rather than direct portfolio liquidity.

Focus on the liquidity challenges faced by illiquid assets

While many closed-ended funds may hold relatively illiquid assets, these assets may well contribute to higher growth in the value of a portfolio over the long term and are not necessarily inappropriate for a regularly dealing fund provided they are held in such proportions that they do not undermine the ongoing liquidity of a fund. We therefore recommend focusing on the overall portfolio liquidity using qualitative measures as well as looking at individual liquidity positions for retail funds. It is important that liquidity measures are aligned with pricing policies and committees, taking into consideration the provision for ad hoc reviews particularly in times of market stress.

The role of liquidity risk management

As with all risk management, the appropriate data, systems, tools and reporting should be in place and the process needs to be understood as qualitative rather than as a purely commercial process. While it is extremely useful to set a number of thresholds for internal monitoring purposes, in our view it is important that these do not always have to be treated as strict limits but are viewed as part of a wider qualitative analysis as to whether a CIS can continue to meet its liquidity profile. Individual thresholds should then be treated as a series of indicators within a wider overall liquidity analysis. It is also important to ensure that liquidity management is appropriate for the investor base of the CIS in question and expected liquidity requirements – for example, retail investors in CIS subject to hard-coded regulatory investment limits may have very different liquidity requirements from a long term pension fund investor.

As noted in the ESMA advice on AIFM, it is important that responsible entities identify, manage and monitor conflicts of interest arising between investors wishing to redeem their investment(s) and those investors wishing to maintain their investment(s) in the portfolio, and any conflicts between the responsible entity’s incentive to invest in illiquid assets and the CIS’s redemption policy.
Liquidity policies need to focus not only on redemption restrictions but also on the life cycle of a CIS and the wider management context

The Principles focus on liquidity measures through the optics of redemptions restrictions. It is also important in the case of open-ended funds for responsible entities to focus on liquidity issues throughout the life cycle of a fund and liquidity issues vary depending on whether the fund is in start-up mode, taking in large numbers of subscriptions as well receiving high levels of redemptions. It is also important to situate the CIS in the wider context of the responsible entity’s book of business. In specialised or growth markets, a key issue governing liquidity is the size of the underlying markets. If a fund grows too quickly or too large it may not be able to invest in available assets without damaging its liquidity profile. In this case, the responsible entity will need to prepare for and consider a variety of options, such as temporary closure to new subscriptions, offering limited issue shares and providing suitable warnings to investors of market constraints. The responsible entity may also be managing a number of separate CIS (e.g. UCITS, AIF, US RIC) as well as segregated accounts all investing in the same market. In this case to ensure a fair allocation of liquidity across all its end investors the responsible entity will also need to consider liquidity issues across its entire book of business. The liquidity challenges faced by a CIS can change significantly depending whether the CIS is in its launch phase or whether it is well established. We would stress the need for continuous engagement by the responsible entity with its portfolio and risk managers to assess whether specific measures need to be taken to manage liquidity.

Distinguishing between liquidity management for collateral as opposed to the CIS investment portfolio

The Principles refer to collateral management as part of the overall Principles. While we concur that stringent risk management and liquidity management policies need to apply as part of the responsible entity’s overall risk management process, it is important to view collateral management in a different light from investment management. Collateral management exists as a security mechanism to protect the CIS in the event of a counterparty defaulting on its obligations to the CIS. The collateral provided does not need to and in many cases should not match the liquidity profile of the fund in questions but rather be able to be liquidated in as speedy a manner as possible to allow the fund to recoup the loss it has suffered. Accordingly, collateral management should be encompassed within counterparty assessment and management.

Looking at the individual Principles in turn we have the following comments:

Principle 1

It is important that the liquidity risk management process sits within the wider risk management process adopted by the CIS. We emphasise that liquidity risk management is an on-going process which should be capable of being applied in all market conditions not just at times of greater liquidity risk.

In the fifth paragraph we recommend that the responsible entity “seeks to ensure” consistency rather than an absolute requirement given the inability of any manager to predict all market conditions.

Principle 2

As mentioned above, we recommend focusing on qualitative liquidity management techniques so that the responsible entity puts in place a liquidity management framework comprising quantitative thresholds and a qualitative overlay and analysis rather than pure hard quantitative limits. For example, specific thresholds need to be understood in the wider context of market movements and the likelihood of significant investor subscriptions and/or redemptions.
Given the specific focus on money market funds and, in particular, the recent IOSCO consultation on money markets funds which raises specific questions on liquidity, we suggest deleting the example of a money market fund and including the example of a more generic daily dealing retail fund. This would avoid any confusion as to whether other daily dealing funds should have the same liquidity profile as money market funds. We would also recommend giving examples relating to a true closed-ended fund or a fund which offers secondary market liquidity through trading on an exchange.

**Principle 3**

Dealing frequencies should not just apply to redemptions but also to subscriptions and the notice given for such deals. In certain funds it may be appropriate to consider liquidity measures such as limited issue units.

**Principle 4**

We have concerns with the first paragraph of the principle which implies that specific tools or measures stand apart from risk management measures. We understand the use of these tools or measures forms part of the qualitative assessment by the responsible entity. In many cases, the ability to use tools such as deferred redemption or gates is an essential part of on-going negotiations with larger investors to ensure that their deals do not unfairly affect the interest of remaining long-term investors. Measures such as anti-dilution mechanisms for example are often used as an everyday occurrence to ensure that the cumulative market impact of subscriptions or redemptions does not affect non-dealing investors who remain in the CIS.

**Principle 5**

There are many intermediated models of distributions each giving different degrees of transparency as to the underlying identity of end-investors. It would assist responsible entities if greater focus was made by regulators on requiring distributors, where regulated, to provide further information as to investor concentration for the purpose of liquidity management.

Rather than “obtain” information as to investor concentration we recommend the use of the term “understand, where appropriate”.

**Principle 6**

As with Principle 1, we recommend that the responsible entity “seeks to ensure” …access to information as it may not always be possible to ensure contractual compliance by a third party. In comparison, the ESMA advice on AIFMD does not impose an absolute obligation but notes that “AIFMs shall, where the AIF invests in other collective investment undertakings, monitor the approach adopted by the managers of those other collective investment undertakings to the management of liquidity, including through conducting periodic reviews, to monitor changes to the redemption provisions of the underlying collective investment undertakings in which the AIF invests.”

**Principle 7**

The level and manner of disclosure of investors will very much depend on the CIS and its underlying investment policy. We agree it is essential to make appropriate and sufficient disclosure of the liquidity management tools applicable to a particular AIF to investors before they invest and in the event of material changes.

As noted in the ESMA AIFMD advice, this could include disclosure of notice periods in relation to redemptions, details of lock-up periods, an indication of circumstances in which normal redemption mechanics might not apply or may be suspended, together with details of any measures which may be considered by the responsible entity such as gates, side pockets, lock ups, closure to new subscriptions or penalties. The level and details of disclosure will depend on the underlying assets and intended client base. In some cases, lengthy text may be unavoidable given, for example, the complexity of operating side pockets in an institutional fund
and we recommend focussing instead on the clarity of the description of the relevant measures in the CIS’s offering documents and associated marketing documents.

**Principle 8**

As discussed above in our introductory comments, we note that liquidity risk management must form part of the wider risk management process and where relevant take into account subscription policies.

**Principle 9**

In terms of the reference to independent risk management it would be useful to clarify that this is not necessarily through a legal independent body but can also apply through a hierarchically separate risk management team.

**Principle 10**

We note that “continuously” monitoring may not be appropriate for all types of funds and that “regularly” may be a more appropriate term to use.

**Principle 11**

The assessment of liquidity risk referred to in the second paragraph should be assessed in the context of the investment parameters of each investment portfolio. In the first paragraph, the reference to considering the impact the transaction will have during the lifetime of the investment implies a knowledge of future events rather than a requirement to “continuously”, or as we prefer to say “regularly” monitor the impact of liquidity of a fund as noted above in Principle 10.

In the fourth paragraph, as mentioned above, we recommend treating collateral arrangements as a separate issue from liquidity management of individual portfolios and recommend considering this as part of a wider discussion on counterparty assessment and risk management.

**Principle 12**

As with our comments on Principle 4, we have concerns that specific tools or measures are seen as standing apart from on-going risk management measures. We recommend deleting the example in the third paragraph especially given that certain funds in some peer groups are not always managed against the same benchmarks and may well be performing in accordance with their stated objectives but have a different result when compared with competing funds.

**Principle 13**

This principle refers to various additional qualitative measures in addition to the narrower measures referred to in Principles 1 and 2. As we have mentioned, we support a qualitative and not only a quantitative view of liquidity risk management so we would recommend merging the requirements and example in this Principle with the text under Principles 1 and 2.

**Principle 14**

Please note our comments on separate treatment of collateral management under Principle 11.

The examples given should be seen as applying in a manner which is proportionate to the liquidity requirements of a particular CIS so that what is required for a closed-ended CIS may be very different for an open-ended CIS.
Principle 15

It should be made clear to whom disclosure should be made e.g. regulators, and/or existing or future investors.

In the third paragraph, disclosure of liquidity positions need to be taken in the context of pre-existing disclosure requirements in offering documents and/or specific regulatory requirements and to avoid repeated disclosures to investors.

Conclusion

In conclusion, the Principles set out a workable basis to address the issues identified following the recent financial crisis. It is, however, important that the Principles recognise the diversity of fund and governance structures involved and dealing cycles. Ultimately, responsibility for liquidity risk management lies with the responsible entity of the CIS which will need to ensure it has an experienced function able to ensure its liquidity risk management policies are appropriate, particularly in respect of funds with inherently lower liquidity assets and/or in exceptional conditions of stressed liquidity. This requires the use not only of quantitative risk thresholds but of also of wider qualitative measures of risk oversight.

If we can answer any questions or provide further information regarding this important topic, please do not hesitate to contact us.

Yours sincerely,

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