BlackRock.

August 16, 2021

Submitted via email to fsb@fsb.org

RE: Policy proposals to enhance money market fund resilience

BlackRock, Inc. (together with its affiliates, "BlackRock")[1] respectfully submits its comments to the Financial Stability Board ("FSB") in response to its Consultation report on Policy Proposals to Enhance Money Market Fund Resilience ("Consultation Report"). Our views in this letter reflect our *ViewPoints* on Lessons from COVID-19: The Experience of European MMFs in Short-Term Markets and Lessons from COVID-19: U.S. Short-Term Money Markets. The views in this letter are also generally consistent with those expressed in our recent responses to the President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds and the ESMA Consultation on EU Money Market Fund Regulation, both of which are attached as appendices.

Executive Summary

The market dislocation in March of 2020 ("COVID-19 Crisis") stemmed from a global public health crisis, which created unprecedented shocks to the real economy, supply chain disruption, and worldwide uncertainty. During this period, investors moved quickly to increase liquidity by raising cash. As investors and issuers worldwide chased liquidity simultaneously, short-term funding markets ("STFMs") largely froze with many holders of even high-quality commercial paper ("CP") struggling at times to find a bid from dealers in the secondary market. Money market funds ("MMFs") were left to balance the competing pressures of rapidly changing end-investor need for cash and liquidity with a breakdown in the STFMs. That said, the reforms implemented after the 2008 Global Financial Crisis ("GFC") made MMFs more resilient, allowing them to weather the dash for cash during the COVID-19 Crisis much more smoothly than they otherwise would have.

The lack of a secondary market that does not rely on bank dealer intermediation, particularly for CP, was the root cause of the turmoil in the STFMs, including with respect to MMFs, during March 2020. The COVID-19 Crisis underscores the need to consider improving the liquidity of the STFMs by making changes in the market structure for CP and other short-term instruments to develop a more robust market for secondary trading. While MMFs were not without issue, any reforms to MMFs in isolation will not be effective in enhancing market stability and preventing the need for

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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. We are a global leader in cash and liquidity management; with MMF offerings across a range of different fund structures and currencies in the US, Europe and internationally.

extraordinary official sector interventions in the future if the underlying issues in the STFMs are not initially or concurrently resolved.

As such, BlackRock recommends the following:

- The liquidity strains in the STFMs need to be addressed at the root cause, as those strains would exist with or without MMFs. We recommend regulators consider implementing standardization in the CP market, increasing transparency, and encouraging the structure to move from an OTC market to greater use of all-to-all platforms for both primary and secondary trading of CP to deepen the pool of liquidity providers. Without addressing these market dynamics, we respectfully disagree that enhancing MMF resilience will minimize the need for future extraordinary central bank interventions. While it may not be necessary to provide relief to the MMF sector, it could still be necessary to support the STFMs in a future liquidity event.

- Additionally, to further enhance the stability of the secondary market for high-quality CP, policymakers could consider encouraging the use of banks' balance sheets as a countercyclical buffer. We recommend the FSB consider guidance on how such buffers may be utilized in a future STFM liquidity crisis to provide additional stability to the STFMs. We believe that banks are better holders of high-quality CP relative to other investors such as corporates, particularly during periods of stress, as they have more options available to them for financing.

- With respect to MMF reform, there are important jurisdictional differences in MMF structure, experience, and regulation, particularly given the divergent reforms post-GFC. In March 2020, US and European MMFs exhibited different market dynamics, and, within Europe, the dynamics further varied across different fund types and currencies. The distinctive features and idiosyncratic nature of MMFs make 'one size fits all' reforms an inappropriate solution. We cover some broader themes in this letter and have attached letters to the U.S. Securities and Exchange Commission ("SEC") and the European Securities and Markets Authority ("ESMA") that dive deeper into reform suggestions for the US and European MMF structures, respectively, as appendices.

- We agree that mitigating the impact of large redemptions, while simultaneously helping to reduce the likelihood of destabilizing redemptions, should be the primary focus of MMF specific reforms. To achieve this, we believe that the policy focus should be on ensuring that liquidity thresholds and fees are adequately calibrated, useable, and do not create "bright lines" which enhance client redemption risks. To achieve this result, we recommend:

    (1) decoupling the potential imposition of gates and fees from regulatory liquidity thresholds;

    (2) retaining the regulatory liquidity threshold requirements as a portfolio construction feature to provide MMFs a substantial liquidity buffer;

(3) implementing changes to currency-denomination specific daily liquidity levels; and

(4) decoupling not just fees and gates from liquidity thresholds but also decoupling fees from gates to more appropriately effectuate the primary purpose of fees.

- We strongly disagree that swing pricing, capital buffers, or minimum balance at risk options are appropriate reform measures for MMFs. Such measures are not operationally feasible for the vast majority of MMFs and are unnecessary when the above enhancements to the liquidity thresholds and fee requirements are implemented. With regards to swing pricing specifically, while we find that to be a valuable tool for other types of open-ended funds ("OEFs"), we believe liquidity fees are the more appropriate mechanism for assigning potential costs in MMFs.

- We also believe that changing the redemption terms of MMF shares would undermine their fundamental utility to investors, and could prompt a shift into alternative products, which may have unknown market functioning or financial stability implications.

- Finally, we believe that some MMF reform options (a liquidity exchange facility and concentration limits) could have the unintended consequence of enhancing the transmission of risk across MMFs; we are not therefore supportive of pursuing these proposals.

Short-Term Funding Markets

The STFMs are an important funding source for a wide range of issuers: from banks and the underlying clients they serve, to public authorities and national governments, as well as non-financial corporates who tap the markets directly. Equally, a wide range of investors use the STFMs - directly and indirectly through MMFs and other vehicles - to manage their cash and liquidity positioning. We believe that directly addressing the STFMs through market structure changes would enhance the resilience of these markets for all participants, including MMFs (and their investors), and disagree with the Consultation Report's statement that none of the proposed measures would alter the characteristics of the MMFs that gave rise to illiquidity.

During the GFC, liquidity and credit shocks in certain fixed income assets eventually became a deep banking and financial crisis. The source of the turmoil differs greatly from the COVID-19 Crisis, which arose from a pandemic, a government shut-down of the economy, and the resulting unprecedented shocks to the real economy. The reaction to the fears generated by the pandemic and the steps required to mitigate the spread of the virus created massive and unanticipated demand destruction and supply chain disruption as well as uncertainty around the world. This uncertainty arose almost instantaneously and abruptly halted a robust economy that had been performing at historically high levels of employment and economic output.

The broader market turmoil placed acute strains on the STFMs. For close to two weeks, market participants like BlackRock often struggled to find bids from dealer banks in the secondary market for much of the CP, bank certificates of deposits ("CDs"), or municipal debt they were holding. Even Treasury bills came under pressure, and primary issuance for corporate issuers and municipal issuers abruptly halted. Decisive and targeted intervention in the SFTMs by the US Federal Reserve helped to alleviate the strains in the US markets. However, in Europe where central bank interventions only touched a limited segment of the STFM, the secondary market remained highly stressed for several weeks, with banks' ability or willingness to make markets in short-term CP and CD severely diminished. Fragmentation and opacity in the STFMs hamper visibility into the specifics of this "no bid" environment, but anecdotal evidence from market participants is consistent in pointing to this dynamic.

Therefore, BlackRock firmly believes that the issues in the underlying STFMs must be addressed initially or concurrently with MMF reform. The Consultation Report states that one of the two vulnerabilities of MMFs is "that they may face challenges in selling assets, particularly under stressed conditions." The Consultation Report credits this vulnerability "to the fact that some MMFs hold financial instruments that have limited liquidity, even under normal market conditions." However, in our experience, there is ample capacity for bank dealers to purchase and hold CP in normal market conditions.

While we agree that the lack of liquidity in the market in March 2020 exposed a vulnerability related to the difficulty of liquidating assets, the Consultation Report fails to recognize that this is a vulnerability of the STFMs as a whole, not a vulnerability exclusive to MMFs. MMFs were not the only seekers of liquidity in the STFMs during March 2020. For example, MMFs make up less than 25% of the CP investor base in the US. BlackRock believes, based on anecdotal conversation, that other participants in the STFMs, such as insurance companies and pension plans, were also facing pressure to raise cash in the face of the uncertainty brought on by COVID-19. While their cash-raising attempts were not as visible as those of MMFs, given the opacity of the STFMs, we believe that pressure was no less acute.

Changes to MMFs will do nothing to address the underlying vulnerability of limited liquidity during market stress in the STFMs and, if the changes in MMFs were made in isolation, these reforms may decrease the limited transparency in the STFMs. We suggest potential reforms for the STFMs in the following section.

Finally, we note that a significant reduction in the footprint of MMFs in the STFMs would not necessarily mean a reduction in the possible need for central banks to intervene in future crises. For example, if corporates struggle to convert direct holdings into cash in times of need, or pension funds are unable to liquidate assets to post margin during market stress (noting that direct holders of CP would not have the minimum cash buffer requirements of MMFs), the real economy and financial stability imperative for central banks to underpin the functioning of STFMs maybe arguably greater than today's status quo.

CP Market Structure

In normal markets, banks play a critical role as intermediaries and liquidity providers to both the primary and the secondary STFMs. Market participants who are looking to sell their CP in normal times will ask the bank from whom they purchased the CP to bid the paper in the secondary market, as banks are often unwilling to bid paper from issuers unless they are a named dealer on that program. The result is a "single source of liquidity" model.

In March 2020, as the potential impact of the COVID-19 Crisis became clearer, banks withdrew from the STFMs to (in many ways, understandably) protect their own capital and liquidity and to maintain compliance with their regulatory requirements.[2] However, this left holders of CP with no place to turn, causing a "no bid" environment for CP. BlackRock experienced this in our own attempts to transact in these markets, even for the highest-rated CP, and heard from clients who held CP portfolios directly, outside of MMFs, that they also had trouble finding liquidity.

This "single source of liquidity" model failed during the COVID-19 Crisis and will fail again in the next liquidity crisis if fundamental changes to the CP market structure are not implemented. We recommend that the FSB convene a group of banks, issuers, MMF sponsors, and other market participants to consider and propose CP market reforms. Ideas we recommend for consideration include (i) standardization in the CP market, (ii) enhanced market transparency, and (iii) an all-to-all platform for primary and secondary trading to deepen the pool of liquidity providers.

The fragmented nature of the CP market is in part due to the bespoke nature of most CP contracts. There are currently no standard terms for CP, leaving it to each CP issuer to design bespoke contracts with their issuing bank, causing contracts to vary from issuance to issuance. We believe that standardization of CP contacts along with the development of an "all-to-all" trading platform would defragment the market leading to deeper liquidity pools and more transparency through enhanced data. It would also benefit the CP issuers by giving them easier access to funding during both normal market conditions and times of stress.

We acknowledge this would be a significant overhaul of CP market structure yet note that other markets have successfully navigated similarly large-scale changes post-GFC. The development of all-to-all trading platforms for the corporate bond market has resulted in deeper liquidity and more transparency as market participants can more readily find one another. We see strong parallels to the evolution of the credit default swaps market where, following the GFC, the industry coalesced around trading standard tenor and coupon contracts and adopted a standard pricing model for upfront fee calculations. These industry-led changes, combined with policymaker-mandated central clearing and post-trade swap reporting, created greater liquidity and transparency in a market that needed transformational change.

Given the complexity of potential reforms, we believe that regulators will need to step in to mandate fundamental change to how CP is traded in both the primary and secondary markets. While we believe all-to-all trading platforms and contract standardization are the right starting point, we expect that a holistic look at solving the liquidity concerns of the CP market during stressed times may lead to other potential solutions.

Countercyclical Bank Buffers

During the COVID-19 Crisis, the strength of the banks' balance sheets provided an opportunity for prudential regulators to selectively dial back some of the regulations

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[2] For example, CP is not considered a High Quality Liquid Asset, making it difficult for banks to hold it on balance sheet when facing pressure on their capital ratios.

imposed post-GFC, effectively treating bank capital and liquidity as countercyclical buffers in a crisis. However, this capacity was used solely for lending and was not used for market making**. We recommend policymakers consider how best to encourage the use of banks' balance sheet capacity during times of market stress as a countercyclical buffer.**

Possible Substitutes for MMFs

BlackRock does not believe the Consultation Report has fully considered the impact to the STFMs and broader financial stability if MMFs were to directly (through a ban) or indirectly (through significantly diminished appeal to investors as a useful cash management tool) disappear or were significantly reduced within the ecosystem. While the Consultation Report suggests that liquidity transformation risks would be less relevant for other institutions that would play a greater role in STFMs absent MMFs, these institutions can still experience acute cash and liquidity needs which can, in turn, put strain on the STFMs; this stress would be magnified if MMFs did not exist.

If no viable or attractive MMF option was available, investors would need to find cash and liquidity management solutions in other parts of the STFMs. We agree that certain investors have found public debt MMFs to be a viable alternative to credit MMFs in USD for addressing their liquidity needs; however, this is not the only reason investors use MMFs to access the STFMs. Critically, there is insufficient public debt issuance[3], or uniformity of issuance, to create scalable public debt MMFs in other currencies, notably Euros and Sterling. Therefore, public debt MMFs are unlikely to be a replacement for prime and credit MMFs in all circumstances.

In our view, investors other options for accessing the STFMs are most likely to break down along the following:

- **Bank deposits:** It is unlikely that the banking system would be able to absorb the amount of additional cash that currently resides in prime or credit MMFs through overnight deposits as bank balance sheets are not infinitely "elastic nodes".
    - Banks in many jurisdictions have discouraged investors from placing sizeable deposits because of the impact on banks' capital and liquidity ratios and profitability, particularly if short-term rates are negative, or close to zero. These capital and profitability constraints reduce banks' ability to comfortably increase balances, especially given already high levels of excess liquidity and non-operating deposits for many banks. Investor deposits would likely be placed with lower credit quality banks, reducing both investors' cash management utility and overall STFM resilience. Additionally, deposits offer less diversification for large investors than MMFs.
- **Direct investment in CP:** If viable MMF options are limited, institutional investors with appropriate capabilities will likely turn to direct investment in CP. If this occurs without addressing the vulnerabilities in the CP market discussed

[3] Note for example there was only £59bn UK Treasury Bills outstanding as of the end of July 2021 (Treasury Bill Issuance and Stock (dmo.gov.uk)

above, the result will be a less transparent market for regulators and further fragmentation of CP secondary market liquidity during stress events.

  - Many pension plans, insurance companies, and non-financial corporates who are active investors in STFMs today rely on MMFs for material portions of their short-term investment liquidity. Many invest both directly in STFMs and MMFs, and others wholly in MMFs. Eliminating MMFs could lead to these investors increasing their direct participation in the CP market, either themselves or through unregulated entities or separately managed accounts. As a result, these investors would likely hold less liquid (and possibly less diverse) portfolios, which could increase concentration risk and result in a more opaque market. This could increase market risk during a stress event if the underlying market vulnerabilities in the STFMs are not addressed.

- **Reverse repurchase agreements**[4]: Investors could seek exposure to banks via reverse repurchase agreements ("Reverse Repo") for short-term liquidity investments but will face market access constraints: Reverse Repo is generally only available to large institutional investors, requires complex and costly infrastructure and oversight, and is subject in some jurisdictions to strict regulatory requirements. MMFs provide investors easy, diversified and convenient access to this segment of the STFMs.

- **Short-term bond funds /fixed income funds:** Short-term bond funds and longer duration fixed income funds are not a substitute for MMFs as they provide a different investment proposition with longer dated maturity profiles, different dealing, and settlement characteristics, among other features.

  Non-financial corporations and bank issuers would not look to such funds to place short-dated CP and CD and, therefore, may struggle with short-term issuance without MMFs as a ready buyer.

- **Emergence of new substitutes:** New alternatives that are already being reviewed, and in some cases used by investors, as substitutes for MMFs include supply chain finance special purpose vehicles, alternative note structures, and Stablecoins. Increased use of these alternatives could shift risk into currently unregulated areas of the financial markets and present unknown market vulnerabilities.

  - A recent research report from JP Morgan[5] estimated that Stablecoins could potentially have a footprint in the US commercial paper market that nears that of US prime MMFs. Equally, another recent report from Fitch highlighted that 'the rapid growth of Stablecoin issuance could, in time have implications for the functioning of short-term credit markets'. If short-term credit markets were to malfunction, Stablecoin could face challenges and run risk when faced with redemption pressures given Stablecoins' high proportion of collateral in commercial paper and no minimum standards (today) for liquidity or asset quality[6].

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[4] The definition of reverse repo varies in some jurisdictions. Here we are referring to repo agreements where the user places cash in exchange for collateral (usually high-quality government debt).
[5] The Financial Stability Risks of Stablecoins", Joshua Younger, Alex Roever, JP Morgan, July 22, 2021
[6] "Stablecoins Could Pose New Short-Term Credit Market Risks," Fitch Ratings research note, July 1, 2021

Further, we believe that a review of the potential impact of investors moving away from prime or credit MMFs due to fundamental reforms should more thoroughly consider the implications for borrowers in STFMs. The effect of much wider adoption of MMF substitutes on borrowers could have notable implications that require robust analysis. If prime or credit MMFs were to disappear, non-public sector borrowers' funding costs in the STFMs would likely increase and the efficiency of their funding would likely diminish.

Money Market Fund (MMF) Reform

During the GFC, MMFs' stable per share net asset value ("NAV") structure came under pressure when the Reserve Primary Fund "broke the buck" in September 2008 due to impaired credit held in its portfolio. Investors then subsequently raced to withdraw balances from a broad array of other cash and enhanced cash funds out of fear that these products might hold similarly impaired credits (as disclosure of MMF holdings was at that time limited).

Reforms in the years following the GFC were data-driven and intended to enhance systemic resilience; they included: (i) changes to the underlying portfolios – maturity limits, credit criteria, minimum liquidity levels (ii) greater transparency to investors around the underlying portfolios, (iii) changes to the structure of the MMFs – changes to how prime or credit MMFs calculated their NAV with greater reliance on mark-to-market pricing[7], fees and redemption gates, and (iv) changes to reporting – more frequent, more detailed, and stress testing.

While the root cause of the COVID-19 Crisis was drastically different than that of the GFC, the COVID-19 Crisis provided an opportunity to assess the post-GFC reforms. It is our view that, overall, the reforms [largely] addressed the vulnerabilities present in MMFs in 2008. However, the COVID-19 Crisis highlighted the need to modify certain post-GFC reforms to address remaining structural vulnerabilities in certain MMFs.

Reforms BlackRock Supports

We have outlined below a combination of recommendations that we believe will enhance the resiliency of MMFs while also preserving the product features that provide the greatest utility to investors.

The reforms implemented post-GFC were regionally specific rather than global, which reflected (and also further enhanced) structural differences in MMFs and the overall shape of STFMs in different jurisdictions. As such, we believe that it is most appropriate that subsequent reforms reflect the regional differences including, but not limited to: variations in fund structures, investor bases, and relative importance of government versus prime or credit MMFs.

That said, we believe that some reform concepts can improve the resilience of all MMFs regardless of jurisdiction and structure and have framed our suggestions in this

[7] In the US, this involved requiring institutional MMFs to float their NAV, in Europe, this required non-public debt MMFs to convert to either VNAV or LVNAV, which allows for fund-level NAV rounding if the MTM value of the portfolio is within a set tolerance of 1.00.

section in a global context, highlighting where circumstances warrant divergences.[8] We believe that fund structure (e.g. VNAV or LVNAV in Europe) was not a determining factor in the flows experienced in prime or credit MMF and that reforms should be focused on liquidity and not NAV methodology.

REMOVAL OF TIES BETWEEN REGULATORY THRESHOLDS AND IMPOSITION OF GATES AND FEES

The policy reform that would most directly address the investor behavior seen during the COVID-19 Crisis is decoupling the potential imposition of gates and fees from the regulatory liquid assets thresholds.

Regulatory liquidity thresholds are primarily a way to ensure that the MMF is organically replenishing its available portfolio liquidity. Such thresholds are therefore an indicator that can help assess a MMF's ability to meet redemptions over a relevant time period.

Due to the link between breaches of regulatory minimums and the potential imposition of gates or fees, such minimums took on outsized importance during the COVID-19 Crisis. Instead of being taken as one indicator of a MMF's overall liquidity positioning, such levels became a focal point for many investors and forced MMF managers to increase their liquidity thresholds - not because their fund was in need of more liquidity but simply to assuage investor fear of potential gates - at the same time as MMFs were experiencing redemption pressures and the STFMs were in need of buyers to facilitate market liquidity.

For this reason, the regulatory thresholds should be decoupled from the potential imposition of gates and fees to allow MMFs to use this liquidity buffer for its intended purpose without incenting investors to redeem. This would be a resiliency-enhancing reform for MMFs because it would reduce the risk of pre-emptive redemptions related to these thresholds and reduce the need to sharply increase the liquidity profile of the MMF during times of heightened redemption pressure over and above the regulatory requirements (with procyclical effect).

In addition, we recommend a decoupling of fees from gates in the regulations. Fees are the most appropriate anti-dilution mechanism for a MMF to address the liquidity cost imposed by a redeeming investor during a time of market stress. Gates, on the other hand, should be limited to extreme circumstances such as when a MMF board has made the fiduciary decision that the fund should be liquidated and, therefore, should not be equated with the use of fees.

Once decoupled from gates and liquidity thresholds, as well as detangled from investors' fear of possible gates, fees can be used for their intended purpose of imposing liquidity costs on redeeming investors during times of market stress. BlackRock believes fees are the best mechanism for a MMF to recoup the liquidity cost of a redeeming investor during a time of market stress because they allocate that cost

[8] Detail on our jurisdiction-specific reform suggestions can be found in our comment letters President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds and the ESMA Consultation on EU Money Market Fund Regulation, attached in the appendix.

while fitting within the existing operational structure of MMFs. Rather than relying on a regulatory liquidity threshold test, BlackRock suggests requiring each MMF's Board to approve parameters, in accordance with their specific MMF regulator's procedures as well as the specific attributes of the fund's portfolio and its investor base, within which a fee can be applied and designate authority to the MMF's adviser, a fiduciary, to impose fees on redemptions when those specified parameters are met. During a time of increased redemption pressure, which requires an immediate market response, the MMF adviser would be able to impose fees within the parameters set by the MMF's Board and thereafter provide the MMF's Board with timely information for their oversight purposes.

ADDITIONAL LIQUIDITY REQUIREMENTS

The COVID-19 Crisis – where many MMFs faced heightened redemptions – highlighted the need to ensure that MMFs are provisioned with enough overnight liquidity to meet even significant outflow pressures. **As such, BlackRock supports not only retaining the regulatory liquidity thresholds as a portfolio construction feature but also increasing the MMF's minimum level of overnight liquidity[9] to at least 15%, with minimums depending on the MMF's currency denomination.**

Overnight liquidity *(which is cash on hand during the trading day but placed on either a secured or unsecured basis overnight*) is the key tool by which MMFs meet redemptions. The turnover of overnight liquidity into cash on hand the next trading day is non-dilutive, unlike sales of assets with remaining residual maturity. This means there is no need for fund-level liquidity management mechanisms when MMFs are functioning normally.

BlackRock believes that it is appropriate for USD-denominated prime or credit MMFs to hold a minimum of 20% of their assets in overnight liquidity[10].

- This increase reflects the breadth and depth of US dollar markets, which has a wide range of bank counterparties that accept US dollars, and the effect of the US Federal Reserve's Reverse Repo Program ("RRP"), which ensures that any reduction in the capacity of the banking system to accept deposits or act as a reverse repo counterparty does not result in a liquidity disruption.
- For offshore US dollar MMFs that do not have access to a RRP, it may be necessary for such MMFs to allocate 5% of the minimum 20% overnight liquidity to US dollar Treasury Securities or to US dollar Government Debt MMFs.
- The higher level of minimum overnight liquidity for US dollar MMFs both reflects the ability of US dollar markets to absorb the increased demand for overnight deposits and reverse repos, but also reflects the reality observed in

[9] Currently, all US 2a-7 MMFs (excluding tax exempt funds), EU short-term Public Debt CNAV, and LVNAV MMFs are required to have a minimum overnight liquidity level of 10% of the funds' assets; in Europe, both short-term and standard VNAV funds have lower overnight liquidity requirements of 7.5%.
[10] US 2a-7 tax exempt funds would continue to be exempt from maintaining a minimum overnight level of liquidity.

March of 2020 that US dollar MMFs (in the US and Europe) experienced greater redemption pressures than Euro (EUR) or Sterling (GBP) MMFs[11].

We believe that it is appropriate for Euro and Sterling denominated MMFs to hold a minimum of 15% of their assets in overnight liquidity.

- EUR and GBP markets have a smaller number of banks that can provide significant balance sheet capacity for cash deposits or act as reverse repo counterparties. Additionally, there is no equivalent program to the RRP from the ECB or the Bank of England to accept cash from non-banks. Therefore, a 20% minimum overnight maturity requirement for Euro or Sterling MMFs could create risks that MMFs would be unable to place that volume of cash on certain dates.
- We believe that 15% would both ensure that MMFs are strongly provisioned to meet even significant redemption pressures while minimizing the risk of disruptions due to the inability to place cash at all times.

MARGIN REQUIREMENT RECOMMENDATIONS

Post-GFC reforms to swaps and derivatives clearing greatly enhanced financial systemic resilience. They also increased the need for many participants in these markets to hold cash and liquidity portfolios in order to meet potential margin requirements. For many investors, MMFs have been a critical tool to help manage these needs.

We observed that for some MMFs, a significant driver of client redemptions in March 2020 was their need to raise liquidity to post margin. The European Central Bank pointed out a strong correlation between the margin requirements of European pension funds and observed outflows from EUR Low Volatility Net Asset Value ("LVNAV") MMFs. We recommend that MMF units /shares be deemed eligible for uncleared and cleared margin globally, as well as for reinvestment by Central Clearing Counterparties. If MMFs units/shares could be directly posted as margin, the interplay between increasing margin requirements and increased redemption pressures on MMFs would decrease.

Reforms BlackRock Does Not Support

BlackRock believes that swing pricing, minimum balance at risk, capital buffer requirements, and changing the terms for redemption will likely result in the elimination of MMFs. Additionally, BlackRock does not believe that liquidity exchange banks or concentration limits will address any of the root causes of the issues in MMFs during the COVID-19 Crisis. We believe the following reforms would either render MMFs unviable, inappropriately shift risk to the sponsor or other funds, or address credit risks that were not a root cause of this Crisis and that were addressed post-GFC. We provide more detail below.

- Asset managers have used **swing pricing** as an anti-dilution investor protection tool for non-MMF OEFs in major fund jurisdictions for over twenty years. It protects remaining investors in a fund from transaction costs generated by the

[11] See Appendix 3

redemption and subscription requests of other investors. While OEF swing pricing can incentivize investors to spread large transactions over time to reduce transaction costs, it *does not* and *should not* change strategic allocation decisions by investors responding to market conditions or individual investment requirements.

While OEF swing pricing *does* remove the first mover advantage *in funds* by eliminating incentives created by the fund structure for some investors to transact in advance of others, it *does not* address first-mover advantage *in markets:* that is, the advantage for market participants to take up available market liquidity ahead of other market participants.

Swing pricing is not appropriate for MMFs. MMF redemptions are generally paid from cash on hand (which comes from maturing assets or overnight liquidity and is non-dilutive for the MMF), not by selling assets from the portfolio as with OEFs. MMF swing pricing therefore would bring theoretical benefits only in extreme circumstances where a fund cannot pay redemptions without selling assets (again, MMFs pay redemptions from cash on hand, which does not generate transaction costs). On the other hand, liquidity fees would more appropriately address the cost to the MMF of redeeming investors.

Additionally, there are a number of idiosyncratic issues specific to MMFs that make swing pricing operationally challenging. Two key features are (i) a T+0 settlement structure and (ii) multiple NAV strikes in a day. The T+0 settlement feature, which is critical to investors in many MMFs, would make the implementation of swing pricing even more challenging as we do not believe it permits enough time for price discovery to calculate the appropriate swing factor to apply prior to the need to send redemption proceeds out. Additionally, the timing problem is magnified further for those MMFs that strike a NAV multiple times a day as there would not be sufficient time to implement a swing factor between NAV cutoffs.

We believe the changes that would be needed to make swing pricing operationally feasible within a MMF would make the product critically unappealing to investors. Conversely, fees are already operationally feasible, as the fee structure fits easily into the back-end infrastructure of MMFs while providing the same effect of directing costs to redeeming shareholders.

- Imposing a **minimum balance at risk** effectively creates a rolling gate. Liquidity investors will not be interested in investing in a MMF with this feature and it would be operationally extremely challenging to implement. We explored this idea in our 2012 Viewpoint, "Money Market Funds: A Path Forward." In our discussions with US MMF clients at that time, they uniformly told us they would abandon the product if redemption holdbacks or capital requirements were implemented.
- **Capital buffers**, which can have various constructions, are an ineffective tool with respect to liquidity redemption pressure because they are a tool intended to address credit risk concerns. Importantly, the cost of imposing capital buffer requirements is expected to be prohibitive, especially in the current low-yield environment. Fund sponsors are unlikely to be willing to offer MMFs with this feature. Additionally, BlackRock disagrees with the Consultation Report's finding that capital buffer requirements would preserve the cash-like features of MMFs. BlackRock believes that absent the tie to liquidity thresholds, the

combination of fees and reforms to how prime or credit MMFs calculate their NAVs in the US and Europe, introduced post-GFC, would appropriately allow funds to manage their redemptions, precluding the need for a capital buffer.

- **Changing the terms for redeeming MMF shares** in order to reduce liquidity transformation would eliminate investor utility. The ability to offer same day liquidity is key to the utility of a MMF for investors. Changing the terms for redemptions to non-daily dealing and/or liquidity-based redemption deferrals would also likely impact the 'cash equivalence' accounting treatment that many investors and some regulators give to MMFs. This is an important factor for many MMF investors, especially corporates. Other redemption alternatives, like redemptions in-kind, would also likely become operationally challenging and would result in a decreased investor base. These options would make MMFs less cash-like, which could result in more significant shifts by investors towards less transparent alternative products, especially those with cash-like features.
- Requiring **liquidity exchange bank** membership was explored at length in the debates leading up to the 2010 MMF reforms and the 2014 MMF reforms. We are opposed to this approach as it socializes risk across fund sponsors who have no control over each other's actions. This approach could incentivize certain MMFs to take more risks at the expense of the other MMFs.
- **Concentration limits** would disperse investments across funds amplifying potential contagion risk across MMFs during times of stress. The US and EU MMF regulations already strive to address client concentration risks, with rating agency criteria and internal stress testing models further supplementing the ability to manage investor concentration. However, in order for portfolio managers to be able to better manage the liquidity of their MMFs, asset managers should be given anonymized data on the investors in their funds such as flow per entity and type of entity (e.g. hedge fund, retail, etc.).

Conclusion

BlackRock thanks the FSB for the opportunity to comment on the Consultation Report. We appreciate and support policymakers' efforts to further strengthen the STFMs and MMFs. In addition to our own response, we have contributed to the responses of several wider industry associations and would like to express our support for these submissions; in particular, we support the submissions of the Investment Company Institute ("ICI"), the European Fund and Asset Management Association ("EFAMA"), the International Capital Markets Association ("ICMA"), and the Institutional Money Market Fund Association ("IMMFA").

We welcome any additional questions or further discussion and remain at your disposal should you require any further input.

Sincerely,

Thomas Callahan
Managing Director, Global Head of Cash Management Business

Carey Evans
Managing Director, Global Public Policy Group

Elizabeth Kent
Managing Director, Global Public Policy Group

Appendix 1: BlackRock's response to the President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds

Dear Ms. Countryman:

BlackRock, Inc. (together with its affiliates, "BlackRock") respectfully submits this comment letter to the Securities and Exchange Commission ("SEC" or "Commission") in response to the President's Working Group on Financial Market's report, "Overview of Recent Events and Potential Reform Options for Money Market Funds" (the "Report"). We appreciate the opportunity to comment on the Report and share our views on further strengthening the resiliency of money market funds.

The disruption to the markets in March of 2020 as a result of COVID-19 (the "COVID-19 Crisis") highlighted weaknesses in money market funds ("MMFs") and the surrounding short-term market ecosystem. We believe this affords regulators and market participants the opportunity to revisit and improve the resilience of MMFs and the short-term markets. As noted in our recent ViewPoint "Lessons from COVID-19: U.S. Short-Term Money Markets", we recommend that policymakers look holistically at short-term markets to identify areas for improvement rather than look at MMFs in isolation. We outline three areas for improvement in commercial paper market structure, banks' role as intermediaries, and MMFs.

- First, in the current **commercial paper ("CP") market structure**, market participants must frequently ask the bank from whom they purchased the CP to bid that paper back in the secondary market when they want to sell it. Typically, banks are unwilling to bid CP from issuers where they are not a named dealer on the issuer's program. This "single source of liquidity" model failed during the COVID-19 Crisis and will fail again in the next liquidity crisis if fundamental changes to the CP market structure are not implemented, especially in light of current bank regulations. *We recommend that the SEC convene a group of banks, issuers, MMFs and other market participants to study potential CP market reforms. Ideas we recommend for consideration include: (i) standardization in the CP market and (ii) an all-to-all platform in primary and secondary trading to deepen the pool of liquidity providers*.

- Second, the strength of the **banks**' balance sheets provided an opportunity for prudential regulators to selectively dial back some of the regulations imposed after the Great Financial Crisis of 2008-2009 ("GFC"), effectively treating bank capital and liquidity as countercyclical buffers in a crisis. However, this capacity was used solely for lending and was not used for market making. *We recommend policymakers provide guidance on what provisions of the banking regulations might be relaxed in a future market liquidity crisis to provide additional liquidity to the market.* Additionally, we believe that banks are better holders of CP relative to other investors such as corporates, particularly during periods of stress, as they have more options available to them for financing. *In order to incentivize banks to bid CP in times of market stress, we recommend the highest rated CP be treated as a high-quality liquid asset ("HQLA") for purposes of a bank's liquidity coverage ratio ("LCR").* As displayed in the data below, there were no defaults in any CP program in 2020, emphasizing that the issues in the CP market were not due to credit quality concerns. We understand that changing the HQLA formula may be outside the remit of the President's Working Group, but this is worthy of consideration given CP's importance to the short-term market ecosystem.

Financial Institutions (excluding Insurance Companies) Commercial Paper

Credit Ratings as of 12/31/2019		Credit Ratings as of 12/31/2020 (Percent)				Other Outcomes During 12/31/2019 - 12/31/2020 (Percent)	
Credit Ratings	Number of Ratings Outstanding	P-1	P-2	P-3	NP	Withdrawn	Default
P-1	289	94.5%	2.1%	0.0%	0.0%	3.5%	0.0%
P-2	71	1.4%	93.0%	2.8%	0.0%	2.8%	0.0%
P-3	8	0.0%	12.5%	75.0%	12.5%	0.0%	0.0%
NP	13	0.0%	0.0%	0.0%	53.8%	46.2%	0.0%
Total	381						

Insurance Company Commercial Paper

Credit Ratings as of 12/31/2019		Credit Ratings as of 12/31/2020 (Percent)				Other Outcomes During 12/31/2019 - 12/31/2020 (Percent)	
Credit Ratings	Number of Ratings Outstanding	P-1	P-2	P-3	NP	Withdrawn	Default
P-1	19	94.7%	5.3%	0.0%	0.0%	0.0%	0.0%
P-2	15	0.0%	80.0%	0.0%	0.0%	20.0%	0.0%
P-3	2	0.0%	0.0%	100.0%	0.0%	0.0%	0.0%
NP	-						
Total	36						

Nonfinancial Corporates Commercial Paper

Credit Ratings as of 12/31/2019		Credit Ratings as of 12/31/2020 (Percent)				Other Outcomes During 12/31/2019 - 12/31/2020 (Percent)	
Credit Ratings	Number of Ratings Outstanding	P-1	P-2	P-3	NP	Withdrawn	Default
P-1	209	89.0%	7.2%	0.0%	0.0%	3.8%	0.0%
P-2	374	0.5%	91.7%	1.9%	0.8%	5.1%	0.0%
P-3	59	0.0%	8.5%	64.4%	16.9%	10.2%	0.0%
NP	32	0.0%	0.0%	0.0%	81.3%	18.8%	0.0%
Total	674						

Asset Backed Commercial Paper

Credit Ratings as of 12/31/2019		Credit Ratings as of 12/31/2020 (Percent)				Other Outcomes During 12/31/2019 - 12/31/2020 (Percent)	
Credit Ratings	Number of Ratings Outstanding	P-1	P-2	P-3	NP	Withdrawn	Default
P-1	113	93.8%	0.0%	0.0%	0.0%	6.2%	0.0%
P-2	2	0.0%	100.0%	0.0%	0.0%	0.0%	0.0%
P-3	1	0.0%	0.0%	0.0%	100.0%	0.0%	0.0%
NP	-						
Total	116						

Source: Ratings Transition Matrix for FY 2020, Moody's

- Third, we recommend a detailed review of MMFs to identify possible improvements to these products. We note that **government MMFs** performed well and we do not recommend any further reforms of these funds. Given the recent experience with the potential for triggering the implementation of liquidity fees and redemption gates creating uncertainty among investors in **non-government MMFs**, *we recommend decoupling the potential imposition of liquidity fees and redemption gates from the 30% weekly liquid asset ("WLA") threshold. In addition, we recommend generally retaining the 30% WLA requirement as a portfolio construction feature to provide MMFs a substantial liquidity buffer*[12]. During the COVID-19 Crisis, the WLA threshold held in MMFs was similar to banks holding significant liquidity but not being able to use it. As such, *we recommend that the SEC provide clear guidance on whether a non-government MMF can waiver or modify the 30% WLA requirement during periods of market stress and provide parameters for such waiver or modification*. Additionally, to further enhance the resiliency of Prime MMFs, *we recommend adjusting the portfolio requirements of these MMFs, prohibiting the purchase of CP that does not have "strong capacity for repayment" and eliminating the 5% illiquid bucket*. Separately, mutual fund boards should have the ability to implement liquidity fees and redemption gates at any time that they deem it to be in the best interests of a MMF. Finally, we note that improvements made in bank regulation and CP market structure would be beneficial to all purchasers of CP generally, including MMFs.

With the context of our overall views on how short-term markets can be strengthened laid out above, we categorize the President's Working Group's proposed reforms to MMFs into three categories: those that BlackRock supports, those that might be beneficial for investors and MMFs but require additional analysis, and those that would make Prime and Municipal MMFs unattractive to investors, and expensive or operationally difficult to implement. We note that the third category is likely to lead to the end of these non-government MMFs and recommend considering an outright ban on these products rather than pursuing complex implementation plans if these reforms are considered.

Reforms BlackRock Supports

BlackRock is supportive of the President's Working Group's proposed reform for removing the tie between the 30% weekly liquidity requirements and liquidity fee and

[12] We recommend studying whether the 10% WLA level might remain as a threshold for Board action.

redemption gate thresholds, which directly tracks our suggested action in our ViewPoint noted above. While we believe decoupling liquidity fee and redemption gate considerations from the 30% WLA threshold is a critical element of any MMF reform, we recognize that additional reforms should be paired with this for the optimal outcome. In addition, we recommend studying whether the lower 10% WLA level might remain as a threshold for Board action or whether that threshold should also be decoupled.

We are additionally supportive of codifying the suggested countercyclical WLA requirements. We recommend this <u>in addition to</u> decoupling the link between WLA and redemption gates and liquidity fees. Lowering the minimum WLA requirements in times of market stress would send a strong signal to the market that the buffer is intended to be used. Consequently, investors would be less concerned about the imposition of liquidity fees or redemption gates. We recommend that the parameters for relaxing the 30% WLA threshold should be proscribed by the SEC in a revised final rule to provide uniform and consistent adoption across the MMF industry.

In March 2020, the Office of the Comptroller of the Currency's ("OCC") allowed for a temporary extension of maturity limits (Weighted Average Maturity and Weighted Average Life limits), for short term investment funds, allowing these funds to continue to operate in an orderly fashion while permitting them to use some of their shorter maturity holdings for redemptions. This was a good example of a regulator setting out clear guidelines to take countercyclical measures during the crisis.

We believe that the ability to use some of the liquidity within a MMF during a crisis period without the threat of a redemption gate or a liquidity fee, under proscribed measures, could be similarly beneficial. We recommend further study to understand how much liquidity could be used and whether to set a hard lower limit (see the response to *Changing the conditions for imposing redemption gates* below).

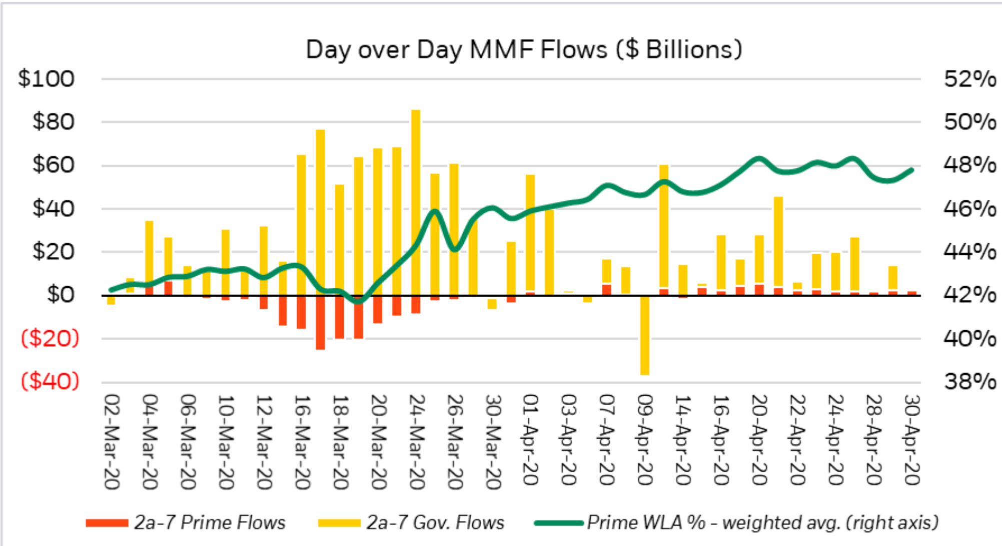
Portfolio construction criteria. In our Viewpoint, we also propose reconsidering portfolio construction criteria, an idea not covered in the PWG's proposed recommendations. Specifically, prohibiting CP that does not have a "strong capacity for repayment" and eliminating the 5% illiquid bucket could help improve prime MMFs credit quality and maturity profiles.

<u>Reforms that Require Additional Analysis</u>

The following proposed reforms recommending changing the conditions for imposing redemption gates, implementing a new category of MMF liquidity management requirements, and implementing floating NAVs for all prime and tax-exempt MMFs require additional analysis to understand whether they would be beneficial to investors and MMFs and whether they would help prevent a run during a liquidity crisis.

Changing the conditions for imposing redemption gates would require the consideration of (i) how redemption gates are implemented and (ii) when redemption gates are implemented. In our view, requiring MMFs to ask permission from the SEC prior to implementing redemption gates would be unlikely to prevent the run scenario experienced in March 2020. The issue is not that investors lack trust in fund boards to make good decisions; rather the issue is fundamentally the risk of the redemption gates themselves regardless of who authorizes them. The sequencing of redemption gates and liquidity fees is also largely irrelevant as we believe both redemption gates and liquidity fees raised concerns for MMF investors in March 2020 and created "run" incentives during this period of market liquidity stress. Retaining the WLA threshold as a portfolio requirement and decoupling the WLA threshold for considering a redemption gate could enable a MMF to use its liquidity buffer as described in our ViewPoint. Looking at the redemption behavior in March 2020, allowing a MMF to use the buffer below 30% WLA while perhaps leaving the 10% WLA level for a MMF board to consider a redemption gate or liquidity fee merits further consideration.

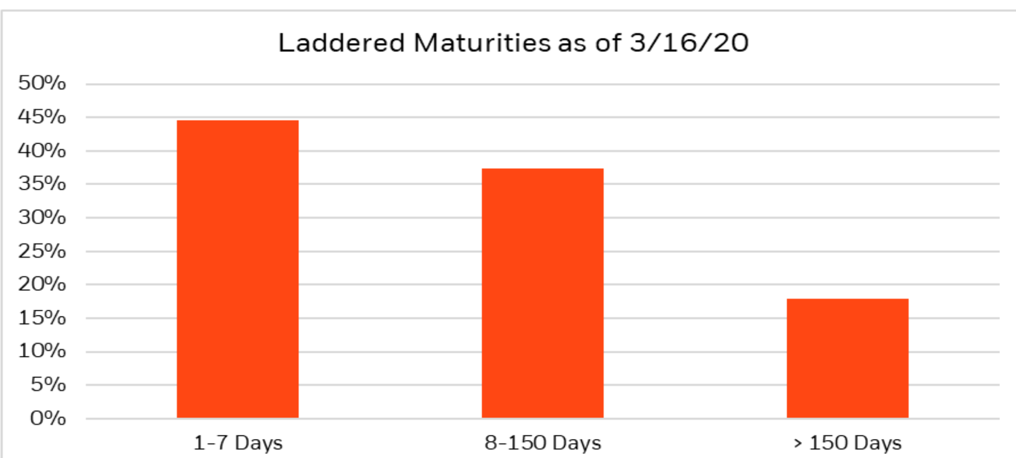
In the chart below, it is clear that the weighted average WLA across prime MMFs remained well above 30% throughout March 2020 as fund sponsors built WLA levels well above 40% in order to alleviate investors' concerns that a redemption gate or liquidity fee might be imposed[13].



Source: iMoneyNet

The suggested **implementation of a new category of MMF liquidity management requirements** appears to address a perceived concern that MMF holdings were barbelled. While we have not seen evidence that barbelling was a problem in March 2020, or that MMFs' portfolios were generally structured with a barbell, we believe studying the impact of shorter maturity requirements for non-government MMFs would be useful.

The graph below shows a representative BlackRock prime MMF as of the March liquidity crisis. We believe this was not an unusual maturity structure for non-Government MMFs at the time. As you can see, this prime MMF held nearly 40% in short-term securities with 8 to 150 days to maturity, and the MMF did not employ a barbell strategy.



Source: BlackRock

[13] According to iMoneyNet, 104 of 31,141 (0.3%) funds reported a WLA below 30% from February 28, 2020 to April 30, 2020.

In March 2020, the problem MMFs faced was the 'dash for cash' across the entire market which resulted in wholesale redemption requests simultaneous to a closed secondary market. Changing the maturity lengths or threshold levels within a MMF might help on the margin but would not address the root problem as even high-quality overnight CP met "no bid" in the market during the worst days in March. To address the liquidity problem at the root, we recommend addressing the CP market directly as outlined in our ViewPoint. We conclude that, on its own, this proposal is unlikely to solve the resiliency issues of non-government MMFs.

Converting all **Retail prime and tax-exempt MMFs to a floating NAV ("FNAV")** is unlikely to address the issues seen in March. This idea may warrant further study to ascertain any other potential benefits as well as any concerns. We note that existing FNAV MMFs faced redemption challenges due to a dash for cash amid the perception of the impending imposition of liquidity fees or redemption gates. We believe converting retail prime and tax-exempt MMFs to FNAV would likely lead to a significant reduction in the number of these funds available. We recommend studying both fund sponsor willingness and investor demand for FNAV products before proceeding with this option. We note that many intermediaries have operational issues with supporting FNAV funds which would need to be addressed and these intermediaries may choose to instead stop offering non-government MMFs.

Reforms That Would Likely Lead to the End of Non-Government MMFs

We believe the proposals which impose a minimum balance at risk, capital buffer requirements, liquidity exchange bank membership requirements, governing sponsor support, and implementing a swing pricing framework each require extensive changes to funds and the operating environment for funds and these changes will likely result in the elimination of both prime and municipal institutional MMFs. Policymakers should consider an outright ban rather than requiring complex and expensive changes that will result in the elimination of these funds.

- Imposing a **minimum balance at risk** effectively creates a rolling gate. Liquidity investors will not be interested in investing in a MMF with this feature and it would be operationally extremely challenging to implement. We explored this idea in our 2012 Viewpoint, "Money Market Funds: A Path Forward." In our discussions with US MMF clients at that time, they uniformly told us they would abandon the product if redemption holdbacks or capital requirements were implemented.
- The cost of **imposing capital buffer requirements** is expected to be prohibitive, especially in the current low-yield environment. Fund sponsors are unlikely to be willing to offer MMFs with this feature.
- **Requiring liquidity exchange bank membership** was explored at length in the debates leading up to the 2010 MMF reforms and the 2014 MMF reforms. We are opposed to this approach as it socializes risk across fund sponsors who have no control over each other's actions. This approach could incentivize certain MMFs to take more risks at the expense of the other MMFs.
- **A regulatory framework governing sponsor support** would reduce the pool of potential MMF sponsors as some current sponsors might be unable to commit to providing support. Bank sponsors that can commit to sponsor support will need to evaluate any new bank regulations which are likely to address bank sponsors' capital and liquidity needs associated with offering MMFs. We note that in the US, the Federal Reserve and the SEC gave banks waivers to purchase securities in March 2020 and we assume bank sponsors will be subjected to new capital and liquidity requirements if such waivers are to be available. Finally, this approach would codify regulatory inconsistency as sponsor support is prohibited in the EU.
- While **swing pricing** has been used successfully in some open-end funds in certain jurisdictions in Europe, there are a number of idiosyncratic issues specific to MMFs that make swing pricing operationally challenging. Two key features are (i) a T+0 settlement structure and (ii) multiple NAV strikes in a day. We note that swing pricing has been

permitted for non-MMF US open-end mutual funds for several years, yet the ecosystem for mutual funds in the US includes late fund closing times and tight turn arounds. As a result, swing pricing has not been implemented in the US even for non-MMF open-end funds. The T+0 settlement feature, which is critical to investors in many MMFs, would make the implementation of swing pricing even more challenging as we do not believe it permits enough time for price discovery to calculate the appropriate swing factor to apply. Additionally, the timing problem is magnified further for those MMFs that strike a NAV multiple times a day as there would not be sufficient time to implement a swing factor between NAV cutoffs. We believe the changes that would be needed to make swing pricing operationally feasible would make the product critically unappealing to investors. *Conversely, liquidity fees are already operationally feasible in MMFs while providing the same effect of directing costs to redeeming shareholders.*

Looking beyond MMF and short-term market reform, we could explore potential new structures to serve as an alternative to MMFs by expanding the definition of cash equivalents to encompass additional structures. Several alternative structures already exist, such as ETFs. These structures would require a cash equivalency designation to overcome the hurdles for cash investor adoption. Many of these alternative options, such as ETFs, proved resilient and were a source of stability through the March market volatility by continuing to trade efficiently, despite deteriorating liquidity in the underlying market, which provided price discovery for investors and banks.

BlackRock thanks the Commission for the opportunity to comment on the Report. We appreciate and support your efforts to further strengthen MMFs following the COVID-19 Crisis and we welcome any additional questions or further discussion.

Sincerely,

Thomas Callahan
Managing Director, Global Head of Cash Management Business

Kate Fulton
Managing Director, Head of US Public Policy

Appendix 2: BlackRock's response to the ESMA Consultation on EU Money Market Fund Regulation.

Re: Consultation Report – EU Money Market Fund Regulation – legislative review
BlackRock[14] appreciates the opportunity to respond to the questions raised by ESMA in its consultation on the review of the EU Money Market Fund Regulation (MMFR).

The short-term markets experienced sharp stresses in March of 2020 because of COVID 19 and an overall flight to liquidity. This highlighted potential weaknesses in money market funds (MMFs) and vulnerabilities in the surrounding short-term market ecosystem. Such an unprecedented market-wide event affords regulators and market participants the opportunity to draw conclusions from a live 'stress test' that can help improve the resilience of MMFs and the short-term markets.

In forming a clear view of the stresses on MMFs in March 2020, it is important to note first and foremost, that the experience of US and European MMFs was different; and again, within Europe, the dynamics varied across different fund types and currencies. While the extent of, and underlying reasons for, client redemptions differed, one universal observation shared by MMFs in the US and across Europe is that the short-term credit markets were highly distressed, with bank dealer-driven liquidity severely constrained.

The liquidity of the entire short-term market ecosystem in the US improved quickly and dramatically upon the introduction of the U.S. Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF) and other facilities which both provided bank dealers with a dedicated liquidity backstop and ensured any liquidity they provided to the market was capital neutral. In Europe, however, market interventions by the European Central Bank (ECB) and Bank of England (BoE) had a far more indirect effect; as a result, the European short-term market ecosystem did not return to more normal liquidity conditions for months.

As noted in our recent ViewPoint "Lessons from COVID 19: The Experience of European MMFs in Short-Term Markets", we recommend that policy makers look holistically at shortterm markets to identify areas for improvement rather than look at MMFs in isolation. We outline three areas for improvement: short-term market structure; bank capital and liquidity rules; and MMF product regulation. It is our view that improvement in all three areas is essential to enable short term markets (and in turn MMFs which provide the most transparent access to these markets) to respond effectively to potential future shocks of the magnitude of that experienced in March of last year.

We appreciate that the subject of this consultation focuses on the final element of that holistic view: MMF product regulation and in particular on identifying potential vulnerabilities exposed by the COVID-related market turmoil. We would summarise our input to this consultation around four key observations:

1. **March 2020 was fundamentally a liquidity shock, and the primary policy question this should raise is whether or not MMFs' portfolios were positioned with sufficient levels of useable liquidity to navigate the situation.**

   We are strongly supportive of the proposal to decouple the mandatory consideration of redemption gates or fees when an MMF breaches its weekly liquid asset (WLA)

[14] 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. We are a global leader in cash and liquidity management; in Europe we manage Public Debt Constant NAV (CNAV) MMFs, Low-Volatility NAV (LVNAV) MMFs, short-term Variable NAV (VNAV) MMFs, and Standard VNAV MMFs (which we market as Ultra-Short Duration Bond Funds) in all three main currencies (EUR, USD, GBP).

thresholds. In practice during March 2020, this meant that many funds that had ample liquidity were nevertheless incentivised not to draw it down, but rather to significantly *increase* the liquidity of the portfolio, in many cases by selling longerdated assets and not rolling over new paper.

2. **In situations where short-term liquidity is insufficient to meet redemptions, MMFs need tools to manage any dilutive effect of selling longer-dated securities to meet redemptions.**

Whilst many MMFs sought to raise their levels of WLA through asset sales, we did not observe any European short-term MMFs (the parts of the market ecosystem for which we have available data) experiencing redemptions in excess of their daily liquid assets levels, which would have required them to sell assets to meet outflows. Nevertheless, we appreciate the need for MMFs to have the appropriate tools to manage liquidity stresses in circumstances where this may be necessary. We are therefore supportive of creating a framework around the ability to apply liquidity fees during such instances. However, the regulatory construct of these tools must be appropriately cautious to not create first-mover advantages where they do not exist today; we are therefore supportive of Fund Boards making the final decision on their use.

We do not support the mandated use of swing pricing for MMFs; despite the clear use case in other types of open-ended mutual funds, the unique features of MMFs mean that swing pricing would be extremely challenging to operationalise while maintaining the features that investors value most. Furthermore, swing pricing would be a more complex way to deliver the same outcome as a liquidity fee framework.

3. **With the possible exception of the rotation from prime MMFs into government MMFs observed in the US market and the (less-severe) spillover we saw in USD LVNAV funds, outflows were driven by investors' underlying cash and liquidity needs**, ***not*** **by investor confidence in the structural features of different types of MMFs.**

We do not support the elimination of either Public Debt CNAV or LVNAV MMFs. Both types of funds are highly valued by investors, and we do not believe that the data supports the idea that either fund type exhibited unique structural vulnerabilities or were in any way less resilient than VNAV MMFs.

We note the particular focus on LVNAV MMFs throughout this consultation paper. It is important to emphasise that we view LVNAV MMFs as fundamentally VNAV, not stable NAV funds as their pricing and dealing is contingent on mark-to-market valuation of the portfolio. Operationally, we run LVNAV funds in exactly the same way as we do short-term VNAV MMFs; this has the added benefit of ensuring that they would continue dealing seamlessly were a fund to breach the 20bps collar. Their VNAV nature could be further underpinned by removing the ability to use amortised cost accounting for assets under 75 days to residual maturity.

Finally, a number of assessments of the impact of the March 2020 market turmoil on European MMFs have highlighted that in addition to USD LVNAVs, the other structure which came under the most notable outflow pressures were EUR Standard VNAV funds. As a manager of both short-term and standard VNAV funds, we would welcome further reflection from ESMA on the regulatory framework for these funds.

4. **Beyond any specific reforms to money market funds, we believe that transparency can and should improve in short term markets where data about issuers, investors, and even some MMFs can be difficult to source for both market**

participants and public authorities. We are highly supportive of efforts to bring more transparency to the underlying markets, and equally supportive of more frequent reporting by MMFs, as suggested in the consultation paper.

We commend the structure of ESMA's request for feedback not just on the specifics of the policy options presented in the paper, but on the potential impact on investors and any broader macro implications of pursuing specific reforms. We believe these are incredibly important considerations and should be central to shaping future policy.

MMFs play an extremely important role for a wide range of investors. In recent years, regulatory reform has heightened the importance of intra-day cash movement, for example collateral movements, and capital and interest rate pressures have reduced the willingness and capacity of banks to have this cash move through their balance sheets. Combined, these factors have meant that short-term markets play a more important role in liquidity management for a wide range of companies and market participants.

Investors have been using MMFs to diversify their counterparty risk (government deposit schemes only cover retail investors, so companies take counterparty risk with bank deposits: MMFs give them exposure to a diversified portfolio of underlying issuers) for many years. Increasingly the investor focus is on the quality of an MMF's risk management and liquidity provisioning through intraday settlement. Additionally, many investors have specific preferences for Government Debt CNAV funds or LVNAV funds for tax, accounting or operational reasons. In short-term MMFs, yield is not a primary consideration (for many investors, the yield on a short-term MMF – whether invested in government securities or credit – is often *less* than a bank deposit), though many investors do use Standard MMFs (often called ultra-short duration bond funds) for yield uplift.

Any policies which seek to remedy identified vulnerabilities should be considered within the use case for MMFs generally and within the specific fund structures. If regulatory measures remove the specific features that investors rely on, there is no guarantee that those investors will simply migrate to other MMF structures. Equally, it is unlikely that the banking system would be able to absorb this additional cash in overnight deposits as bank balance sheets are not infinitely elastic nodes. This may force clients into less liquid, higher risk or more opaque money market products with same day access or term products with breakage clauses if liquidity is needed.

MMFs, because they are the most transparent point within the short-term market ecosystem, are often seen as analogous to the entire investor base in short-term markets, but this is not the case. There are a variety of other investor types who invest in these markets directly, and if the use case of MMFs is removed through regulatory reforms, it is likely that direct investment through investors' own in-house treasuries would increase. This would result in more disaggregated, opaque markets, and less direct regulatory oversight over the investor base in the short-term markets. And as direct investors would likely not be holding the same quantity and quality of overnight and short-dated liquidity as a MMF would, in a future disruption in short-term markets, a wide range of companies and market participants may have far greater difficulty raising cash than was actually experienced in March of last year. This could increase, rather than reduce, the potential need for public sector interventions to support market functioning.

We appreciate the opportunity to raise these and other issues contained in our responses to the questions set out in the consultation. We would be delighted to work with ESMA and other European public authorities to provide any insight or data that could aid the process of analysing the effects of March 2020 and developing an appropriate and effective regulatory and policy response.

We remain at your disposal should you require any further input.

Sincerely,

Peter Loehnert
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Head of International Cash Management
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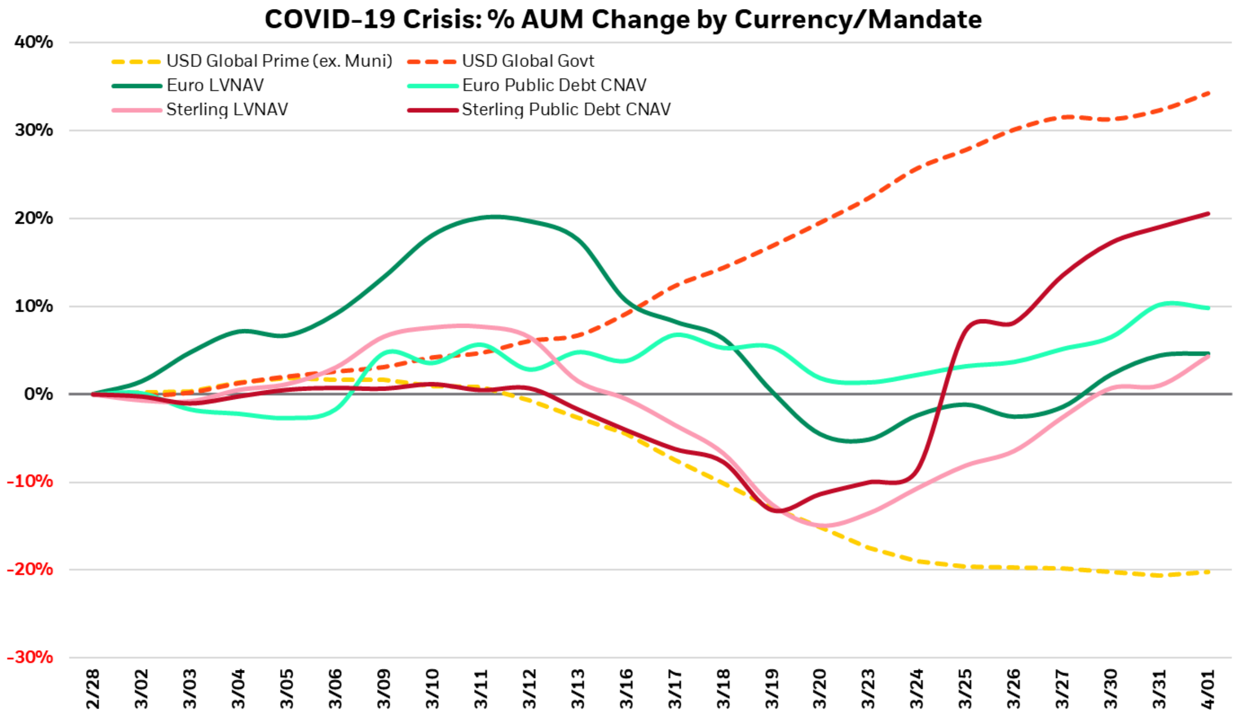
Carey Evans
Managing Director
Global Public Policy Group
carey.evans@blackrock.com

Please see hyperlink for the full response.

Appendix 3: COVID-19 Crisis % AUM Change by Currency /Mandate



Source: iMoneyNet

USD Global Prime includes 2a-7 prime MMFs (Institutional and Retail) and ESMA USD LVNAV MMFs domiciled in the EU or UK.

USD Global Govt includes 2a-7 government MMFs and ESMA USD public debt MMFs domiciled in the EU or UK.

Euro LVNAV, Sterling LVNAV, Euro public debt and Sterling public debt figures include all funds reporting to iMoneyNet in these categories and domiciled in the EU or UK.

Appendix 4: European MMF Experience (from BlackRock's response to the ESMA Consultation, above)

MMF type	Peak average daily outflows	Minimum overnight liquidity requirement	Peak average weekly outflows	Minimum WLA requirement	March total flows	April total flows
USD LVNAV	-6%*	10%	-15%*	30%	-28%*	+19%*
EUR LVNAV	-6%*	10%	-16%*	30%	+4%*	+2%*
GBP LVNAV	-3%*	10%	-9%*	30%	+5%*	+7%*
EUR Standard VNAV#	*no marketwide data*	7.5%	*no marketwide data*	15%	-15%**	-3%***

Sources: *iMoneyNet; #due to data availability, sample is limited to French-domiciled EUR Standard VNAV funds; **Banque de France, Financial overview of Investment Funds – France Q1 2020; ***Morningstar; all figures rounded to nearest %