BLACKROCK

14 January 2013

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel, Switzerland

Via e-mail: fsb@bis.org

RE: Consultative Documents – Strengthening Oversight and Regulation of Shadow Banking

Dear Sir or Madam:

BlackRock, Inc. ("BlackRock") appreciates the opportunity to submit comments on the following three sets of proposals: the policy recommendations for money market funds ("MMFs") issued by the International Organization of Securities Commissions ("IOSCO") and developed as a part of the Financial Stability Board's (the "FSB") shadow banking workstream ("WS2") in October 2012, as well as the proposals contained in the Overview of Policy Recommendations and the Consultative Documents entitled, "A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"[1] and "A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos"[2] issued by the FSB on November 18, 2012 (together, the "Proposals"). This comment letter will address the questions explicitly raised by each of the Proposals in turn.

Financial regulatory reform fundamentally impacts asset managers and end-investors. As a fiduciary for our clients, BlackRock supports the creation of a regulatory regime that increases transparency, protects investors, reduces systemic risk and facilitates responsible growth of the capital markets, while preserving investor choice and balancing the benefits against costs. We support the current initiatives by the FSB to the extent that they provide positive outcomes for end-investors by strengthening the financial markets while continuing to allow investors the ability to make investment choices appropriate for their risk appetite.

About BlackRock

BlackRock is one of the world's leading asset management firms, managing approximately US$3.67 trillion (€2.86 trillion) as of 30 September, 2012, on behalf of institutional and individual clients worldwide, including governments, pension funds and endowments. BlackRock and its predecessor companies have managed money market mutual funds ("MMF") since 1973 and has offered its clients investment strategies that include securities lending, repurchase agreement ("repo") transactions and reverse repo transactions since at least 1981. Clients have benefitted from the additional return these investment strategies have provided.

As of 30 September, 2012, BlackRock manages approximately US$248.3 billion (€193.0 billion) in cash management assets worldwide, principally in the US and Europe. Our success in

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[1] *Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Strengthening Oversight of Shadow Banking Entities*, FSB Consultative Document (November 18, 2012), available at: http://www.financialstabilityboard.org/publications/r_121118a.pdf.

[2] *Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, FSB Consultative Document (November 18, 2012), available at: http://www.financialstabilityboard.org/publications/r_121118b.pdf.

building this business came not because we always offer the highest yield. We have grown because we have earned our clients' trust through multiple interest rate cycles and a wide variety of market events. We believe cash management is a distinct investment category, different from other fixed income strategies. We understand the importance of putting safety and liquidity first, not as a marketing message, but as the foundation of our investment philosophy. At BlackRock, we have investment, credit research and risk management personnel and processes that are dedicated to our liquidity business. These teams work collaboratively to develop and maintain proprietary approved lists, and only securities on those lists are eligible for purchase in our money fund portfolios. This process goes beyond an assessment of whether a particular security will mature at par; it is a rigorous analysis of multiple facets of the instrument and its issuer, including how it is likely to perform under many different conditions and scenarios.

As of 30 September, 2012, BlackRock also managed US$1.47 trillion (€1.14 trillion) in strategies which employ securities lending, with an average on-loan balance of US$135.9 billion (€105.6 billion) as of the same date. Securities lending generates income for a client that is in addition to the performance of the underlying investment strategy employed by the client's fund or account. Similarly, BlackRock manages large pools of assets which employ repo and reverse repo securities transactions, in both cases providing clients with significant return in line with their investment objectives. Our success in building this business is based on our clients recognizing the additional value these strategies can add to their investment returns, and on clients' confidence in BlackRock's ability to manage these strategies in an appropriate risk-controlled manner.

We appreciate the extensive discussions and work that the FSB has done in preparing these Proposals. We and our clients are immensely grateful for the work of the various government agencies throughout the financial crisis in 2008. The swift and decisive actions taken, in concert, by multiple government agencies were essential in restoring confidence and order to the markets. After the 2008 crisis, BlackRock and others in the industry worked collaboratively with government agencies in each jurisdiction to help them evaluate and prepare additional regulation appropriate for the issues being addressed. Our comments to the Proposals, as well as our participation in hearings held by the FSB and IOSCO are offered in the same spirit of partnership.

In this letter, we briefly summarize our overall views and our comments on each of the Proposals. We have also provided more detailed responses to certain questions included within each Proposal in the attached Appendices.

<u>Overall Summary of BlackRock's Views on "Shadow Banking"</u>

BlackRock supports the recognition by the FSB of the positive contribution to markets and to individual investors of many of the activities described as "shadow banking". We believe that they play a key role in providing benefits and appropriate protections for end-investors, the mainstay of which are pensioners and savers. These activities are also important in funding banks, the 'real economy', as well as contributing to the liquidity and stability of financial markets.

BlackRock also appreciates the FSB's strategy of balancing comprehensive data monitoring with a narrow approach toward regulatory policy proposals. We also welcome the FSB principles, such as "focus" and "proportionality." Indeed, we believe that it is critical that regulatory responses should be proportionate to the risks that "shadow banking" activities pose to the financial system.

We do, however, have two significant concerns with the approach taken, namely the scope of the definition of "shadow banking" and – we perceive – a belief within certain regulatory circles that prudential regulation is considered superior and to be preferred to other forms of regulation – for example, securities markets supervision.[3]

With regard to our first concern, BlackRock recommends that the term "shadow banking" be used only to refer to certain off balance sheet structured finance entities sponsored by banks (principally, term finance entities such as securitizations). This would appropriately focus regulatory attention on the area that gave rise to some of the greatest systemic issues during the financial crisis of 2007 and 2008. Bank risk managers apparently failed to provide for housing declines in their potential loss calculations and then had limited capacity to adjust these structures to reflect actual losses as, generally, they had fixed haircuts and credit enhancements.

We further recommend that an alternative label – for example "market finance" – be used to refer to the broader set of activities often included in the "shadow banking" discussion such as MMFs, securities lending, repo transactions and hedge funds. Such market finance activities and entities were impacted by the bank failures during the financial crisis and transmitted these shocks through the financial system but they did not cause the crisis. The risk exists that regulators address the symptoms – market finance – without wholly addressing the causes of the crisis.

Our second concern is that the term "shadow banking" implies that while banks are regulated, market finance activities are not regulated. While it is true that banks are subject to capital requirements and other banking regulations, it is also true that most market finance activities are subject to a host of securities markets regulations. The differences in the regulations for banks and market finance activities reflect the differences between banks and such activities. Taking MMFs as an example, the primary similarity between banks and MMFs is the parallel between a shareholder's ability to redeem shares in a MMF and a depositor's ability to demand deposits from a bank. Beyond this similarity, the differences are critical to understand as they drive the need for different regulations. Banks rely on government guaranteed deposits as a source of funding and have access to central bank discount windows to meet liquidity needs. Bank assets reflect a wide range of lending practices, and banks also employ leverage which can amplify positive and negative aspects of their portfolio. As a result, banking regulators require banks to hold capital as a way of protecting customers and the government insurance fund. In contrast, applying prudential regulation such as capital requirements to MMFs would – besides failing to reduce the risk of a "run" on MMFs in times of market stress when concerns about bank credit are acute – undermine their economics, depriving clients of a valuable source of credit diversification and banks of a cheaper and relatively more stable source of funding (compared to inter-bank loans).

BlackRock would therefore argue that the appropriate tools from securities markets supervision – including increased disclosure, circuit breakers, specific asset standards, heightened risk governance and reinforced conduct of business rules should be deployed where regulation is deemed to be necessary to mitigate systemic risk.

A danger with any new set of regulatory changes is that they reduce or eliminate the benefits of the transactions they seek to regulate – in this case, the measurable benefits to investors of these market finance activities could be lost, along with the known benefits to securities markets of the enhanced liquidity and financing provided to market participants.

Summary of BlackRock's Views on WS2 Proposals on MMFs

BlackRock supports the general approach taken by IOSCO and the vast majority of the IOSCO recommendations. We also applaud the attempt to establish global standards whilst

[3] *See* FSB's Proposal on *A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities*, at page ii ("But whereas banks are subject to a well-developed system of prudential regulation and other safeguards, the shadow banking system is typically subject to less stringent, or no, oversight arrangements.").

giving national regulators the flexibility to implement measures appropriate to their national specificities. For the most part, significant commonality exists between IOSCO and BlackRock's recommendations. We arrived at our proposals by considering MMFs specifically as market finance vehicles and reviewing the ideas that have most helped to ensure the robustness and safety of markets: specific asset standards, increased disclosure and circuit breakers. Based on this concept, we recommend that the following steps should be taken by global regulators with appropriate tailoring to local markets:[4]

1. *Consistent standards for asset quality, duration and liquidity*

The majority of IOSCO's recommendations[5] are focused on establishing standards, which, in our view, are fundamental in reinforcing the resilience of MMFs to market stresses. We highlight in particular the critical role of portfolio weighted average maturity ("WAM") and weighted average life ("WAL") limits, cash buffers with daily and weekly liquidity requirements and "know your client" policies and procedures. WAM and WAL limits reduce the ability of an individual fund manager to take significant risk in a MMF. They narrow the playing field and seek to eliminate the outlier firm, which is taking more risk to build market share, as was the case with The Reserve Fund in the US. Cash buffers ensure that a significant amount of liquid assets are immediately available to meet client redemptions without relying on secondary market liquidity, with the aim of avoiding the need for a "fire-sale" of longer maturity securities to raise cash. Finally, "know your client" provisions are important to incentivise fund managers to hold higher cash buffers than are set out in regulation if such higher cash buffers are prudent given the composition and concentration of the client base.

2. *Enhanced Disclosure*

BlackRock believes that transparency[6] is just as important as the standards for asset quality, duration and liquidity set out above. Investors run when they are concerned about the quality of the underlying assets in a portfolio; hence many commentators have characterised the redemptions from MMFs in September 2008 not so much as a run on MMFs as a run on bank credit. Greater transparency over the holdings and market price ("shadow price") of a portfolio should stop an idiosyncratic problem from devolving into a systemic run.[7] In the event that a single MMF closes for any reason, increased transparency should allay investor's concerns about other MMFs. It is reasonable to assume that those fund sponsors will over-communicate with their investors, and investors will have no incentive to leave a fund that does not have underlying asset or liquidity issues. We expect that enhanced transparency will act as decelerant to a run, not as an accelerant, as some have speculated.

BlackRock strongly believes that the combination of tighter asset standards and greater transparency will change fund manager behaviour, forcing them to become even more conservative and greatly strengthen the ability of MMFs to withstand stressed market conditions. Indeed, both IOSCO and the US Securities and Exchange Commission ("SEC") highlight the importance of the SEC's 2010 MMF reforms in this respect. As noted in a recent SEC study of the 2010 MMF reforms, "The findings indicate the funds are more resilient now to both portfolio losses and investor redemptions than

[4] In this section, we summarize our views and discuss them in more detail in Appendix A attached hereto.
[5] Recommendations 1, 2, 6, 7, 8, 9, 11 and 12.
[6] Disclosure provisions are covered in IOSCO recommendations 5 and 10 and are implicit in 11 and 15.
[7] In January 2013, certain MMF sponsors, including BlackRock, decided to publish daily asset values for their MMFs in an effort to help investors better understand how day to day market movements or events can affect the value of a fund's portfolio. *Money-market funds to publish value daily*, FINANCIAL TIMES, Jan. 9, 2013.

they were in 2008,"[8] and concluded that the probability of breaking the buck declined after the 2010 MMF reforms.

3. *Circuit breakers*

BlackRock was very pleased that IOSCO included circuit breakers in the form of gates in Recommendation 9 and liquidity fees in Recommendation 10. We also note that the US Financial Stability Oversight Council ("FSOC") included liquidity fees and/or gates in its proposed recommendations on MMF reform. However, we do differ with IOSCO in the relative importance given to liquidity fees. BlackRock strongly believes that standby liquidity fees ("SLFs"), combined with consistent asset standards and increased transparency are the only regulatory solution that will both preserve the benefits of MMFs for all investors and borrowers while definitively stopping a run.

We propose that the basic features of a stable NAV MMF with standby liquidity features would include:

- Objective triggers: we recommend one half of the required weekly liquidity level;

- Enhanced transparency: we recommend at least weekly public disclosure of the mark to market and the weekly liquidity level[9].

- Gates: once the objective liquidity trigger is met, a mandatory gate would come down to prevent additional investor withdrawals until the MMF is reopened with a SLF (we anticipate that this would be the next business day); and

- Standby Liquidity Fee: we recommend that a fee of 1% be imposed on withdrawals occurring after the gate has been put in place. This rate has been chosen to create incentives for investors not to run. The SLF rate is likely to be in excess of the cost of selling securities to raise cash to meet redemptions and the excess would remain in the fund and accrue to the benefit of the remaining shareholders. For those who "want" but do not "need" their money, this would act as a disincentive to run.

BlackRock disagrees with IOSCO and the FSB that the solution to the perceived vulnerabilities of stable value MMFs ("CNAV MMF") is a conversion "where workable" to a floating or variable NAV MMF ("VNAV MMF"). IOSCO considers this as the preferred solution to the stated vulnerabilities of the constant NAV, which it indicates gives the impression of safety and causes contagion, amplifies the first mover advantage, creates a discrepancy between the amortised NAV and the mark to market price, and transmits the impression of implicit sponsor support.

BlackRock would respond by making the following observations:

- The mass redemptions from MMFs in 2008 prove that investors do not believe that there is a guarantee or impression of "greater safety."

- Asset standards combined with greater transparency will reduce significantly any contagion effect as described above.

- The first mover advantage is far weaker for MMFs than for banks given the very real structural differences between banks and MMFs as set out in IMMFA's paper entitled, "Money Market Funds, Bank Runs and the First-Mover Advantage".[10]

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[8] *See* SEC Staff Report by the Division of Risk, Strategy, and Financial Innovation, *Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher*, (Nov. 30, 2012) ("SEC Staff Report"), available at http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf, at 4.

[9] Currently in the US we report daily and anticipate moving to daily reporting in other regions in the future

- MMFs buy assets with the position intention and ability to hold them to maturity; as a daily basis result under international accounting standards, these assets are accounted for using amortised cost, which is readily understood by investors. In addition, such accounting is common amongst banks today and will continue under IFRS 9 where the objective of the entity's business model is to hold the financial asset to collect the contractual cash flows (rather than to sell the instrument prior to its contractual maturity to realise its fair value changes) and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

- Concerns around "sponsor support" should be addressed through banking regulation and not regulation of MMFs. Banks could, for example, be required to seek approval from prudential regulators prior to entering any affiliate transactions.

Ultimately, we believe that MMF reform options should be evaluated by their ability to provide a mechanism to manage mass client redemptions and to preserve the benefits of the product for investors and for the short term funding market. The SLF will protect investors from the behaviour of others, gives all investors access to their cash and provides incentives to stay invested rather than run. A conversion from CNAV to VNAV MMFs will not protect the product from runs but in our opinion will shrink the product significantly. Holding back a small portion of the shareholders' investments will not just shrink the product but effectively eliminate MMFs. Equally, the amount of capital necessary to protect MMFs fully against a systemic market failure will destroy the commercial viability of the product. In the event that MMFs are eliminated, it is reasonable to assume that a significant percentage of these assets will move to bank deposits, which would transfer the risk from MMF investors to the insurers of those banking institutions.

Finally, in considering the statement made in the FSB's Integrated Overview of Policy Recommendations: "that the safeguards required to be introduced to reinforce stable NAV MMFs' resilience to runs (...) should be functionally equivalent in effect to the capital, liquidity and other prudential requirements on banks that protect against runs on their deposits."[11] In the absence of access to central bank liquidity or a credible deposit insurance policy for the MMF industry, for the reasons stated above, we believe that suspension of convertibility (that is, gating and SLFs) is the most functionally equivalent to prudential regulation and best able to mitigate runs.[12]

Summary of BlackRock's Views on WS5 Proposals on Securities Lending and Repo

A summary of our views follows, and detailed responses to the individual Proposals are provided in Appendix B attached hereto.

General Comments

We agree that regulators should obtain additional information regarding the securities lending and repo markets on a non-public basis. Position- or exposure-based reporting should be preferred to the transaction-based reporting suggested in the Proposals, which would:

- leverage reporting mechanisms which already exist;

- reflect the way that the industry already evaluates the markets and simplify regulators' analysis of collateral and collateralization; and

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[10] *Money Market Funds, Bank Runs and the First Mover Advantage*, Mark Hannam, Institutional Money Market Fund Association, January 2013.
[11] *Strengthening Oversight and Regulation of Shadow Banking: An Integrated Overview of Policy Recommendations*, FSB Consultative Document (November 18, 2012), available at: http://www.financialstabilityboard.org/publications/r_121118.pdf, at p. 8.
[12] Hannam, *supra* note 10.

- not require that regulators build a data matching and cleansing process.

While we question whether the benefits of providing transparency to the markets would outweigh the potential negative impacts, we believe strongly that if data is to be disclosed by the regulators to the public, such data should be aggregated and made anonymous to ensure the confidentiality of client and proprietary information.

We agree that there should be a set of "best practices" for fund disclosures. Fund investors should be provided with consistent information regarding the investment activities of their funds. We believe that fund-level disclosure should, however, be proportionate to the materiality of the transactions or exposures being disclosed. We do not believe that the extensive data that is called for in the Proposals would be appropriate for any circumstance of which we are aware.

We agree that there should be "best practices" for collateral management and valuation, and that there should be a mandatory minimum of 100% collateralization based on a daily mark-to-market process. We disagree, however, with mandatory minimum haircuts above a floor of 100% and believe that haircuts, like other risk-control decisions, should be left to investors and their agents. This would permit investors (or their agents) to best protect their (or their clients') interests by being able to set contractual haircuts.

We agree that there should be "best practices" for cash collateral reinvestment and that those standards should apply to all lenders, with the flexibility as described in the Proposals. We also agree that there should be reasonable restrictions on rehypothecation and an appropriate level of disclosure to impacted clients.

Specific Comments

Transparency: We support increased transparency so long as it provides information that is useful to regulators and to investors. However, we believe the Proposals go beyond that and seek to mandate reporting that would be of little value to regulators or investors and potentially be confusing or distracting.

- ***Transparency to Regulators***

  We agree that additional transparency to regulators in the areas of securities lending and repo and reverse repo transactions will help regulators to better understand the markets which they are responsible for overseeing, to see trends over time, and therefore to better understand where regulation could be helpful or harmful.

  We believe that regulators could achieve these goals by leveraging existing platforms that are already used by the major market participants to share information for existing operational and regulatory purposes, without significant additional effort by the industry or by regulators. These existing platforms provide reports of positions or exposure on a regular (nightly) basis and would provide regulators with useful time-series views of the trends in the markets.

  By contrast, the Proposals' focus on transactions and transaction level detail, as opposed to positions or exposure, would require a significant effort by regulators to build a "matching" process to cleanse data they receive from all participants in the market. This data matching and cleansing at the transaction-level does not currently exist market-wide (although it is conducted between counterparties and is highly manual) and we believe does not add value for the purposes described above. We would be happy to work closely with regulators, service providers, and others in the industry to discuss how the existing platforms could be utilized for the purposes of providing useful data to the regulators.

We address the transaction-level details listed in Box 1 in Appendix B.

- ***Increased Corporate Disclosure***

  As discussed in greater detail in our response to Question 9, while we support increased disclosure to investors, we believe that disclosure of securities lending and repo and reverse repo transactions are generally already well-addressed under the detailed requirements of the International Accounting Standards Board ("IASB") and International Financial Reporting Standards ("IFRS") requirements which apply to any public filer.

  In addition, we suggest that the additional detailed transaction-level information suggested in Recommendation 4 would either be so stale as to be of no use or, even if disclosed more quickly, would be useful only for those who wished to reverse-engineer a trading strategy or to trade against a strategy being employed by the public filer. We believe that the current international disclosure requirements are adequate.

- ***Increased Fund Disclosure***

  As the world's largest manager of investment funds, we support the goal of increased disclosure to fund investors. We are confident that we have led the way in the transparency of our fund filings and disclosures, including with regard to securities lending and repo and reverse repo transactions. Given our experience, we support the intention, but not the details, of the Proposals.

  We agree that there should be a minimum "best practices" for disclosure of any investment activity such as securities lending, repo or reverse repo that is proportionate to the materiality of the activity. The Proposals, however, go beyond that standard. Securities lending, repo and reverse repo are techniques which are used to support the primary investment strategy of a fund. As such, the disclosures proposed would provide investors with a significant amount of data about these three particular techniques when compared with the primary investment strategies used by the fund. This could divert investors' focus from the primary investment strategies that are truly material. We suggest below more general risk-based concepts for fund disclosure which we believe are consistent with most markets' existing disclosure regimes and which will serve to enhance investors' understanding of the activities of their funds and the risks and benefits of those activities.

  We also question whether increased disclosure to fund investors would address any of the shadow banking risks identified at the start of the workstream's process, or whether these issues are not better left to those securities and market regulators who are responsible for considering the appropriate level of disclosure.

Regulation: This section of the Proposals makes suggestions regarding collateral and the collateralization process. While we agree that there should be broad "best practices" with regard to collateral and the collateralization process we believe that the Proposals may unduly restrict market participants' ability to make appropriate risk-based determinations regarding collateral, which could make securities lending, repo and reverse repo less attractive for investors.

- ***Minimum Haircuts***

  We agree that a regulatory floor of 100% as applied to all participants in the securities lending, repo and reverse repo markets would be a beneficial "best practice," but we question whether mandatory haircuts on top of that level would achieve more good than the possible danger of becoming the *de facto* norm.

We believe that there will be more overall benefit from mandating a robust daily mark-to-market process using independently-established valuation as suggested in Recommendation 11 than from requiring a minimum haircut without robust processes. In addition, we question whether the likely reduction in market liquidity as well as the reduced income to investors which would come from the increased cost and friction imposed by minimum haircuts would outweigh any possible benefits.

We believe that a minimum of 100% would still permit investors or their investment manager to make risk-informed decisions regarding the level of haircut they believe is appropriate for a given loan/collateral combination or a given counterparty.

Finally, we note that the Proposals do not provide any evidence that the lack of a minimum haircut for securities lending increased cyclical risk during the financial crisis, and thus we question the underlying argument which appears to be based on theory rather than fact.

- ***Cash Collateral Reinvestment***

As with other aspects of the Proposals, we support the establishment of "best practices" which should apply to all participants in the market and not only those who are already highly regulated.

We believe the Proposals make reasonable, common sense suggestions for consistent regulatory action that would still permit lenders or their investment managers to make reasonable determinations regarding how their cash collateral is invested.

It is important to recognize that such "best practices" should accommodate the different needs of investors and funds. Such accommodation should include such factors as the price volatility and persistence of demand of the assets on loan, and an investor's investment horizon, risk tolerance and investment style.

- ***Rehypothecation***

We support the Proposals' focus on disclosure to and express agreement by clients regarding the rehypothecation of their assets. We also support the Proposals' reasonable restrictions on the purposes for which client assets can be rehypothecated. Lastly, we agree that the issues raised are complicated and that the best way to proceed would be to create an expert group to review rather than making specific proposals at this time. BlackRock would be willing to be a part of any such group to represent the investor's point of view.

- ***Standards for (non-cash) Collateral Valuation and Management***

We support the Proposals' recommendation of daily mark-to-market and the collection of variation margin for exposure to counterparties. As discussed above, we believe that this requirement would be a greater improvement to existing processes than a minimum haircut requirement.

We also support the recommendation for counterparty default planning. While we agree that lenders should only accept collateral that they could legally hold outright in the event of a borrower default pending liquidation, we urge that this requirement not be interpreted to require that collateral be limited to instruments within a lenders investment mandate, as that would potentially risk further concentrating an investor's positions at a time of stress when the focus should more appropriately be on ensuring greater diversification and liquidity.

Structural Aspects:

- ***Central Clearing***

  We agree with the Proposals' conclusion that, although encouraging the use of central counterparties ("CCPs") may be appropriate for highly standardized repo transactions (i.e., versus Sovereign Debt collateral), regulatory changes to encourage the use of CCPs for other less-standardized repo transactions as well as securities lending is probably not appropriate at this time.

- ***Changes to Bankruptcy Law***

  We agree with the Proposals' conclusion that changes to bankruptcy law should not be prioritized for further work at this time.

Summary of BlackRock's Views on WS3 Proposals on Shadow Banking Entities

A summary of our views follows, and detailed responses to the individual Proposals are provided in Appendix C attached hereto.

General Comments

We support information sharing among authorities through the FSB process for credit investment funds. We question whether bank-like regulation for registered mutual funds and ETFs (with low risk objectives) is necessary given the substantive requirements of existing capital market regulations across jurisdictions and existing applicable regulations.

We disagree that separately managed accounts, which are a segment of the client cash pools market defined by the FSB, with low risk objectives pose systemic risks. We believe that risk adjustment frameworks should be left to investors and their agents.

We agree with the FSB's attention to leverage within separately managed accounts and believe that reasonable oversight of leverage metrics would help provide assurances these pools will meet their obligations. We disagree, however with the balance of the proposed policy toolkits for the management of separately managed accounts and believe the expected costs would outweigh the benefits of such regulatory response.

Specific Comments

Information gathering: We broadly support the FSB proposal to increase surveillance and information gathering, designed to identify systemic risks within non-bank credit intermediation. We support additional disclosure so long as it is accessible only by regulators. We welcome an approach in which supervisors develop a framework to collect relevant data and are free to raise inquiries relating to concerns about investment portfolio information or dynamics in a way which best suits the nature of the concern and the company involved without necessarily resorting to public disclosure.

Bank-like regulations for registered mutual funds and ETFs: We believe the perceived deficiencies of regulation to which registered mutual funds and ETF products are currently subject are misplaced. We believe an evaluation of the existing capital markets regulatory regimes in various jurisdictions leads to the conclusion that such entities are subject to very substantive oversight. Additionally, substantial progress has been made (and continues) in the US and Europe adopting rules and enhanced oversight of non-bank credit intermediaries via capital markets regulation. We believe regulation of capital markets activities has been successful at safeguarding the interests of investors while ensuring that risks are kept to an acceptable level.

Private cash pools: While we agree that effective measures by authorities on systemic risk are important, we have concerns the FSB proposal could have an adverse impact on the ability of advisors to operate and manage separately managed accounts given the heterogeneous structures and diverse risk profiles within these markets. We believe that separately managed accounts do not pose “run” risk due to clients (1) directly owning the underlying securities (2) high levels of portfolio customization and (3) mandates constituting a medium to long-term investment horizon. The proposed rules would likely make it very difficult to manage the strategies and bring into question the ability of firms to compete fairly and support client needs in the global market place for such services. BlackRock asks that FSB be flexible in the way the proposed framework is applied to separately managed accounts to mitigate adverse impacts to this market given that such pools do not face bank-like risk to financial stability.

Leverage: We agree with the FSB’s attention to leverage within the separately managed account market and believe that leverage plays an important role in determining the overall risk considerations in such accounts. Though such calculations may not fully capture the actual level of risk, we believe reasonable oversight of leverage metrics would help provide assurances these pools will meet their obligations.

Policy toolkit for client cash pools: We disagree, however with the balance of the proposed policy toolkits for the management of separately managed accounts and believe the expected costs would outweigh the benefits of such a regulatory framework. We support a flexible approach that allows firms to balance a variety of risk-adjustments to achieve a risk profile that is manageable and consistent with the risk tolerances of the underlying clients. BlackRock welcomes FSB’s recognition of the large scope of diversity in business models and risk profiles and believes separately managed accounts are a sector in which we encourage the FSB to take a more granular approach in considering if the policy toolkit should be applied to the sector.

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We appreciate the opportunity to address and comment on the issues raised by the Proposals. We would welcome the opportunity to assist the FSB and the participants in Workstreams 2, 3 and 5 in any way we can, and look forward to continued dialogue on these important issues. Please contact any of the undersigned if you have comments or questions regarding BlackRock’s views.

Sincerely,

Richard Prager
Managing Director
Head of Trading & Liquidity
Strategies
+1 212 810 5882
richie.prager@blackrock.com
55 East 52nd Street, 6th Floor
New York, NY 10055

Joanna Cound
Managing Director
Head of EMEA Government Affairs
& Public Policy
+44 (0)20 7743 5579
joanna.cound@blackrock.com
12 Throgmorton Avenue
London, EC2N 2DL

APPENDIX A

The following section sets out background information on MMFs that may help to place the FSB / IOSCO recommendations in context as well as provides a more detailed rationale for the positions that we have set forth in our summary remarks on MMFs.

Role of Money Market Funds

MMFs play a unique role in the economy, providing benefits to both borrowers and investors. As noted in the FSOC's MMF Proposals, "MMFs provide an economically significant service by acting as intermediaries between investors who desire low-risk, liquid investments and borrowers that issue short-term funding instruments. MMFs serve an important role in the asset management industry through their investors' use of MMFs as a cash-like product in asset allocation and as a temporary investment when they choose to divest of riskier investments such as stock or long-term bond mutual funds."[13] Borrowers include commercial and governmental/municipal entities who issue commercial paper, certificates of deposit, and sovereign and supranational securities. For these issuers, the flexibility to borrow through the capital markets is an important alternative to borrowing from banks and helps these borrowers achieve lower costs of financing. In many cases, banks are neither equipped nor inclined to provide comparable lending, particularly to other financial institutions.

Investors in MMFs include a wide range of retail and institutional clients from individuals on a direct basis, to individuals in defined contribution pension plans, to small, medium, and large institutions seeking cash equivalents. Corporate treasurers in many countries, in particular, find the CNAV MMF structure, with same day liquidity, stable NAV and well established subscription and redemption processes, particularly useful in managing variable cash flows in an efficient manner and have expressed concern at the prospect of having to rely on VNAV MMFs. Investors in MMFs currently enjoy the benefits of diversification, ease of operation, accounting treatment as cash equivalents and market competitive returns. For many investors, MMFs represent a favorable alternative to bank deposits or to the direct purchase of instruments in terms of both liquidity and diversification. In addition, tax-exempt MMFs in the US provide an important source of funding to municipalities and tax-exempt income to investors that bank deposits cannot replicate.

Differentiating between MMFs and Banks

The FSB refers to MMF as part of the "shadow banking system." We would make the following comments. First, the name "shadow bank" has a negative connotation, when, in fact MMFs play a critical role in what we call "market finance." Second, the term "shadow banking" implies that while banks *are* regulated, MMFs *are not* regulated. While it is true that banks are subject to capital requirements and other banking regulations, it is also true that MMFs are subject to a host of mutual fund and MMF-specific regulations. The differences in the regulations for banks and MMFs reflect the differences between banks and MMFs. The primary similarity between banks and MMFs is the parallel between a shareholder's ability to redeem shares in a MMF and a depositor's ability to demand deposits from a bank. Beyond this similarity, the differences are critical to understand as they drive the need for different regulations. Banks rely on government guaranteed deposits as a source of funding and have access to central bank discount windows to meet liquidity needs. As discussed below, bank assets reflect a wide range of lending practices, and banks also employ leverage which can amplify positive and negative aspects of their portfolio. As a result, banking regulators require banks to hold capital as a way of protecting customers and the government insurance fund.

[13] *See*, Financial Stability Oversight Council, "Proposed Recommendations Regarding Money Market Mutual Fund Reform", 77 Fed. Reg. 69455 (Nov. 19, 2012), available at http://www.treasury.gov/initiatives/fsoc/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform%20-%20November%2013,%202012.pdf, at 8.

In assessing the differences, we start with the government guarantee. While some bank deposits are guaranteed, MMFs clearly disclose that shares are not insured and are subject to investment risks, including the possible loss of principal amount invested.[14] While many cite an "implied guarantee" for MMFs, in the case of the Reserve Fund, investors did not recoup $1.00 upon liquidation of the Reserve Fund; the final recovery for investors was approximately $0.99. Clearly, MMFs are not guaranteed and investors understand that they bear the risk of investment results.

Another key difference is the assets that are held by banks and MMFs. A typical bank holds commercial and individual loans ranging from commercial real estate loans, syndicated loans to large companies, small business loans, unsecured credit card receivables, home mortgages and more. Banks hold "loan loss reserves" specifically to cover the expected losses on their portfolio which reflect the range of credit quality of their loans. Compare that to the permissible assets of a MMF regulated under Rule 2a-7 in the US or the ESMA Classification in Europe, where portfolios are subjected to minimum liquidity and diversification requirements, dollar-weighted average maturity limits, dollar-weighted average life limits and restrictions on credit quality.[15]

Banks and MMFs also have different governance structures. The Boards of Directors of banks are focused on the shareholders of the banks and not directly on the depositors. In contrast, the Boards of Directors of MMFs are charged with overseeing the management and operations of the MMF on behalf of the fund's shareholders.

Banks and MMFs also differ in terms of both transparency and liquidity. The assets of a bank are generally opaque to investors and customers, whereas the assets of a MMF are publicly disclosed on a regular basis. MMFs in the US and triple A rated MMF are subject to specific daily and weekly liquidity requirements, which further distinguish MMFs from banks. Discussions focused on "maturity transformation" ignore these overnight and weekly liquidity requirements of MMFs, and these discussions also do not reflect the fact that MMFs have a small duration gap between their assets and their liabilities, especially when compared to banks. Even in an extreme scenario, the assets of a MMF will either mature or can be substantially liquidated in fewer than 90 days.[16]

Motivation of Investors to Run

One of the primary concerns expressed about MMFs is the potential for a "run". Sometimes this issue is linked to the accounting conventions used in MMFs which allow the net asset value to be rounded to $1.00; these funds are called stable NAV or CNAV funds.[17] An assumption is made that investors will run when the market value of the portfolio (also known as the mark-to-market or shadow NAV) is less than the "official" NAV of $1.00. In reality, the adoption and continued use of MMFs by investors are driven fundamentally by three things: the quality of the assets in the MMFs, the limited duration of those assets and the amount of available liquidity held in the MMFs.

[14] *See*, SEC Form N-1A, Item 4(b)(1) (ii) which requires: "If the Fund is a Money Market Fund, state that: An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund."

[15] Rules and Regulations, Investment company Act of 1940, 17 C.F.R. §270. *See* rule 2a-7(c)(5) (liquidity requirements); rule 2a-7 (c)(4)(i)(A) - (c)(4)(i)(B) (diversification requirements); rule 2a-7 (c)(2)(iii) (dollar-weighted average maturity limits and dollar-weighted average life limits); rule 2a-7(c)(3)(i) (credit quality restrictions).

[16] In BlackRock's experience, approximately 75% or more of fund assets typically mature within 90 days, while an additional 10-15% of assets could be liquidated through sales at or near par.

[17] *See*, Financial Stability Oversight Council, "Proposed Recommendations Regarding Money Market Mutual Fund Reform", *supra* note 13, p.4: "But the 2010 reforms did not address the structural vulnerabilities of MMFs that leave them susceptible to destabilizing runs. These vulnerabilities arise from MMFs' maintenance of a stable value per share."

Economists speculate about the potential first mover advantage in a CNAV fund; however, in our experience, clients decide to leave a MMF based on their assessment of the quality of assets, duration of assets and liquidity levels and their assessment of whether those are deteriorating in an unusually dramatic way.[18] Moreover, we and academics who have studied this believe that in VNAV MMFs, the potential for a first mover advantage is still present.[19] Because MMFs will sell their most liquid assets first to support redemptions, the remaining investors will be left with a riskier, less liquid portfolio. Consequently, the first mover advantage still exists whether the NAV of a fund is variable or constant.[20]

In observing actual investor behaviour, the primary reason for a run is a crisis of confidence. In 2008, liquidity had already seized in the capital markets well before the Reserve Fund broke the buck. This incident was simply the final straw that shattered what little remained of investor confidence and led to panic behaviour. Investors were fearful about the creditworthiness of the underlying assets given the seeming meltdown of the global financial system, and they made the decision that they could not take *any* risk given the overall environment; they therefore liquidated their holdings in Prime MMFs. Many of these investors did not "need" cash, so they took these funds and invested in Government MMFs, Treasury MMFs, or T-bills. Over the 40-year history of US MMFs, while mark-to-market NAVs have fluctuated regularly, investors have not run en masse, except in 2008.[21] Furthermore, VNAV funds (such as VNAV funds in Europe[22] as well as enhanced cash mutual funds sold to retail investors in the US) also experienced significant withdrawals in 2007-2008.

Perception of MMF Guarantee

Although some have expressed concern that investors believe MMFs are guaranteed, investor behavior does not support this theory. For example, in 2007, institutional investors moved from weaker Prime MMFs to stronger Prime MMFs[23] and government MMFs in response to the Structured Investment Vehicle ("SIV") Crisis. Exhibit A illustrates this behaviour.

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[18] *See,* SEC Staff Report, *supra* note 8, at 4 ("The incentive for investors to redeem shares ahead of other investors is heightened by liquidity concerns.").

[19] *See* id, at 10 (academic studies show "empirical evidence that the sale of illiquid assets to meet redemption requests impairs future performance in all mutual funds, creating incentives to redeem ahead of other investors").

[20] David W. Blackwell, Ph.D., Kenneth R. Troske, Ph.D. & Drew B. Winters, Ph.D., *Money Markets Funds Since the 2010 Regulatory Reforms: More Transparency, Increased Liquidity, and Lower Credit Risk* (Center for Capital Markets Competitiveness Report, Fall 2012) at 36 ("a floating NAV does not change investors' incentives to remove their money quickly when they believe there has been a change in the riskiness of the fund. In other words, MMFs reporting floating NAVs can still experience runs.").

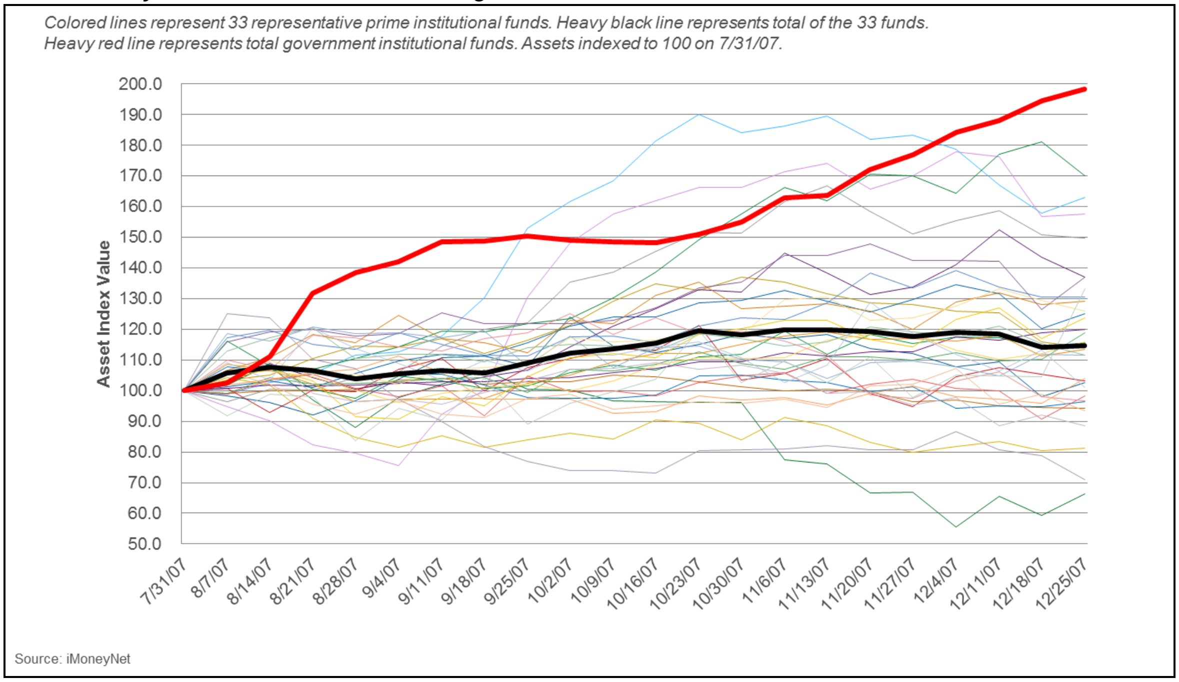
[21] *See, e.g*., Center for Capital Markets Competitiveness Report, *supra* note 20, at 39 ("First, since retail investors were largely spared any losses and disruptions in the 2008 run, and since as far as we are aware, there has never been a run on retail money market funds, any additional regulation of MMFs designed to reduce the probability of a run will impose additional costs on retail investors without providing any meaningful additional benefits to them."); ICI Research Report, Pricing of US Money Market Funds (January 2011) at 3 ("Between 1996 and 2010, investor net redemptions from taxable money market funds in a single week exceeded 20 percent of a fund's assets in fewer than 1 percent of instances. Over four-week periods during those years, redemptions exceeded 20 percent of assets in fewer than 2.5 percent of instances.").s

[22] *See*, Comment Letter of the Investment Company Institute; Comment Letter on the President's Working Group Report on Money Market Fund Reform Options (Rule No.4-619) (Jan. 10, 2011) at 51 ("French floating NAV dynamic funds lost about 40 percent of their assets over a three-month time span from July 2007 to September 2007").

[23] *See* SEC Staff Report, *supra* note 8, at 7 (prime money funds lost assets as a whole during the 2008 crisis, but certain prime money funds gained assets during that period).

Exhibit A

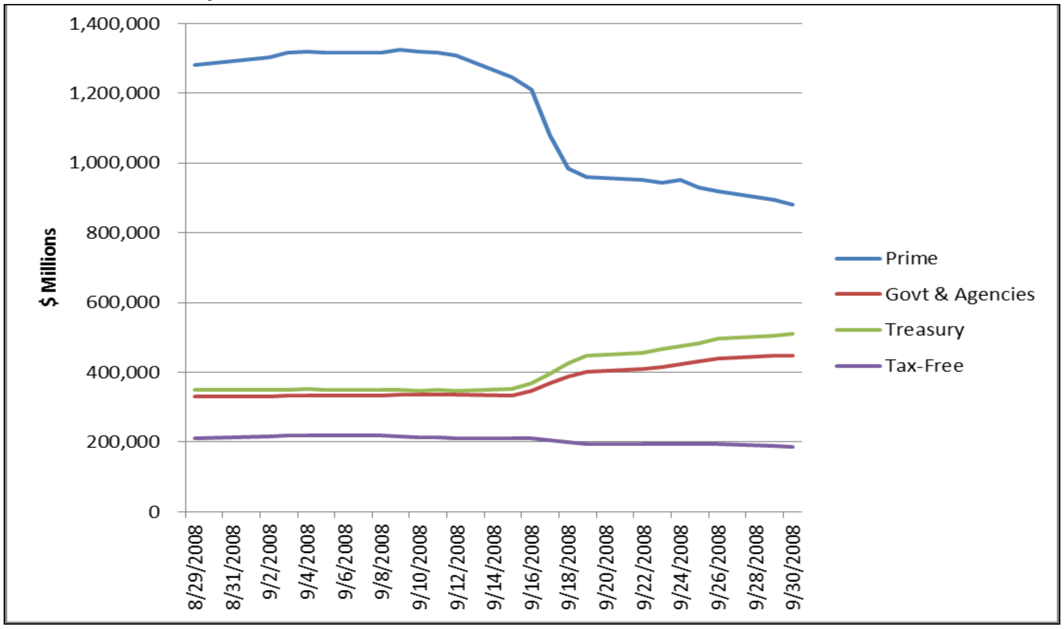
Prime Money Market Fund Assets During the ABCP / SIV Turmoil



Likewise, as the SEC staff report on MMF states "[d]uring the peak of the financial crisis, in September 2008, investors redeemed assets from prime money market funds and, to a great extent, reinvested those assets into Treasury money market funds with the same structural features as prime money market funds."[24] This is also highlighted in Exhibits B and C. Clearly, if investors believed their MMFs were guaranteed, they would not have moved from funds they perceived as weaker to funds they perceived as stronger. And, as stated above, investors in the Reserve Fund received less than $1.00 and no investors have approached the government to be made whole, nor are any claims expected.

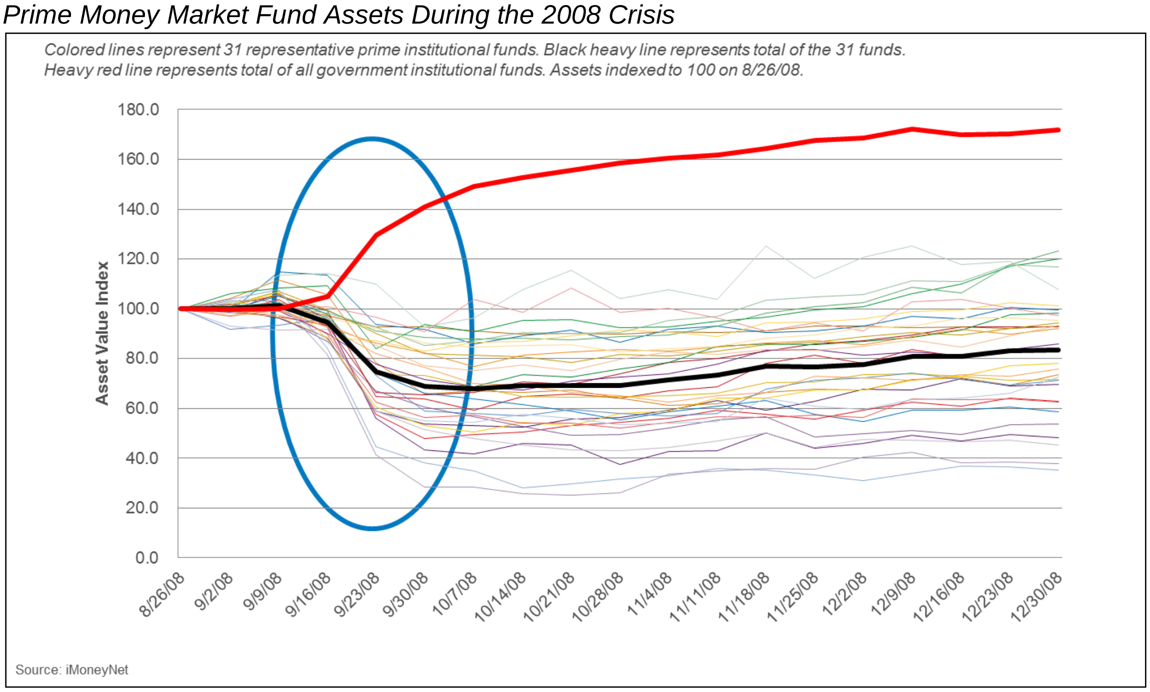
[24] SEC Staff Report, *supra* note 8, at 6.

Exhibit B
Institutional Money Market Fund Assets



Source: iMoneyNet

Exhibit C
Prime Money Market Fund Assets During the 2008 Crisis



<u>Objectives of Additional Reform</u>

Agreeing on the objectives and scope of additional reforms is critical to defining potential solutions. Many commenters have cited protecting against systemic runs (and protecting taxpayers) as the key objective of MMF reforms. Others have noted the need to be able to support an individual fund which is experiencing a credit impairment. Yet others want to be assured that investors recognize the risk of MMFs and even want investors to explicitly pay for the CNAV feature. And, finally, investors and borrowers have expressed concern that MMFs remain a viable product given the important role of MMFs in the broader economy.

As discussed above, investors have demonstrated that they understand the risks of investing in MMFs. We believe that any further MMF regulation must satisfy a two-part test:

a. Preserve the benefits of the product as a liquidity management tool for investors and preserve the functioning of the short-term funding markets; and

b. Provide a mechanism for managing mass client redemptions, or "runs" and minimize the risk of a run on a single fund triggering a systemic run.

<u>BlackRock's Constant Net Asset Value with Standby Liquidity Fees ("SLF") Proposal</u>

IOSCO's MMF recommendations and the FSOC Proposals both include a potential solution using liquidity fees and/or gates. BlackRock strongly supports SLF.

The basic features of a CNAV fund with SLFs would include:

1. *<u>Objective triggers</u>*. The SLFs would not be active during times of normal market functioning. We recommend that SLFs be triggered when a fund has fallen to one half of the required weekly liquidity levels. This level has been chosen to ensure that the fund still has some liquidity if triggered, and yet the trigger is remote enough that it is unlikely to be reached during times of normal market functioning.
2. *<u>Enhanced transparency</u>*. This proposal would include a requirement of a weekly public disclosure with a 5-business day delay of the mark-to-market NAV.
3. *<u>Gates</u>*. Once the objective liquidity trigger is met, a mandatory gate would come down. This gate would prevent additional investor withdrawals until the fund could be reopened with a SLF. This closing is anticipated to be brief, i.e., by the next business day, to provide enough time to address any operational concerns in imposing the SLF. Making the closing mandatory removes any questions of conflicts of interest or hesitancy to take action. As soon as a fund is closed, the Board will be expected to reopen the fund with a SLF.
4. *<u>Standby Liquidity Fee</u>*. We recommend that a fee of 1% be imposed on withdrawals occurring after the gate has been put in place. This rate has been chosen to create incentives for investors not to run. The SLF rate is likely to be in excess of the cost of selling securities to raise cash to meet redemptions, and the excess would remain in the fund and accrue to the benefit of the remaining shareholders. For those who "want" but don't "need" their money, this would act as a disincentive to redeem. With SLFs in place, the NAV of a fund would improve as investors who leave are charged a fee, which would create a natural brake on a run, and investors remaining in the fund would be protected from the behavior of those who redeemed.
5. *<u>Removal of SLF and Special Distribution</u>*. Any SLFs gathered by the fund would be retained in the fund to restore the NAV. Once the NAV reached $1.00, the SLF would be removed and the fund would return to functioning normally. If the fund had built up any excess, this would be paid as a special return of capital distribution to shareholders of record on the last day in which the SLFs were in force. In this scenario, shareholders that remained in the fund or made new investments in the fund during this period of stress would be rewarded for their behavior. We recommend placing a 30-day limit on the period a fund can operate with a SLF in place.

We envision enhanced portfolio transparency. As we noted earlier, investors run when they are concerned about the underlying assets in a portfolio. Given the increased transparency already contained in the 2010 MMF Reforms, an idiosyncratic problem should not devolve into a systemic run. In the event a single MMF closes for any reason, increased transparency should allay investors' concerns about other MMFs. It is reasonable to assume that those fund sponsors will over-communicate with their investors, and investors will have no incentive to leave a fund that does not have underlying asset or liquidity issues. We expect that enhanced transparency will act as a decelerant to a run, not as an accelerant, as some have speculated.

Just as the WAM and WAL limits changed fund manager behavior, the presence of liquidity triggers should also change fund manager behavior. A fund manager will focus on managing both assets and liabilities to avoid triggering a gate. On the liability side, a fund manager will be incented to know the underlying clients and model their behavior to anticipate cash flow needs under various scenarios. In the event a fund manager sees increased redemption behavior or sees reduced liquidity in the markets, the fund manager will be incented to address potential problems as early as possible.

If a truly systemic run were underway and every fund experienced a dramatic run combined with reduced market liquidity as we saw in 2008, gates would come down very quickly to protect investors. When a fund reopened with a SLF, in most circumstances, a run would stop as investor behavior would reflect new incentives. Critically, the SLF approach gives clients a choice in a crisis, based on straight-forward economic incentives. Clients that truly need liquidity (e.g., to meet specific payments) or clients who simply decide they want their cash can get it, however, they must pay a fee for this access. Those investors choosing to access their cash will pay a fee which is comparable to the situation they would face if they owned another instrument and decided they must sell into a distressed market situation. On the other hand, if a client can wait for their liquidity, they are not disadvantaged by remaining in the fund. Since redeeming shareholders would pay a fee in excess of the discount of the mark-to-market, remaining shareholders would stand to benefit from any excess fees paid by redeemers. Rather than a first-mover advantage, the financial incentives of SLFs would encourage the behavior desired so that those who don't need their funds remain in a fund and do not exacerbate a crisis situation.[25]

Funds with a CNAV and SLF ("CNAV with SLFs") provide a number of important benefits over the other MMF reform proposals discussed herein.

1. CNAV with SLFs preserve many of the benefits of MMFs for both investors and borrowers, therefore, there should be minimal impact on the utility of MMFs.
2. Investors would be able to continue to enjoy the benefits of a diversified portfolio rather than be forced into concentrated investments or investments that are not cash equivalents.
3. For borrowers, this means continued access to MMFs as a source of funding which translates into important benefits in their liability structure and helps preserve the functioning of the short-term funding markets.
4. The gates are "standby", not "continuous", so that investors can transact normally except in abnormal circumstances. Based on interviews with clients, this construct is considered more acceptable, especially as it affords them protection from the behavior of others by removing first-mover advantage for redeeming investors.
5. Client choice is also an important element. In the event an investor needs or wants cash, they have access to it (albeit at a cost).
6. Concerns about systemic runs would also be allayed. Fund managers will have clear incentives to avoid triggering the gates, and in the tail event situation that a gate is triggered, the SLF will stop a run rather than allowing it to snowball. MMF boards will be mandatorily required to use gates if the objective triggers are met, which removes any

[25] It is worth noting that this is not just a hypothetical solution, but, in fact, a similar model was used in 2007 to solve the problem with the Florida Local Government Investment Pool ("LGIP"). This fund had experienced severe withdrawals leaving the fund with mostly longer maturity (9 to 12 months) instruments. The Trustees halted redemptions and when they reopened the LGIP, a mandatory redemption fee provided a financial incentive which encouraged many investors to stay invested. Over the course of a year, the LGIP was able to meet the redemptions requested and during that time most of the underlying securities matured eliminating the need for ongoing redemption fees. In the LGIP case, some investors chose to take their cash early and some waited, just as you might expect, given the incentives.

questions about conflicts of interest or discretionary decisions. In the US, for example, this will create a level playing field for all SEC-regulated MMFs, with all such MMFs subject to the Rule's requirements.

7. SLFs are a solution that works for all sponsors of and investors in MMFs. This approach does not favor large firms versus small firms, public companies versus private or mutual companies, bank-owned versus independent fund managers, or institutional versus retail investors. This proposal has several benefits when compared with other options, including: (a) regulators are not put in the position of picking "winners", (b) there is no regulatory pressure for industry consolidation, and (c) once operational issues are addressed, this solution can be implemented quickly requiring little or no transition period.
8. The only issue not addressed in this proposal is the lack of a cushion to deal with idiosyncratic risk in a specific fund. This returns to the question of whether investors understand that MMFs are not guaranteed. Actual behavior of investors in 2007, 2008, and again in 2011, suggests that they definitely understand that their investment is not guaranteed, making it unnecessary to provide this cushion. We discuss capital in more detail below under "NAV Buffer and Other Measures".

Floating Net Asset Value Proposal

During the early phases of the MMF reform debate, a number of policymakers recommended converting MMFs from CNAV to VNAV. Proponents of VNAV have cited two reasons to pursue this approach: (i) a floating NAV reflects a fund's true market value, allowing investors to see regular fluctuations in their investment and provide a clearer, market-based assessment of the risks associated with a particular fund, and (ii) a belief that floating the NAV reduces the likelihood of a run on a fund because all investors receive the true value of their shares, regardless of when they redeem. The industry has consistently opposed floating the NAV for two reasons: (a) a VNAV MMF product is much less appealing to investors and will result in significant shrinkage of the MMF product, and (b) there is evidence that floating the NAV will *not* address systemic runs.

Before we discuss the structural issues of a VNAV MMF, we need to address these opposing arguments. While it is true that a VNAV fund will reflect the true market value, it is not clear why that is necessary or helpful to an investor. We have already demonstrated that investors are aware that their investment in MMFs is not guaranteed. While it is tempting to believe that a change in accounting treatment may be all that is needed to provide run-protection for this industry, the experience of French Variable Net Asset Value (VNAV) funds[26] as well as the experience of enhanced cash fund in the US, suggests that marking to market a MMF's assets does not prevent a run as these fluctuating NAV funds were subjected to severe withdrawals during the 2007-2008 crisis.

VNAV provides a mixture of costs and benefits relative to the other MMF reform proposals discussed in this Appendix:

1. A VNAV product is significantly less attractive to investors in many countries. In the US, a stable \$1.00 NAV has been the hallmark of MMFs since their introduction in the 1970's and is used by corporate treasurers in many countries. While some have derided the \$1.00 NAV as an accounting gimmick, most investors in MMFs are seeking a "cash equivalent" instrument and MMFs are currently treated as cash equivalents for accounting purposes. Some investors *must* have a stable NAV. For example, MMFs are

[26] A prevalent form of MMF in France is a hybrid VNAV fund. These hybrid VNAV funds principally use a combination of mark-to-market accounting, model-based accounting and/or amortized cost accounting to determine the value of assets. Such hybrid VNAV funds reflect in part the paucity of market pricing in short maturity Euro instruments, such as CP and CD under 1 year, making pure floating VNAV funds difficult to manage. Hybrid VNAV funds offer accumulating shares. Interest earned is added to the value of shares as this is the most tax efficient approach in some countries, although retention of earnings is not permitted in many other markets. The result is shares that are indeed variable, but they are almost always rising. These funds are susceptible to runs if their shares begin to behave in an unusual way (e.g., by ceasing to accumulate).

often used by corporate treasurers to meet their payroll needs. As a result, a move from CNAV to VNAV is likely to result in substantial shrinkage of the impacted MMF products.

2. A reduction in demand by clients will in turn reduce the financing available (and possibly increase the cost) to issuers of commercial paper and other short term debt.
3. A more disturbing outcome of VNAV is the question of where investors will invest their cash in lieu of MMFs. In a world where we are concerned about systemic risk and "too big to fail", a reduction in MMFs will result in increased deposits at the very same institutions that policymakers are concerned are already too big.[27]
4. On a positive note, a well-constructed VNAV reform proposal can mitigate some (but not all) of the impact on demand for the product.

Assuming VNAV is limited to Prime MMFs, we can expect an interesting bifurcated market. Those investors who must have CNAV will have the ability to invest in CNAV MMFs albeit at a lower yield. On the other hand, those investors who can deal with a VNAV operationally and otherwise should be able to enjoy somewhat higher returns.

NAV Buffer and Other Capital Measures

Over the past few years, we have spent a significant amount of time exploring various ideas relating to capital. In any discussion on capital, it is important to recognize the potential uses of capital and the limitations of capital. Regardless of the source of funds, capital can only address some idiosyncratic risks associated with an individual MMF. For example, if a fund sells a security at a loss, a capital buffer could be tapped to cover the loss. While this may be desirable, we would argue that investors are already aware of the market risk and are making informed investment decisions, therefore capital should not be necessary from a regulatory perspective. On the other hand, capital should not be expected to stop a run. The amount of capital and the source of capital are important questions. The current interest rate environment, which is expected to continue for the foreseeable future, only allows a MMF to retain a few basis points of capital. Given the low fees associated with MMFs, any capital over 0.75% will make the MMF product uneconomical for sponsors to offer.

There are three potential sources of capital for MMFs: sponsors, shareholders, and third parties. Unfortunately, while each of these has been explored, they each present challenges. As stated in the FSOC's Proposal, sponsors who supply the capital likely will be required to consolidate the assets of the entire fund onto their balance sheet. Such consolidation could have regulatory and minimum capital requirement repercussions. Shareholder capital is complicated and will take a significant amount of time to accumulate. Third party capital is extraordinarily complicated and there is currently insufficient demand from investors for this type of instrument. In light of the concerns related to capital, we return to the question of the purpose of capital in a MMF, and whether it is necessary to require capital from a public policy perspective.

An NAV buffer or other capital proposals will similarly deter sponsors from offering a MMF product, leading to the elimination of MMFs. As with minimum balance at risk, we believe continuing to pursue this option adds no value to the MMF reform discussion.

Sponsor Support

Over the past few years, many sponsors have chosen to provide support to MMFs. This support has included purchasing assets from a fund at the amortized value, even when that value exceeds the market value, providing a credit support agreement that would trigger payments to the fund in certain circumstances and outright payments to a fund to bolster the NAV. In discussions on MMF reform, some policymakers have suggested that sponsors should not be permitted to provide support to MMFs. The decision to provide support (or not) should be a private sector business judgment rather than part of a MMF regulatory rule. Each sponsor should

[27] Federal Reserve Governor Daniel K. Tarullo, Speech at the University of Pennsylvania Law School (Oct. 10, 2012).

have discretion to exercise their own judgment regarding the funds they sponsor and whether or not providing support is warranted for their business or even permitted by their regulators.

Conclusion

Money market funds play an important role, providing benefits to both investors and borrowers. While we support additional reform, before undertaking structural reforms, the goals should be clearly identified and agreed upon. We believe that structural reforms should be undertaken if they satisfy the two part test noted earlier:

a. Preserve the benefits of the product as a liquidity management tool for investors and preserve the functioning of the short-term funding markets; and

b. Provide a mechanism for managing mass client redemptions, or "runs" and minimize the risk of a run on a single fund triggering a systemic run.

As discussed in this Appendix, each of the proposals will have different impacts on MMFs and on the risks associated with MMFs. Our Constant NAV with Standby Liquidity Fees Proposal is designed to meet this two-part test. This approach preserves the benefits to all investors and borrowers, while also definitively stopping a run. Importantly, this approach should change the behavior of both the manager of a fund and the investors in a fund. Finally, this approach protects investors from the behavior of others, gives all investors access to their cash and provides incentives to stay invested rather than to run. In the case of Floating the NAV, we believe the product will shrink significantly *and* we do not believe the product will be protected from runs. We are further concerned that capital solutions will not just shrink the product, but will effectively eliminate MMFs. In the event MMFs are eliminated, it is reasonable to assume that a significant percentage of these assets will move to bank deposits resulting in increased concentration in insured banks that are already large.

APPENDIX B

The following section sets forth our responses to specific Questions raised by the FSB Consultative Document, "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework For Addressing Shadow Banking Risks in Securities Lending and Repos"

General questions

Q1. Does this consultative document, taken together with the earlier interim report, adequately identify the financial stability risks in the securities lending and repo markets? Are there additional financial stability risks in the securities lending and repo markets that the FSB should have addressed? If so, please identify any such risks, as well as any potential recommendation(s) for the FSB's consideration.

Yes, the potential risks to financial stability that could arise within or as a result of securities lending and repo markets have been identified. However, we offer comments on the risk of inappropriate and/or unevenly applied regulation to the securities lending and repo markets and the impact this may have on individual investors.

Securities lending and repo transactions, like many other everyday investment management activities, intersect with the regulatory policy analysis of "shadow banking". The investment management industry is primarily that of managing end-investors' money, which is already a highly regulated activity in Europe, the US, and around the globe. For example, in Europe both the UCITS framework and Alternative Investment Fund Managers (AIFM) Directive regulate securities lending and repo activities for UCITS funds and alternative investment funds, respectively. US pension funds' engagement in securities lending is regulated by the Employment Retirement Income Security Act of 1976, the Exchange Act of 1934, the Internal Revenue Code, and by the guidelines for securities lending adopted by all US banking agencies through the Federal Financial Institutions Examination Council; Canadian mutual funds' are governed by National Instrument 81-102, etc. These are just examples of the rules that apply to some lenders in the European, US, and Canadian markets and are by no means intended as an exhaustive list of all rules around the globe. In short, there is already an elaborate web of rules and regulatory oversight which apply to these activities when carried out by most, although not all participants.

The existing regulatory regimes mentioned above regulate securities lending activities through a combination of disclosure and investor consent, mandatory limits on the percentage of securities on loan, restrictions on permissible forms of collateral, requirements for collateral and counterparty diversification and quality, and restrictions on permitted borrowers. We view these as "best practices" and we suggest that a first focus of regulators should be to impose these existing restrictions to all participants in the securities lending market before considering new and different requirements such as mandatory minimum haircuts. Combined with enhanced transparency to regulators, we believe that this would address the concerns described in the Proposals without harming the existing markets.

The financial stability risks identified by this FSB workstream appear to be based primarily on a bank regulator's perspective, not a market regulator's. We point out that bank regulation and securities markets regulation are different, with different objectives and different tools. Fund management activities are governed by extensive sets of rules requiring proper authorization and supervision of the fund manager and in most instances, also authorization and separate regulation of each single investment fund, as well as requiring extensive disclosure of the funds' activities to investors and (in some instances) to the markets as a whole.

As discussed above, we believe it is important that any regulations which result from the Proposals should apply to all securities lenders and all borrowers regardless of their regulatory form. As an example, insurance companies, public pensions, or sovereign wealth funds are permitted to participate in securities lending and repo and reverse repo transactions in many jurisdictions, yet such entities are generally exempt from banking regulation and from securities law regulation. We suggest that bringing such participants into a consistent set of rules would provide greater systemic benefit than adding even more regulation to those participants that are already highly regulated by either banking or market finance rules.

Q2. Do the policy recommendations in the document adequately address the financial stability risk(s) identified? Are there alternative approaches to risk mitigation (including existing regulatory, industry, or other mitigants) that the FSB should consider to address such risks in the securities lending and repo markets? If so, please describe such mitigants and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

We generally agree that the Proposals address the identified financial stability risks and are generally aligned with concepts of good regulation of market finance activities: increased transparency and disclosure with some reasonable restrictions to provide a “best practices” framework applicable to all participants in the market.

We believe that individuals and firms that participate in market finance activities are better positioned to protect their interests and importantly, the interests of their clients. The policy recommendations set forth in the Proposals generally provide a reasonable framework within which participants can operate. That said, we provide specific comments below regarding the recommendations and make suggestions for a more appropriate approach.

Q3. Please explain the feasibility of implementing the policy recommendations (or any alternative that you believe that would more adequately address any identified financial stability risks) in the jurisdiction(s) on which you would like to comment?

With regard to Recommendations 1, 2, and 3, we specifically note that the proposal to create a new “transaction repository” for the securities lending, repo, and reverse repo markets would impose significant costs on the industry as well as on the regulators who seek information. Each party reporting each transaction would generate an enormous amount of data that would have to be matched and “cleansed” by the regulators to understand. We do not believe that this information will be actually useful to regulators, as securities lending transactions in particular can have a very long life and the various terms can and will change over time.

We believe that a better way to achieve the goal of greater transparency would be through “position reporting” or “exposure reporting” through which lenders and borrowers each report their respective positions on a regular basis (daily, weekly, monthly or quarterly). Position reporting would further make it easier for regulators to view related collateral positions as collateralization is normally done at an overall exposure level per principal client and not per transaction. Position reporting could also leverage off existing platforms used by the industry and would provide regulators with a robust view of the markets over time.

Other issues of cost and feasibility are generally addressed in our individual comments below.

Q4. Please address any costs and benefits, as well as unintended consequences from implementing the policy recommendations in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers, to the extent possible, which would assist the FSB in carrying out a subsequent quantitative impact assessment.

Cost and feasibility as well as unintended consequences are addressed in our individual comments below.

Q5. What is the appropriate phase-in period to implement the policy recommendations (or any alternative that you believe would more adequately address any identified financial stability risks)?

To the extent that operational processes must be changed, an appropriate phase-in period would allow for the industry to work with regulators to ensure that regulatory goals are achieved in a cost-effective manner. This may include leveraging existing processes and platforms which have already been built and are in use by major players in the industry around the world. To the extent additional processes or platforms must be built those would take a significant lead time to agree and to build as all participants in the securities lending, borrowing, repo, and reverse repo markets as well as regulators would need to design and build technology systems to link their systems together.

2. TRANSPARENCY & DISCLOSURE

2.1 Improvement in regulatory reporting

Q6. Do you agree with the information items listed in Box 1 for enhancing transparency in securities lending and repo markets? Which of the information items in Box 1 are already publicly available for all market participants, and from which sources? Would collecting or providing any of the information items listed in Box 1 present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided to replace such items.

We understand and agree that regulators need additional data markets to provide them with a better understanding of the market's flows and inter-connections to reduce systemic risk. As suggested in the Proposals, we believe that regulators should start by gathering limited information on a periodic basis whether through a survey process or through automated data feeds. This initial effort will help regulators understand the information which is available, the sources from which it can be obtained, and the routine variation in balances, etc. After evaluating the information which can be obtained through a periodic process, regulators may want to move to a more frequent process where feasible.

The ultimate goal should be that any data gathering should be automated and standardized among participants. We believe that existing means through which data are shared by participants in the securities lending and repo markets should be leveraged before the building of any new systems are considered. These existing platforms include private data vendors who consume and cleanse data from most major market participants today as well as certain platforms or utilities that are used by most major market participants for transaction processing and data sharing. In addition, there are other vendors who are not currently working with securities lending or repo data but who are experienced with moving large amounts of data among many users. Existing vendors with experience with securities lending data include Markit and SunGard; existing platforms include EquiLend, Loanet, and DTCC; and other data vendors who are experienced with moving large amounts of data include Bloomberg and Thompson Reuters. In addition, the tri-party custodians who hold collateral have built extensive systems to report positions to both lenders and borrowers and should be leveraged, where possible.

The use of any existing vendor, platform, or data product should be evaluated under agreements with those vendors, plus the privacy and confidentiality rules applicable to each underlying client would have to be considered prior to the sharing and use of any such data.

As noted above, transaction-level information would not fulfill FSB objectives as a point of meaningful comparison or to provide useful historical trend analysis over time as there would be no opportunity to cleanse and reconcile the data between the respective counterparties, unless the FSB proposal envisions the regulators obtaining data from the borrowers and performing the matching and cleansing process. We believe that a simpler alternative could be position level or exposure reporting, which reflects settled, confirmed trades and could more easily include reporting on collateral positions.

We have the following comments regarding the specific data points listed for securities lending in Box 1:

- Transaction-level data
  i. Principal Amount
     - We assume this is the market value of the securities lent.
  ii. Currency
     - Reports could be provided in any currency requested, whether the currency of the security being lent, of the lender, of the transaction, or other (perhaps determined by the regulator) although any foreign exchange conversion must be done using the same conversion rate for all aspects of the trade (both securities and collateral) as of the same date and time the underlying process was run.
  iii. Type and value of collateral (cash vs. non-cash; breakdown of non-cash by asset type) –
     - Regulators would need to clearly define the definition of "asset type," or, alternatively, it would be easier to just report the Security Identifier (CUSIP, SEDOL, ISIN, etc.).
     - The form of collateral, the asset type, and the particular securities can change over the life of a trade.
     - A "basket" or "bag" of pooled collateral is normally obtained vs. an exposure to a counterparty rather than linking a specific piece of collateral to a specific loan transaction. This provides the benefits of diversification as well as operational convenience.
  iv. Securities lending fee or rate, including breakdown of fee and cash reinvestment return
     - The rate or fee can change over the life of the trade.
  v. (Ultimate) counterparty
     - A lender can only provide the identity of the direct counterparty.
     - The ultimate end-user of the security is unknown to the Lender.
     - If regulators plan to receive data from each participant in the chain of transactions and conduct a matching and cleansing process they may be able to ascertain these relationships in a very rough way.
  vi. Haircut
     - The form of collateral, the particular securities and the asset type can change over the life of a trade and thus the "haircut" or margin will change depending on the collateral used.
  vii. Maturity date
     - The majority of loans are conducted on an overnight basis with one-day maturity.
  viii. First callable date
     - The majority of loans are conducted on an overnight basis with one-day maturity so the concept of "first callable date" is generally not applicable.

- Firm-level data (could be collected through an official survey or regulatory reporting where a TR does not collect transaction level data):

- We understand “firm” as used here to refer to the principal lender and not the agent lender.
- We assume the regulators would require the same information from Borrowers and each leg in the chain in order to get a complete picture of exposures.

i. Volume and value of securities on loan
   - We assume “volume” = number of shares/bonds and “value” – number of shares/bonds X market price..

ii. Volume and value of securities available for lending

iii. Currency breakdown
   - We could report in any currency but it is not clear what is intended by the question – currency of the security, of the Lender or of the collateral?

iv. Breakdown of counterparties by type and concentration
   - It would be more straightforward to report the identity of the counterparties using a standard legal entity identifier.
   - If regulators prefer to use “type” they will need to define “type” in a consistent manner.

v. Tenor composition
   - It is not clear what is meant by this.

vi. Collateral composition (cash vs. non-cash; breakdown of non-cash by asset type)
   - Collateral is generally not tied to a specific transaction but is held against the overall exposure from a principal lender to a particular counterparty.
   - Position-level or exposure-level reporting would be a more accurate way to evaluate the collateral composition held.
   - Regulators would need to clearly define the definition of “asset type,” or, alternatively, it would be easier to just report the Security Identifier (CUSIP, SEDOL, ISIN, etc.) .
   - The form of collateral, the asset type, and the particular securities can change over the life of a trade.

vii. Breakdown of fee and cash reinvestment return
   - The rate or fee can change over the life of the trade.

viii. Haircut ranges
   - The form of collateral, the particular securities and the asset type can change over the life of a trade and thus the “haircut” or margin will change depending on the collateral used.

ix. Re-use and re-hypothecation data: share of collateral received that is re-used or re-hypothecated, compared to the maximum authorised amount if any, and whether it is restricted to some type of securities only
   - The form of collateral, the particular securities and the asset type can change over the life of a trade and thus the characteristics can change depending on the collateral used.
   - BlackRock does not re-hypothecate collateral and, as far as we are aware, this is not normal market practice in the securities lending market.

x. Number of custodians where received collaterals are kept and the value of collateral assets held by each
   - The form of collateral, the particular securities and the asset type can change over the life of a trade and thus the custodians involved may change depending on the collateral used.

xi. The way securities received by the counterparty are held, i.e., in segregated accounts or pooled accounts

- We can only provide the identity of the direct Counterparty and their custodian/depository/broker which receives the security.
- The way securities received by the counterparty are held is unknown to the Lender.
- If regulators plan to receive data from each participant in the chain of transactions they can require the counterparty (borrower) to provide this information.

With regard to repo and reverse repo transactions, BlackRock generally supports additional disclosure to regulators in a non-public format, with the same issues of clarification noted above. We also point out that data for the US Tri-Party repo market is collected and made public on a monthly basis from the Federal Reserve Bank of New York (http://www.newyorkfed.org/banking/tpr_infr_reform.html) and we suggest that this may be a model for any broader effort to collect data.

2.2 Improvement in market transparency

Q7. Do you agree TRs would likely be the most effective way to collect comprehensive market data for securities lending and/or repos? What is the appropriate geographical and product scope of TRs in collecting such market data?

As discussed above, transaction-level reporting presents some serious "data cleansing" issues unless regulators plan to obtain data from each participant in the market and perform the data matching and cleansing themselves. Data vendors have spent years and significant resources to build reliable cleansed data feeds for position-level or exposure-level reporting and do not attempt to handle transaction-level reporting.

Regulators would be required to commit significant resources to build a robust process to match and cleanse data from all industry participants.

As an alternative, regulators should consider building a position reporting process whereby each participant reports their respective positions and regulators would see exposures as they change over time rather than specific transactions. As discussed above, this would have the benefit of leveraging existing platforms without significant additional resources required.

Q8. What are the issues authorities should be mindful of when undertaking feasibility studies for the establishment of TRs for repo and/or securities lending markets?

Both securities lending and repo transactions are continuing contracts: they are not one-time transactions. Particularly in the case of securities lending an individual trade can stretch for weeks or months. The following list includes some of the implications for the construction of a TR and whether a TR is the most appropriate way to capture any information the regulators seek to gather:

- The principal(s) can change over the life of a trade;
- The particular securities covered can change over the life of a trade in certain kinds of trades;
- The rate or fee for a loan or repo can change over the life of a trade;
- The collateral for a loan or repo can change over the life of a trade;
- As the collateral changes the applicable haircuts can change over the life of a trade.
- Partial returns would need to be linked to the original transaction; and
- Stock splits or other corporate actions would need to be linked to the original transaction.

Position reporting on some regular cycle would likely be a more useful mechanism for regulators and would reflect how lenders and their counterparties operate.

- Position reporting is how existing automated data feeds to data vendors work. Those data vendors then cleanse the data by matching it with corresponding data from other participants to the extent they participate.
- A single global TR, or a limited number of TRs would be preferable to multiple TRs for different jurisdictions or even different asset classes for the following reasons:
  - Easier to send one data feed than multiple;
  - More likely to be consistent the fewer TRs there are.
- Position reporting is also the norm in the repo context for regulatory reporting purposes in the US:
  - The Federal Reserve Bank of New York currently gathers data from repo market participants on a monthly basis with data points which overlap with many of those suggested by the Proposals;
  - The SEC receives detailed reporting from all registered 2a-7 Money Market Mutual Funds on Form N-MFP which substantially tracks the data suggested in the proposals but on a monthly position basis.

2.3 Improvement in corporate disclosures

Q9. Do you agree that the enhanced disclosure items listed above would be useful for market participants and authorities? Would disclosing any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be disclosed instead.

BlackRock supports making available to regulators the information they need to detect and address systemic risk. However, we think it is unlikely that the best way to provide regulators with the information they need about a firm's securities lending and repo activities is to by increased public disclosure in a firm's public financial statements and reports. Those reports are designed to give investors, lenders and other creditors information they need to make decisions about investing or otherwise taking risk against the reporting company, rather than to provide regulators with the information they need for market supervision. Financial statement information is therefore (appropriately) provided in a different manner and at a different level of detail than we believe regulators would need. Since the information relevant to detecting and addressing systemic risk may include proprietary, competitively sensitive and/or confidential elements, it should be provided to the regulators on a confidential basis, rather than disclosed publicly.

As an investor on behalf of our clients, BlackRock also supports robust corporate disclosure of financial information through financial statements and reports. However, we believe that disclosure of securities lending, repo and reverse repo transactions is generally already well-addressed under the detailed requirements of the IASB and IFRS requirements which apply to any public filer. In addition, we suggest that the additional detailed transaction-level information suggested in Recommendation 4 would either be so stale as to be of no use or even, if disclosed more quickly, would be useful only for those who wished to reverse-engineer a trading strategy or to trade against a strategy being employed by the public filer. We believe that the current international disclosure requirements are adequate. We summarize the existing disclosure requirements below.

Summary of current corporate disclosure requirements regarding Securities Lending and Repo

Financial statements normally are issued in accordance with regulatory filing or other statutory deadlines. Their issuance typically lags the balance sheet date by 45 days to up to three months. As a result, transactional information would be dated, particularly since many repurchase agreements are for periods of less than one week, and virtually all of securities lending arrangements are callable on a day's notice. Thus, transactional data that might be used by analysts would be both stale and, at best, only indicative of past activity.

For certain entities, such as investment companies that have proprietary trading models, disclosure of transactional activity may be problematic because it could enable third parties to reverse engineer such models. If the data is disseminated on a real-time basis or subject to only minor delays, it also could enable third parties to trade against such entities.

IASB mandated disclosures are quite extensive and were developed based on significant input from user groups to ensure that financial statements contained information necessary to their understanding of the financial position and results of operations of an entity. Inclusion of more granular information on securities lending and repurchase agreement exposures would not enhance users' ability to achieve that objective. Disclosure of information at a transactional level would overwhelm the financial statements and disproportionately emphasize an activity that for most organizations is a small component of a larger set of activities. Current IASB requirements provide information necessary for users to understand the gross and net exposure to such transactions, information related to collateral requirements, and where individually material to the financial statements, their terms.

IFRS currently require extensive disclosure with respect to repurchase agreements and securities lending. These disclosures are governed by IFRS 7, *Financial Instruments: Disclosures*, and amendments thereto. The principles for derecognition are covered in International Accounting Standards 39, *Financial Instruments: Recognition and Measurement*. Additionally, IAS 32, *Financial Instruments: Presentation*, and amendments thereto, provide further guidance for offsetting financial assets and liabilities and additional disclosures.

Transfers of financial assets, such as loans of securities collateral, must be disclosed by class of financial asset. For transferred assets that are not derecognized (such as a transfer of a financial asset with an obligation to repurchase the transferred asset at a future price), an entity must disclose the nature of the assets involved; the nature of the risks and rewards of ownership to which the entity is exposed; a description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets; and the carrying amounts of the transferred assets and the associated liabilities. The risks and rewards of ownership normally would include a discussion of the credit risk control processes, how such risk and collateral are monitored, and the basis for determining the carrying value of the assets and liabilities. As a result, the gross components of the carrying amount of assets, fair value of the liabilities, and the net position is disclosed.

Where financial assets are derecognized in their entirety but the transferor still has continuing involvement (such as a transfer of a financial asset where the transferor has the option to buy the transferred asset back at a fixed price but, at the date of transfer, the option price is deeply out of the money), IFRS 7 requires additional disclosures that would include:

- The carrying amount and fair value of assets and liabilities that are derecognized in the statement of financial position and represent continuing involvement in the derecognized financial assets;
- The maximum exposure to loss from the entity's continuing involvement and how that exposure is determined;
- The undiscounted cash flows that may be required to repurchase the derecognized assets;

- The gain or loss recognized at the date of transfer;
- Income and expense recognized in in the reporting period and cumulatively from the continuing involvement in the derecognized asset; and
- When the greatest transfer activity took place within the reporting period.

In addition, an entity is required to disclose the carrying amount of financial assets pledged as collateral for liabilities when the transferor has the right to sell or pledge the collateral. Those disclosures include the type and amount of collateral that need to be maintained as security for the loans.

If an entity holds collateral as security for financial assets loaned to another entity and it is permitted to sell or repledge them in the absence of default by the owner, the entity must disclose the fair value of the collateral held; the fair value of any such collateral that has been sold or repledged, and whether the entity has an obligation to return it; and the terms and conditions associated with its use of the collateral.

2.4 Improvement in reporting by fund managers to end-investors

Q10. Do you agree that the reporting items listed above would be useful for investors? Would reporting any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be reported instead.

We agree that fund investors should receive disclosure regarding securities lending and repo activity that is consistent with the disclosure standards applied to other investment activities of the same fund.

As a general rule, for a fund that engages in securities lending or repo transactions, that disclosure would typically include:

- The fact that it engages in securities lending or repo transactions;
- A description of the transaction;
- A description of the risks involved and how those risks are controlled;
- A description of how counterparties are selected; and
    - We disagree that a list of specific counterparties is useful information for fund investors, as investors generally appoint investment managers or invest in commingled funds in order to delegate these determinations to other parties
    - Providing a list of specific counterparties could have unintended consequences such as signaling credit decisions by the fund manager or the lending agent
- A description of the fees paid, to whom, and whether any are affiliated parties.
    - Disclosure of fees, the identity of service providers and their affiliate status should be consistent with the same fund's disclosure of other fees and arrangements such as investment management, custody, FX, Swaps, Futures, etc.

We do not believe that there is value to fund investors from disclosing the other items listed:

- The identity of counterparties;
- Repo, reverse repo, and securities lending data breakdowns listed above;
- Re-use and re-hypothecation data;
- Information on any restrictions on type of securities;
- Number of custodians and the amount of assets held by each; and
- The way securities received by the counterparty are held.

As for public company disclosure discussed above, we are concerned that the disclosure regarding securities lending or repo activities by a fund should not be disproportionate to other forms of investment activity (notably, the fulfillment of its primary investment objective) by the same fund.

3. Policy recommendations related to regulation

3.1 Minimum haircuts

Q11. Are the factors described in section 3.1.2 appropriate to capture all important considerations that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

We agree that a regulatory floor of 100% as applied to all participants in the securities lending, repo and reverse repo markets would be a beneficial "best practice," but we question whether mandatory haircuts on top of that level would achieve more good than the possible danger of becoming the de facto norm. We believe that there will be more overall benefit from mandating a robust daily mark-to-market process using independently-established valuation as suggested in Recommendation 11 than from requiring a minimum haircut without robust processes.

With regard to mandatory minimum haircuts, we believe that there can be a conflict in methods and outcomes between protecting investors and protecting the system. We believe that beyond a floor of 100%, investors should have the ability to make reasonable risk-based determinations of the appropriate level of haircut based on their evaluation of the creditworthiness of their counterparty and the volatility of the securities on loan and used as collateral. An investor may reasonably choose to take a lower haircut on collateral from a high-quality counterparty, or when the collateral used is highly liquid or highly correlated with the securities on loan. Higher mandatory haircuts may seem appropriate from a systemic risk perspective but would reduce or eliminate the attractiveness of the transaction for investors and the counterparties.

Q12. What do you view as the main potential benefits, the likely impact on market activities, and possible unintended consequences of introducing a framework of numerical haircut floors on securities financing transactions where there is material procyclicality risk? Do the types of securities identified in Options 1 and 2 present a material pro-cyclical risk?

The main benefit of numerical floors for haircuts would be de-facto initial margin. This should subsequently reduce the amount of upfront funds lent against specific collateral. If a numerical floor becomes the new standard, daily mark to market will be against this minimum threshold anyway. This method will reduce leverage in the system, but could also affect liquidity and raise financing costs to the buy-side in the outright cash market.

As a consequence, investors would now require a wider spread (lower price) in evaluating potential investments. Prices would need to be at more distressed levels for certain investments to make sense, when being evaluated on a return on equity basis as higher haircuts reduce the return on equity used. This could lead to downward pressure on asset prices in the cash market.

It is difficult to make a general statement about the amount of pro-cyclical risk in each security type. The last credit crisis was based largely on excessive leverage (creating securitization) from years of relaxed lending standards in the housing market and related securities.

We further do not believe there should be a minimum haircut for Sovereign securities. We provide a more detailed explanation of why Sovereign securities should be excluded in our response to Question 17 below.

Q13. Do you have a view as to which of the two approaches in section 3.1.3 (option 1 – high level – or option 2 – backstop) is more effective in reducing procyclicality and in limiting the build-up of excessive leverage, while preserving liquid and well-functioning markets?

We partially addressed this question in our response to Question 12 above. As a corollary to that response, the financing market and leverage are largely driven by activity in the outright cash market. When prices for assets become distressed, there becomes an equilibrium point when an investment makes sense. At the backstop level, these assets will be more attractive at higher (less distressed prices) in the outright cash market. This will help promote greater price stability and liquidity.

Q14. Are there additional factors that should be considered in setting numerical haircut floors as set out in section 3.1.3?

Q15. In your view, how would the numerical haircut framework interact with model-based haircut practices? Also, how would the framework complement the minimum standards for haircut methodologies proposed in section 3.1.2?

We agree with and support the responses of the International Securities Lending Association ("ISLA") and the Securities Lending Committee of the Risk Management Association ("RMA") to Questions 14 and 15.

3.1.4 Scope of application of numerical floors

Q16. In your view, what is the appropriate scope of application of a framework of numerical haircut floors by: (i) transaction type; (ii) counterparty type; and (iii) collateral type? Which of the proposed options described above (or alternative options) do you think are more effective in reducing procyclicality risk associated with securities financing transactions, while preserving liquid and well-functioning markets?

We agree that certain transactions to borrow specific collateral should be excluded. In addition to other benefits this would help promote liquidity. When securities become hard to borrow (special) liquidity often becomes constrained in the outright cash market. When certain incentives to lend securities exist in the market (lower haircuts and financing rates), investors are more willing to do so, thus promoting liquidity.

With regard to transaction type, it would be difficult to discern which transactions have a primary motivation of financing rather than to lend/borrow specific securities. There is no universal way to run the financing book of a levered fund. Some bonds are bought outright in the cash market specifically to be financed via repo and some are not. Each fund/investment is different.

We continue to believe the best practice would be to let the market determine appropriate risk measures with regard to transaction type, collateral type and counterparty type.

Q17. Are there specific transactions or instruments for which the application of the numerical haircut floor framework may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.

Q18. In your view, how should the framework be applied to transactions for which margins are set at the portfolio basis rather than an individual security basis?

We support the RMA and ISLA responses to Questions 17 and 18.

3.2 Cash collateral reinvestment

Q19. Do you agree with the proposed minimum standards for the reinvestment of cash collateral by securities lenders, given the policy objective of limiting the liquidity and leverage risks? Are there any important considerations that the FSB should take into account?

As with other aspects of the Proposals, we support the establishment of "best practices" which should apply to all participants in the market and not only those which are already highly regulated. We believe the Proposals make reasonable, common-sense suggestions for consistent regulatory action that would still permit Lenders to make reasonable determinations regarding how their cash collateral is invested. It is important to recognize that such "best practices" should accommodate the different needs of investors and funds. Such accommodation should include such factors as the price volatility and persistence of demand of the assets on loan, and an investor's investment horizon, risk tolerance and investment style.

3.3 Requirement on re-hypothecation

Q20. Do you agree with the principles set out in Recommendation 9?

We support the Proposals' focus on disclosure to and express agreement by clients regarding the rehypothecation of their assets. We also support the Proposals' reasonable restrictions on the purposes for which client assets can be rehypothecated. Lastly, we agree that the issues raised are complicated and that the best way to proceed would be to create an expert group to review rather than making specific proposals at this time.

3.4 Minimum regulatory standards for collateral valuation and management

Q21. Do you agree with the proposed minimum standards for valuation and management of collaterals by securities lending and repo market participants? Are there any additional recommendations the FSB should consider?

We support the Proposals' recommendation of daily mark to market and the collection of variation margin for exposure to counterparties. As discussed above, we believe that this requirement would be a greater improvement to existing processes than a minimum haircut requirement. We also support the recommendation for counterparty default planning. While we agree that lenders should only accept collateral that they could legally hold outright in the event of a borrower default pending liquidation, we urge that this requirement not be interpreted to require that collateral be limited to instruments within a lenders investment mandate, as that would potentially risk further concentrating an investor's positions at a time of stress when the focus should more appropriately be on ensuring greater diversification and liquidity.

4. Policy recommendations related to structural aspects of the securities financing markets

4.1 Central clearing

4.2 Changes to bankruptcy law treatment of repo and securities lending transactions

Q22. Do you agree with the policy recommendations on structural aspects of securities financing markets as described in sections 4.1 and 4.2 above?

Central Clearing: We agree with the Proposals' conclusion that, although encouraging the use of CCPs may be appropriate for highly standardized repo transactions (i.e., vs. Sovereign Debt collateral), regulatory changes to encourage the use of CCPs for other less-standardized repo as well as securities lending is probably not appropriate at this time.

Changes to Bankruptcy Law: We agree with the Proposals' conclusion that changes to bankruptcy law should not be prioritized for further work at this time.

APPENDIX C

The following section sets forth our responses to specific Questions posed by the Consultative Document, "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"

General questions

Q1. Do you agree that the high-level policy framework effectively addresses shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?

By its very nature, "shadow banking" is a loosely defined and broad market that requires a variety of inputs from a broad array of global participants to accurately summarize the implied risk factors within these markets. Given the breadth of changes that are being proposed and the diverse global investor base that is likely as heterogeneous in their response to the FSB policy framework as they are in their investment strategies and risk tolerances, assessing the direction and magnitude of the impact on the defined economic functions is not straightforward. As a fundamental issue, BlackRock objects to the use of the term "shadow banking" as the term is fundamentally inaccurate and fallacious. We agree with the concerns expressed by numerous US regulators and national associations regarding market activities broadly labeled "shadow banking" as inherently inappropriate.

In assessing the five economic functions defined within non-bank financial entities, BlackRock's activities are limited to Economic Function 1 - Management of client cash pools. As such, our responses will focus on the firm's activities that fall within this economic function defined within the proposal. We believe that it is important to concentrate our responses to the firm's involvement in the aforementioned functions in order to develop a well-rounded perspective on addressing shadow banking risks and on the potential market impact of the FSB proposal.

BlackRock believes the high-level policy framework and toolkits proposed by the FSB has the ability to affect the five defined economic functions in a variety of ways, including through changes in product, market liquidity, leverage and transparency. An important determinant of the supply of credit intermediation within various segments of the capital markets is the existence of distinct classes of natural buyers within the economic functions listed in the proposal. The classes exist for a variety of reasons such as a special expertise which may be required to perform the function; natural buyers may be less risk averse; or more optimistic about returns on the particular business. *At the highest level, the proposed framework may restrict the ability of the non-bank financial entities to provide efficient means of allocating capital.*

Furthermore, the policy framework and general principles for regulatory measures are not without risks as the unintended consequences may include a *permanent* decrease in the supply of investment capital within the credit intermediation chain. A sizable supply-side disturbance would likely shift the aggregate supply curve, resulting in financial intermediary supply decreased *at many levels* of the credit market. Increased regulation aimed at non-bank activities already subject to detailed regimes of capital markets regulation could reduce market liquidity and efficiency. It is plausible that current participants may reconsider and ultimately exit affected businesses while potential new investors would look for other, more attractive options. In such a scenario, market liquidity and efficiency within broad areas of credit intermediation would decline, which would increase borrowers' cost of credit.

While the ultimate effects of a disruption in the supply of intermediation are unclear, a large enough disturbance is likely to result in higher equilibrium credit spreads across multiple markets (and hence, corporate borrowing costs rising) and the potential for a contraction in economic activity. The nature of this consideration undoubtedly has consequences for the risk of financial instability in spite of the best efforts by authorities to design and implement such measures in an effective manner.

Regarding the issue of regulatory arbitrage, we do not agree with the notion of the perceived deficiencies or fractional nature of regulation to which the defined economic functions are currently subject. We urge the FSB to re-evaluate the current regulations of these entities and the extensive regulatory framework and oversight to which these entities are subject through numerous securities and capital markets laws.

Existing regulations placed on the so-called non-bank entities listed in the proposal generally impose minimums/ requirements for leverage, capital, liquidity, and concentration and help provide assurance that non-bank entities will be able to meet their obligations throughout market cycles. As such, we believe existing regulations reasonably limit the risks non-bank entities might pose to the financial markets broadly.

Q2. Do the five economic functions set out in Section 2 capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space? Are there additional economic function(s) that authorities should consider? If so, please provide details, including the kinds of shadow banking entities/activities that would be covered by the additional economic function(s).

Economic function 1 is defined as “Management of client cash pools with features that make them susceptible to runs”. Relevant examples included in the proposal are unregulated liquidity pools and ultra-short term funds. The proposal states that investment funds whose investment objective provides investors with an expectation that their investment will not lose value and that are fully redeemable upon demand or within a short timeframe, can face “run” risk if the funds are perceived to be at risk of experiencing a loss in value.

Ultra-short bond funds

With regard to Ultra-short bond funds, we do not believe bank-like regulation is appropriate or workable for ultra-short term bond funds registered and regulated under all four of the major US securities laws: the Securities Act of 1933; the Securities Exchange Act of 1934; the Investment Advisers Act of 1940; and most importantly, the Investment Company Act of 1940 (“Investment Company Act”), which requires all mutual funds to register with the SEC and to meet significant operating standards.

We support the June 3, 2011 response from the Investment Company Institute urging the FSB to reevaluate the “universal bank” framework set forth in the FSB note as it pertains to FSB defined “client cash pools” that are registered under the Investment Company Act.

BlackRock does not agree that registered mutual funds (as defined within the FSB report) with low risk investment objectives give rise to systemic risks and regulatory arbitrage as described in the FSB proposal. Registered variable net asset value (VNAV) mutual funds in the US and Europe are required by law to determine the price of their shares each business day. Specifically, the net asset value per share calculation must reflect the current market value of the fund’s securities. In addition, the Investment Company Act clearly places limits on leverage, illiquid assets and assets concentrations. Further, the robust requirements of the Investment Company Act do not provide opportunities for regulatory arbitrage or attempt to circumvent banking regulation. Similarly, the OCC-regulated Bank STIF funds operated by BlackRock are strictly regulated with regard to their leverage, illiquid assets and concentration, and the regulatory structure does not permit regulatory arbitrage and indeed are already subject to banking regulation.

Similarly, European registered mutual funds (as described within the FSB proposal) are governed and must meet significant operating standards through regulations from the UCITS and are subject to supervision and guidelines from the European Securities and Markets Authority (ESMA) and its member domestic European regulatory authorities. UCITS requires that mutual funds operate on a principle of risk spreading, which means that restrictions apply which limit the spread of investments, leverage and exposure. Authorities at a European level have recently finalised guidelines addressing certain arrangements in UCITS funds in order to enhance the risk management framework in which these products operate.

Client cash pools

Regarding client cash pools, BlackRock has maintained a viable business of managing institutional separate accounts which involve the management of low-risk client cash pools of various scope and design to help investors address their evolving cash management needs. Separately managed cash accounts[28] offer alternative risk profiles and achieve different goals than registered mutual funds because many institutional investors use such accounts as a complement to their money market fund investments. Additionally, mutual funds and separately managed accounts are distributed differently, operate under different legal and regulatory structures, and have different business risks. While most separately managed accounts structures do not fall under the direct supervision of the Investment Company Act, the investment mandates are fundamentally similar to registered low-risk funds whose primarily objective is preservation of principle.

The unique features and operating structures that institutional investors seek within separately managed accounts offerings are the driving force behind the existence of the asset class. As such, the high level of customization that investors seek in individual separately managed accounts tends to make these pools long-term, multi-year investments. Institutional investors utilize these pools for specific pockets of cash that are labeled as “core” or long-term” with typical investment horizons of three to five years. For reference, BlackRock’s average mandate tenor within this market segment is three to five years.

The FSB proposal states that separately managed accounts “may face serious run risk if their investors no longer perceive the investments as safe due to the deterioration in the investment portfolio and/or the ability of the fund’s sponsor to prevent losses in value.” We believe separately managed accounts do not engage in activities that create the “run” risk defined for the followings reasons.

1. **Longer-term investment horizon.** Separately managed accounts are sought out by sophisticated institutional investors who have specific cash management needs and experience. The high level of customization is the major commercial selling point of many privately placed separately managed accounts. Investors have the ability to customize their accounts by excluding certain securities or industries, due to social, political or environmental concerns, and managing the portfolio to help reduce tax liabilities. Investors are more closely attuned to the objectives and constraints set forth in the investment policy statement and, as such, the typical mandate is initiated and managed within a multi-year agreement.

2. **Mark-to-market accounting.** Separately managed accounts are almost universally structured as mark-to-market vehicles whereby the client has frequent access to the portfolio’s market-based value. Given the accounting treatment and client access to the fluctuating market value or the pool(s) we contend that such vehicles do not provide investors with an expectation their investment will not lose value. The FSB proposal’s

[28] Throughout our response, the reference to “separately managed cash accounts” is intended to mean an institutional separate account.

concern of other accounting mechanisms for enhancing portfolio stability is not applicable to these pools.

3. **Perfected security interest**. Separately managed accounts do not issue shares and utilize documentation that details the direct investor ownership of each security within the pool. The client has sole direct exposure to the assets and thus is not incentivized to "run". The manager of the pool is hired to make discretionary decisions consistent with the investment objectives set out by the client. The documentation between the investor and manager state that no financial support or guarantee will be provided by the asset manager or sponsor.

4. **Leverage**. Separately managed accounts do not typically utilize leverage on a sizable scale. The management of separately managed accounts that have a cash management or very low risk investment objective do not typically include the use of leverage within a normal operating environment. The constitution of the mandates and risk-averse nature of these assets generally makes the use of leverage inconsistent with long-term investment objectives.

Q3. Are the suggested information items listed in the Annex for assessing the extent of shadow banking risks appropriate in capturing the shadow banking risk factors? Are there additional items authorities could consider? Would collecting or providing any of the information items listed in the Annex present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

BlackRock supports the information finding efforts with the FSB proposal as we believe it is important to have greater transparency into these markets to ensure that any new rules avoid unintended consequences. We support additional disclosure so long as it is accessible only by regulators. It is not always the case that more public information results in predictable market responses. Depending on how much information each market participant has to reveal to the public, participants may believe their trading advantages or entire strategy may be jeopardized. We believe that market participants would be particularly sensitive if this information was in a public forum and would potentially change their trading behavior. Further, public access to certain information may give market participants the ability to position or hedge against such information. If market participants believe certain strategies were being compromised through additional disclosure they could change markets abruptly. Pushing participants out of certain markets in the name of disclosure would damage liquidity in affected markets. BlackRock believes the capital markets currently provide efficient systems of allocating capital and a means of managing risks. Capital market laws and regulations (to which separately managed accounts adhere/are subject) provide extensive rules for the provision of public information about issuers and managers.

Comments specific to the Annex items

WAM – can be misleading if the majority of WAM is utilized through purchases of high quality government securities. Setting strict limits on the maturity of portfolio assets would disproportionately affect funds with mandates that predominantly invest in high quality assets. If restrictions are pursued, limits should have the flexibility to support a manager's ability to compete, while ensuring that it supports effective risk management.

Liquidity buffers - Provisions for liquidity would likely come in the form of government securities; current interest rate environment and outlook across the developed markets may lead to negative yields on such securities and hamper liquidity profiles in certain segments of the government securities markets.

Q4. Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function? Are there additional policy tool(s) authorities should consider?

While we agree there is merit in the FSB policy toolkit to mitigate systemic risks for each economic function, we ultimately expect the proposed policy toolkit for the economic functions in which BlackRock is involved (Economic function 1 – Client cash pools), has the potential to (1) reduce the size of the dedicated investor base in these markets, (2) alter market depth and liquidity, (3) and ultimately decrease the size of these markets.

Separately managed accounts, as a product within Economic Function 1, exist because clients are seeking a flexible, capital efficient structure for certain core assets compared to funding in traditional, institutionalized products, which results in less flexibility and product diversification. BlackRock is concerned FSB's policy toolkit, as it relates to this economic function, may significantly reduce the attractiveness of these products by attempting to reduce the flexibility and customization that cannot be duplicated in a tightly defined market.

Comments specific to the Annex items

Side pockets – BlackRock would object to mandated side pockets via legal separation of certain portions of separately managed accounts as the legal structure of such pools include direct client ownership of the securities within the pool. BlackRock's business model and pricing within this business does not support the concept of regulatory mandated "side pockets". If mandated, we believe the market may come to expect that managers will either implicitly or explicitly guarantee the principal or par value of side pockets.

Additionally, we believe there is merit in FSB's suggestion that conflicts of interests would develop if a manager is allowed to determine whether to use side pockets. Separately managed accounts are fully controlled by the investor. We would suggest the ability to utilize side pockets exists today within separately managed accounts as investors have the ability to segregate a portion of a portfolio if the investor believes this is the most efficient means by which to manage the overall portfolio.

Finally, we agree side pockets would only be effective when the redemption pressure is triggered by a problem related to specific assets. It cannot address a widespread run.

Q5. Are there any costs or unintended consequences from implementing the high-level policy framework in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers to the extent possible.

BlackRock supports the proposed high-level framework as a means to monitor the management of client credit pools, such as by improving data collection to assist regulators in determining whether additional regulatory measures may be required to strengthen the resilience of the non-banking entities. While the policy framework is subject to a wide range of interpretations, BlackRock believes the framework will change investor behavior, and is concerned a strict interpretation of the FSB framework would result in an unbalanced response from market participants.

Specifically, we view a decline in the size of this market as a likely response to the FSB proposal. Given the size and importance of the ultra-short fixed income markets, a meaningful decrease in the size could have a much larger impact in terms of market depth, liquidity and credit spreads than the mitigation of systemic risks accomplished through the high-level policy framework.