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Re: Consultation Report – EU Money Market Fund Regulation – legislative review

BlackRock[1] appreciates the opportunity to respond to the questions raised by ESMA in its consultation on the review of the EU Money Market Fund Regulation (MMFR).

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

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

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

As noted in our recent ViewPoint "Lessons from COVID 19: The Experience of European MMFs in Short-Term Markets", we recommend that policy makers look holistically at short-term markets to identify areas for improvement rather than look at MMFs in isolation. We outline three areas for improvement: short-term market structure; bank capital and liquidity rules; and MMF product regulation. It is our view that improvement in all three

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world. We are a global leader in cash and liquidity management; in Europe we manage Public Debt Constant NAV (CNAV) MMFs, Low-Volatility NAV (LVNAV) MMFs, short-term Variable NAV (VNAV) MMFs, and Standard VNAV MMFs (which we market as Ultra-Short Duration Bond Funds) in all three main currencies (EUR, USD, GBP).

areas is essential to enable short term markets (and in turn MMFs which provide the most transparent access to these markets) to respond effectively to potential future shocks of the magnitude of that experienced in March of last year.

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

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

   We are strongly supportive of the proposal to decouple the mandatory consideration of redemption gates or fees when an MMF breaches its weekly liquid asset (WLA) thresholds. In practice during March 2020, this meant that many funds that had ample liquidity were nevertheless incentivised not to draw it down, but rather to significantly *increase* the liquidity of the portfolio, in many cases by selling longer-dated assets and not rolling over new paper.

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

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

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

3. **With the possible exception of the rotation from prime MMFs into government MMFs observed in the US market and the (less-severe) spillover we saw in USD LVNAV funds, outflows were driven by investors' underlying cash and liquidity**

needs, ***not* by investor confidence in the structural features of different types of MMFs.**

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

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

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

4. **Beyond any specific reforms to money market funds, we believe that transparency can and should improve in short term markets where data about issuers, investors, and even some MMFs can be difficult to source for both market participants and public authorities**. We are highly supportive of efforts to bring more transparency to the underlying markets, and equally supportive of more frequent reporting by MMFs, as suggested in the consultation paper.

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

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

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

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

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

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

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

Sincerely,

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Question 1:

i) **Do you agree with the above assessment of the difficulties faced by MMFs during the COVID-19 March crisis? Do you agree with the identification of vulnerabilities?**

The COVID–19 crisis posed unprecedented challenges resulting in significant market stress in March 2020. Many banks and investors alike concentrated their actions on preserving and increasing liquidity. At the same time, other factors, such as the need to fund margin requirements, as well as asset allocation changes and opportunistic investment[2], resulted in pressures on short-term markets to raise cash.

We agree with ESMA's assessment that there was a notable and sustained liquidity dislocation in European short-term credit markets, which led to many MMFs having to navigate a period of notable redemption pressures (due to a variety of unique liquidity needs from end-investors) and stressed underlying markets simultaneously.

However, we do not agree with every aspect of the ESMA assessment of the difficulties faced by MMFs during the COVID-19-related market turmoil; nor do we agree with all the vulnerabilities that ESMA has identified.

In particular, we do not entirely agree with the 'three intertwined challenges' which ESMA cites: that MMFs i) have a large market footprint in the asset classes they invest in, ii) these markets are not liquid even in normal times, and iii) MMF portfolios have a high degree of overlap.

i. MMFs are undoubtedly an important part of the investor base in European short-term credit markets (for this purpose, we consider this to be both commercial paper (CP) and tradeable certificates of deposit (CDs), as well as short-term government and agency debt), but due to lack of transparency across the different segments of the European market (as ESMA points out), we find it impossible to say with certainty what percentage of the investor base is made up of MMFs. We estimate holdings across all types of MMFs account for less than half of the market for CP and CDs in Europe and represent an even smaller proportion of overall short-term liabilities of European banks[3].

ii. With regard to the liquidity of the market, we disagree with the assertion that short-term credit markets are not liquid even in normal times due to low trading volumes (para 24). Because of the nature of these securities (which due to their short duration are generally held to maturity by investors), and the market structure in the short-term space (which is over the counter (OTC) and generally dealer-based),

[2] While the initial stages of the 'dash for cash' observed in markets in March 2020 resulted in *inflows* to many MMFs, the continued price decline in many asset classes presented tactical investment opportunities for many investors. Although this was not one of the most significant drivers of outflow pressures on MMFs in the second half of March last year, it highlights that there were a wide variety of drivers of underlying investors' need for cash which manifested in redemptions from MMFs.

[3] For further detail, please see BlackRock, "Lessons from COVID 19: The Experience of European MMFs in Short-Term Markets", July 2020.

assets do not turn over or trade with great frequency – a common metric of liquidity for regulatory purposes in other asset classes. But our experience as an active participant in short-term markets is that the market structure generally functions well in normal market conditions. Liquidity can generally be understood through the lens of banks' ability to intermediate, which becomes impaired to some degree only when banks seek to shrink the size of their balance sheets (at quarter-end dates, for example, or more centrally to the subject of this consultation, during March 2020).

However, we do believe that improvements could be made to the CP market structure where market participants must frequently ask the bank from whom they purchased the CP to bid that paper back in the secondary market when they want to sell it. Typically, banks are unwilling to bid CP from issuers where they are not a named dealer on the issuer's programme. This "single source of liquidity" model failed during the COVID-19 Crisis and will fail again in the next liquidity crisis if fundamental changes to the CP market structure are not implemented, especially in light of current bank regulations.

iii. Finally, the high degree of portfolio overlap amongst MMFs should be seen as a positive, not a vulnerability. Issuers which are accepted by a wide degree of fund managers by their nature have higher degrees of liquidity in a world where dealers will look to sell on any securities they bid for in the markets.

Moving into ESMA's assessment of the key issues faced by MMFs in March 2020, we agree with the clear commentary around short-term markets as a whole at the time and the impaired liquidity conditions. We believe that improving the resilience of the short-term funding markets overall should be a strong focus for policymakers. In fact, we strongly agree with ESMA's conclusion (in para 43) that increasing the liquidity of underlying markets [in times of market stress] would have a significant positive impact on the resilience of MMFs during these stress periods.

We also agree that central bank interventions played a critical role in shoring up market confidence *across **all** asset classes*, which undoubtedly relieved pressures facing a wide variety of market participants at the time, including MMFs. However, whilst in the US the Federal Reserve's market interventions (in particular, the announcement of the MMLF which provided targeted capital relief to dealer banks) proved very effective in calming overall market liquidity conditions, the ECB and BoE asset purchase programmes (the Pandemic Emergency Purchase Programme (PEPP) and COVID Corporate Financing Facility (CCFF) respectively) had highly limited direct effects on the segment of the market that European short-term MMFs invest in.[4] These programmes, however, undoubtably had

[4] Short-term MMFs, due to maturity and credit quality restrictions, invest almost exclusively in financial CP (very few corporate CP issuers are rated A1P1, the credit rating that short-term MMFs invest in). We accept that the PEPP and BoE asset purchase programmes may have had a more direct relief effect on unrated MMFs, who are able to invest in longer maturity paper and often go beyond the A1P1 credit rating into lower rated names. As a result, it is possible these MMFs would have held more meaningful allocations to corporate CP, and hence, felt more direct relief from the ECB and BoE programmes.

a positive indirect effect. For example, corporate issuers were again able to fund themselves in primary markets which alleviated liquidity pressures on other sources of cash like MMFs or bank credit facilities.

Within the assessment of vulnerabilities, we have two overarching comments about ESMA's analysis:

1) There is an over-emphasis on vulnerabilities arising from scenarios where MMFs are forced sellers of assets to meet redemptions. If MMFs are holding the appropriate levels of meaningful liquidity, and these liquidity buffers are constructed in such a way so as to be useable for their intended purposes of meeting redemptions, MMFs should not need to sell assets to meet outflows.

   It is true that many European MMFs sold assets in March 2020, but in our experience, these sales were primarily to reposition the funds with shorter maturities and more liquidity well in excess of WLA; they were not done to meet redemptions.[5]

2) As a manager of all types of MMFs regulated under the MMFR, we are concerned by the over-focus on LVNAV funds in ESMA's analysis. While we do agree that there are some specific features of the regulatory structure for LVNAVs (in particular the rules around redemption fees and gates, which we will expand upon further elsewhere in this response) which hindered the ability of funds to navigate the March 2020 market turmoil that are worthy of deeper consideration, there are equally regulatory features of VNAV funds under the MMFR that warrant closer scrutiny.

   The observation that inherent structural features of the LVNAV create tensions between maintaining liquidity levels and staying inside the 20bps NAV collar is not a unique 'vulnerability' of LVNAV funds. Managing the dual objectives of maintaining liquidity and minimising fluctuation of NAV was a central consideration for VNAV MMF managers as well during March 2020.

   The experience of European MMFs in March 2020 shows that stresses were not specific to a particular fund structure. Indeed, we concur with ESMA's analysis that the strains were felt in both LVNAV funds (and that the degree of strain varied across currencies), and in Standard VNAV funds. This, in itself, points to the need to look across a wider horizon rather than focusing in on specific issues within one fund type when identifying key vulnerabilities (see our response to Q6).

[5] Looking at outflow data across the different types of MMFs, redemptions from LVNAV funds were lower than the minimum levels of liquidity prescribed by the MMFR (in the cases of EUR and GBP, well within those levels). Outflows may have been much closer to the regulatory levels prescribed for funds where investor flow data is not publicly available.

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More specifically, as identified by ESMA (para 15), we believe that investors' use of MMFs for managing cash needs related to margin calls was an important dynamic that merits closer focus.

The COVID-related market turbulence was the first period of sustained market stress under the clearing and margining rules put in place following the Global Financial Crisis. While there are undoubtedly conclusions to be drawn about margin rules helping contribute to market-wide institutional resilience in the market turmoil of March 2020, there is equally a debate to be had about whether margin rules increased procyclical pressures at specific points in the system. Our observation is that within the MMF sector, margin rules contributed to the initial redemption pressures that MMFs faced during the period of acute stress in late March, due to MMF end-investors who themselves faced liquidity pressures to post margin.

We believe this specific market pressure could benefit from a targeted solution that would help alleviate future stresses stemming from similar dynamics. As such, we would recommend a closer look at MMF shares being approved as collateral for margin purposes. This would mean that, instead of an investor needing to redeem from a MMF to raise cash for posting margin, the investor's MMF units could be posted directly as margin. Were these to be accepted by clearing counterparties and CCPs, it would significantly ameliorate needless pressure on money markets during times where system-wide margin pressures are likely to already be evidence of market stress.

Question 3:
Do you agree with the above assessment of the: i) potential need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation, ii) potential reforms of the conditions for the use of redemption gates? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

We believe that the introduction of minimum liquidity requirements for MMFs under the MMFR was positive for MMFs, investors, and the overall resilience of the sector. That said, the direct link between a breach of the 30% Weekly Liquid Asset (WLA) requirements and the trigger of a decision making process that could lead to the potential imposition of liquidity fees and redemption gates became a focal point for many investors both in the US and Europe.

In Europe, the regulatory structure around the decision to impose redemption gates and liquidity fees is constructed slightly differently (requiring a breach of the WLA minimums *as well as* 10% daily outflows) and investors are more familiar with these tools via the UCITS regime. Still, European MMF managers had a powerful incentive not to 'test' any investor response to a fund dropping below the 30% WLA levels. Instead, like US MMFs, the natural response was to *increase* the levels of short-term liquidity that the funds were carrying. **We strongly believe that the construct of the liquidity buffers disincentivised**

their use in times of stress, therefore undermining the countercyclical role they *should have played* in such a market event.

We know from experience that many European MMF investors were monitoring funds' WLA levels closely during March 2020. However, from our own data (see our answer to Q6), and publicly available industry data, we see little evidence of a strong correlation between redemption patterns and fluctuations in the level of MMFs' WLA.

However, investor behaviour does not refute the fact that the linkage between gates and fees and the WLA levels created disincentives for managers to let WLA dip near regulatory minimums to meet redemptions. Indeed, the incentives inherent in the construction of the liquidity buffers meant many LVNAV funds sought to increase their WLA positions to levels of 40% or even 50% (net of redemptions) by selling longer-dated assets or not rolling over maturing paper.

Ultimately, despite some significant outflow pressures, very few LVNAV funds fell below 30% weekly liquidity at any point during the March 2020 market turmoil, and for those that marginally did, this only materialised for a very short period of time. This underlines that, in March 2020, the WLA buffers effectively became floors for LVNAV funds, and as such were not able to serve their primary function, which is to provide MMF portfolios with organic sources of short-term liquidity to meet redemptions. Although market-wide data is more difficult to source across VNAV funds (where breaches of WLA requirements incur no other consequence beyond the prudent requirement to only purchase weekly liquid assets), anecdotal evidence suggests that weekly-maturing assets were able to serve this purpose and that VNAV MMF managers were more readily able to draw down these buffers to meet redemptions.

With regards to the potential reforms to the conditions for the use of redemption gates, we agree with the proposed option (para 86) that regulatory liquidity thresholds should be de-coupled entirely from mandatory actions to be taken by fund boards.

That said, the fund board should always have the ability to use its discretion to impose redemption fees or gates where it is in the best interests of investors. In our view, requiring MMFs to ask permission from regulatory authorities prior to implementing redemption gates (as considered in para 87) could mean these tools would be less responsive to immediate and urgent circumstances, where they may be most needed. At the same time however, this would be unlikely to prevent investor aversion to their use. The issue is not that investors lack trust in fund boards to make appropriate decisions; rather the issue is fundamentally the risk of the redemption gates themselves regardless of who authorises them.

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Question 4:

i) **Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or Anti-Dilution Levies / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)?**

ii) **If you are of the view that swing pricing might not be workable for certain types of MMFs, which instruments would you suggest as an alternative for these types of MMFs going forward? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.**

We believe that anti-dilution mechanisms can be important tools in fund managers' liquidity management toolkits, and if applied appropriately, can be important investor protection tools. BlackRock is a strong supporter of swing pricing for open-ended mutual funds other than MMFs, and we have been successfully operating swing pricing for funds based in certain jurisdictions in Europe since the early 2000s. However, key differences between other types of longer dated open-ended mutual funds and MMFs mean that swing pricing does not bring the same functional value to MMFs, and several technical features unique to MMFs make swing pricing for MMFs operationally challenging.

Open-ended mutual funds tend to be fully-invested in the underlying securities specific to the asset class(es) the fund's investment strategy focuses on; these funds carry low cash positions which are generally used for potential investment opportunities, not for meeting redemptions. Mutual funds meet redemptions by liquidating a representative sample of assets of different maturity and liquidity profiles within the portfolio. In certain market conditions or to meet certain redemption profiles, a mechanism is needed to reflect any material differences between the price at which an asset is valued when the NAV is struck, and the price at which the manager is able to sell it. Properly constructed[6], this ensures that the cost of liquidity is borne by the redeeming investor(s), not by those who remain invested in the fund.

MMFs by contrast, are specifically designed to hold significant amounts of their portfolio in cash and daily liquid assets for the specific purpose of using these buffers to meet redemptions. As we have outlined elsewhere in our response, an MMF should not be forced to sell assets to meet redemptions unless the redemptions exceed the available cash and daily liquid assets the fund is holding. It is only in this extreme circumstance in which the use of an anti-dilution mechanism becomes necessary for an MMF. Therefore, swing pricing would not internalise the liquidity costs of investors' redemptions and would not reduce or eliminate any first-mover advantage of redeeming investors.

The operational features of short-term MMFs make swing pricing challenging to implement while preserving the key features of the funds that investors value. Two key features of LVNAV and short term VNAV MMFs are (i) a T+0 settlement structure and (ii) multiple NAV strikes in a day.

[6] For more detailed commentary on the construction of swing pricing mechanisms, please see BlackRock, Lessons from COVID-19: Liquidity Risk Management is Central to Open-Ended Funds, November 2020.

The T+0 settlement feature, which is a critical for most investors in these MMFs, makes the implementation of swing pricing even more challenging as it does not permit enough time for price discovery to appropriately calculate the appropriate swing factor to apply. The timing challenge is magnified further for those MMFs that strike a NAV multiple times a day as there is insufficient time to implement a swing factor between NAV cut-offs. The changes to the operating model needed to make swing pricing operationally feasible (likely ending intraday liquidity and multiple pricing points which underpin this) would make short-term MMF's critically unappealing to investors.

In our view the existing MMFR provisions (Article 34 (b)(i)) surrounding the ability of the Board to impose liquidity fees are the most appropriate tools to accommodate the scenario under which the use of an anti-dilution mechanism would be necessary for an MMF (instances where the fund has insufficient cash and daily liquid assets to meet net redemptions). We recommend that these tools be allowed for all types of MMFs as it is the best and most appropriate means of passing the cost of raising liquidity in stressed markets conditions to these redeemers in an MMF.

As we have previously stated, in our opinion, data supports the view that asset sales by most short-term MMFs were for the purposes of increasing the liquidity profile of the fund; not to meet redemptions. An effective anti-dilution mechanism externalises costs so that the redeeming investors bear any cost associated with selling assets to fund their redemption, rather than internalising it on the remaining investors in the fund. However, when an MMF sells assets to reposition the portfolio, it is precisely the investors remaining in the funds who *benefit* most from those asset sales.

Any effective anti-dilution tool must be subject to a governance structure that is used to uphold the best interests of the remaining investors in the fund – for this reason, we believe it is most appropriate that the exercise of this tool rests with the Board.

Question 5:

i) **Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation?**

ii) **With respect to option 1 above, views are sought in particular on the relevant threshold (on the size of redemptions) from which WLA would need to be automatically adjusted. When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.**

We believe that regulatory liquidity thresholds are an important feature of the post-financial crisis MMF reforms and are critical to market integrity and resilience. Per our answer to Q3, we are supportive of de-coupling breaches of the WLA from the need to consider the imposition of redemption gates or liquidity fees as we believe this will help reduce the disincentives in times of stress to draw down these liquidity buffers for their intended purpose of provisioning for redemptions.

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Meeting any daily net redemptions is the purpose of an MMF's 'daily' liquidity – often either secured (overnight reverse repo) or unsecured (overnight deposits) exposures to bank counterparties which are entered into at the end of a trading day, with the cash returned to the fund at the start of the next trading day. WLA is a measurement of an MMFs investments which mature within the space of a week; this is primarily a way to ensure that the fund is organically replenishing its available overnight liquidity over the course of a trading week. WLA should therefore be best understood as an indicator that can help assess an MMF's likely ability to provision itself to meet redemptions over the course of a five-day period.

The events of March 2020 strongly illustrate the need to ensure that all types of MMFs have robust liquidity provisioning and to be able to draw on these liquidity reserves effectively in times of market stress. The outflow pressures observed in March 2020 across LVNAV MMFs, though large, were well inside of the minimum regulatory liquidity levels.

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

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

We are supportive of efforts to assess the adequacy of liquidity buffers in light of the events of March 2020 – an extremely compelling real-life stress test which allows us to judge minimum liquidity thresholds against real outflows which were significantly elevated above normal conditions. Should the incentives be in place that these buffers can be draw upon effectively in times of market stress, we believe that the existing calibration of the buffers for LVNAV and Public Debt CNAV MMFs are adequate.

We do believe it is appropriate to assess the adequacy of the liquidity buffers for VNAV funds (both from a quality and quantity perspective and recognising the different objectives of short-term MMFs and Standard MMFs) to ensure they are appropriately calibrated vis-à-vis the observed outflows in March 2020.

Provided the buffers are constructed appropriately and liquidity fees, gates and fund suspensions are decoupled from the weekly liquid assets (as outlined in our response to Question 3), we see no need for supervisors to relax the WLA requirements in times of market stress (option 1). As stated in our response to Question 3, it is important that the regulatory liquidity thresholds still apply and an MMF should continue to be prohibited from purchasing securities outside of the weekly liquid assets when the WLA level is below the minimum, as is consistent with the requirements for Short Term and Standard VNAV MMFs in the current regulations.

We believe clarity and visibility around liquidity levels is a key feature of MMFs for many investors, and as such, are not convinced policy approaches that would make the buffers non-public (option 2) would enhance investor confidence.

Equally, we have reservations about option 3. As ESMA has pointed out in their consultation paper, the vast majority of investors in European MMFs are institutional investors; we find it difficult to understand how regulators would differentiate between 'volatile institutional investors' and those who are not, for the purposes of this option. In any case, the experience of March 2020 showed that there was no one single driver of outflow pressures across MMFs – no one 'type' of investor that was necessarily more likely to have an acute need for liquidity in the circumstances than others.

Question 6:
What are your views on the potential need to eliminate CNAV and LVNAV funds, in light of the recent market developments, and the corresponding potential proposal of amendment of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

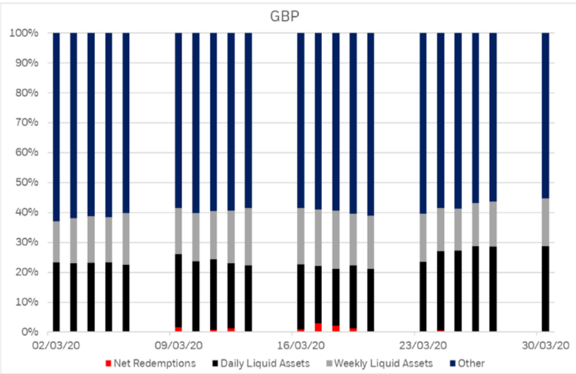
We believe the utility and proven resilience of CNAV and LVNAV fund structures make an elimination of these fund structures both unnecessary and detrimental to the broader ecosystem.

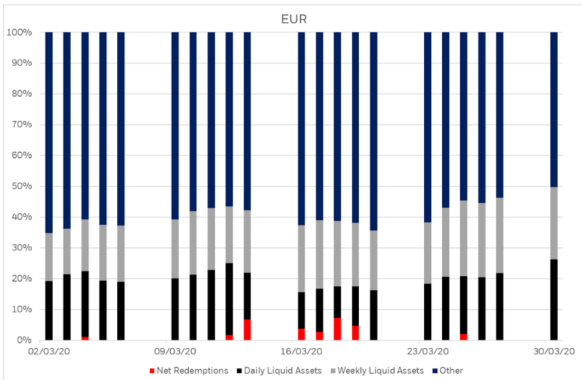
Public Debt CNAV funds were not adversely impacted by the March 2020 liquidity crisis. While the European universe is significantly smaller than the US Government MMF sector, we would equally highlight the robustness and indeed growth of those US funds during and post crisis as evidence for their overall value to clients and ecosystem.

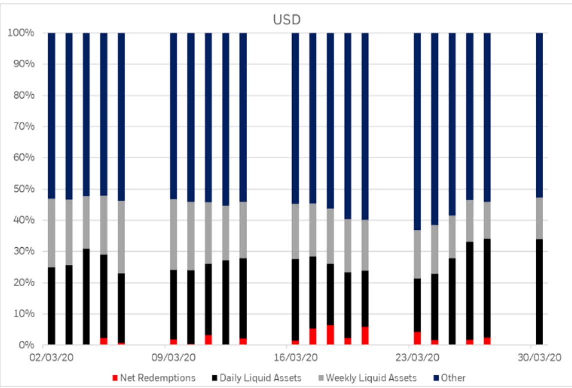
While the corresponding EU-based EUR and GBP Public Debt CNAV MMFs are relatively small today, these products could grow in the future and become more important to clients and the overall ecosystem. However, overall supply constraints in EUR and GBP public debt mean that these funds will not be able to grow near to the size of LVNAV funds today.

LVNAV MMFs played an important role as sources for immediate liquidity for those investors who needed it during March 2020. However, to be clear, there was no “run” on these funds; investors did not redeem in full from these funds and many ultimately used them to “store” their cash positions once secured through drawing down bank credit lines; this is not behaviour we would have expected to have observed, were redemptions driven by a fundamental lack of investor confidence in the structure.

We also believe that LVNAV funds generally showed robust handling of the liquidity pressure: peak outflows, though significant, were always well within the levels of short-term liquidity that these funds held (see data below for BlackRock's LVNAVs, showing outflows against daily and weekly liquid assets). At no point during the March 2020 episode, did we observe investor confusion or irrational behaviour because of ambiguity around the fund structure.







Source: BlackRock; note only days with net outflows are shown

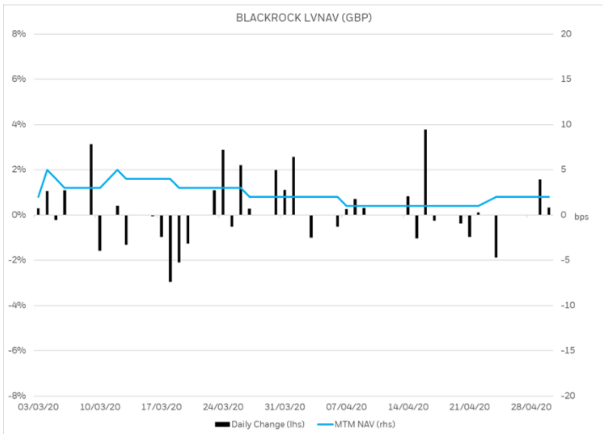
Even with some of the behaviour observed in the US market (the move from credit into government debt MMFs) and the spillover into European-domiciled USD MMFs, USD LVNAV managers were still able to navigate the market conditions without any funds breaching the 20bps collar or needing to impose liquidity fees and/or redemption gates to deal with redemption pressures, as outlined in the Consultation (para 40).

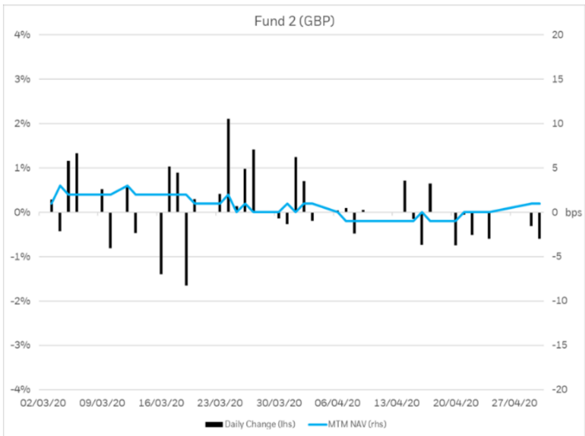
We have three specific comments on the framing of this question/ policy option within the consultation paper:

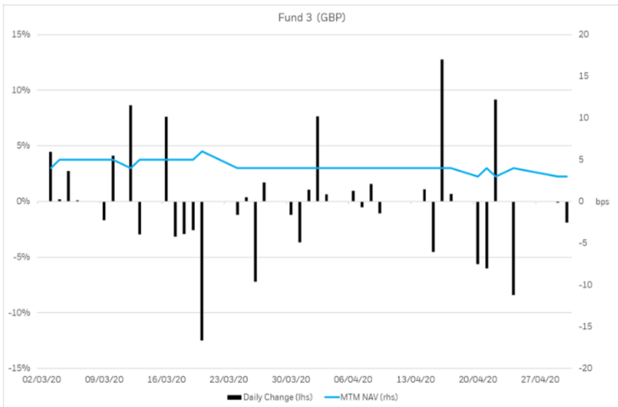
1) The paper suggests that the 20bps collar in the LVNAV structure presents the risk of a ‘cliff edge’ which could prompt investor runs (para 121). We believe that the experience of March 2020 shows otherwise.

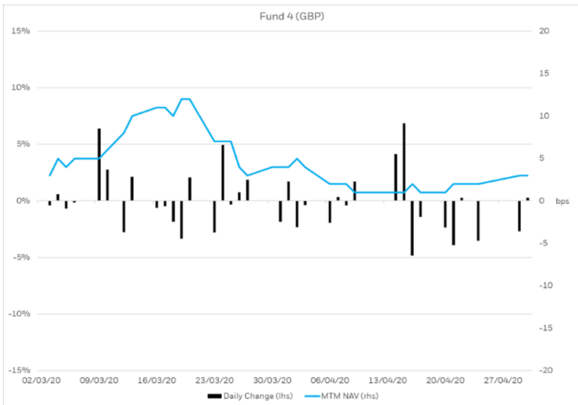
   Were the risk of breaching the 20bps collar to represent such a cliff edge, we would expect to see this borne out in the flow data of those LVNAV MMFs which came closest to breaching in the collar. Instead, in a number of instances, we actually observed *inflows* into LVNAV funds corresponding to their period of the most acute price deviation. Represented in the following graphs are our own LVNAV funds and a sample of other LVNAV funds that experienced the most acute MTM deviation mapped against daily change in net assets over the March 2020 period:

   ***GBP LVNAV** (source iMoneyNet)*









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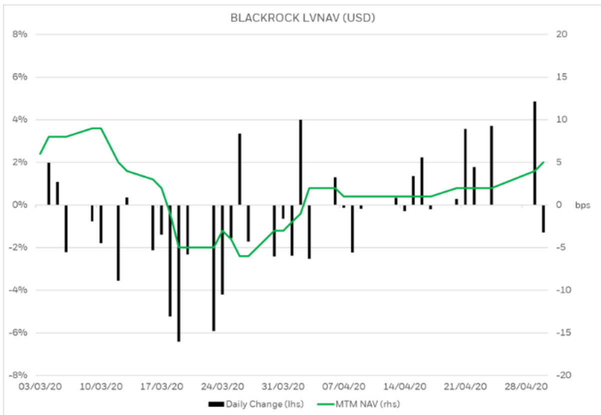
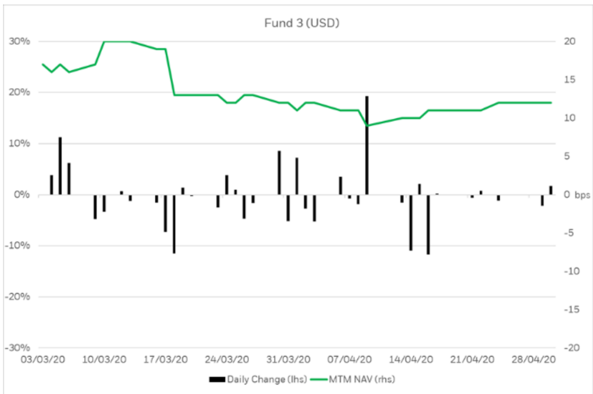
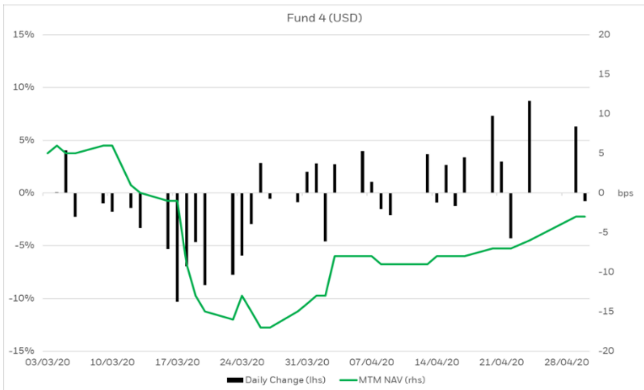
BlackRock

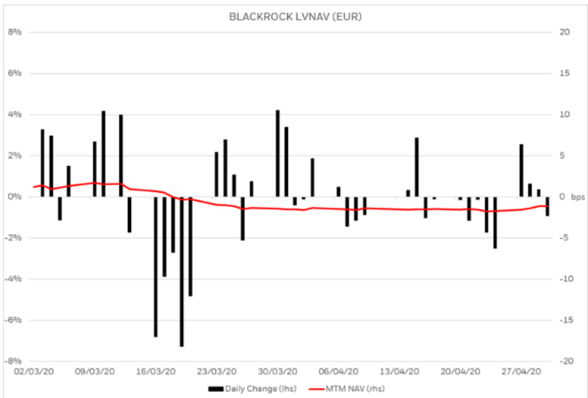
USD LVNAV (source iMoneyNet)

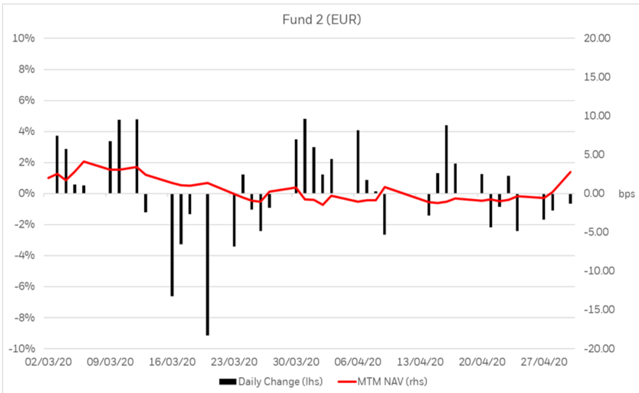






EUR LVNAV (source iMoneyNet)





2) The Consultation infers in several places that LVNAV funds are effectively stable NAV funds – we disagree.

   The construct of the LVNAV fund is such that mark-to-market pricing of the portfolio is a precondition for dealing at a per share price of 1.00. We believe this means that, effectively, an LVNAV fund is structurally a VNAV fund, which as long as the price remains within a set tolerance, is able to round the NAV to two decimal places. This is very different to CNAV funds which have the ability to use amortised cost accounting.

   While we recognise that not all LVNAVs operate in this way, we see merit in standardising expectations around LVNAVs' use of intraday mark-to-market pricing which better corresponds to dealing windows. Equally, we believe that LVNAV funds run in this way do not need to use amortised cost accounting (which they are allowed to do today to value assets up to 75 day maturity).

3) Finally, it is not apparent why a move to VNAV across the whole European MMF market would result in a more resilient MMF sector. Indeed, VNAV funds came under significant strains in March 2020; arguably to an equal or even greater extent than many LVNAV MMFs.

   Equally, VNAV funds are allowed to use mark-to-model pricing under the MMFR, and so can be prone to the same nonlinearities in stressed market conditions as the paper suggests might exist for CNAV and LVNAV funds.

We commend ESMA for seeking input not just on the merits of individual policy proposals themselves, but on their potential impact on the wider market ecosystem. This particular question raises some very important issues in this regard.

There are certain investors who would not be willing or able – for a variety of reasons from tax and accounting to operational considerations – to use VNAV MMFs were CNAV and LVNAV structures to be eliminated. It's not immediately clear what alternatives they may readily have: many European banks are not willing to accept short-term cash deposits at scale, and so asset owners would have to consider a variety of options – such as direct investment in underlying money market instruments – which are likely to be less liquid and less transparent to the market and to regulators.

As we stated in our introductory comments, one very strong possibility is that the elimination of fund structures which investors find of critical importance from a utility perspective results in a short-term market that is more disintermediated, less transparent, and even more prone to shocks.

Question 7:
What are your views on the extent to which Article 35 of the MMF Regulation should be i) clarified ii) amended? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

The prohibition of external ('sponsor') support was a deliberate and prominent feature of the MMFR.

While we would of course welcome further clarification of some of the concepts in Article 35 (some of this has already been provided by the July 2020 ESMA statement on this topic), we do not believe that ambiguity over these provisions was a meaningful problem during the market turmoil in March 2020.

Clarification of the definition of support should not create any expectation that sponsors support the fund in particular ways under certain conditions. ESMA rightly points out (para 143) that a circumstance under which sponsor support became normalised would favour bank-sponsored funds, and potentially increase concentration as those sponsors not willing or able to support funds would exit the market.

We also believe that an outcome where MMFs are offered under explicit or implicit sponsor support conditions would have negative impacts on systemic resilience. This could take MMFs closer to the perception of being a 'guaranteed' product, and encourage investors to differentiate funds based on yield rather than diversification, liquidity, credit or maturity profile, etc. – both would be contrary to key aims of recent reforms around the world.

Question 8:

i) **Do you agree with the above assessment of the potential need to assess the role of MMF ratings in light of the difficulties faced by MMFs during the March crisis, and the potential need to introduce regulatory requirements for MMF ratings?**
ii) **In your view, based on your experience, what are the benefits of MMF rating from investors' perspective, having in mind that rules applying to MMFs are already very stringent? What would be the likely consequence on investors from the downgrade of one or several MMFs? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.**

We are strongly supportive of the global regulatory community's efforts following the 2008-09 financial crisis to reduce mechanistic reliance on credit ratings. It is important to note, however, that fund-level ratings are not expressing a view on an MMF's creditworthiness, but rather, presenting a wider set of information about (amongst other factors) the fund's adherence to regulatory requirements, liquidity and risk management and the credit quality of exposures in the portfolio.

In our opinion, fund ratings themselves were not a key driver of investor behaviour in March 2020. Fund ratings are an important feature of much of the short-term MMF landscape, and as we have previously illustrated, we do not believe outflow pressures were uniform across fund types and currencies.

Were a risk of a ratings downgrade (and in turn the impact of an investor potentially having to revisit their determination of cash equivalent classification) to have been a material driver, we would expect to have seen more uniform pressures across the short-term MMF space. Equally, where a fund receives a regulatory designation of being 'cash and cash equivalent' which is not based in part on a fund rating (as is the case for many Standard VNAV MMFs), we would have expected to see more muted flows from those funds, as they would have been in theory isolated from that potential vulnerability. As we have outlined above, this was not the case.

The recent ESMA Report on Trends, Risks and Vulnerabilities cites[7] an example of three UK MMFs that were put on negative watch by a Credit Rating Agency (CRA) and experienced outflows as a result. However, it is worth noting that this example is from 2011 (i.e. before the MMFR), and the downgrade was caused by concerns not about the MMFs themselves, but rather the MMF sponsor having insufficient resources.

Generally speaking, a fund rating provides investor benefit through their independent scrutiny and analysis of individual MMFs. In our experience, investors are familiar with the rating agency frameworks, which each present a transparent and objective methodology that considers credit, counterparty diversification, maturity, and liquidity profiles.

Many fund rating criteria are indeed closely aligned with the regulatory requirements of MMFs (in some cases, ratings methodologies have additional criteria over and above the regulatory requirements) and as a result, the ratings and accompanying information serve an additional useful purpose of helping investors monitor a fund's adherence to strict regulatory standards.

However, this also illustrates a key point: any investor response to a fund rating is more likely driven by the data and assumptions that rating is built upon (level of adherence to regulatory thresholds, credit quality and liquidity of the portfolio, etc.), rather than the rating itself. For example, it is true that the imposition of a redemption gate or liquidity fee by an MMF would result in a downgrade from AAA status, but in this case, investors would most likely be more concerned with the cause (the gate/fee) than the effect (the rating downgrade).

Question 9:
Do you agree with the above assessment of the potential need to amend the requirements on stress tests included in the article 28 of the MMF Regulation? When

[7] ESMA, Trends and Vulnerabilities Report, No. 1 2021 (March 2021)

you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

We would not support mandatory actions based on MMF stress tests since these stress tests can quickly become out of date in stressed market conditions and we do not believe they can predicate for every eventuality as we experienced in March 2020. Instead, stress test results may be used to drive engagement with regulatory supervisors if there is a concern in respect of a particular MMF.

We are supportive of increased regulatory reporting and engagement with supervisors around the result of stress tests. However, as we have outlined previously, we believe the fund board is best placed to interpret and decide upon any action that might be required to protect the interests of investors in the fund.

Question 10:
Do you agree with the above assessment on the potential need to review the reporting requirements under the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

BlackRock is supportive of ensuring regulators have the necessary informational tools to identify and monitor risks in a timely manner.

We would note that while the MMFR only mandates quarterly reporting for most MMFs (yearly for those <100m AUM), the reality is that many supervisors asked for data far more frequently during March of 2020 and even throughout much of the rest of the year.

We are open to reporting data more frequently than the timeframes set out under the MMFR and agree that monthly reporting for most MMFs is a reasonable regulatory ask.

While ESMA's suggestion of more frequent reporting along a subset of key indicators during stressed market conditions (para 166) is very similar to what we were expected to provide our lead regulator for a number of months over the course of 2020, we would stress that data availability is only part of the information that supervisors need to monitor market conditions during stressed situations. We believe that 'market intelligence' functions within regulators are invaluable during times of market stress as they can get qualitative feedback from market participants to help supervisors make sense of quantitative data they receive.

Question 11:
Do you agree with the above assessment of the potential need to include additional requirements in the MMF Regulation, and/or potentially in other types of EU piece of legislation on the disclosure of money market instruments (MMIs) and main categories

of investors to regulatory authorities (e.g. detailed information on liabilities)? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

We are supportive of efforts by regulators and policymakers to look more closely at the overall functioning of short-term credit markets. As acknowledged by ESMA (para 45), changes to the structure of money markets resulting in higher liquidity of money market instruments would be largely effective in improving MMF resilience as well. While these changes maybe longer term, as we have stated elsewhere in our response, and in previous contributions we have made to this debate, we believe that addressing underlying structural problems in short-term credit markets is critical to ensuring the resilience of MMFs and other investors that rely on these markets to manage liquidity and cash needs.

Transparency is an important part of the structural improvements in CP markets that should be made. In Europe, what transparency exists today is fragmented across the different CP markets (e.g. STEP, NeuCP, ECP, etc.), and as a result it can be difficult to size the market, identify other investors and gather meaningful trading information. Transparency is an important tool that can help bring new investors into these markets contributing to a more dynamic and diverse investor base, which can have knock-on effects on liquidity in times of market stress.

As long as short-term credit markets remain dealer-driven, the most important driver of market dysfunction will continue to be the ability and willingness of banks to use their balance sheets to make markets and provide liquidity. As such, we believe that policymakers should look beyond transparency, and into potential market structure adjustments (such as greater standardisation and electronification: advances that have benefitted equity and longer-dated fixed income market structures in recent years) that could help reduce reliance on bank intermediaries, or prudential rule changes that could help remove the disincentive for banks to shrink their balance sheet in stressed markets.

Question 12:

- **i) Do you agree with the above assessment on the potential creation of a LEF? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.**
- **ii) Several open questions related to the creation of the LEF, on which ESMA would specifically welcome feedback from stakeholders, include:**

  - **What should be the appropriate size of such a pooling vehicle as the LEF?**
  - **In terms of funding, how much MMF would have to pay each year to participate in the pool?**
  - **How much of the funding would/should be provided by other sources?**
  - **How long would it take to establish such a LEF?**
  - **Under which conditions would the LEF be activated?**
  - **Who would be responsible for activating the LEF**

The idea of a Liquidity Exchange Facility (LEF) received significant interest and attention in some jurisdictions following the 2008-09 financial crisis but was not ultimately pursued for a variety of reasons.

We have strong reservations about the concept; not least of which is the fact that it is difficult to envision a design of such a facility that does not effectively socialise risk across MMFs and lead to contagion risks across the sector. We see significant moral hazard in an approach that could actually incentivise some MMFs to take more risks that would ultimately be borne at the expense of other funds.