

7 August 2017

European Securities and Markets Authority
103 Rue de Grenelle
75345 Paris
France

RE: Consultation Paper on Draft technical advice, implementing technical standards and guidelines under the MMF regulation.

BlackRock^[1] is one of the world's leading asset and risk management firms, and is a global leader in the cash management business. In Europe, we manage over €100 billion in cash portfolios on behalf of a wide range of companies and other investors.

BlackRock remains supportive of ESMA's efforts to bring additional resiliency to the MMF sector via the introduction of L2 rules and we look forward to continue to work with ESMA towards that aim.

We welcome the opportunity to comment on ESMA's Consultation Paper (CP) on the Level 2 (L2) measures for the EU Money Market Fund Regulation (MMFR).

We have engaged with policymakers at the global and European levels with regard to Money Market Fund (MMF) reform over recent years, and look forward to continuing the dialogue towards the aim of finalising the full suite of rule changes for MMFs. We share the aim of policymakers to ensure that there are appropriate measures in place to promote MMF resiliency and preserve investor utility.

BlackRock has worked with a range of trade associations on their responses to this consultation – amongst others, the Institutional Money Market Funds Association (IMMFA), European Fund and Asset Management Association (EFAMA), and IrishFunds – and we support the collective input from their submissions. However, in addition, we would like to highlight three specific areas which are of particular importance to us (below).

Please do not hesitate to contact us if we can provide further input.

1) 'Share destruction'

The statement within the reporting section that ESMA understands the Regulation to prohibit share destruction (line 186) is troubling. We do not share the interpretation of the Level 1 text that the practice of 'reverse distribution' is prohibited by the Regulation.

All funds create and destroy shares as part of normal subscription and redemption processes, and we consider it impractical that the Regulation should prohibit such a practice. However, we expect that this comment is intended to refer more specifically to 'reverse distribution', which has become a relatively common practice amongst many European Constant-NAV (CNAV) funds to deal with the challenges of negative interest rates, and involves the destruction of shares to account for the negative yield (not to account for mark-to-market fluctuations of the portfolio).

The interpretation cited by ESMA in the CP is built upon the definition of a CNAV fund in the MMFR, which is essentially unchanged from the definition in the 2011 CESR/ ESMA MMF Guidelines. The reverse distribution mechanism has been approved by supervisors and investors (usually via shareholder votes – showing the investor utility of the mechanism) during

^[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.

BLACKROCK

the time that this definition has been applied to European MMFs, so we do not believe that the MMFR should affect the permissibility of reverse distribution.

While there are of course no additional rules being proposed with regard to share destruction within this consultation, or indeed, within the Level 2 rulemaking process itself, nevertheless, we find the statement in the CP to be concerning. We already anticipate that the considerable implementation process will require much of the transition period for existing funds in order to build new systems and processes to adapt to the new product rules; additional uncertainties on such a fundamental concept to be, at this stage, create confusion. We recommend that ESMA clarify that reverse distribution is permitted to address negative yields.

2) Reverse repurchase agreements ('reverse repo')

We believe that the rules on reverse repo collateral are some of the most consequential rules in the Level 2 process.

The Regulation itself forces (in particular) Government CNAV MMFs to rely on reverse repo in order to meet the strict liquidity requirements, meaning that a fund will need to, at all times, have access to reverse repo in order to be compliant with the Regulation. Repo markets in Europe have already been clearly experiencing stress at regular intervals (at quarter- and year-end especially, but increasingly at month-end as well), where market participants are experiencing supply constraints and pricing dislocation¹.

In these periods of stress, it is critical that MMFs do not experience disruption in their access to reverse repo, and therefore the additional rules set out in the Level 2 measures on collateral and (potentially) specific haircuts, should not hinder a MMFs ability to compete for reverse repo supply with other market participants. We have identified a few specific recommendations to foster a good framework for reverse repo.

- 1) MMFs generally take back only very high quality collateral in reverse repos, and the Regulation itself sets out strict rules on the collateral type and overall quality of collateral that is acceptable. Indeed, the Level 2 provisions on this subject only apply to government debt which receives a favourable credit assessment within the rules laid down in the Regulation and subsequent Level 2 measures. This means that, in practice, the assets covered by the CP are some of the highest quality assets in the entire financial system. As a result, we do not believe further prescriptive rules on credit quality are necessary.
- 2) As regards liquidity criteria, we note that option a) is the most appropriate, and fits with how we would undertake risk management for our reverse repo activity: with risk management (incl. haircuts) set based on an assessment first of the counterparty, and then the collateral.

However, it is important to note that repo markets are changing: banks are the main counterparties today, but increasingly, the market may move more towards a less dealer-driven market structure where (e.g.) MMFs deal directly with insurers or pension funds (who, because of clearing rules, will see an increase in demand for the asset side of repo). Other developments could see MMFs looking at direct access to cleared repo (and hence CCPs as counterparties) or indeed, even seeing central banks provide reverse repo facilities (as with the NY Federal Reserve Reverse Repurchase Program in the US). The rules need to recognise not just what the market looks like today, but allow for how the market is expected to evolve in the near future. The proposed measures recognise CCPs and central banks alongside credit institutions and investment firms. We recommend including insurers and pension funds rather than treating them as 'unregulated' for the purpose of the liquidity assessment criteria.

¹ This assessment was supported by the recent paper from the Bank for International Settlements 'Repo Market Functioning' (April 2017), which can be found here: <http://www.bis.org/publ/cgfs59.pdf>

- 3) Finally, we recommend (in the case of dealing with counterparties not covered under the scope of 'regulated entity' definition) that Level 2 measures should not set out prescriptive haircut schedules. Haircuts are an essential risk management tool for dealing with counterparty risk in repo trades, and as such reflect a number of factors: both credit quality of the repo counterparty, as well as the collateral received. As such, we believe that haircuts should remain a function of risk management done by the manager, who should be able to assess the counterparty and collateral risks and set haircuts on that basis.

3) Stress testing

Stress testing funds is a critical risk management tool and we believe the MMF industry will be more robust as a result of the new requirements both in Europe and the US. We support much of what has been suggested by ESMA in the proposed Guidelines. However, we urge caution on the recommendation that managers might potentially stress test their MMFs *in aggregate*.

We note that this specific recommendation originates from the FSB recommendations on potential structural vulnerabilities related to specific asset management activities².

Recommendation #9 states:

Where relevant, authorities should give consideration to system-wide stress testing that could potentially capture effects of collective selling by funds and other investors on the resilience of financial markets and the financial system more generally.

The FSB's Standing Committee on Assessing Vulnerabilities (SCAV) is currently doing work to see whether or not such testing is possible or valuable. Given the status of this dialogue, we feel that policy measures would be premature.

BlackRock has been particularly engaged in this broader debate with policymakers from around the world, and one area where we have consistently expressed reservations is around the aggregation of stress testing across funds. A fund is, by definition, a unique legal entity: its portfolio strategy and construction, its investor base, and many other features are unique to the individual fund, and hence, risk management is done at the fund level. In the case of MMFs, many funds are segmented by currency, which means they will experience very basic events for which a stress test will control – such as interest rate movements – entirely differently from funds focused on other currencies.

The CP suggests that aggregating the positions across all a manager's MMFs will give them a better idea of possible liquidity risks in the assets of their funds. However, given even a single manager only represents a small portion of all MMFs, an industry which in and of itself is but one investor type in short-term credit markets, we are sceptical that aggregation of stress testing will give a manager a more useful picture of risk than stress testing at the fund level, which we believe is likely to be a more sound basis for appropriate risk management.

We note that the reference to aggregating stress tests is itself an optional measure within the proposed Guidelines, but we believe that encouraging managers to undertake such tests could be counterproductive. Aggregate stress testing across funds managed by the same firm are unlikely to yield meaningful results, and in the worst-case scenario, could actually build a false picture of risk in a fund where it does not exist.

We recommend that ESMA does not include aggregate stress testing in the final Guidelines.

² The Financial Stability Board's *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* (Jan 2017) can be found at: <http://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf>