

BLACKROCK

October 14, 2014

Mr. Kevin M. O'Neill
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Submitted via electronic filing: <http://www.sec.gov/rules/proposed.shtml>

Re: Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule (Release No. IC-31184; File No. S7-07-11)

Dear Mr. O'Neill:

BlackRock, Inc. ("BlackRock")¹ is pleased to have the opportunity to respond to the request of the Securities and Exchange Commission ("Commission") for comments on the re-proposed amendments relating to the removal of certain references to credit ratings in Rule 2a-7 under the Investment Company Act of 1940, as amended ("Act") and Form N-MFP.² BlackRock previously submitted a comment letter ("Original Response Letter")³ to the Commission in April 2011 in response to the Commission's original proposal of these amendments.⁴ These proposed amendments are in response to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),⁵ which requires the Commission to remove references to the credit ratings of nationally recognized statistical rating agencies ("NRSROs") as an assessment of the credit-worthiness of a security or money market instrument and to substitute other standards of credit-worthiness that the Commission determines to be appropriate.

As discussed below, BlackRock appreciates the Commission's permitting the continued use of credit ratings in a fund manager's minimum credit risk determination, but we believe that the Commission should explicitly recognize the use of NRSRO credit ratings as a benchmark in a fund manager's minimal credit risk analysis.

¹ BlackRock is one of the world's leading asset management firms, managing approximately \$4.594 trillion (as of June 30, 2014) on behalf of institutional and individual clients worldwide, including governments, pension funds, and corporations. BlackRock and its predecessor companies have been involved in the management of money market funds since 1973, and today, BlackRock manages approximately \$125.759 billion (as of June 30, 2014) in Rule 2a-7 money market fund assets regulated by the Securities and Exchange Commission.

² Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule, Investment Company Act Release No. 31184 (July 23, 2014) (available at <http://www.sec.gov/rules/proposed/2014/ic-31184.pdf>) ("Re-Proposing Release").

³ Letter to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from Simon Mendelson, Managing Director, and Richard Hoerner, Managing Director, BlackRock, Inc., April 25, 2011 (available at <http://www.sec.gov/comments/s7-07-11/s70711-16.pdf>).

⁴ Reference to Credit Ratings in Certain Investment Company Act Rules and Forms, Investment Company Act Release No. 29592 (March 3, 2011) (available at <http://www.sec.gov/rules/proposed/2011/33-9193.pdf>) ("Original Proposing Release").

⁵ Public L. No. 111-203, 124 Stat. 1376 (2010).

I. *Changes to Rule 2a-7*

Eligible Securities

BlackRock recognizes the challenges faced by the Commission in removing references to NRSRO ratings in the definition of eligible security under Rule 2a-7 of the Act. BlackRock supports the Commission's proposed definition of eligible security as one that would be a security that, along with meeting certain maturity requirements, the fund's board of directors (or its delegate) "determines presents minimal credit risks, which determination includes a finding that the security's issuer has an exceptionally strong capacity to meet its short-term obligations."⁶ Furthermore, BlackRock applauds the Commission for recognizing that "[i]n determining whether a security presents minimal credit risk, a fund adviser could take into account credit quality determinations prepared by outside sources, including NRSRO ratings, that the adviser considers are reliable in assessing credit risk."⁷ BlackRock appreciates the Commission's continued acknowledgement of the value of NRSRO credit ratings, but we think that the Commission should go further by including NRSRO credit ratings as a benchmark in its guidance around the minimal credit risk analysis.

While Section 939A of the Dodd-Frank Act requires the Commission to "remove any reference to or requirement of reliance on credit ratings and, to substitute in such regulations such standard of credit-worthiness as [the Commission] shall determine as appropriate for such regulations,"⁸ BlackRock believes that NRSRO credit ratings can be utilized as a benchmark, in combination with other factors, in a manner that is both consistent with the Dodd-Frank Act and fund manager practices. In particular, as BlackRock has previously noted, we support the requirement embedded in Section 939 of the Dodd-Frank Act that NRSRO ratings should not be the *sole determinant* of whether a particular security should be included in a money market fund ("MMF") portfolio.⁹ BlackRock believes that the Commission's guidance relating to the minimal credit risk determination should incorporate the use of NRSRO credit ratings as a benchmark and basis of comparison for a fund manager's own determination. Explicitly enumerating the use of NRSRO credit ratings as a benchmark as one of the factors for a minimal credit risk determination would continue to set a base line for the inclusion of particular securities in a MMF portfolio. This type of guidance would be useful to MMF investors as they would have at least a basic understanding as to how to assess the risks of a MMF portfolio and the ability to compare one fund to another. Adding such a clarification to the Commission's guidance on minimal credit risk would also be consistent with the practices we believe boards and fund managers, as delegates of the board, follow today. In making investment decisions, we believe fund managers use credit ratings as a preliminary screen prior to conducting their own credit analysis. This screen narrows the initial universe of investments that fund managers may review for minimal credit risk. In our opinion, NRSRO credit ratings provide a useful benchmark and initial basis for screening securities.

Without such explicit guidance from the Commission, removal of the NRSRO ratings requirements from the definition of eligible security and the removal of the second tier security definition could have the opposite of the intended effect of the Commission's proposals because these changes could permit a MMF to purchase a security that does not meet the thresholds created by the NRSRO rating requirements today in the event that a fund manager believes the credit to be better than the NRSRO does. Without emphasizing NRSRO ratings as a benchmark in the guidance relating to Rule 2a-7, fund managers could take vastly different views on the factors used to conduct the minimal credit analysis. This could cause a divergence in the quality of securities held by different MMFs, which would be almost impossible for investors, especially retail investors, to discern. This consequence was recognized by Commissioner Aguilar in his comments at the Commission's Open Meeting on Money Market Fund reform on July 23rd when he said, "[R]emoving the objective baseline of credit rating references from Rule

⁶ Re-Proposing Release at 13.

⁷ *Id.* at 16.

⁸ Pub. L. No. 111-203 § 939A(b).

⁹ Original Response Letter at 2.

2a-7 could encourage funds to invest in riskier portfolio securities and may therefore increase, rather than decrease, risks to investors.”¹⁰

In the absence of external credit ratings requirements provided by NRSROs, many MMF investors would need to rely almost exclusively on the fund manager in determining whether a security has an “exceptionally strong capacity” to meet its short-term obligations. As such, using credit ratings as a factor may prove beneficial to MMF investors by offering them the benefits of a third party assessment.

Moreover, while a credit rating of a security is public (and often the criteria for receiving such a rating is also public), the criteria a fund board or its delegate may use to make an “exceptionally strong capacity” determination will likely not be public. As a practical matter, MMF investors will not be able to track each fund manager’s credit process and any changes to that process, thereby causing these investors to have little insight into the securities held in a MMF.¹¹ Some MMFs could make a determination that a security that is second tier, or possibly even of a lower tier, meets the “exceptionally strong capacity” standard.¹² Eliminating the distinction between first tier and second tier securities and consolidating the credit quality standard will almost surely lead to a greater proportion of second tier securities in MMF portfolios (particularly in prime funds that might be seeking more yield), thereby exacerbating variability of credit quality across MMFs. Indeed, the Commission acknowledges that it anticipates that second tier securities would qualify under the “exceptionally strong capacity” standard.¹³ Every fund manager will have a distinct view on the meaning of “exceptionally strong capacity,” potentially causing a race to the bottom in credit quality in a search for higher yield. Those fund managers that apply a rigorous standard and are conservative in their interpretation of “exceptionally strong” will be at a competitive disadvantage vis-à-vis their competitors.

This concern is particularly apposite in the case of retail MMFs because retail MMFs are frequently not rated themselves by NRSROs. Generally, retail investors do not invest in rated MMFs and therefore will not benefit from the required investment guidelines around the ratings of the securities to be included in the funds to which rated institutional MMFs will continue to be subject.¹⁴ As a result, in periods where yield is low, MMFs, particularly retail MMFs, could be incentivized to make credit and liquidity findings that permit them to invest in lower credit, higher yielding securities. Thus, we believe that explicitly including the utilization of NRSRO ratings as a benchmark for a fund manager’s minimal credit risk analysis furthers the Commission’s mission of investor protection.

BlackRock does not believe that objective criteria for credit analysis comparable to credit ratings exist. We believe that the Commission has identified appropriate subjective credit analysis factors that boards

¹⁰ Luis A. Aguilar, Comm’r, Securities and Exchange Commission, Statement at SEC Open Meeting on Money Market Fund Reform, July 23, 2014 (transcript available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542342915#.U9-kwvldXEK>).

¹¹ While credit rating information would be disclosed in the Form N-MFP under the proposed rule, thereby potentially mitigating the risk of credit deterioration, we believe that most retail investors would not utilize this information to actively compare credit risk across MMFs.

¹² The Commission notes, “[T]he re-proposed standard would *generally* preclude funds from determining that securities rated third tier (or comparable unrated securities) would be eligible securities under rule 2a-7.” Re-Proposing Release at 16 (emphasis added and internal quotation marks omitted). Thus, the Commission recognizes that there may be instances in which securities that are below second-tier today might be considered eligible securities under the re-proposed standard. This concern is particularly apposite in the case of municipal securities MMFs because municipal securities are more likely to be unrated than traditional corporate securities held in institutional prime funds. Fund managers exercise significant discretion in evaluating the credit risk of unrated securities and may look to a variety of factors, such as the rating of the issuer and the rating of long-term securities by that issuer.

¹³ “The re-proposed standard . . . is designed to preserve the current degree of risk limitation in rule 2a-7 without reference to credit ratings by requiring a fund’s board (or its delegate) to determine that the issuer of a portfolio security has an exceptionally strong capacity to meet its short-term obligations, a finding that some boards or fund advisers may determine can be met by second tier rated securities (but only of the highest quality).” *Id.* at 15–16.

¹⁴ MMFs that are rated are required to maintain their assets in certain rated securities. For example, certain rating agencies require all securities in a AAA rated MMF portfolio to be rated in the top rating category.

and their delegates should consider, along with using credit ratings as a benchmark.¹⁵ As credit analysis factors are inherently subjective, BlackRock would not support the codification of these factors.

Monitoring Minimal Credit Risk

BlackRock agrees with the Commission's proposal to require that each MMF adopt written procedures that require the fund manager to conduct an "ongoing review of the credit quality of each portfolio security ... to determine that the security continues to present minimal credit risks."¹⁶ We believe this requirement is consistent with how fund managers currently monitor for minimal credit risk. BlackRock believes, however, that the assessment of having an "exceptionally strong capacity to repay" presents the same issues in an ongoing review as in the initial review, as discussed above.¹⁷ The credit analysis of each fund manager would be looking to the individual criteria that each fund family has created for this standard to attempt to predict which issuers will no longer meet these criteria. Each fund family will make different determinations. We note that the Commission recognizes the use of credit ratings as part of the ongoing monitoring,¹⁸ and we encourage the Commission to continue to do so in the adopting release.

Stress Testing

BlackRock supports the Commission's requirement for MMFs to stress test for an event indicating or evidencing credit deterioration of particular portfolio security positions, each representing various exposures in a fund's portfolio. BlackRock recognizes that a downgrade cannot be the only trigger for a stress test in order to have robust stress testing procedures. As BlackRock has stated previously, we believe that all MMFs should continue to be required to perform stress tests as they do today and report the results of those stress tests to the funds' boards.¹⁹

Additionally, we recommend that the Commission adopt rules that require MMFs to obtain information about the underlying shareholders in omnibus accounts that hold shares of a MMF and factor this information into stress tests. MMF stress tests could be enhanced if complete fund shareholder information were available. With enhancements to shareholder transparency, MMFs could stress test against scenarios in which specific clients redeem shares of the fund (i.e., the top 5 shareholders in a fund), certain types of shareholders redeem shares (i.e., hedge funds), as well as other tests that the fund manager and board might find useful. Without a specific Commission requirement, such an imposition from fund managers would be perceived as burdensome to intermediaries and would incentivize intermediaries to invest shareholder assets with fund managers who do not seek such information.

II. Form N-MFP Issues

Reporting Ratings

Under the new amendments to Rule 2a-7 that the Commission adopted in July, the public release of Form N-MFP information will be more timely.²⁰ The re-proposed form would require the reporting of two items: "(i) each rating assigned by a NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the rating, and (ii) any other NRSRO rating that the fund's board of directors (or delegate) considered in making its minimal credit risk determination, as well

¹⁵ Re-Proposing Release at 22–26.

¹⁶ *Id.* at 32–33.

¹⁷ *Id.* at 33.

¹⁸ *Id.* at 33.

¹⁹ Letter to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from Barbara Novick, Vice Chairman, and Richard Hoerner, Managing Director, BlackRock, Inc., September 12, 2013, at 20 (available at <http://www.sec.gov/comments/s7-03-13/s70313-115.pdf>).

²⁰ See Money Market Fund Reform: Amendments to Form PF, Investment Company Act Release No. 29592 (July 23, 2014) at 451–453 (available at <http://www.sec.gov/rules/final/2014/33-9616.pdf>).

as the agency providing the rating.”²¹ BlackRock believes that public disclosure of ratings on Form N-MFP could help investors monitor risk in a MMF and that reporting a benchmark NRSRO rating promotes investor protection. Furthermore, many MMF investors have investment guidelines that limit their holdings to instruments that carry third party ratings or funds that invest primarily in such instruments, and the proposed reporting requirements would assist in monitoring the fulfillment of these criteria.

Rather than require the reporting of each NRSRO rating, however, which would be burdensome to some MMFs, we recommend requiring the reporting of the rating of two NRSROs approved by the fund board for all rated securities in a MMF’s portfolio, as this information would provide an appropriate benchmark. Reporting any additional ratings to which the fund manager subscribes, in BlackRock’s view, is both misleading and burdensome. The Commission incorrectly assumes that fund managers consider each rating assigned to a portfolio security by a NRSRO to whose services the fund or the manager subscribes.²² Fund advisers may subscribe to a number of NRSROs for a variety of reasons in order to obtain information across asset classes, but they may place emphasis on only one or two for a given asset class. Reporting all of the ratings of NRSROs for a given security would not serve investor protection and would place an unnecessary burden on fund managers. Providing two ratings gives MMF investors a third party reference point by which they can compare MMF portfolios easily while not burdening fund managers by making them report extraneous information.

MMF investors use credit ratings (i) to compare portfolios and (ii) to define minimum investment criteria. Reporting the rating of two NRSROs approved by the fund board furthers both of these ends. These disclosures will allow MMF investors to detect potential systematic deterioration in credit quality in a particular MMF and possibly observe any risks that a fund manager may be taking to achieve higher yield in a particular MMF. For these reasons, reporting relevant NRSRO ratings, as determined by the fund board, is useful information that serves investor protection. The reporting of more than two NRSRO ratings is unnecessary and would burden asset managers with operational and technological costs while providing little to no additional benefit to investors.

III. *Exclusion from the Issuer Diversification Requirement*

The Commission proposes to eliminate the distinction between controlled and non-controlled guarantors for the purposes of the issuer diversification limit. BlackRock believes that such a proposed change is premature at this stage. While the Commission notes that in the current market fewer than 2% of MMFs exceed the 5% issuer threshold for securities subject to a guarantee,²³ we believe that many changes to the MMF market may occur as a result of both the amendments adopted on July 23, 2014 and those proposed here. The supply and demand for MMF securities will surely be impacted by the changes to floating NAVs for institutional prime funds, including institutional municipal money market funds. Some institutional investors may be seeking MMFs that have more stable NAVs, and non-controlled person guarantors are a good source of mitigating volatility because of the two sources of payment – the issuer and the guarantor. Imposing further diversification requirements without knowing how demand for particular securities will change as a result of the newly adopted amendments is, therefore, premature and could artificially lower the supply of issuers that may be desirable by virtue of their guarantee by a non-controlled person. As the Commission notes, the risks of an issuer with a guarantee from a non-controlled person are far less significant than that of other issuers because:

The money market fund would have two potential sources of repayment—the issuer whose securities are subject to the demand features or guarantees and the providers of those features or guarantees if the issuer defaults. Both the issuer and the demand feature provider or guarantor would have to default at the same time for the money

²¹ Re-Proposing Release at 40.

²² *Id.* at 41.

²³ *Id.* at 47.

market fund to suffer a loss. And if a guarantor or demand feature provider were to come under stress, the issuer may be able to obtain a replacement.²⁴

Thus, BlackRock urges the Commission to observe how the market evolves before limiting the flexibility of MMFs by removing the exclusion from the issuer diversification requirement.

* * * * *

We thank the Commission for providing BlackRock the opportunity to comment on the Re-Proposing Release. Please contact the undersigned if you have any questions or comments regarding BlackRock's views.

Sincerely,

Barbara G. Novick
Vice Chairman

Richard K. Hoerner, CFA
Managing Director
Co-Head of Global Cash Management

cc:

The Honorable Mary Jo White
Chairman
Securities and Exchange Commission

The Honorable Luis A. Aguilar
Commissioner
Securities and Exchange Commission

The Honorable Daniel M. Gallagher
Commissioner
Securities and Exchange Commission

The Honorable Kara M. Stein
Commissioner
Securities and Exchange Commission

The Honorable Michael Piwowar
Commissioner
Securities and Exchange Commission

Norman B. Champ, III
Director
Division of Investment Management
Securities and Exchange Commission

²⁴ *Id.* at 43–44.