BlackRock.

26 October 2021

Re: EBA Consultation Paper on Draft RTS On Criteria for the Identification of Shadow Banking Entities

BlackRock[1] appreciates the opportunity to respond to the European Banking Authority's ("EBA") consultation on banks' exposure to 'shadow banking' entities, more specifically, on the criteria for the identification of such entities.

On behalf of BlackRock's cash management business[2], the comments herein are limited to the potential inclusion of money market funds ("MMFs") under the EBA's proposed definition of shadow banking entities. We believe that MMFs *should not* fall under the definition of shadow banking entities. The consultation paper states that a key reason for the consideration of MMFs as shadow banking entities is that the European Securities and Markets Authority ("ESMA") is currently conducting a review of the EU Money Market Regulation ("MMFR") with a specific focus on the stresses experienced by MMFs in March of 2020 during the COVID-19 related market turmoil.

The short-term markets (of which MMFs are only a part of, albeit an important one) experienced sharp stresses in March 2020 due to system-wide pressures brought about through COVID 19 and an overall flight to liquidity by many market participants. This highlighted the need to reflect on the existing regulatory framework for MMFs to identify ways to further increase their resilience. It also drew attention to vulnerabilities in the wider short-term market ecosystem which both the Financial Stability Board ("FSB") and ESMA have identified as areas for consideration rather than a focus solely on MMFs.

Such an unprecedented market-wide event affords regulators and market participants the opportunity to draw conclusions from a live 'stress test' that may help improve the resilience of MMFs and the short-term markets. Throughout this live stress test European MMFs continued to be able to provide liquidity with no MMF imposing a gate on redemptions or liquidity fees, a testament to the robustness of the current EU regulatory framework in place.

Whilst we agree that there are lessons to be learned from the experience of markets in March 2020, we have concerns about the implications of designating MMFs as shadow banking entities.

[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.

[2] 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).

MMFs play an important role for a wide range of investors providing diversified access to the short-term markets. In recent years, regulatory reform has heightened the importance of intra-day cash movement, 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 MMFs, and short-term markets generally, play a more important role in liquidity management for a wide range of companies and market participants.

It is important to recognise that MMF do not conduct 'banking activities' and fall within an existing highly regulated framework. UCITS MMFs are considered as low risk as indicated by their mandatory 'Synthetic Risk and Reward Indicator' on their respective Key Investor Information Document ("KIID"). MMFs' investment objectives typically include maintenance of capital and provision of liquidity as principal objectives. Designating the MMFs as shadow banking entities, prior to the outcomes of the ESMA and FSB consultations, may inhibit their important role in short-term markets both for investors and the financial institutions and corporations to which they provide funding.

The regulatory and external rating agency investment criteria for MMFs provides robust and prescriptive limits on the amounts of daily and weekly liquidity that must be held and the weighted and final maturity of assets. Under MMFR, MMFs are arguably the most transparent actor in the short-term markets but they are one among many.

If defining a 'shadow banking' entity as one which enters into "*maturity transformation (borrowing short and lending/investing on longer timescales); (b) liquidity transformation (using cash-like liabilities to buy less liquid assets); (c) leverage; and (d) credit risk transfer (transferring the risk of credit default to another person for a fee)*"[3], MMFs do not meet this criteria.

MMFs conduct limited maturity and liquidity transformation within their portfolios, but only within this prescriptive and transparent regulatory framework. For example, a minimum of 10% daily and 30% weekly liquid assets must be held for LVNAV and Public Debt CNAV MMFs and the Weighted Average Maturity for all short-term MMFs is limited to no more than 60 days. These liquidity management standards are consistent with the redemption profiles of MMFs and minimise any risks associated with maturity or liquidity transformation, which arise from situations where redemptions cannot be managed by a portfolio's ability to generate cash and so selling assets before they mature becomes necessary. MMFs do not use leverage and importantly do not undertake 'credit risk transfer'.

The EBA also cites interconnectivity related risks as pertinent to the consideration of shadow banking. MMFs are connected to the financial sector through their exposure to underlying portfolio holdings, however, sponsor support is expressly prohibited by the MMFR, minimising any potential contagion risk between sponsors and MMFs.

We note that the EBA explained in the 2015 version of its guidelines related to shadow banking exposures that because the MMFR was not yet agreed and in place, that MMFs

[3] Consultation Paper on Draft RTS On Criteria for the Identification of Shadow Banking Entities, Article 2 (p.33)

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were deemed to be shadow banking entities. The regulatory framework since put in place in the EU by the MMFR mitigates the principal risks which the EBA identified in the 2015 guidelines as fundamental to address vis-à-vis banks' exposures to shadow banking entities[4]. The work that ESMA is currently undertaking in review of this framework is an opportunity to ensure the regulatory regime is calibrated with the market events of March 2020 taken into account; it should not, in our view, be taken to call into question the wholesale adequacy of the existing regime.

In conclusion, while we are supportive of ESMA's efforts to ensure that potential vulnerabilities of MMFs should be identified and addressed through targeted reforms, we do not believe that the fact that this effort remains in progress should mean that MMFs are considered as shadow banking entities.

In addition to our own response to this consultation, we also support the responses submitted on behalf of wider industry through the Institutional Money Market Funds Association ("IMMFA") and the European Fund and Asset Management Association ("EFAMA").

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

Sincerely,

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[4] Identified as: run risk and/or liquidity problems; interconnectivity and spillovers; excessive leverage and procyclicality; opaqueness and complexity. *Guidelines on* Limits *on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013* (2015) (p.6)