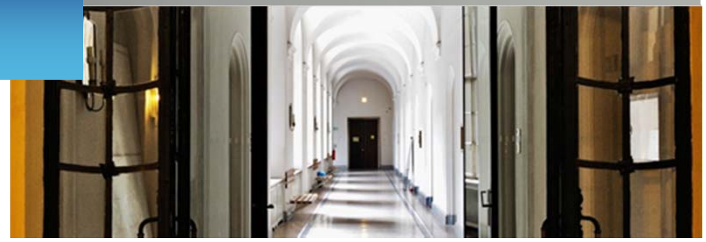
Money Market Funds
Importance of Both Credit Research and NRSRO Ratings



Following the worst financial crisis in recent history, the money market fund industry came under heightened scrutiny. The events of 2008, including the historic "breaking of the buck" by the Reserve Primary Fund in September of that year, brought to light both idiosyncratic (fund-specific) and systemic (industry-wide) risks associated with money market funds, and gave rise to several reform measures designed to enhance the stability of that segment of the market. For example, the Securities and Exchange Commission ("SEC") Rule 2a-7 reforms, which took effect in May 2010, enhanced oversight and transparency in the industry by expanding disclosure requirements and imposing tighter restrictions on money market funds' portfolio maturity, credit quality and liquidity guidelines. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), signed into law in July 2010, subsequently instructed the SEC to make certain additional changes to money market fund regulations. One recent proposal resulting from this mandate addresses the use of NRSRO ratings by fund advisors.[1] In this *ViewPoint*, we assess the SEC proposal, highlighting our belief that while advisors must conduct independent credit evaluations, ratings provide useful preliminary screens in the evaluation process.

SEC Proposal

Section 939A of the Dodd-Frank Act directs the SEC, along with other federal agencies, to review regulations that rely on credit ratings as a standard of measurement. The legislation further requires them to eliminate references to ratings as a standard of creditworthiness and to substitute alternate standards of creditworthiness. On March 3, 2011, the SEC proposed amendments to two rules (Rules 2a-7 and 5b-3) and four forms (N-MFP, N-1A, N-2, and N-3) under the Investment Company Act and the Securities Act that contain references to credit ratings. The SEC also proposed a new rule (Rule 6a-5) under the Investment Company Act to establish a standard of creditworthiness to replace the NRSRO references that are to be eliminated.

Though BlackRock agrees that all money market fund advisors must conduct independent credit research, we do not support the proposed elimination of NRSRO references in these rules and disclosure forms. In our view, ratings provide a useful screen for advisors performing their own credit assessments and enable investors to compare different money market fund products.

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We believe Rule 2a-7 should continue to permit money market fund Boards or their delegates to consider NRSRO ratings along with other factors as a minimum credit quality standard. BlackRock supports the assumption 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 portfolio. Under current Rule 2a-7, a fund is required to limit its investments to those securities that its Board or its delegate determines present minimal credit risks. This determination must be based on factors in addition to NRSRO ratings.

We believe it is essential that a Board or its delegate make an informed and independent assessment of the creditworthiness of each issuer and security – not only prior to purchase, but on an ongoing basis for those securities held in the portfolio. In our view, a NRSRO rating provides a useful preliminary filter. Removal of the NRSRO requirement could have the opposite of the intended effect, as it could permit a money market fund to purchase a security that would not meet the minimum threshold created by the current rating requirements. This would cause a divergence in the quality of securities held by different funds which could be difficult for investors to discern.

[1] NRSROs are credit ratings agencies, recognized by the SEC, that provide opinions on the creditworthiness of entities and the financial obligations, such as debt, that they issue.

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Given that Congress has required the SEC to eliminate NRSRO ratings as a standard of creditworthiness, we believe it is important that the SEC make clear in the adopting release that such ratings continue to be a permissible factor for money market fund Boards or their delegates to consider in making credit quality determinations. The SEC already appears to support this idea. For example, in its proposal, the SEC suggested that a fund Board would not be prohibited from continuing to consider NRSRO ratings when making credit quality determinations for securities subject to a conditional demand feature.

Section 939A of the Dodd-Frank Act does not apply to the forms listed as they are disclosure forms rather than assessments of creditworthiness. Section 939A of the Dodd-Frank Act was not intended to require the wholesale elimination of references to ratings, but rather a review by the SEC of "any regulation…that **requires the use of an assessment of the creditworthiness** of a security or money market instrument; and…any references to or requirements in such regulations regarding credit ratings…[emphasis added]" The SEC must modify "such regulations" and substitute a standard "taking into account…the purposes for which…[regulated] entities will **rely on such standards**" [emphasis added]. The emphasized language makes it clear that Section 939 was only intended to address regulations where an entity is required to rely on the credit quality assessment of rating agencies.

In contrast, the forms under consideration for amendment by the SEC do not require a fund to rely on an assessment of creditworthiness by a rating agency, but are simply disclosure documents intended to facilitate evaluation of a money market fund's investment strategy and portfolio holdings. Forms N-MFP, N-1A, N-2 and N-3 are disclosure documents which require or which may include disclosure of, among other things, NRSRO ratings on portfolio holdings. In short, the forms are not a regulation that "requires the use of an assessment of the creditworthiness," and therefore are not covered by the requirement for SEC review in Section 939A.

In our view, the removal of references to ratings on these forms would harm money market fund investors. For example, many current and potential investors in money market funds have investment guidelines which limit their holdings to instruments which carry ratings from NRSROs or funds which invest primarily in such instruments. These investors include pensions, foundations, endowments, insurance companies, and corporate treasurers. References to ratings on disclosure forms help these investors evaluate money market fund portfolios and compare competing money market fund products. There is not comparable alternative data available to investors.

BlackRock's fundamental credit analysis framework

Qualitative Analysis

Industry Attractiveness
Macro Economic View
Market Demand/Growth Potential
Revenue/Cash Flow Predictability
Degree of Commoditization

Competitive Position
Relative Market Position
Operating Performance
Revenue/CF diversification
Event Risk Potential

Management Quality
Experience
Bench strength
Operating track record

Quantitative Analysis

Leverage
Ability to repay obligations
Debt market access
Resiliency/"shock" absorbency

Liquidity
Back up liquidity
Refinancing needs
Covenant compliance

Equity Market Perspective
Equity market access
Investor confidence
Event risk potential

Key Positive Characteristics

- Leading business in its industry
- Strong management team
- Pricing power and ability to maintain /expand margins
- Free cash flow to reduce debt
- Strong covenants and prudent capital structure
- Catalyst to reduce credit risk and drive value higher

Key Negative Characteristics

- Highly volatile revenues/cash flows or minimal operating cash flows
  - Seasonal, project-oriented or start-up companies
- Downside risks that cannot be clearly defined
  - Litigation, environmental, regulatory, etc.
- Weak management teams
- Industries at a competitive disadvantage

BlackRock's Approach to Credit Evaluation

BlackRock and its predecessor companies have been involved in the management of money market funds since 1973. Today BlackRock is one of the largest cash management providers in the world, managing a total of $207.6 billion in U.S.-registered money market funds subject to Rule 2a-7[2]. BlackRock money market funds do not seek to offer the highest yield; we believe they have grown because we have earned our clients' trust through multiple interest rate cycles and a wide range of market events by making safety of principal and liquidity our highest priorities.

BlackRock's investment philosophy emphasizes a commitment to fundamental research and independent credit evaluation. Our research team follows a rigorous process when assessing the creditworthiness of a security. In order to develop a formal view, we conduct both quantitative analyses of corporate capital structures and qualitative assessments of management and industry positioning.

BlackRock has also developed proprietary tools that support the research process. For example, Galileo™, our global research database, allows analysts to share, store and access information and insights across asset classes and locations. GPLive™, our risk monitor, enables portfolio managers to view issuer exposure across portfolios on a real-time basis.

[2] Data as of March 31, 2011

Conclusion

While we support the need for independent credit research, we do not believe all references to NRSRO ratings should be eliminated. We maintain that money market fund advisors should not **rely** on a security's NRSRO rating, but instead should consider ratings as preliminary screens in an independent credit review. In fact, the elimination of references to ratings may inadvertently result in the creation of **new** risks for money market fund investors, as lower quality securities may be deemed creditworthy by advisors. In addition, we believe the disclosure of ratings on portfolio holdings is helpful to investors. In our view, these benefits outweigh the risks; the SEC proposal represents an unnecessarily broad interpretation of Section 939A of the Dodd-Frank Act.

Related *ViewPoints*

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