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**VIA ELECTRONIC MAIL**

September 17, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: Money Market Fund Reform; Amendments to Form PF**

Dear Ms. Murphy:

On June 5, 2013, the Securities and Exchange Commission (SEC) published its request for public comment on two proposed alternatives for amending rules that govern money market mutual funds (MMFs) under the Investment Company Act of 1940 (Proposed Rule).[1] The first proposed alternative would require certain MMFs to transact at a "floating" net asset value (NAV) based on the current market price of the securities in a fund's portfolio. The second alternative would require, at a fund board's determination, MMFs to impose a temporary liquidity fee if a fund's liquidity levels fell below a specified threshold and would permit funds to temporarily suspend redemptions, or "gate," the fund under the same circumstances. The two alternatives can be adopted separately or in combination. The Proposed Rule also includes additional amendments aimed at improving portfolio diversification, enhancing stress testing, and increasing transparency.

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this important proposal. While FSI remains opposed to additional MMF reforms, we applaud the SEC for proposing alternatives that leave the fundamental characteristics of MMFs unchanged for retail investors. As the empirical evidence demonstrates, retail investors do not pose a pronounced systemic risk to the stability of MMFs. While we offer some specific improvements and commentary on the Proposed Rule, we believe the SEC has pursued a careful approach to this issue and has conducted a robust cost-benefit analysis to support their arguments.

<u>Background on FSI Members</u>
The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a

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[1] Money Market Fund Reform; Amendments to Form PF, Release No. 9408, 78 Fed. Reg. 36,834 (June 19, 2013).
[2] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has more than 100 Broker-Dealer member firms that have approximately 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64% percent of all practicing registered representatives – operate in the IBD channel.[3] These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[4] Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

<u>Comments</u>
IBDs and independent financial advisors are committed to providing all individuals, regardless of wealth or income, with access to competent financial advice, products, and services. In normal interest rate environments, MMFs serve a crucial role by providing FSI members access to liquid cash-like accounts with market-based yields. IBDs often use money market funds for customer cash balances and other cash management type accounts. These balances can be used for the purchase of securities. Interest, dividends, and proceeds of securities sales due to the investor are also held in these accounts. Most firms sweep customers' cash balances into MMF shares which are owned by the customer. This segregates the customer's cash from that of the broker-dealer, which provides safety for customers in the event that a broker-dealer goes out of business and the remaining cash balance held in a customer's account exceeds that covered by the Securities

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[3] Cerulli Associates at http://www.cerulli.com/.
[4] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisers.

Industry Protection Corporation (SIPC).[5] It also allows customers to have rapid access to cash for purchases. The current system facilitates the efficient processing of cash balances, allowing for reduced settlement periods that provide customers access to cash balances in their brokerage accounts through debit cards and checks, in a fashion similar to a standard checking account. These accounts are very popular and convenient for investors because they combine low risk, market-based yields, and high liquidity. Investors, however, are not under the false impression that money market funds are without risk; indeed, 75% of retail investors surveyed by Fidelity Investments understood that MMFs are not guaranteed by a government entity.[6] MMFs are required to clearly disclose that "[a]n investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund."[7] In addition, many of the largest providers of institutional and retail money market funds recently announced that they would begin publishing the daily share value for their funds.[8] This further underscores that MMFs serve as highly transparent investments that provide investors with low but well disclosed risks.

FSI appreciates the opportunity to provide our comments on the SEC's Proposed Rule. In general, we remain opposed to additional MMF reforms. While the SEC's arguments in favor of reform appear to be well-researched, FSI finds them ultimately unpersuasive. In addition to the increase in operational costs to investors, funds, and intermediaries, the SEC has inadequately addressed the widespread disruption likely to occur in the wake of additional regulations, particularly a floating NAV. We discuss these concerns in greater detail below.

- Floating NAV – The Proposed Rule's first alternative would require all institutional prime MMFs to convert to a floating NAV.[9] This alternative would fundamentally alter the core characteristics of MMFs. Investors in floating NAV MMFs would lose operational advantages and principal preservation qualities that have led to MMF's widespread use. The SEC's rationale for proposing a floating NAV is to reduce the "first-mover advantage" by eliminating incentives to redeem when shareholders believe that the NAV will decline significantly in the future.[10] Although the Proposed Rule has provided an exemption for retail MMFs (FSI's views on the "retail fund exemption" are discussed in more detail in the following section), there are remaining concerns regarding the adverse effects that the conversion to floating NAV on institutional prime funds would have on retail investors. Many IBD firms operate as "introducing broker-dealers," that clear customer transactions through "carrying firms." The MMF purchases and redemptions of multiple customers are routed through the introducing firm to the clearing firm and conducted through omnibus accounts which represent the net purchases or redemptions of multiple customers. Under current market conditions, these omnibus accounts are often held in large institutional class MMF funds. Although the Proposed Rule has provided a remedy for Omnibus Accounting,

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[5] *See* 15 USC § 78fff–3(a).
[6] Letter from Fidelity Investments to SEC (Feb. 3, 2012) at 3; *available at* http://www.sec.gov/comments/4-619/4619-116.pdf.
[7] *See* 15 U.S.C. § 80a-34; 17 C.F.R. § 279.34b-1; 17 C.F.R. § 230.482.
[8] Charles Schwab Corp., "Schwab Announces Plans to Provide Daily Per-Share Market Values for All Domestic Money Market Funds" (January 11, 2013); *available at* http://pressroom.aboutschwab.com/press-release/schwab-investor-services-news/schwab-announces-plans-provide-daily-share-market-values; see also Federated Investors, "Daily Market NAV for Prime Funds" (January 11, 2013); *available at* http://www.federatedinvestors.com/FII/campaign/detail.do?cid=82911&link=eql.
[9] *See* Release No. 9408, at 47.
[10] *Id.*

we remain concerned that excluding other institutional investors will drive up costs for retail investors accessing MMFs through omnibus accounts at introducing broker-dealers. In addition, the SEC has not adequately analyzed adverse impacts to the short-term credit markets. Another very real possibility articulated by the President's Working Group is that converting to a floating NAV may trigger a series of large scale redemptions forcing funds to sell assets, causing concerns of investment losses to become self-fulfilling.[11]

In our view, the changes to Rule 2a-7 instituted by the SEC on January 27, 2010, have solved the biggest issues facing MMFs. Those rules included provisions to:

- Improve the quality of holdings by restricting funds from investing more than 3% of assets in second tier securities, 0.5% of assets in second tier securities by a single issuer; and no second tier securities with a maturity date over 45 days,
- Requiring MMF's weighted average maturity to be lowered from 90 to 60 days,
- Requiring all taxable MMFs to hold at least 10% of their total assets in cash, United States Treasuries, or securities that convert to cash within one day,
- Requiring all MMFs to hold at least 30% of assets in cash, U.S. Treasuries, specified government securities with remaining maturities of 60 days or less, or securities that convert to cash within a week,
- Disclosure of portfolio holdings and portfolio values to the SEC monthly and on their websites,
- Investments in securities must be restricted to those in the top two rating categories, and
- Conduct periodic stress testing.[12]

These changes, as demonstrated during the Eurozone crisis and debt ceiling standoff in the summer of 2011, have left MMFs remarkably resilient during periods of significant negative cash flow.[13] For these reasons, FSI remains opposed to additional reforms to MMFs, and particularly a floating NAV.

- Retail Exemption – The Proposed Rule has provided an exemption from the floating NAV alternative for certain types of funds, including government MMFs and retail MMFs. The Proposed Rule has defined "retail MMF" as a money market fund that allows a maximum of $1 million per day to be redeemed per shareholder.[14] As indicated previously, we applaud the SEC for their careful approach in this rulemaking and for providing the operational flexibility to retail investors due to their reduced run risk on MMFs. The Proposed Rule has requested comment on several different criteria for retail MMFs, including concentration limits and account size. Of the proposed and alternative criteria, FSI supports the $1 million per day exemption criteria. However, we suggest a limited number of additional exemptions for retail investors that will not impact the financial stability of MMFs. We suggest that certain transactions, including real estate purchases

[11] Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options (October 2010), at 22; *available at* http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf.
[12] Money Market Fund Reform, Release No. IC-29132, 75 Fed. Reg. 10,600 (Mar. 4, 2010).
[13] *See* David W. Blackwell, Ph.D., Kenneth R. Troske, Ph.D., & Drew B. Winters, Ph.D., *Money Market Funds Since the 2010 Regulatory Reforms: More Transparency, Increased Liquidity, and Lower Credit Risk* (Center for Capital Markets Competitiveness Report, Fall 2012) at 28.
[14] *See* Release No. 9408, at 72.

and retirement account rollovers, be exempt from the $1 million per day restriction for retail MMFs. These transactions are more likely than typical redemption activity to exceed this threshold yet do not pose additional run risk. In addition, we suggest that individual investors be permitted to redeem in excess of $1 million per day if the fund is given prior notification of this redemption. This exemption will provide additional flexibility to retail investors while not providing any additional stability risk to funds because risks to fund stability typically occur over much shorter periods of time and are based upon suddenly occurring negative market sentiment.

- Omnibus Accounting – As indicated above, many FSI members operate as introducing broker-dealers that clear transactions through carrying firms. Carrying firms typically transact with funds through an omnibus accounting structure for increased efficiency. However, the proposed retail exemption would be complicated in situations where no individual shareholder invested in a retail MMF redeems in excess of $1 million per day, but the omnibus account of the carrying firm exceeds this redemption limit. The Proposed Rule has dealt with this issue well by allowing carrying firms operating as omnibus account holders to redeem in excess of $1 million per day provided that the fund can reasonably determine that no individual shareholder has exceeded the threshold.[15] This flexible requirement allows industry participants and investors to create solutions and procedures to best fulfill the SEC's policy vision without introducing unnecessary additional costs. We support the SEC's approach on omnibus accounting issues related to retail MMFs and applaud their efforts to remedy the concern.

- Gates and Fees – The proposed second alternative would require, at a fund board's determination, MMFs to impose a temporary liquidity fee if a fund's liquidity levels fell below a specified threshold and would permit funds to temporarily suspend redemptions, or "gate," the fund under the same circumstances.[16] We support the approach in theory because it continues to maintain the stable NAV which provides flexibility and operational benefits to investors. In addition, investors would rarely if ever incur this type of restriction as it would only be imposed during a low probability event. However, we have some concerns with the proposal. The same rationale for exempting retail MMFs from a floating NAV applies consistently to the gate and fee alternative. Retail investors pose a substantially lower risk of high redemption activities during periods of market stress, and therefore do not require additional regulatory policies that encroach upon the key features making MMFs a suitable and safe investment product. We suggest that the SEC provide an additional exemption from the fees and gates alternatives for retail funds. Another complication from this proposed alternative is that it may make retirement accounts governed under ERISA ineligible to invest in MMFs. ERISA plan sponsors' fiduciary duties to plan participants and beneficiaries may experience significant difficulties if not permitted to sell MMF shares while a liquidity gate is imposed on MMF. We suggest that the SEC provide an exemption for funds to permit share redemption to ERISA covered accounts in instances where a liquidity gate has been lowered by an MMF.

- Amortized Cost Accounting – The Proposed Rule would allow MMFs to use amortized cost to value securities with maturities of 60 days or less but requires that MMFs use market-

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[15] *Id*. at 89.
[16] *Id*. at 153.

based factors for all other instruments.[17] We have concerns that the elimination of amortized cost accounting, and relying solely upon penny-rounding methods to achieve a stable NAV for retail MMFs, will increase operational costs for funds and increase the transaction times for investors' redemptions of MMF shares. These proposed changes are unnecessary, as amortized cost for MMF assets is materially the same as market-based pricing in nearly all cases.[18] The amortized cost method of accounting for stable-price MMF's remains the most appropriate and cost effective approach and we urge the SEC to reconsider these proposed changes.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with the SEC on this and other important regulatory efforts

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel

[17] *Id. at* 374.

[18] Dennis R. Beresford, *Amortized Cost is 'Fair' for Money Market Funds* (U.S. Chamber of Commerce Center for Capital Markets Competitiveness, Fall 2012); *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Money-Market-Funds_FINAL.layout.pdf.