THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

***VIA* Electronic Delivery**

January 18, 2013

Financial Stability Oversight Council
Attention: Amias Gerety, Deputy Assistant Secretary
1500 Pennsylvania Avenue N.W.
Washington, DC 20220

Re: Proposed Recommendations Regarding Money Market Mutual Fund Reform [Docket Number: FSOC-2012-0003]

Ladies and Gentlemen:

The Financial Services Roundtable[1] (the "Roundtable") appreciates the opportunity to provide the Financial Stability Oversight Council (the "Council") with our comments regarding the Council's Proposed Recommendations Regarding Money Market Mutual Fund Reform, 77 Fed. Reg. 69455 (Nov. 19, 2012) (the "Proposed Recommendations"). The Roundtable and its members appreciate the work of the Council and share its goal of seeking to ensure that money market funds ("MMFs") remain a convenient and cost-effective means of pooling investments in money market instruments.

The Roundtable respectfully submits, however, that the Council's Proposed Recommendations are premature. As the Council itself recognizes, the Securities and Exchange Commission ("SEC") is best positioned to assess alternative approaches to MMF reforms and to implement any additional reforms.[2] By all accounts, the SEC

1 The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

2 *See* 77 Fed. Reg. at 69460 (stating that "[t]he SEC, by virtue of its institutional expertise and statutory authority, is best positioned to implement reforms to address the risks that MMFs present to the economy").

continues actively to consider reforms and best approaches.[3] Indeed, the SEC staff recently issued an important study addressing questions from three SEC Commissioners[4] and, on the basis of this staff work, SEC Commissioners Aguilar and Gallagher have stated that the SEC should be in a position later this year to put forward an informed proposal for public comment.[5]

The Council has stated that it would not issue final recommendations if the SEC moves forward with reforms to MMFs.[6] The SEC Study and the SEC Commissioners' public comments indicate that the SEC is actively considering how best to move forward with additional MMF reforms. The Roundtable urges the Council to accommodate the SEC's deliberative process and to allow the SEC to proceed with its important work. In the Roundtable's view, the SEC's careful work—which will benefit from the SEC's deep experience with MMFs—has the greatest chance of producing meaningful reforms without disruptive and unintended consequences. Accordingly, we respectfully request that the Council refrain from further action pending the SEC's consideration of all the related issues.

I. Executive Summary

Although we believe strongly that the Council should permit the SEC to continue its work on MMF reforms, we offer our comments on the Proposed Recommendations to

---

3 *See* Commissioner Daniel M. Gallagher; Commissioner Troy A. Paredes, Statement on the Regulation of Money Market Funds (Aug. 28, 2012), *available at* http://www.sec.gov/news/speech/2012/spch082812dmgtap.htm (the "Gallagher/Paredes Statement") ("Although we cannot support the Chairman's specific proposals, we are not opposed to further improvements to the Commission's oversight and regulation of money market funds. But further action must be advanced on the basis of data and rigorous analysis showing that any such changes to our existing rules would be workable, would be effective in achieving their purpose, and would not unwisely disrupt the functioning of money market funds and short-term credit markets."); SEC Commissioner Luis A. Aguilar, Statement Regarding Money Market Funds (Aug. 23, 2012), *available at* http://www.sec.gov/news/speech/2012/spch082312laa.htm (emphasizing that a critical analysis of the efficacy of the SEC's 2010 reforms to money market mutual funds "must precede any proposals to further amend" the rules).

4 Division of Risk, Strategy, and Financial Innovation, SEC, Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher (Nov. 30, 2012) (the "SEC Study").

5 *See* Jessica Holzer, SEC's Aguilar Warms Up to Money-Fund Overhauls, Wall Street Journal (Dec. 7, 2012) at p. B2, *available at* http://professional.wsj.com/article/SB10001424127887324640104578165590981680774.html?mg=reno64-wsj (quoting Commissioner Aguilar stating that "[t]he proposal currently under development at the SEC would draw from the study's findings because staff had a window into the study as it was being written ... I expect that sooner rather than later in 2013 we should be in a position to put forth a more informed proposal for comment."); Jessica Holzer, SEC's Gallagher Expects SEC to Move Soon on Tougher Money-Fund Rules, Wall Street Journal (Jan. 16, 2013), *available at* http://blogs.wsj.com/economics/2013/01/16/secs-gallagher-expects-sec-to-move-soon-on-tougher-money-fund-rules/ (quoting Commissioner Gallagher stating that "I hope and expect we'll have a proposal out for comment in the first quarter").

6 77 Fed. Reg. at 69460.

inform the Council's implementation of its authority under Section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and its understanding of the impact and implications of the various reform alternatives the Council cites (the "Alternatives"). Our comments can be grouped into three categories.

- First, the Roundtable respectfully submits that the Council's Alternatives do not meaningfully advance the debate on how, if at all, MMFs may be better regulated. The Council principally has proposed variations on existing ideas, many of which have drawn significant prior public comment, which the Council does not acknowledge or address.[7] Furthermore, the Council does not attempt to resolve the long-recognized operational, accounting, and tax issues with the Alternatives, which means that the Council has not addressed the real and practical challenges of implementing these reforms. Additionally, the Roundtable believes that the Council has paid insufficient attention to whether the Alternatives will be acceptable to the full range of MMF investors or whether, instead, the reforms will cause investors to abandon MMFs entirely.

- Second, the Roundtable respectfully submits that the Council's analysis of the systemic risks posed by MMFs is predicated on a particular—and, in our view, flawed—interpretation of the events of the financial crisis of 2008 and the role that MMFs played in that crisis. In short, MMFs were not a cause or leading event of that crisis but, instead, experienced difficulties much like other pooled investment vehicles and other financial intermediaries after other triggering events. The Council also has not adequately analyzed the effects of the amendments to Rule 2a-7 under the Investment Company Act of 1940 (the "Investment Company Act") adopted in 2010 (the "2010 Amendments").[8] In the Roundtable's view, the Council's misinterpretation of the role of MMFs during the 2008 crisis and failure to acknowledge the salutary effects of the 2010 Amendments have hindered the Council's economic and systemic risk analyses and colored its views on the need for and approaches to reform.

- Third, the Roundtable respectfully submits that the Council and other regulatory agencies have not satisfied fully the various predicate requirements under Section 120 of the Dodd-Frank Act to issue recommendations to a primary financial regulatory agency to apply new or heightened standards. The Roundtable believes that the Council should exercise its authority under Section 120 only after carefully and fully adhering to the requirements of the statute.

---

7 *See, e.g.*, President's Working Group Report on Financial Markets Report on Money Market Fund Reform Options (Oct. 21, 2010), *available at* http://www.sec.gov/rules/other/2010/ic-29497.pdf, and comments thereto, *available at* http://www.sec.gov/comments/4-619/4-619.shtml.

8 Money Market Fund Reform, SEC Release No. IC-29132 (Feb. 23, 2010)(adopting amendments to Rule 2a-7 under the Investment Company Act).

Given these considerations, the Roundtable respectfully suggests that the Council refrain from taking further action on the Proposed Recommendations. Instead, the Roundtable urges the Council to allow the SEC to continue its consideration of MMF reforms.

II. Alternatives

The Council presents, in the main, three Alternatives to address features of MMFs that the Council believes make MMFs susceptible to runs: (a) the stable net asset value ("NAV"); (b) the liquidity feature of MMFs, which enables fund investors to access their investments immediately; and (c) the market-based yields offered by MMFs that exceed the returns of bank deposits and Treasury securities.

The Roundtable respectfully submits that none of the Alternatives are apt to achieve the results that the Council seeks. For example, as discussed further below, economic studies and recent experience show that floating NAV funds are not less susceptible to runs than stable NAV funds.[9] We also are concerned that several of the Alternatives are so highly complex as to be essentially unworkable, which will cause investors to abandon MMFs altogether. To this end, we do not believe that the Council has adequately considered the impact of the Alternatives on investors, both retail and institutional, and we ask the Council to bear in mind that investors require a product that is transparent and uncomplicated.[10]

In addition, with respect to the Alternatives, the Council raises the possibility for a restriction or a ban on sponsor support (but does not provide any additional detail). Investors, as owners of an investment product, understand that they own both the risks and the rewards of the product. Thus, the Roundtable agrees that MMF investors should not expect sponsor support. However, the Roundtable believes that a complete ban on sponsor support may be inappropriate, because there are circumstances where sponsor support would be in the best interests of fund investors and the sponsor. To this end, we believe that the Council and the SEC should carefully consider these circumstances before placing any restriction on sponsor support.

Finally, the Roundtable respectfully submits that the Proposed Recommendations do not provide enough specificity as to the Alternatives (and the possible variations on the Alternatives) for a full evaluation by the public. We note several places below where the Council has left open key details that could significantly affect the feasibility of an Alternative and assist the public in evaluating and commenting on the Alternatives.

We offer more detailed comments on each Alternative below.

---

9 *See infra* note 12 and the accompanying text.

10 *See infra* section IV.C; *see also* Technical Committee of the International Organization of Securities Commissions, Money Market Fund Systemic Risk Analysis and Reform Options: Consultation Report (April 27, 2012) (the "IOSCO Study") at 9 (discussing the importance of MMFs to retail investors).

A. Alternative 1: Floating NAV.

The first Alternative in the Proposed Recommendations would require MMFs to have a floating—rather than a stable—NAV. The Council believes that moving to a floating NAV would reduce the run risk, since there would be less of a first-mover advantage to redeeming fund shares. The Council, however, acknowledges that a floating NAV "would ... not eliminate" the first-mover advantage it believes is present in MMFs today.[11]

It is uncertain how investors in floating NAV MMFs will behave in financial crises or stressed market environments, and floating NAV MMFs may still be susceptible to "runs." There is evidence to suggest that floating NAV MMFs do not behave significantly differently from stable NAV MMFs in normal and stressed market environments and that, consequently, both types of MMFs are susceptible to "runs."[12] To this end, the SEC Study notes both that (i) there are significant explanations for the "run" during the 2008 crisis other than the stable NAV, including most significantly a flight to quality (*e.g.*, from prime MMFs to Treasury MMFs) and (ii) all mutual funds, and not just stable NAV funds, are subject to a first-mover advantage problem.[13] In its analysis of the 2011 European sovereign debt crisis, the SEC Study also shows that substantial investor redemptions over a long period of time can be managed by stable NAV MMFs.[14]

The potential for significant redemptions effectively forcing the liquidation of a fund is not a unique issue for stable NAV funds. This issue is most likely to occur where there is a sudden loss of value in a high quality security (*e.g.*, Reserve Primary Fund). Even a floating NAV MMF likely would face heavier redemptions in these situations (whether as result of a flight to quality or as a result of the first mover advantage) and likely would face liquidation.

There are other difficult issues with a floating NAV. One is the transition period between a stable to floating NAV structure, which transition itself could present systemic risks by artificially causing a "run" on funds prior to their adoption of a floating NAV.[15]

Other important practical issues also exist for floating NAV funds. Floating NAV funds will not be considered an acceptable cash management product by investors, sponsors and other intermediaries unless the accounting and tax treatment is simple to understand and implement, and investors do not have to consider daily price fluctuations

---

11 77 Fed. Reg. at 69467.

12 *See* IOSCO Study at 14 (discussing how the "first mover" advantage still remains in variable (*i.e.*, floating) NAV MMFs).

13 SEC Study at 8 – 10.

14 SEC Study at 33 – 35.

15 *See* IOSCO Study at 14 – 15 (discussing potential risks in the transition from a stable NAV to a variable (*i.e.*, floating) NAV).

for every transaction, including writing checks, using a debit card, making ATM withdrawals, paying payroll and bills, and processing cash through sweep accounts. The Council acknowledges the importance of these tax and accounting issues and indicates that the Treasury and the IRS may provide relief with regard to the tax treatment of gains and losses from floating NAV MMFs; the Council, however, does not actually present potential resolutions by the Treasury or the IRS (and offers no prospect of resolving the accounting questions).

The absence of any discussion of how the accounting and tax questions may be resolved makes it difficult to know whether the Council's floating NAV Alternative could be viable for investors and fund sponsors. It also makes it difficult to comment meaningfully on this Alternative. We suggest that the Council keep open the comment period for the Proposed Recommendations until the Treasury and the IRS have provided the necessary guidance.

B. Alternative 2: 1% NAV Buffer and Minimum Balance at Risk (MBR).

The second Alternative included in the Proposed Recommendations would (i) require that MMFs maintain a one-percent NAV buffer (the NAV buffer is discussed in more detail in Alternative 3), and (ii) require that three percent of any shareholder's highest account value in excess of $100,000 during the previous 30 days be available for redemption with a 30-day delay (the "MBR"). Losses in excess of the NAV buffer would be borne first by the MBRs of shareholders who have recently redeemed.

The Roundtable believes that a MMF with an MBR would be completely unacceptable to many investors. In our view, a MMF with an MBR simply would be considered too "foreign" and confusing a concept for most investors, who seek in MMFs simplicity and liquidity equivalent to other cash management products. For example, corporate treasurers who use MMFs to meet payroll and pay other bills would be unlikely to continue to use MMFs if they do not have daily access to their entire MMF holding. Similarly, the use of MMFs for sweep accounts would be made operationally impractical if the MBR restricted access to the entire account.

It also is not clear to the Roundtable whether an MBR would sufficiently reduce the first mover advantage that the Council believes exists with stable NAV MMFs. Even with an MBR, an investor may still have the incentive to reduce its MMF holdings up to the value of the MBR.

In addition, the MBR presents significant operational difficulties, including with respect to client reporting, transaction, and reconciliation processes. For example, transfer agent systems will need to be reprogrammed to calculate the MBR daily (*i.e.*, the highest account value during the previous 30 days) and restrict those shares from redemption. The operational issues also include the fact that the MBR will be applied to recordholders (who are generally financial intermediaries) and not the ultimate beneficial owners. Application of the MBR to omnibus accounts held by financial intermediaries could result in inequities (if one investor could be affected by other investors' redemptions). Overcoming these operational challenges will require significant and expensive revisions to accounting and administration systems.

Finally, the designation of the $100,000 threshold for the MBR appears to be an arbitrary distinction between "retail" and "institutional" investors. If such a distinction is to be made, we believe that a more appropriate analogy is the threshold subject to Securities Investor Protection Corporation (SIPC) protection (*i.e.*, $500,000 for customers' cash, stock, and other securities and property held at a financially troubled securities brokerage firm).

We discuss the issues relating to the NAV buffer in our discussion of Alternative 3 below.

C. <u>Alternative 3: 3% NAV Buffer.</u>

The third Alternative in the Proposed Recommendations would require MMFs to have a three-percent NAV buffer, which would be a tailored amount of assets of up to three percent in excess of those needed for a fund to maintain its $1.00 share price and which would absorb day-to-day fluctuations in the value of the fund's portfolio securities. The Council presents a series of options with how to build and structure a buffer, but the Roundtable respectfully submits that each has flaws that present significant challenges.

- A sponsor-funded subordinated shares or escrow account is not possible because it would require the sponsor to consolidate the MMF on its balance sheet for accounting purposes, causing a range of issues, particularly with respect to capital requirements.

- The externally financed subordinated shares option is completely unknown to investors. This approach would present significant marketing challenges and, as a result, increased costs. In addition, the current low interest rate environment (which is expected to continue for the foreseeable future) would likely make it uneconomical to pay a preferred return. Taken together, this means that the time to build the buffer from the inception of this requirement could be very long (and almost definitely longer than the proposed two-year transition period).[16]

- The retained earnings option for the buffer is not possible due to the significant tax implications, since the fund would be required to pay tax on the amounts that it does not distribute if it fails to distribute substantially all of its earnings each year. The Council has acknowledged this significant tax issue but has not indicated that the Treasury or IRS will provide relief on this matter.[17] Absent specific tax guidance, this option is not practical. This option also appears economically impractical in the foreseeable low-interest rate environment.

---

16 We note that IOSCO suggested that a 10-year build up period would be economically feasible. IOSCO Study at 16.

17 77 Fed. Reg. 69470.

The Roundtable also is concerned about the impact of each of these approaches on MMF shareholders. First, the increased costs associated with raising capital for the buffer will decrease the yields of MMFs. Again, this is a significant (and possibly insurmountable) problem in the current low interest rate environment. Second, existing shareholders during the buffer build-up period will be disadvantaged (through increased costs and lower performance) as opposed to shareholders who invest after a buffer has been established.

In addition, the range of operational, accounting, tax, and marketing issues presented by each of the buffer options may decrease the profitability of MMFs for fund sponsors.[18] The Roundtable believes that this would be particularly burdensome on smaller and mid-size asset managers and may result in increased market concentration and decreased investor alternatives.

Finally, given that the Council appears to be concerned with extraordinary tail risk events, it is unclear why—and the Roundtable respectfully suggests that the Council has not offered sufficient reasons why—any size buffer could prevent a "run" under those circumstances. The SEC Study has shown that a large percentage of a "run" in these circumstances is not an attempt to make a preemptive run but rather a flight to quality.[19] Investors who are reacting to the quality of the assets will not be affected by likelihood of the fund "breaking the buck," since the investors will be moving to funds with higher quality assets regardless of whether the MMF is at risk of "breaking the buck."

III. <u>The Council's View of MMFs and the Financial Crisis</u>

The Council's Proposed Recommendations appear to be predicated on a particular view of recent events. In particular, the Council believes that the "2007-2008 financial crisis demonstrated that MMFs are susceptible to runs" that can have systemic risk consequences. The Council goes on to argue that MMF activities and practices amplify the transmission of risks and credit problems in the financial system. The Council further insists, without supporting data or evidence, that the 2010 Amendments do not address the vulnerabilities and risks posed by MMFs.[20]

In the Roundtable's view, the Council does not properly evaluate the 2008 crisis and does not adequately acknowledge the beneficial effects of the 2010 Amendments, particularly as evidenced during the European sovereign debt and U.S. debt ceiling crises of 2011. We think a different view of these events would affect the Council's perception of MMFs and the systemic risks, if any, that they may pose.

---

18 The Roundtable notes that the 2010 Amendments have already reduced the potential for MMF sponsors to use yields as a basis for competitiveness by limiting the range of instruments in which MMFs may invest.

19 *See* SEC Study at 8 (citing Wermers, Russ, March 2012, Runs on Money Market Funds, working paper, Smith School of Business).

20 77 Fed. Reg. 69464.

The Roundtable believes the Council should re-consider how it views MMFs in the 2008 financial crisis. First, as the SEC Study has notably recognized, it is difficult to pinpoint the cause of MMF investor redemptions during the 2008 financial crisis; there are many potential causes, which the Council does not recognize or assess.[21] Second, the Council also fails to note, as the SEC Study does, that there were at least 11 other occasions on which one or more MMFs faced significant financial stress, but none of these led to systemic problems or otherwise posed destabilizing risks for the financial markets or U.S. economy.[22] Third, the Council admits that money flowed from prime MMFs to government MMFs during the 2008 crisis, which indicates that investors were not simply moving out of stable NAV MMFs;[23] however, the Council also asserts that government MMFs are vulnerable to runs but provides no example of such a run.[24]

As the Council acknowledges, the 2010 Amendments made MMFs more resilient and better able to withstand financial crises. Among the changes were the creation of liquidity buffers (designed to mitigate liquidity and run risks), the imposition of tighter portfolio maturity limitations and meaningfully increased fund disclosures. The SEC Study clearly details how MMFs are more liquid, less volatile, and less likely to "break

---

21 SEC Study at 8 – 15. The Council also fails to explain why during the financial crisis investors continued to invest in MMFs (including prime MMFs) that were not guaranteed or beyond the guarantee limit even while bank deposits had unlimited guarantees. Jonathan R. Macey, Money Market Funds: Vital Source of Systemic Stability at 23 (Fall 2012), *available at* http://www.regulations.gov/#!documentDetail;D=FSOC-2012-0003-0010%20 [hereinafter, *Macey*].

22 SEC Study at 15 – 17 (evaluating situations where MMFs required sponsor support or no-action relief permitting sponsor support). The SEC Staff stated that "[i]t is important to note that although these events affected money market funds and their sponsors, the events did not appear to cause systemic problems. *Id.* at 15.

23 *See* 77 Fed. Reg. at 69464; *see also* SEC Study at 7 (describing how investors sold prime MMFs but purchased government MMFs during the Lehman crisis); Dr. David W. Blackwell, Dr. Kenneth R. Troske, and Dr. Drew B. Winters, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, "Money Market Funds Since the 2010 Regulatory Reforms: More Transparency, Increased Liquidity, and Lower Credit Risk" (Fall 2012), *available at* http://www.uschamber.com/sites/default/files/reports/FinalpaperwithCover_smalltosend.pdf [hereinafter, *Blackwell*] (reviewing academic literature showing that, while prime MMFs experienced net cash outflows, government MMFs experienced net cash inflows). Certain studies have linked this flow as related to a general move away from commercial paper exposure (specifically, commercial paper issued by financial firms). *See* Blackwell at 34 – 35.

24 77 Fed. Reg. at 69464.

the buck" because of the 2010 Amendments.[25] External analyses of the impact of the 2010 Amendments are in accord with these findings.[26]

Unlike the SEC Study, the Council does not adequately assess the 2010 Amendments and their implications. The Council indicates that the 2010 Amendments address "certain" MMF risks but asserts, without support or evidence, that the regulatory changes do not address MMF "structural vulnerabilities."[27] We think that the 2010 reforms significantly increased the resilience of MMFs, which the Roundtable strongly believes the Council should recognize.

In our view, the Council's analysis of the 2011 MMF outflows is similarly incomplete.[28] While the Council states that heavy outflows from institutional prime MMFs in the summer of 2011 further highlighted MMFs' continued vulnerability to runs even after the 2010 Amendments, the Council fails to support its analysis. For example, the Council notes that institutional investor redemptions, apparently in response to concerns about the funds' European holdings and the U.S. debt-ceiling impasse, were heavy. From this, the Council speculates that institutional investors may have become more reactive and run-prone since 2008. The Council states that the increase in certain MMFs' exposure to European securities "appears to have been motivated by increased risk-taking in an attempt to boost investment yields and revenues," concluding that the same motive "was also reportedly a significant factor in the investment policies that ultimately led the Reserve Primary Fund to break the buck."

In the Roundtable's view, this analysis ignores that (i) the MMF industry was maintaining a very high percentage of liquid assets in anticipation of possible redemptions (as required by the 2010 Amendments to Rule 2a-7) and handled the redemptions received without any problem; (ii) the vast majority of MMFs' European securities exposure was not to troubled banks, but was to stronger institutions, many of which were located outside the European Union; and (iii) much of the investor "concern" over MMF's European holdings arose in the wake of press articles that exaggerated fund

---

25 SEC Study at 19 – 31. We note that the SEC Study did not evaluate the increased transparency or the liquidation tools related to the 2010 Amendments. SEC Study at 31.

26 *See, e.g.*, FitchRatings, Money Fund Liquidity: Regulation Versus Risk Aversion (Nov. 14, 2012) (noting that the 10 largest U.S. prime MMFs have significantly increased their liquidity from 20% of total MMF assets at the end of 2006 to about 45% as of the end of September 2012); Macey at 8 (noting that prime MMFs are now holding well over 40% of their portfolios in seven-day liquid assets, which is "roughly triple the percentage redeemed from prime MMFs in the seven days after Lehman failed in September 2008"); Macey at 10 (showing that the robustness of MMFs has increased 50% according to the Standard & Poor's criteria in determining criteria for rated funds and that MMFs could now withstand a shock greater than the worst one-day shock to the federal funds rate since 1990).

27 77 Fed. Reg. at 69464.

28 77 Fed. Reg. at 69465.

exposure to the European debt problem and quoted ominous statements from banking regulators.[29]

Accordingly, we believe it is possible to draw very different conclusions from the 2011 crisis than the Council does. MMFs, in large part due to the 2010 Amendments, were able to withstand extraordinary geopolitical events in 2011 and were able to do so despite the availability of alternative products that enjoyed unlimited U.S. government deposit insurance (in the form of the FDIC's Transaction Account Guarantee program). The Roundtable respectfully asks the Council to re-examine these events and reevaluate their implications.

IV. Dodd-Frank Act Section 120 Procedural Requirements

As the Council knows, Section 120 of the Dodd-Frank Act requires the Council to take a number of steps before making recommendations to apply new or heightened standards and safeguards. Given that the Proposed Recommendations are the first time that the Council is seeking to use its Section 120 authority, and because any exercise of such authority may establish a precedent for future Council actions, the Roundtable believes it is vital that the Council carefully adhere and follow to the statutory requirements. The Roundtable is concerned that the Council has not met the statutory requirements in several respects.

A. Determination that an "Activity or Practice" Is Systemically Risky.

Under Section 120(a), the Council must determine that "the conduct, scope, nature, size, scale, concentration, or interconnectedness of [an] activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities" prior to issuing any recommendations. The Roundtable believes that the Council did not adequately meet this predicate statutory requirement.

In the Roundtable's view, the Council fails to define with adequate precision the activity or practices that create the risks it observes and, instead, intermixes other irrelevant observations about the MMF industry. For instance, the Council contends that MMFs have "extensive interconnectedness with financial firms." The Council then provides various examples of such interconnectedness.[30] The statutory requirement,

---

29 *See, e.g.*, Brian Reid, Investment Company Institute, Dispelling Misinformation on Money Market Funds (July 1, 2011), *available at* http://www.ici.org/mmfs/mmfeurope/11_mmfs_euro_reid (noting that prime MMFs had minimal exposure to government and bank debt in the European countries suffering the crisis); SEC Study at 31 – 35 (analyzing the 2011 crisis and noting, among other things, that the liquidity requirements of the 2010 Amendments provided MMFs "greater resources to redeem shares than in 2008"); *see also* Blackwell at 18 – 20 (analyzing the 2011 crisis and concluding that there is not "any compelling evidence of a run against prime MMFs in the summer of 2011" but rather "a general increase in demand for liquidity … and not a quiet run specifically against MMFs with eurozone exposure").

30 77 Fed. Reg. at 69462-63.

however, is that an "activity or practice" must create systemic risk. It is, at best, unclear what MMF "activity or practice" the Council believes contributes to this interconnectedness. Similarly, the Council argues that the MMF industry is highly concentrated since, for example, the top five MMF sponsors manage 46% of the industry's assets.[31] Once again, the Council's observations about the size and concentration of the MMF industry are not directed at any MMF activity or practice and, thus, are inapposite.

Even if it were germane, the Council's measure of concentration in the MMF industry is flawed and should be measured at the fund level, not the sponsor level. The fact that the top five MMF sponsors manage 46% of the industry assets and the top 20 manage 90% of the industry assets is not relevant to any consideration of an activity or practice that potentially causes concerns. A "run" on one of a sponsor's funds does not indicate that there will be a "run" on all of the other funds of a sponsor, since the funds do not pursue the same investment objectives and are legally distinct entities.[32]

The Council also makes other observations that the Roundtable respectfully submits either do not advance the analysis or are flawed in other ways. For example, the Council appears to overstate the importance of MMFs to banking institutions by focusing on only a limited set of financing on which banking institutions rely (*e.g.*, ignoring customer deposits). The Council also notes that 41% of MMF industry assets are sponsored by banking firms, but it does not credibly contend why such sponsorship increases risks.

In addition, the Council makes contradictory statements on the importance of MMFs to short-term financing markets. In the analysis of MMFs' systemic significance, the Council states that "MMFs are important providers of short-term funding to financial institutions and play a dominant role in some short-term funding markets."[33] However, in its analysis of the impact on long-term economic growth, the Council minimizes the importance of MMFs as a source of credit.[34]

---

31 77 Fed. Reg. at 69462.

32 We note that similar arguments have been made as to why asset managers are not systemically important nonbank financial institutions. *See, e.g.*, comment letters of BlackRock, Inc. (Dec. 19, 2011), Fidelity Management & Research Company (Dec. 19, 2011), Investment Company Institute (Dec. 19, 2011), Managed Funds Association (Dec. 19, 2011), and Private Equity Growth Capital Council (Dec. 16, 2011), with respect to Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64264 (Oct. 18, 2011) (proposing standards for determining systemically important nonbank financial institutions).

33 77 Fed. Reg. at 69462.

34 *See* 77 Fed. Reg. at 69481 (noting that MMFs provide only five percent of the total debt outstanding of U.S. businesses, households, and state and local governments); 77 Fed. Reg. at 69482 (noting that commercial paper outstanding accounted for just 1.1 percent of domestic nonfinancial business debt).

B. Determination that Recommendations Would Reduce the Risks that the Council Determines to Exist.

In our view, Section 120 not only requires the Council to consider whether an activity or practice poses risks, as discussed immediately above, but also implicitly mandates that the Council assess whether its recommendations themselves create or increase those systemic risks.[35]

We believe that the Council has not adequately performed this analysis. The Council has not considered the systemic risks created by the Proposed Recommendations and analyzed whether the systemic risks it believes to exist would be significantly reduced under one of the Alternatives. For example, one or more of the Alternatives may significantly diminish investor interest in MMFs, and the reduction of financing through MMFs may make commercial paper and other issuers even more reliant on the traditional banking system. Similarly, MMF investors may deposit more in bank accounts, including beyond the deposit insurance limit. Both of these effects would increase the systemic risks inherent in the traditional banking system, including the systemic risks relating to "too big to fail" banks.[36] Furthermore, as discussed above, the Proposed Recommendations themselves could cause financial instability (including "runs") if implemented.

Finally, the Council should consider the interaction between the Proposed Recommendations and other reforms. For example, the Basel III capital and liquidity reforms being implemented by the Board and other banking regulators may affect bank appetite for certain types of deposits, and the combination of such reforms with the Council's MMF recommendations could lessen cash management alternatives for investors. We think that, under Section 120, the Council needs to assess the combined effects of these various reforms on funds, fund sponsors and investors.

C. Evaluation of the Long-Term Economic Impact of the Council's Recommendations.

Section 120(b)(2)(A) of the Dodd-Frank Act requires that, in making recommendations, the Council "take costs to long-term economic growth into account." The Roundtable believes that the Council has not adequately met this statutory standard and believes that the Council must perform a more thorough economic analysis.

An overarching issue with the Council's analysis in the Proposed Recommendations is that the Council has inaccurately defined the relevant economic

35 *See* Macey at 36 (discussing how stable asset value funds regulated by federal bank regulators also broke the buck during the 2008 financial crisis and noting that "[i]t is unclear why regulating MMFs like banks would reduce vulnerability" as opposed to heightening it).

36 *See* Macey at 13 – 19 (discussing the systemic risks inherent in bank deposit accounts) & 24 – 28 (describing why MMFs are more stable than banks including (i) better matching of assets to liabilities, (ii) greater transparency, (iii) higher quality holdings, (iv) a better alignment of shareholder incentives through shareholding, and (v) MMFs do not cause credit markets to seize up).

market in which MMFs compete. For much of the analysis, the Council appears to assume that MMFs are their own market. In fact, MMFs are just one of a range of cash management products including, among others, bank deposit accounts, private funds, offshore funds, bank collective funds, local government investment pools, separately managed accounts, ultra-short bond funds, and direct investments in money market instruments.[37] Viewing the entire market appropriately would require any systemic risk and economic analyses of the Alternatives to cover not just MMFs but also other cash management products.[38]

The Roundtable is concerned that the Proposed Recommendations could result in MMF investors moving funds to less regulated, and possibly more opaque, investment vehicles. Institutional investors, who appear to be a primary target of several of the policies proposed in the Alternatives, will generally qualify to invest in private funds relying on Section 3(c)(7) of the Investment Company Act.[39] To the extent registered MMFs do not provide the liquidity and simplicity that institutional and other investors expect, more and more fund sponsors likely will design private funds aimed at attracting these investors with stable-asset values. This development could result in a shift of systemic risk into another segment of the cash management industry—one that is not subject to the important safeguards of Rule 2a-7. Such a development would be contrary to the Council's desired outcome.[40] In this regard, the economic costs of the Council's proposed recommendations appear to be considerably higher than the Council acknowledges.

Any systemic risk and economic analyses of the Alternatives also need to include a sophisticated model of investor behavior. The Council presents no analysis of how

---

37 *See* SEC Study at 38 – 46 (describing investment alternatives to MMFs).

38 For example, the Council states that its other members have "the authority to take action to address certain of the risks posed by MMFs and similar cash-management products, as appropriate." 77 Fed. Reg. at 69460. The Roundtable believes that systemic risks presented by the alternatives to MMFs should be explored further by the Council, because eliminating or reducing the systemic risk in one segment of the cash management industry has little merit if investors simply migrate to another segment of the cash management industry that may present higher systemic risks. *See* SEC Study at 45 – 46 (discussing the potential increased risk concentration in the banking sector from retail investors shifting their assets from MMFs into bank deposit accounts).

39 The SEC Study, p. 45, states that as many as 21% of institutional investors are already currently permitted to invest in private funds. While the SEC staff appears to believe that this is a low number, we note that only 44% are permitted to invest in prime MMFs. In addition, the Alternatives presented above may require institutional investors to revise their investment guidelines, which could prompt them to also reconsider their current restrictions on private funds. *See* 77 Fed. Reg. at 69468 (discussing how some institutional investors would be required to amend their investment guidelines to permit investments in floating NAV MMFs).

40 *See* Section V (discussing alternative regulatory options including designation as systemically important financial institutions); *see also* Macey at 22 (noting that "MMFs were the <u>last</u> asset class to encounter difficulty and suffered the smallest losses in both real and proportional terms")(emphasis in original).

investors will react to the Proposed Recommendations.[41] Therefore, it is not possible to evaluate the impact on the cost of capital for businesses that currently rely on MMF financing, and which may find such financing unavailable in the future.

There are more specific issues with the analysis that the Council does provide, which we highlight below.

1. *The need for a more rigorous analysis of the Proposed Recommendations.*

In our view, the Council provides only limited economic analysis and presents only an array of somewhat conclusory statements. Many of those statements, as well as the flaws and gaps in the analysis identified below, raise the concern that—rather than performing a careful economic analysis—the Council has pre-judged the results. By contrast, the SEC Study takes a more careful and less conclusory approach to its analysis of MMFs, although the SEC Study is not without its own flaws and it is not intended to provide a comprehensive economic analysis required by Section 120 of the Dodd-Frank Act.

2. *The need for a full economic analysis of each Alternative.*

The limited analysis the Council provides focuses primarily on Alternative Three (the three-percent NAV buffer) with little justification. The Council states that Alternative Three "may have the most direct and largest effect on lending costs," but provides no analysis as to why this is the case.[42] The Council states that the three-percent MBR would have a smaller impact on MMF lending rates based on the theory that investors will respond to the three-percent MBR by maintaining an extra balance of three-percent in the MMF.[43] As discussed below, the Roundtable believes that the more likely impact of a three-percent MBR is that investors will reduce their balances in MMFs, not increase their balances.

The Council does not provide support for its statement that Alternative 1 will have a smaller impact on borrowing costs than Alternative 3.[44] Furthermore, the Council appears to rely on this conclusion that Alternative 3 has the largest impact on lending costs to skip the analysis of the other Alternatives along other dimensions, including, in particular, their effectiveness in reducing the likelihood and cost of a financial crisis.

---

41 The SEC Study presents only a limited qualitative analysis of the potential substitutes for MMFs (p. 38 – 46) but does not develop any model that could be used to fully evaluate which other cash management products will receive any flow away from MMFs as a result of the Proposed Recommendations.

42 77 Fed. Reg. at 69480.

43 77 Fed. Reg. at 69482 and fn. 126.

44 *See* 77 Fed. Reg. at 69482.

By focusing on only one Alternative, the Council does not provide the MMF sponsors, corporate treasurers, municipal governments, and other members of the public adequate information to evaluate which of the options is most appropriate. The Roundtable respectfully suggests a more complete analysis is necessary and asks the Council to undertake such an analysis.

3. *Flaws in the Council's economic analysis.*

The core claim of the Council's economic analysis appears to be that the reduction to economic growth from the increased cost of credit that may result from the Alternatives is outweighed by the decreased risks of a significant reduction in economic growth from financial stress. The calculations of the effect on cost of credit and the cost of a MMF financial crisis lead us to worry that the Council's consideration of the impact on long-term economic growth is not sufficient.

(a) Cost of Capital

The primary flaw with respect to the Council's analysis of the cost of capital is that it focuses solely on the cost of financing the three-percent NAV buffer in Alternative 3 but does not analyze the impact of investors shifting their funds out of MMFs. Most shareholder surveys indicate that MMF assets will likely decline if the Council's proposals are adopted.[45] As investors exit MMFs, the MMFs will need to sell off their assets, decreasing the demand for commercial paper and similar short-term financing products and leading to increased costs to the issuers. Furthermore, the tightening in the credit standards has decreased the participation by banks in the commercial paper market—meaning that other financial institutions may not step in to provide the financing in the amount necessary to fill the gap.

The numerical analysis also does not appear to fully address the impact of the cost of capital. The Council's analysis of the increased cost of capital is based on the estimate that MMFs only constitute 5% of the total debt outstanding (including businesses, households and state and local governments) and, therefore, a reduction in the asset holdings of MMFs would only cause a small increase in the cost of credit. However, there is not a single market for debt but rather several different markets. For example, MMFs purchase significantly more commercial paper than residential mortgages; therefore, the impact on the cost of credit will likely be significantly greater for businesses relying on commercial paper financing.

The Roundtable submits that there are similar issues with the Council's claim that the impact on liquidity of short-term funding markets will be minimal since only 1.1% of all domestic nonfinancial business debt is represented by commercial paper. In addition, this analysis ignores the fact that many corporate and municipal issuers have replaced

---

45 *See, e.g.*, Treasury Strategies, Inc., Money Market Fund Regulations: The Voice of the Treasurer (April 2012), *available at* http://www.ici.org/pdf/rpt_12_tsi_voice_treasurer.pdf (finding that a vast majority of corporate, government, and institutional investors would reduce MMF holdings in response to floating net asset values, redemption holdbacks, or capital buffers).

their short-term borrowing with long-term borrowing, so as to lock in the low long-term rates available in the current environment. It is unlikely that this current interest rate environment will continue indefinitely.

(b) Cost of Crisis

The Council cannot conclude that the effect of the increased cost of credit is less than the effect of an MMF financial crisis without estimating the effect of the MMF financial crisis and the difference in the likelihood of the financial crisis with and without the implementation of the Proposed Recommendations.

The Council states that the Proposed Recommendations would only need to "modestly reduce the probability or severity of a financial crisis."[46] However, the Council has not analyzed the extent to which the Proposed Recommendations would, in fact, reduce the likelihood of a financial crisis. In our view, the Proposed Recommendations would not (and could not) fully eliminate any "run" risk and, instead, could create an artificial "run" risk during any transition period.

Furthermore, this "modest reduction" standard is only valid to the extent that the cost of an MMF crisis is extremely large. The Council's analysis appears to present the costs of a crisis in the financial system as a whole (about 20% to 150% of real GDP) as if they are the costs of a crisis relating to MMFs. The Council has not presented evidence as to the percentage contribution of the reduction in real GDP growth that was caused by MMFs. As noted above, the Council takes the position that MMFs are only a small source of funding and, therefore, restrictions on MMFs would only have a small impact on economic growth. Thus, it is unclear why the MMFs' contribution to the reduction in GDP growth in a financial crisis would not be correspondingly small.

The Council also has not presented evidence that the failure of an MMF itself would cause a financial crisis on this scale.[47] In fact, the only instance of a fund "breaking the buck" outside of the 2008 financial crisis did not have a significant effect on the financial markets.

4. *Analysis of the economic impact on investors and sponsors.*

The analysis does not include an analysis of the effect on investors, including on corporate and government treasurers. The available historical evidence suggests that MMF crises do not result in significant losses to the MMF investors.[48]

---

46 77 Fed. Reg. at 69482.

47 *See* Macey at 19 (noting that "no action directly taken by an MMF contributed to the credit crisis") & 21 (noting that the "Reserve Primary Fund's breaking the buck did not precipitate the crisis; it was a product of the crisis").

48 *See* Macey at 19 – 21 (analyzing the impact of the 2008 financial crisis on MMF investors and noting that "the overwhelming majority of MMF shareholders did not lose a single penny in the crisis, and the relatively few investors who did lose money lost less than a penny on the dollar").

As noted in several places above, investors may move their money into other cash management products, which may result in greater systemic risks in other segments of the cash management industry.[49] In addition, the other cash alternatives, such as bank deposits, will likely provide lower returns (particularly, as noted, due to separate Basel III reforms being adopted for banks).[50]

There would also be a significant impact on the MMF industry. MMF sponsors would face significantly lower profits—in fact, certain MMFs (and their sponsors) may not be viable in the new environment, leading to significant job losses. The Council provides no analysis of the impact of the Proposed Recommendations on the ongoing viability of the MMF industry.

D. Definition of "Predominantly Engaged in Financial Activities."

To use its authority under Section 120 of the Dodd-Frank Act with respect to "nonbank financial companies," the Council should wait until the Board has adopted a definition of "predominantly engaged in financial activities." Section 120 authorizes the Council to issue recommendations pertaining to financial activities conducted by "bank holding companies or nonbank financial companies." In its proposal, the Council asserts that MMFs are "nonbank financial companies" for purposes of Title I of the Dodd-Frank Act because they are "predominantly engaged in financial activities."[51]

The Roundtable respectfully submits that the Dodd-Frank Act requires the Board, not the Council, to "establish, by regulation, the requirements for determining if a company is *predominantly engaged in financial activities*" and is, thereby, a non-bank financial company under Title I of the Dodd-Frank Act.[52] The Board has proposed—but has not finalized—a rule to define "predominantly engaged in financial activities," on which the Board has received significant comment.[53]

The Roundtable believes that, absent a final rule by the Board, the Council lacks authority to determine that MMFs are "nonbank financial companies" that are "predominantly engaged in financial activities."[54] Therefore, the Council must not

49 *See supra* notes 37 – 41 and the accompanying text (discussing possible movement of investor money into other cash management products including unregistered funds and bank deposits) and *supra* Section IV.A (discussing potential increased systemic risks in banking sector).

50 IOSCO Study at 9.

51 77 Fed. Reg. at 69,460.

52 Dodd-Frank Act § 102(b) (emphasis added).

53 Definition of "Predominantly Engaged in Financial Activities," 77 Fed. Reg. 21494 (Apr. 10, 2012), and 77 Fed. Reg. 22,686 (Apr. 17, 2012) (technical correction)(supplemental proposing release); Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 76 Fed. Reg. 7731 (Feb. 11, 2011) (proposing release).

54 Indeed, the treatment of money market and other funds under the Board's proposed definition of this key term was the subject of much industry comment.

exercise its authority to issue the Proposed Recommendations regarding financial activities of MMFs (or any other entities that are not bank holding companies) until the Board has finalized the definition of "predominantly engaged in financial activities."

E. The Consultation Requirement of Section 120(b)(1).

Section 120 of the Dodd-Frank Act directs the Council to "consult with the primary financial regulatory agencies" regarding any proposed recommendations.[55] We think that this consultation requirement is an important one and evidences the congressional intent for the Council to work collaboratively with a primary regulator in proposing recommendations under Section 120.

The Council has not presented any evidence of such collaboration and consultation. Instead, the Council has asserted only in passing that it consulted with the "staff of the SEC."[56] We think that Section 120 calls for a much closer working relationship with the primary federal regulator than the Council evidences. Full consultation with the SEC is fundamentally important in a case such as this one, in which the primary regulator has a long history of considering industry regulation and possible reforms.

V. Other Council Alternatives to Section 120

Although the Council states it may pursue the regulation of MMFs using authorities other than Section 120 of the Dodd-Frank Act, including, for example, designation as a systemically significant nonbank financial institution,[57] we note that regulators have stated that these regulatory methods would be less cost-effective than the regulatory tools available to the SEC.[58] For these and other reasons, the Roundtable continues to believe that the Council should accommodate the SEC's deliberative process and allow that agency to continue its work on the appropriate regulation of MMFs. The SEC is most familiar with the product and the industry and has the most effective regulatory tools available to address any reforms that may be warranted.

* * *

[55] Dodd-Frank Act Section 120(b)(1).

[56] *See* 77 Fed. Reg. at 69,457.

[57] 77 Fed. Reg. at 69,460.

[58] *See, e.g.*, Governor Daniel K. Tarullo, Financial Stability Regulation, At the Distinguished Jurist Lecture, University of Pennsylvania Law School, Philadelphia, Pennsylvania (Oct. 10, 2012), available at http://www.federalreserve.gov/newsevents/speech/tarullo20121010a.htm ("The protective tools available to the rest of us do not fit the problem precisely and thus will not regulate at the least cost to the funds while still mitigating financial risk.")

The Roundtable and its members appreciate the opportunity to submit comments to the Council relating to the Proposed Recommendations. If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org or Rich Foster at Richard.Foster@fsround.org.

Sincerely yours,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel

With a copy to:

The Honorable Timothy F. Geithner
Secretary of the Treasury, Chairman of the Financial Stability Oversight Council

The Honorable Ben Bernanke
Chairman, Board of Governors of the Federal Reserve System

The Honorable Martin J. Gruenberg
Chairman, Federal Deposit Insurance Corporation

The Honorable Elisse B. Walter
Chairman, Securities and Exchange Commission

The Honorable Gary Gensler
Chairman, Commodity Futures Trading Commission

The Honorable Richard Cordray
Director, Consumer Financial Protection Bureau

Mr. Edward J. DeMarco
Acting Director, Federal Housing Finance Agency

The Honorable Deborah Matz
Chairman, National Credit Union Administration

The Honorable Thomas J. Curry
Comptroller of the Currency

Mr. Roy Woodall
Independent Member, Financial Stability Oversight Council

The Honorable Luis A. Aguilar
Commissioner, Securities and Exchange Commission

The Honorable Daniel M. Gallagher
Commissioner, Securities and Exchange Commission

The Honorable Troy A. Paredes
Commissioner, Securities and Exchange Commission

Mary J. Miller
Under Secretary for Domestic Finance, Department of the Treasury

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