CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

DAVID T. HIRSCHMANN
PRESIDENT AND CHIEF EXECUTIVE OFFICER

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5609 | (202) 463-3129 FAX

March 28, 2013

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

Re: Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, Division of Risk, Strategy, and Financial Innovation staff report, November 30, 2012

Dear Ms. Murphy:

The U.S. Chamber of Commerce is the world's largest business federation representing more than three million businesses and organizations of every size, sector and region. The Chamber supports a modern and effective regulatory system for capital markets that promotes economic growth and job creation. We appreciate the opportunity to provide comment to the Securities and Exchange Commission ("SEC" or "Commission") on its staff report regarding money market mutual fund reform on November 30, 2013 entitled "*Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher*" ("the Report")[1].

Money market mutual funds ("MMMFs") play a critical role in the U.S. economy because they provide investors, businesses, and state and municipal governments with the flexibility needed to deploy efficient cash management strategies and meet short-term funding obligations that support their everyday operations. As part of a company's sound financial management, these funds provide the benefits of stability, liquidity and return. MMMFs also own nearly 40% of commercial paper outstanding today, serving as a vital source of financing for business to meet working capital needs. Any structural changes or restrictions placed

[1] Division of Risk, Strategy, & Financial Innovation, U.S. Securities and Exchange Commission, Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher (2012).

on MMMFs could decrease funds' demand for commercial paper, thus increasing the cost of issuance and hampering growth and job creation.

Because of the importance of MMMFs as a cash management tool and as a provider of short-term financing for American companies, we believe that there must be a thorough analysis of the perceived problem the Commission is seeking to solve as a necessary first step before adopting additional modifications to a Rule that was just substantially amended three years ago. We recognize that the Report is intended to respond only to specific questions that the Commissioners posed, and is not a comprehensive review of all issues involved in the debate on MMMF reform. Nevertheless, a comprehensive review is necessary to well-informed rulemaking. Accordingly, the Chamber strongly encourages the Commission to seek out and consider additional information and analysis before proceeding with a rulemaking. To assist with this process, we have provided our analysis of the Report, identifying shortcomings and factors for consideration, as well as additional information on the non-financial commercial paper market.

<u>**Analysis of Report**</u>

I. The Report supports the view that the Reserve Fund's failure was not the cause of increased prime MMMF redemption activity during the 2008 financial crisis.

"*It is difficult, if not impossible, to attribute the redemptions to any single explanation.*"[2]

The Staff correctly note that the redemptions that occurred during mid-September of 2008 were the result of myriad events. The Staff's characterization of the events of the 2008 financial crisis highlighted the following factors:

- Institutional investors began selling prime MMMFs on September 12.
- Massive redemptions started on September 15, before the Reserve Fund announced it had broken the buck at the close of business on September 16.

[2] *Id.* at 4.

- Redemptions began to slow on September 18, before two government guarantee programs were announced on September 19.[3] At the same time, investors began buying Treasury and government MMMFs.[4]

The Staff specifically found that the shift from prime MMMFs toward Treasury and government MMMFs during the 2008 financial crisis was not caused by any single event such as the Reserve Fund breaking the buck.[5] Rather, the Staff found that the redemption activity may be explained by many different factors, including:

- A flight to quality that redirected assets from riskier funds to safer funds;

- A flight to liquidity that manifested itself once investors began reacting to the effect of market turmoil on asset values;

- A flight to transparency because Treasury MMMFs are restricted from holding more than 20 percent of their portfolios in securities of issuers other than the US government and are thus effectively more transparent than prime funds; and

- A flight to better-performing MMMFs.[6]

The Staff referred to academic literature supporting the existence of a flight to quality, citing Russ Wermers[7] (investors redirected from riskier prime MMMFs to safer government MMMFs) and Patrick McCabe[8] (redemption activity was higher for riskier funds).[9]

Significantly, the Report does not take into account the impact of prior government actions in 2008 on redemption activity. The decision to allow Lehman to

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[3] *See id.* at 7, 13 fig.5.
[4] *Id.* at 7.
[5] *Id.* at 5.
[6] *Id.* at 7-9. The Report also sets forth an explanation related to investors' incentive to redeem first given MMMFs' stable NAV. *Id.* at 9-10. See *infra* Section V for a discussion of this explanation.
[7] Russ Wermers, Runs on Money Market Mutual Funds (2012).
[8] Patrick McCabe, Board of Governors of the Federal Reserve System, Finance and Economics Series 2010-51, The Cross Section of Money Market Fund Risks and Financial Crises (2010).
[9] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 8.

fail, after previously orchestrating the rescue of firms like Bear Stearns, shocked the financial markets and certainly contributed to the redemption activity that occurred in MMMFs. This is important as the actions seen in 2008 are unlikely to be repeated, and in many instances would be prohibited by laws passed since 2010.

II. The Report supports the view that the failure of a single MMMF likely would not cause systemic problems.

In the absence of a financial crisis, "idiosyncratic portfolio losses" to an individual MMMF likely would not cause industry-wide redemptions or systemic problems.[10]

MMMF redemption activity in 2008 reflected a shift in investment from prime MMMFs to Treasury and government MMMFs with the same structural features. The Staff cited data showing that, during the so-called "Crisis Month" (September 2 to October 7, 2008):

- Many individual prime MMMFs experienced weekly net purchases that exceeded five and ten percent of their assets (five and ten percent have historically generally represented the 95th percentile of weekly net fund flows).[11]

- Many individual prime MMMFs gained assets even as prime MMMFs collectively lost assets. Overall, prime MMMF assets increased over the 28-month period beginning January 2007 from $1,526 billion to $1,888 billion.[12]

- Treasury and government MMMFs' assets increased by 44 percent as prime MMMFs' assets decreased by 24 percent.[13]

The Staff analyzed eleven "non-systemic" events from 1989 to 2011 during which sponsors to 158 MMMFs chose to provide support to their funds or to seek

[10] *See id.* at Executive Summary, 15.
[11] *Id.* at 5 fig.1, 7.
[12] *Id.* at 7.
[13] *Id.*

SEC staff no-action assurances permitting support[14] and found that none of these events "trigger[ed] industry-wide redemptions"[15] and they "did not appear to cause systemic problems."[16] The Staff mentioned, as a caveat to its conclusion, that the 158 MMMFs may not have broken the buck even without sponsor support.[17] The Staff did not mention that the Community Bankers US Government Fund actually broke the buck in 1994, paying its investors 96 cents per share[18] (though the fund was small and closely held by a small group of banks[19]), causing no systemic consequences.

III. The Report supports the view that the 2010 amendments to Rule 2a-7 produced substantial benefits.

The 2010 amendments to Rule 2a-7 reduced the maximum weighted average maturity of assets and required that at least thirty percent of assets be held in weekly liquid assets—thereby increasing the resiliency of MMMFs to interest rate shocks, security defaults, and investor redemptions.[20]

First, the Staff noted that the range of MMMFs' shadow NAVs has compressed, such that between 1994 and 2012, the minimum reported shadow NAV "used to be as low as $0.995, but now it is always above $0.9970" and the maximum reported shadow NAV "used to be often above $1.003, but now it is generally below $1.003."[21]

Second, the Staff presented economic analysis showing that the mandatory reduction in the maximum allowed weighted average maturity (WAM) of MMMF assets from ninety days to sixty days significantly reduced price volatility as a result of interest rate changes and security defaults.[22] Although the models did not account for investor redemption activity and did not use historical data, the Staff noted that using historical data would result in even lower failure rates because the actual average

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[14] *Id.* at 16 tbl.1.
[15] *Id.* at Executive Summary.
[16] *Id.* at 15.
[17] *See id.* at 16-17.
[18] Vanucci & Andrew, Securities Act Release No. 7625, Investment Company Act Release No. 23638, Investment Advisers Act Release No. 1782 (Jan. 11, 1999).
[19] Wermers, *supra* note 7, at 2 n.2.
[20] *See* Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 30 tbl.2, 38 tbl.5.
[21] *Id.* at 28.
[22] *See id.* at 29-30, 30 tbl.2.

WAM reported by MMMFs is generally a little more than half the maximum allowable WAM.[23] The Staff provided tables showing that, under certain assumed circumstances, as a result of the maximum WAM reductions in the 2010 amendments:

- A prime MMMF is 7.79 times less likely to break the buck in the face of interest rate changes.

- A prime MMMF is 5.11 times less likely to break the buck in the face of interest rate changes *and* security defaults.[24]

Third, the Staff presented economic analysis showing that the requirement that MMMFs hold at least thirty percent of their total assets in weekly liquid assets (WLAs), included in the 2010 amendments, makes MMMFs "more resilient to both portfolio losses and investor redemptions."[25] For example, the Staff pointed out that the 67% probability of a fund breaking the buck due to a 0.5% loss to non-WLA assets with 10% investor redemptions prior to the 2010 amendments falls to just 7% under the new WLA requirement.

The Staff did not opine on the efficacy of the revised wind-down mechanism because the mechanism has not yet been used by any MMMF.[26] However, the amended Rule 2a-7 now allows a fund's board of directors to suspend redemptions without requesting an order from the SEC, enabling an orderly liquidation, and MMMF affiliates now have the ability to purchase distressed assets from funds without the need for approval from the SEC.[27] The effect of these changes may be to curb fire sales and the resultant price depression of securities as well as the risk that a MMMF might break the buck.

The 2010 amendments also require MMMFs to file monthly disclosures on Form N-MFP that include a fund's market value NAV and its portfolio holdings, which the SEC makes public with a 60-day lag. The Staff did not offer any conclusions regarding the effect of these enhanced transparency requirements, citing a

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[23] *See id.* at 30.
[24] *See id.*
[25] *Id.* at 37, 38 tbl.5.
[26] *Id.* at 31.
[27] *See* 17 C.F.R. § 270.2a-7 (2012).

lack of available data.[28] However, the Staff elsewhere acknowledged that "increased transparency, even if reported on a delayed basis, might dampen a fund manager's willingness to hold securities whose ratings are at odds with the underlying risk, especially at times when credit conditions are deteriorating."[29] Earlier this year, at least seven large MMMF sponsors began to disclose daily market value NAVs.

IV. The Report demonstrates that further regulatory changes are likely to decrease investor demand for MMMFs, reduce yields to shareholders, and concentrate risk.

Further regulatory changes to Rule 2a-7 may result in fewer options available to investors and reduced yields.[30]

The Commissioners' questions that the Report attempts to address correctly assume reduced demand for MMMFs as a result of regulatory restructuring ("if . . . investors were then to shun such funds . . ."[31]). This is a conclusion supported by various surveys:

- According to ICI, nearly 80 percent of corporate treasurers and other institutional investors would decrease or discontinue their use of MMMFs with a floating NAV and approximately half of retail investors would use the product less as well.[32]

- As cited by the Report, the 2012 AFP Liquidity Survey revealed that only 21 percent of respondents find enhanced cash funds to be a permissible investment under their short-term investment policies, whereas 44 percent stated that prime MMMFs are permissible and 56 percent stated that Treasury MMMFs are permissible.[33]

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[28] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 31.
[29] *Id.* at 38.
[30] *See id.* at 43-44.
[31] *Id.* at 38.
[32] Letter from Paul Schott Stevens, President & CEO, Inv. Co. Inst., to Amias Gerety, Deputy Assistant Sec., Fin. Stability Oversight Council 61 (Jan. 24, 2013) (noting that two-thirds of retail investors found floating NAV unfavorable, and of those, 72 percent would use the product less).
[33] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 44 n.83.

The Report contains an extensive catalogue of possible investment alternatives and the principal features of each; however, the Staff acknowledged that "none are perfect substitutes for money market funds."[34] The possible alternatives include, for example:

- Bank deposit accounts;
- Bank collective trust funds;
- Local government investment pools;
- Offshore funds;
- Private funds;
- Separately managed accounts;
- Ultra-short bond funds;
- Short-duration exchange-traded funds; and
- Direct investments in MMMF instruments.

The Staff noted that MMMF investors would have to "analyze the various tradeoffs associated with a shift to one of the available cash investment alternatives," and some of the alternatives are simply "unavailable to most current money market fund investors,"[35] such as local government investment pools, short-term investment funds, offshore MMMFs, separately managed accounts, and direct investments in MMMF instruments. Of the alternatives that are widely available, the Staff found that many of them "may create additional operational costs or complexities, and they may impose redemption restrictions or other limitations on liquidity."[36] The Staff did not quantify or detail any costs. As a broad example, the Staff pointed out that investors who value principal stability may consider Treasury MMMFs or bank deposits, but

[34] *Id.* at 39.
[35] *Id.* at 44.
[36] *Id.* at 43.

they would "sacrifice yield," and if they consider bank certificates of deposit, they would "sacrifice liquidity." The Staff found that "most other alternatives would likely involve increased investment risk."[37]

A shift to bank deposits "would increase reliance on FDIC deposit insurance and increase the size of the banking sector, which raises additional concerns about the concentration of risk in the economy."[38]

The Staff acknowledged that some institutional investors are unlikely to shift assets to bank deposits due to the deposit insurance cap of $250,000,[39] but the Staff's concerns about the dangers of "the concentration of risk in the economy" due to an increase in the size of the banking sector are justified, as such a concentration could, in fact, increase systemic risk. A drop in prime MMMF assets would likely lead to an increase in bank deposits, and furthermore, banks have historically paid lower yields than MMMFs.[40]

V. The Report finds that stable NAV share pricing provides an incentive for investors to redeem first, but also acknowledges that the characteristics of MMMFs do not make them more susceptible than other mutual funds to investor losses.

"[I]nvestors have an incentive to sell shares if funds have embedded losses from non-performing assets."[41]

The Staff observed that a fund's stable NAV pricing structure concentrates losses in the hands of shareholders remaining after first-movers redeem their shares, thus providing an incentive for investors to redeem first.[42] The Staff expressed concern that more sophisticated institutional investors may redeem first, leaving retail investors to absorb losses.[43]

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[37] *Id.* at 44.
[38] *Id.* at 45.
[39] *Id.*
[40] *See* Letter from Michael Granito, Chief Risk Officer, Federated Investors, Inc., & Stephen Keen, Counsel, Reed Smith LLP, to Amias Gerety, Fin. Stability Oversight Council 14-15 (Jan. 30, 2013).
[41] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 9.
[42] *Id.* at 3-4.
[43] *Id.* at 10.

"The illiquidity problem is not unique to money market funds."[44]

However, the Staff also cited Qi Chen et al.,[45] providing empirical evidence that the sale of illiquid assets to meet shareholder redemption requests impairs future performance in *all* mutual funds, not just money market mutual funds.[46] The Staff also did not mention in this discussion that it had elsewhere concluded that the failure of a single MMMF, even with the existence of some first-mover advantage, likely would not cause systemic problems.[47]

The Staff did not raise the fact that MMMFs engage in the same activities and practices as other collective investment pools, some of which have a stable NAV. None of these collective investment pools have an explicit loss-absorption capacity aside from the absorption of losses by investors—who are aware of the risks of investing in securities. The Report provides no evidence that investors believe a stable NAV fund represents a riskless security. In fact, a Fidelity survey of retail investors showed that a "vast majority of retail money market mutual fund investors understand that these funds are not FDIC-insured and the prices of securities held by these funds fluctuate up and down daily."[48]

Equally significant is what is missing in the Report. Conspicuous in its absence is any evidence that would support the efficacy of the various proposals currently under consideration. Nothing in the Report indicates that a floating NAV or capital buffer would eliminate the first-mover advantage or otherwise reduce alleged systemic risk.

The Staff stated that, when insufficient liquidity levels at one MMMF force a fire sale of its securities, other MMMFs' holdings of the same securities may be affected by price depression and thus a decreased shadow NAV.[49] However, the Staff did not acknowledge that price depression could affect all financial instruments

[44] *Id.* at 10.
[45] Qi Chen et al., *Payoff Complementarities and Financial Fragility: Evidence from Mutual Fund Outflows*, 97 J. Fin. Econ. 239 (2010).
[46] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 10.
[47] *See supra* Section II.
[48] *See* Letter from Scott Goebel, Senior Vice President and General Counsel, FMR Co., to Elizabeth Murphy RE: File No. 4-619; Release No. IC-29497 *President's Working Group Report on Money Market Fund Reform*. (February 3, 2012). Available at: http://www.sec.gov/comments/4-619/4619-116.pdf.
[49] *See* Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at 4.

whether held by MMMFs or not, nor did it discuss the degree to which other non-cash assets held by MMMFs could be liquidated without price depression. The Staff also failed to mention that the 2010 amendments to Rule 2a-7 (see *supra* Section III) revised the wind-down mechanism for MMMFs, which may eliminate the need for fire sales.

VI. The Report concludes that the Reserve Fund would have failed even if the 2010 requirements had been in place in 2008; but several considerations moderate the significance of this finding.

"Since The Reserve Primary Fund lost 1.26 percent [of its asset value] during September 2008, it would have broken the buck even in the presence of the 2010 liquidity requirements."[50]

The Staff assumed the Reserve Fund would hold all of the same non-WLA securities under the current Rule 2a-7 as it held in 2008 (Lehman commercial paper had a first-tier rating at the time of its default).[51] This assumption fails to consider the possibility that the Reserve Fund portfolio may not have been as concentrated in defaulted Lehman paper under the current Rule 2a-7. The Staff also overlooked or underemphasized the following considerations:

- The government's inconsistent and opaque actions regarding the failure of major financial institutions may have distorted behavior and induced the Reserve Fund and other creditors to retain Lehman securities.

- The benefit of the revised wind-down mechanism that may eliminate the need for fire sales and help prevent MMMFs from breaking the buck.

- As the Staff acknowledged, the Reserve Fund may not have held the same securities if it had been required to report its holdings through monthly Form N-MFP disclosures because investors may have recognized the underlying risk contained in such holdings[52]—and in 2008, such holdings would have been disclosed only quarterly.

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[50] *Id.* at 37 (citation omitted).
[51] *Id.* at 38.
[52] *See id.*

The Staff did not explicitly consider as part of this analysis its own findings noted elsewhere in the Report: that the Reserve Fund's failure was not a systemic event that caused heightened prime MMMF redemption activity in 2008. Rather these redemptions were a result of multiple events and repeated shocks to the financial system. As the Staff itself concluded, idiosyncratic portfolio losses of the kind experienced by the Reserve Fund likely would not on its own cause systemic problems.

"Unlike in 2008, funds in 2011 had sufficient liquidity to satisfy investors' redemption requests," and this is due in no small part to the new liquidity requirements contained in the amended Rule 2a-7.[53]

While acknowledging that the new 2010 liquidity requirements contributed to MMMFs' sound performance in 2011, the Staff also noted a second reason: redemption activity was lighter in 2011 than in 2008.[54] However, this lighter redemption activity very well may have been due to the efficacy of the 2010 amendments. The Report concludes that redemptions were concentrated in funds that had exposure to Eurozone banks through unsecured lending but that no investors were harmed in 2011.

VII. The Report concludes that regulatory changes that reduce investor demand for MMMFs would not harm short-term funding markets; however, the Report's analysis does not account for the risk of significant increases in borrowing costs.

"[S]hifts in investor capital to alternative investment instruments are likely to increase demand for these same assets reducing the net effect on the short-term funding market."[55]

The Report does not contain an in-depth analysis of the potential costs and risks that additional MMMF regulation for commercial paper issuers, municipalities, and the short-term markets generally. First, the Staff simply offers an unsupported conclusion that short-term funding markets would not be affected much because

[53] *Id.* at 34.
[54] *Id.* at 33-34.
[55] *Id.* at 48.

investor demand for short-term debt in which MMMFs currently invest would increase if MMMFs are no longer viable.[56] The Staff assumed that the demand for such instruments would not be impeded because investors will either manage their own cash or invest in alternative investment vehicles.[57] This conclusion is offered despite that fact elsewhere in the report the Staff acknowledged the sometimes prohibitive costs associated with shifts to such alternative products,[58] as well as the lack of a perfect substitute for MMMFs.[59] The Staff's assertion that MMMF investors will simply invest directly in the short-term debt markets is unfounded. The Staff did not address the huge transaction costs that investors would face if they tried, on their own, to spread money across hundreds of commercial paper issuances to replicate the diversification offered by MMMFs. Nor did the Staff acknowledge that many, if not most, MMMF investors—even large corporations—do not have the requisite credit analysis and trading expertise in-house to undertake this money management function. The Staff stated only that the effect on the short-term funding markets, and any associated costs, would depend on investor preferences.[60]

The second major shortcoming of this section of the Report is the analysis on the impact of the proposed changes on issuers of short-term debt. Throughout their analysis in this regard, the Staff attempted to support its findings (*i.e.*, that MMMF reform will not significantly impact corporate and municipal issuers) by citing statistics regarding the size of commercial paper issuance (or municipal equivalents) relative to overall business debt outstanding. Underlying all of this seems to be an assumption that credit can be used interchangeably, which ignores the costs associated with using longer-term debt to replace short-term debt. As discussed further below, the tortured use of statistics is particularly egregious in the discussion regarding non-financial commercial paper. The Staff's conclusions fail to demonstrate that such borrowers would not be affected by increased costs, and are inconsistent with other, more relevant findings that the Staff made in the Report:

- Non-financial commercial paper issuers largely would be "unaffected"[61] because commercial paper financing is only one percent of their overall

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56 *Id.*
57 *Id.* at 46-47.
58 *See id.* at 38-46.
59 *Id.* at 39.
60 *See id.* at 46-47.
61 *Id.* at Executive Summary.

credit market instruments[62]—but, of more relevance to this discussion, the Staff conceded that such issuers receive 58 percent of their commercial paper funding from MMMFs.[63]

- Financial commercial paper issuers would be "by their very nature . . . well suited to identify alternate mechanisms for short-term funding," and their use of commercial paper has declined by over 50 percent from 2008 to 2011[64]—but this is an excessively simplistic assumption that does not consider the tradeoff costs inherent in the use of alternative investment vehicles.

- The commercial paper market has been in a prolonged decline since 2006 independent of any further regulatory changes to MMMFs—but the Staff acknowledged that MMMFs are still an important source of short-term funding for financial institutions.[65]

- Municipalities have been able to increase borrowing from other types of mutual funds, depository institutions, and even life insurance companies, sometimes by lengthening the terms of their debt offers[66]—but the Staff did not discuss whether municipalities also had to pay higher rates, nor mention that banks cannot pass through tax-exempt income as can MMMFs, which uniquely affects municipalities.

Notwithstanding the Report's findings regarding limited availability of funding, it is clear that the ability of both non-financial and financial companies to issue attractively priced commercial paper would be diminished greatly by further MMMF regulation. Reduced funding from MMMFs translates into higher alternative borrowing costs for issuers—today's prime bank lending rate is 3.25 percent, compared with prime commercial paper rates of 9 to 23 basis points.[67]

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[62] *See id.* at 49.
[63] *See id.* at 48 tbl.7.
[64] *Id.* at 51.
[65] *Id.* at 50.
[66] *Id.* at 51.
[67] Letter from Michael Granito to Amias Gerety, *supra* note 40, at 16.

Non-Financial Commercial Paper

As referenced earlier, the Chamber takes issue with the Staff's conclusion that "non-financial commercial paper issuers will be largely unaffected by a decrease in demand because their commercial paper financing is only one percent of their overall credit market instruments."[68] This statement implies that all companies can operate a commercial paper program with minimal risk. However, there are many entities in the credit markets where commercial paper is not a fit (e.g., non-profits, municipalities, state governments and many retailers).

In order to maintain a commercial paper program, there are many hurdles and challenges that a company must overcome. First, a company must obtain a commercial paper credit rating. To obtain a commercial paper credit rating, the issuer must generally secure a credit line backstop through a bank syndicate, which can be costly for smaller companies. The commercial paper credit rating is a critical requirement to participate in a commercial paper program. Thus, in most cases, companies lack this rating due to cost or credit worthiness and do not maintain a commercial paper program, while generally, only the largest and most credit worthy companies do.

The Staff in footnote 90 explained that they took the total amount of non-financial commercial paper outstanding from Federal Reserve Flow of Funds data as of March 31, 2012, $127.6 billion, and compared it with $11,931.4 billion in what the staff labeled "total credit market instruments outstanding for these entities." This is an apples-to-oranges comparison. The $11.9 trillion figure includes financing for "***all entities***" rather than "***these entities***" (issuers of non-financial commercial paper). Rather, the $11.9 trillion total includes ***all*** non-financial businesses, not just commercial paper issuers.

These numbers are reported in the Federal Reserve Flow of Funds Table L2, Credit Market Debt Owed by Nonfinancial Sectors.[69] The Staff took the $127.6 billion in non-financial commercial paper on line 3 of the report for the first quarter of 2012, and compared it with the total $11,931.5 of total non-financial credit market

[68] Div. of Risk, Strategy, & Fin. Innovation, *supra* note 1, at Executive Summary.
[69] http://www.federalreserve.gov/releases/z1/20120607/z1.pdf, page 65.

debt outstanding on line 18.[70] This line includes all non-financial businesses, including unincorporated businesses, not just "***these entities***" that can issue commercial paper. Line 20 indicates that $3,783.9 of the $11,931.5 total comes from unincorporated businesses, which are not qualified to issue commercial paper.

There are only approximately 530 non-financial issuers of commercial paper in the United States.[71] Other businesses must raise funds in other and more expensive ways. The Staff thus incorrectly compared $127.6 billion in non-financial domestic commercial paper issued by only a limited number of companies with all of the credit market debt issued by literally millions of U.S. businesses. Consequently, non-financial commercial paper issuance looks small by that incorrect metric.

Another important factor to note is that commercial paper represents a primary source of short-term funding for many businesses. For example, CVS Caremark reported that as of December 31, 2011, 100% of its $750 million in short-term debt was from commercial paper.[72] Because of the many benefits of commercial paper, it is generally the preferred method of short-term funding for many businesses with the capability to maintain a commercial paper program. Such benefits include:

- ***Short notice requirement***. Funding through commercial paper programs can occur as fast as the same day if the notice is given early in the day. Such flexibility exists because of the nature of commercial paper programs, whereas using a LIBOR based draw down from a bank credit facility generally requires three days' notice unless the borrower is willing to pay a significantly higher interest rate and use a prime-based drawdown.

- ***Low cost of capital***. Immediate, same-day funding for an A2/P2 commercial paper issuer will cost approximately 31 bps for overnight maturity to 38 bps for a 30-day maturity[73]. Contrast this with drawing on a line of credit where companies would have to pay prime plus 1% (425 bps now).

[70] Note that the published version shows a total of $11,931.5, not the $11,931.4 as printed in the staff report. This is another example of the carelessness with which this particular section was addressed.
[71] Compiled from commercial paper data available on Bloomberg.
[72] CVS Caremark 2011 Annual Report, page 34.
[73] Based off 2013 annual average commercial paper rates as of March 20, 2013 available at http://www.federalreserve.gov/releases/cp/rates.htm.

- ***Flexible maturity dates***. The maturity on commercial paper can range anywhere from 1 to 270 days. This is much more flexible than a LIBOR – based draw down from a credit facility, as that often require a minimum maturity of 14 days.

If demand for commercial paper substantially declines, non-financial commercial paper issuers will have to use other, more expensive, alternatives:

a. ***Bank lines of credit***. CP issuers have backup lines of credit, but these are invariably far more expensive than borrowing directly from the CP markets. It is also likely that banks would charge even higher rates to borrowers if the borrowers did not have the alternative of the cheaper commercial paper market competition.

b. ***Public bond markets***. Some firms that may not be able to tap the CP markets may be able to tap public bond markets with longer-term debt. However, the debt would have much higher issuance costs and interest rates, and take much longer to issue. For example, Dominion Resources reports in its 2011 10-K that it has $1.8 billion in commercial paper outstanding with a yield of 0.47%. At that time, Dominion was also able to issue longer-term notes with maturities ranging from 2014 to 2041 with yields ranging from 1.8% to 4.9%. If Dominion had to pay 1.4% more on $1.8 billion in debt, it would cost Dominion $25.2 million more per year, <u>in interest costs alone</u>.

c. ***Private placements***. Similarly, companies could arrange for privately placed debt offerings. However, these are for longer term borrowings that are less flexible and have higher fees and interest rates.

d. ***Idle cash***. Without access to CP or other flexible forms of financing, firms will be forced to hold more idle cash as a precautionary buffer against cash shortfalls. As the firm raises this cash using long-term capital, the difference between the cost of long-term capital and the return on short-term cash represents a deadweight loss to the firm and, when considered in its aggregate, to the economy as a whole.

e. ***Stretching payables***. Companies facing short-term financial difficulties may delay payments to vendors and other creditors, forcing those costs upon the businesses in their supply chain.

f. ***Delaying investment***. Companies without access to sufficiently flexible funding may delay job-creating investments.

g. ***Selling assets***. Companies in need of short-term cash may feel induced to sell assets quickly in order to raise needed cash. It is likely that they would dump the most liquid financial assets they hold in order to raise cash. In times of financial turmoil, such fire sales may increase systemic risk.

In addition, in comparing non-financial commercial paper to the overall credit markets, it should be noted that there are limited bank products to cover daily short-term liquidity. Almost exclusively, these are commercial bank lines of credit. As noted above, utilizing bank lines is significantly more expensive that commercial paper. The other instruments available such as direct notes take time for negotiation of terms plus documentation and coordination with the legal department. Using longer term debt instruments to meet short-term liquidity needs will negatively impact credit ratings.

Finally, it should be noted that the larger companies with a commercial paper program may use the program in different ways. For example, the short-term funding can be used to purchase seasonal inventory swings, gap funding during maturing bond periods, cover receivables float, and bridge financing. Many of these practices may not be reflected in the short-term borrowing outstanding on a company's 10-Q or 10-K as the commercial paper maturities were paid off during the quarter or year.

Summary

We commend the SEC staff for taking the necessary step in examining the impact of the 2010 reforms and addressing the Commissioners' questions before moving forward with additional changes to MMMF regulation. Nevertheless, by its own terms, this analysis was limited to certain questions, and more analytical work remains to be done.

An examination of the costs and benefits of proposed rule changes to money market funds must carefully take into account the importance of MMMFs in providing a market for commercial paper and other short-term debt instruments issued by companies and government entities. Further analysis of the impact of changes in the MMMF industry is warranted, particularly given the assertion that a reduction in funding of over $127 billion for business would "largely unaffect" those businesses.

As we have stated in previous comment letters, we believe that many of the discussed changes to the MMMF industry will have a deleterious effect on the U.S. economy with no countervailing benefit. Instituting a floating NAV would make these funds unattractive to many investors, and thus reduce their ability to provide funding to businesses and state and local governments. Similarly, other proposals that would impose unnecessary costs on the industry (such as capital buffers) will also significantly reduce the economic incentive to sponsor MMMFs. This will result in more expensive funding for businesses and governments, and thus less investment and fewer jobs. It is important for all of these impacts to be carefully estimated in assessing the costs of any proposals.

A careful analysis of any proposed changes must also look at the benefits of proposed changes. As the 2010 reforms already significantly reduced the probability of breaking the buck, any further changes are likely to provide little benefit but at great cost to consumers, workers, investors, governments, and businesses.

Sincerely,

David Hirschmann

David Hirschmann

cc: Elisse Walter, U.S. Securities and Exchange Commission
Luis Aguilar, U.S. Securities and Exchange Commission
Dan Gallagher, U.S. Securities and Exchange Commission
Troy Paredes, U.S. Securities and Exchange Commission
Norman Champ, U.S. Securities and Exchange Commission
Craig Lewis, U.S. Securities and Exchange Commission