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September 17, 2013

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Money Market Fund Reform; Amendments to Form PF; File No. S7-03-13

Dear Ms. Murphy:

The Independent Directors Council¹ appreciates the opportunity to comment on the Commission's proposed money market fund regulatory reforms.² Mutual fund independent directors—whose primary responsibility is to protect the interests of fund shareholders, including money market fund shareholders—have a great interest in the proposals, as they would significantly affect the role and responsibilities of fund directors and, importantly, the interests of money market fund shareholders.

IDC has long supported the Commission's efforts to continue to enhance the resiliency of money market funds to severe market stresses while preserving their essential benefits for shareholders.³

¹ IDC serves the fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute (ICI) member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of \$15.4 trillion and serve over 90 million shareholders, and there are approximately 1,900 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

² See *Money Market Fund Reform; Amendments to Form PF*, SEC Release No. IC-30551 (June 5, 2013), 78 FR 36834 (June 19, 2013), available at <http://www.sec.gov/rules/proposed/2013/33-9408.pdf> ("Release").

³ See Letter from IDC to Financial Stability Oversight Council, regarding Proposed Recommendations Regarding Money Market Mutual Fund Reform (FSOC-2012-0003) (January 23, 2013) ("IDC FSOC Letter"), available at: http://www.idc.org/pdf/13_idc_fsoc_mmf.pdf; Letter from IDC to SEC regarding President's Working Group Report on Money Market Fund Reform (File No. 4-619) (January 10, 2011) ("IDC PWG Report Letter"), available at

We also have strongly supported the Commission as being the primary regulator of money market funds. The Commission has the institutional expertise and statutory authority to regulate money market funds. In addition, and importantly from the fund directors' perspective, investor protection is one of its primary missions.

The Commission's proposal comes just three years after its adoption of far-reaching rule amendments that substantially enhanced the resiliency of money market funds and that IDC supported.⁴ The new liquidity, credit quality, and maturity standards and required stress testing under those 2010 Reforms have made money market funds much more resilient to market stresses than they had been during the 2008 market events. Money market funds also are far more transparent today, as they are now required to report their portfolio holdings and per-share mark-to-market value on a monthly basis, and many do so more frequently on a voluntary basis.

In addition, the 2010 Reforms gave fund directors critically important new authority to make determinations to facilitate an orderly liquidation of a fund that is at imminent risk of "breaking the buck." This new tool—which was not available in 2008—is intended to reduce the vulnerability of investors to the harmful effects of a run on the fund and minimize the potential for disruption to the securities markets. The authority helps fund directors to ensure equitable treatment for all of the fund's shareholders.

The Commission has indicated that it views the 2010 Reforms as only an initial step, and now proposes additional, substantial reforms. We are not convinced that additional reform is necessary, however. The efficacy of the 2010 Reforms was tested, and the reforms were proven to be successful, in 2011, when challenges such as Europe's sovereign debt crisis and the U.S. debt-ceiling impasse resulted in significant outflows.⁵

The Commission proposes two alternative approaches for reform—a floating net asset value (NAV) option and a liquidity fees and gates option. The Commission states that it could adopt either alternative by itself or a combination of the two alternatives. The Commission also proposes enhanced disclosures and stress testing requirements.

http://www.idc.org/pdf/11_sec_pwg_com_idc.pdf; and Letter from IDC to SEC regarding Money Market Fund Reform (File No. S7-11-09) (September 8, 2009) ("IDC 2009 Letter"), available at <http://www.idc.org/pdf/23771.pdf>.

⁴ See *Money Market Fund Reform*, SEC Release No. IC-29132 (February 23, 2010), 75 FR 10060 (March 4, 2010) ("2010 Reforms"); IDC 2009 Letter, *supra* n. 3.

⁵ See IDC FSOC Letter, *supra* n. 3; see also Comment Letter of ICI on FSOC's Proposed Recommendations regarding Money Market Mutual Fund Reform (Docket No. FSOC-2012-0003) (January 24, 2013), available at http://www.ici.org/pdf/13_fsoc_mmf_recs.pdf.

Both of the proposed alternatives would impose significant costs and burdens on funds and their shareholders. For example, both options would require fund transfer agents and intermediaries to undertake complex and costly system modifications to handle the proposed changes, costs that ultimately would be borne by shareholders. Both options also raise significant and complex tax issues that would need to be resolved.⁶ In addition, both options would present significant compliance challenges inasmuch as funds and their boards would have to rely heavily on intermediaries to implement them.

Of the two alternatives, the liquidity fees and gates alternative may be the better option because it addresses the Commission's core concern—*i.e.*, heavy redemption pressures on money market funds during times of fund and market stress—while preserving the essential characteristics of money market funds during normal market conditions. In contrast, the floating NAV option is unlikely to prevent investors from redeeming fund shares in times of fund and market stress.

A combination of the two alternatives would be disastrous for the money market fund industry and its shareholders and unnecessary to address the Commission's concerns. IDC opposes this drastic approach.

While we do not believe that the Commission has presented a compelling case for additional reform, particularly in light of the concomitant costs and burdens, we commend the Commission for putting forth a thoughtful proposal that includes a robust discussion of the advantages and disadvantages of the options being considered. Our comments focus primarily on those aspects of the proposals that concern the role of fund directors and the potential impact of the proposals on fund shareholders.

1. Proposed Reforms

The Commission proposes two alternative approaches to address what it describes as money market funds' susceptibility to heavy redemptions. The proposals also are intended to improve money market funds' ability to manage and mitigate potential contagion from such redemptions and increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds.

The first alternative would require money market funds (other than government and retail funds) to float their NAV. Money market funds would sell and redeem shares based on the current market-based value of the securities in their underlying portfolios, rounded to the fourth decimal place (*e.g.*, \$1.000). The Commission proposes to define a retail money market fund as a money market fund

⁶ These issues are addressed more fully in Letter from ICI to the SEC regarding Money Market Fund Reform; Amendments to Form PF (File No. S7-03-13) (September 17, 2013) ("ICI Letter").

that restricts a shareholder of record from redeeming more than \$1,000,000 in any one business day.

The second alternative permits money market funds to impose liquidity fees or temporarily suspend redemptions in certain circumstances. Under this option, if a money market fund's level of "weekly liquid assets" were to fall below 15 percent of total assets, the money market fund would automatically impose a liquidity fee after the close of business in connection with redemptions received for processing the next business day. The nonrefundable liquidity fee, which would be equal to 2 percent of redemption proceeds, would be paid by redeeming shareholders to the fund. A 2 percent liquidity fee would not be imposed, however, if the fund's board, including a majority of independent directors, determines that the fee is not in the best interest of the fund or that a lesser liquidity fee is in the best interest of the fund.

Once a money market fund's weekly liquid assets fell below 15 percent of total assets, its board also would be permitted to temporarily suspend redemptions (*i.e.*, to "gate" the fund). A money market fund that suspends redemptions would need to restore the right to redeem within 30 days, although the board could determine to restore it earlier. Money market funds would not be able to suspend redemptions for more than 30 days in any 90-day period.

a. Floating NAV

We have previously expressed our opposition to a floating NAV,⁷ and our position remains unchanged. As has been stated before—and as the Commission also acknowledges in its release⁸—a floating NAV is unlikely to prevent investors from redeeming fund shares in times of market stress. Moreover, this option would impose extremely high burdens and costs on funds, their shareholders, and the capital markets.⁹

Thus, we question pursuing this option, which does not directly address the primary concerns of the Commission and whose impact on investors and the capital markets would be so burdensome. Similarly, while the Commission states that the floating NAV proposal is designed to increase the transparency of money market fund risk, there are other, less burdensome ways to do so, such as

⁷ See IDC comment letters cited in n. 3; *see also* Letter from IDC and Mutual Fund Directors Forum regarding President's Working Group Report on Money Market Fund Reform (File No. 4-619) (May 2, 2012), attaching a joint statement, available at: <http://www.sec.gov/comments/4-619/4619-173.pdf>.

⁸ See Release, *supra* n. 2, at 56 ("We recognize that a floating NAV may not eliminate investors' incentives to redeem fund shares, particularly when financial markets are under stress and investors are engaging in flights to quality, liquidity, or transparency.").

⁹ See IDC's comment letters cited in n. 3; *see also* ICI Letter, *supra* n. 6.

monthly disclosure of funds' portfolio holdings and daily disclosure of funds' mark-to-market share prices, which we discuss and support below.

If the Commission nevertheless determines to require a floating NAV, IDC agrees that the requirement should be targeted and exclude "retail" money market funds and government funds. As the Commission observed, retail investors historically have behaved differently than institutional investors in a crisis and are less likely to make large redemptions quickly in response to market stress. In addition, the Commission correctly finds that government money market funds present a lower risk of mass investor redemptions than other money market funds. We believe that tax-exempt money market funds similarly present a lower risk of heavy redemptions, as was the case during the 2008 market events, and should also be excluded from any floating NAV requirement. The Commission has not demonstrated a basis for imposing the floating NAV requirement on these funds, and we believe that they should be treated the same as government money market funds under this proposal.¹⁰

Imposing the floating NAV requirement on prime institutional money market funds necessarily requires drawing a distinction between "institutional" and "retail" money market funds. We commend the Commission for seeking an objective basis for distinguishing these funds, rather than relying on fund boards to make this determination, as it had previously contemplated with respect to liquidity levels in the proposal for the 2010 Reforms.¹¹ As we previously stated, this would be an inappropriate function to impose on fund directors, who do not have the expertise to make such determinations.¹²

The Commission proposes that a retail money market fund be defined as one that does not permit any shareholder of record to redeem more than \$1 million per business day. While we support the Commission's effort to establish an objective basis for distinguishing institutional and retail funds, we understand that basing the distinction on redemption amounts would create significant operational burdens. Therefore, we urge the Commission to consider suggestions from commenters on other ways to draw the line between institutional and retail funds that may not create as many operational hurdles.

As the Commission acknowledges, stable NAV funds simplify tax compliance for money market fund shareholders, and a floating NAV requirement would impose significant burdens on funds and fund shareholders with respect to the tax and accounting treatment of gains and losses. It is critical

¹⁰ Because accounts invested in money market funds through tax-advantaged savings accounts (such as retirement plans and education savings plans) are similarly less reactive to market events, they should be treated the same as retail investments.

¹¹ See Money Market Fund Reform, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)].

¹² See IDC 2009 Letter, *supra* n. 3.

that appropriate action be taken to alleviate these burdens *before* any floating NAV requirement takes effect. Otherwise, these burdens could deter even those investors who might still consider investing in a floating NAV fund from doing so.

b. Liquidity Fees and Gates

The liquidity fees and gates alternative may be the better option because it would address the Commission's core concern regarding heavy redemption pressures on money market funds during times of fund and market stress without radically changing the fundamental characteristics of these funds for their shareholders.¹³ An important advantage of this alternative is that money market funds would operate as usual during normal market conditions, and the liquidity fees and gates requirement would be triggered only if the fund's weekly liquid assets fell below 15 percent of its total assets—an unusual and rare circumstance for a fund. Thus, as compared to the floating NAV alternative, money market fund shareholders would continue to enjoy the substantial benefits of these funds—daily liquidity, stability of principal value, and market-based yields—except in the rare circumstance of significant fund and market stress. We recognize, however, that some investors may nevertheless be reluctant to invest in a fund that could limit access to their investments or affect their achievement of liquidity (*e.g.*, for cash management purposes) and decide to move their assets to government money market funds or other alternatives (including less-regulated cash management vehicles or banks).

In the remote circumstance of a fund imposing a liquidity fee or gate, the fee or gate would offer important shareholder protections. First, a liquidity fee should curtail the level of redemptions, protecting the interests of remaining shareholders. In addition, non-redeeming shareholders would be protected from the liquidation costs associated with any redemptions through the liquidity fee paid by redeeming shareholders. Moreover, shareholders in need of liquidity would still be able access their investments, although at a cost.

If the board were to determine that a liquidity fee is insufficient to protect the interests of non-redeeming shareholders, it could impose a gate, which would provide the fund with breathing room to determine whether and how to address its portfolio liquidity issues. Whether the fund were able to continue or to start an orderly liquidation, the temporary suspension of redemptions would protect shareholders from the effects of early redeemers.

In addition, the 15 percent liquidity trigger would likely lead portfolio managers to manage prime money market fund portfolios more conservatively so that they do not come close to breaching

¹³ We agree with the Commission's proposal to exempt government money market funds from any fee or gate requirement and to permit these funds to impose a fee or gate if they choose to do so. For the same reasons discussed above with respect to the floating NAV alternative, we believe tax-exempt money market funds also should be exempted from any fee or gate requirement.

the 15 percent threshold. Moreover, the proposed increased transparency into the current market-based NAVs and liquidity of money market funds could help investors determine more readily whether a sharp decline in a fund's liquid assets is idiosyncratic or not.

i. The Commission Should Make Clear that Fund Directors' Decisions are Protected under the Business Judgment Rule

The fees and gates alternative imposes important responsibilities on fund boards. Indeed, they may be viewed as extensions of the responsibilities and authorities fund boards have under current regulations. Funds currently may impose redemption fees of up to 2 percent, with board approval, to deter frequent trading.¹⁴ In addition, as previously noted, the 2010 Reforms permit money market fund boards to approve a fund's suspension of redemptions if a fund is at imminent risk of "breaking the buck," in order to facilitate an orderly liquidation.¹⁵ The gate option is an expansion of this authority, allowing boards to suspend redemptions—before a fund is at imminent risk of breaking a buck—when the weekly liquid assets fall below 15 percent.

This is not to say, however, that the decisions fund boards will be required to make will be easy. Indeed, the circumstances will likely be in times of significant market stress, and a fund board may be required to make several determinations—during a potentially chaotic time and relatively quickly—that significantly affect fund shareholders' access to their investments and, possibly, the fund's continued viability.

Fund boards make significant decisions on behalf of fund shareholders all of the time, and their decisions, like the ones they could be required to make under the fees and gates alternative, are protected under the business judgment rule. The business judgment rule presumes that, in making a business decision, directors acted in good faith and in an honest belief that the action taken was in the best interests of the fund.¹⁶ The rule protects a director from personal liability, even though a corporate action approved by the director turns out to be unwise or unsuccessful.¹⁷ In actions against directors, a court will look only to determine whether the directors were disinterested in the matter, appropriately informed themselves before making the decision, and acted in the good faith belief that the decision was in the best interests of the fund.¹⁸ In light of the critical nature of the decisions fund boards will be

¹⁴ Rule 22c-2(a)(1)(i) under the Investment Company Act of 1940 (1940 Act).

¹⁵ Rule 22e-3 under the 1940 Act.

¹⁶ See American Bar Association, Fund Director's Guidebook (3rd ed. 2006) at 99-100.

¹⁷ See *id.*

¹⁸ See *id.*

required to make in unusual and pressing circumstances, we urge the Commission to require a fund adviser to furnish to the fund board such information that it may reasonably be expected to have at that time and as may reasonably be necessary for the board to determine whether the fund should impose a liquidity fee or gate. In addition, the Commission should affirm that fund directors' decisions of whether to impose a fee or gate (and the amount of any liquidity fee) are protected by the business judgment rule—in both private actions and Commission enforcement actions. Absent such an affirmation by the Commission, we would be greatly concerned that boards would be placed in an untenable position and exposed to possible second-guessing.

The need for the Commission to affirmatively clarify the application of the business judgment rule in this circumstance is underscored by questions raised by Chairman White's statement at the open meeting. She stated that a fund board's determination to modify the default fee of 2 percent "would be subject to the board's fiduciary duty, and we believe it would be a high hurdle."¹⁹ Indeed, a fund board would carefully review the facts and circumstances when making the various determinations, including whether or not to impose a liquidity fee; the amount of any liquidity fee; and whether to temporarily suspend redemptions. Consistent with its fiduciary duty to the fund, a board might rationally decide not to impose a liquidity fee on shareholders based on those facts and circumstances of the fund. For example, as the Commission's release suggests, there may be circumstances when a few large shareholders unexpectedly redeem for idiosyncratic reasons, unrelated to current market conditions. In that case, a fund board may reasonably determine that the fund should not impose a liquidity fee or gate.

The Commission asks whether a fund board should be permitted to impose a liquidity fee or gate even before a fund passes the 15 percent liquidity trigger if the board determines that an early imposition of a liquidity fee or gate would be in the best interest of the fund. Assuming a fund board's decisions are protected by the business judgment rule, we recommend permitting the board to impose a liquidity fee or gate before the fund's weekly liquid assets fell below 15 percent, such as when the board determines that it is more likely than not that continued unfettered redemptions would cause the fund's weekly liquid assets to fall below 15 percent before the end of the following business day. When heavy redemptions are already underway or clearly foreseeable, the imposition of a liquidity fee or gate may protect the fund from further heavy redemptions. In this circumstance, the fund could communicate to investors and intermediaries shortly after the close of business that a fee or gate will be implemented the next business day.

¹⁹ See Chairman Mary Jo White, Opening Statement at SEC Open Meeting (June 5, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171575546#.Ugo-yqz8v6o>.

ii. IDC Supports Some, But Not All, Disclosure Enhancements

The Commission also proposes enhanced disclosures in connection with the fees and gates alternative. Under this alternative, a money market fund would be required to make prompt disclosure to the Commission, fund shareholders, and the public whenever its weekly liquid assets fall below 15 percent of its total assets and whenever it imposes liquidity fees or gates or removes them. This information would be required to be posted prominently on the fund's website and filed on the proposed new Form N-CR on the first business day after the triggering event. In addition, the fund would be required to disclose in an amendment to Form N-CR (filed by the fourth business day after the triggering event) a "[s]hort discussion of the board of directors' analysis supporting its decision" to impose or not impose a liquidity fee and, if the fund suspends redemptions, its decision to suspend redemptions.²⁰ The fund also would be required to provide a short discussion of the board's analysis supporting its decisions in its statement of additional information (SAI) regarding any occasion during the last 10 years (but not before the compliance period) on which the fund's weekly liquid assets fell below 15 percent.

IDC supports the prompt disclosure of the triggering events (*i.e.*, when the fund's weekly assets fall below 15 percent of total assets and the fund imposes a liquidity fee or gate) and the SAI disclosure of the board's decisions. We question, however, the requirement that funds disclose the board's analysis of its decisions in Form N-CR so soon after the triggering events when, as the Commission acknowledges, the board and relevant parties will likely be occupied with resolving the fund's liquidity pressures. Any public disclosure about a board's decision-making process would require careful and thoughtful drafting and multiple layers of review (by board counsel, fund counsel, and the directors, among others). Thus, we recommend that funds have at least two weeks by which to amend Form N-CR with this information.

c. Adoption of Both Alternatives would be Disastrous

The Commission states that it also is considering whether to combine the floating NAV and liquidity fees and gates alternative proposals into a single reform package; that is, requiring money market funds (other than government money market funds and, regarding the floating NAV, retail money market funds) to both use a floating NAV and potentially impose liquidity fees or gates in times of fund and market stress. We strongly oppose this approach.

If money market funds were required to both float the NAV and potentially impose a redemption fee or gate in certain circumstances, investors would certainly look to other cash management vehicles (such as less-regulated investment products or banks) not subject to these kinds of onerous restrictions. In addition, the combination would be unduly burdensome and costly.

²⁰ See Release, *supra* n. 2, at n. 719.

2. Enhanced Disclosure and Reporting

IDC has long supported disclosures that help fund shareholders better understand money market funds and their risks. The Commission proposes enhanced disclosure requirements on several fronts, and IDC generally supports the proposed requirements, with some exceptions. For one, the proposed disclosure requirements would be unnecessary for a floating NAV fund and require more detailed and frequent disclosures than other floating NAV funds. Thus, IDC would oppose the application of the enhanced disclosure and reporting requirements to floating NAV funds.

The Commission proposes requiring a money market fund to disclose current and historical instances of sponsor support; daily liquid assets, weekly liquid assets, and net inflows and outflows (on a daily basis); and mark-to-market share prices (on its website on a daily basis). IDC generally supports the enhanced disclosures for stable NAV funds, but we are concerned that the net flow information could be misunderstood as suggesting a fund is under stress when it is not.²¹ The Commission also is considering whether to require more frequent disclosure of money market funds' portfolio holdings on a fund's website, including the market value of individual portfolio securities. The Commission acknowledges that more frequent disclosure might lead to "front running" or "free riding." We agree, and do not believe that this enhanced disclosure is necessary, when money market funds already disclose their portfolio holdings on a monthly basis and other proposed disclosures, such as the daily mark-to-market share prices, offer enhanced transparency.

3. Stress Testing

The Commission proposes to significantly expand the stress tests conducted by money market funds and reported to fund boards. We are concerned that these changes may, unfortunately, hinder the utility of these tests, which have worked well since first required in 2010. Some of the proposed tests, such as testing when a hypothetical event may impact a fund's ability to maintain weekly liquid assets of 15 percent, may not be feasible. In addition, the proposal to require funds to combine stress events in testing is ambiguous and could result in the delivery of "data dumps" to fund boards, which could obscure the relevant and pertinent information. The need for an expansion of the stress testing requirements has not been demonstrated. We urge the Commission to instead allow fund advisers, working with fund boards, to continue to develop and tailor their stress tests to address the circumstances of their funds.

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²¹ See ICI Letter, *supra* n. 6, for a fuller discussion.

Ms. Elizabeth M. Murphy
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If you have any questions about our comments, please contact me at (202) 326-5824.

Sincerely,



Amy B.R. Lancellotta
Managing Director
Independent Directors Council

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

Norm Champ
Director
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