COMMITTEE ON CAPITAL MARKETS REGULATION

September 17, 2013

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

VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: Securities and Exchange Commission (the "**Commission**"), "Money Market Fund Reform; Amendments to Form PF; Proposed Rule" (File Number S7-03-13) (the "**Proposed Rule**")

Dear Ms. Murphy:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the Proposed Rule, which sets forth two alternative approaches to amending the regulations and related requirements governing money market mutual funds ("**money market funds**" or "**MMFs**") under the Investment Company Act of 1940[1] (the "**1940 Act**") and the Securities Act of 1933.[2]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-two leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

While we appreciate the Commission's continued efforts to reform the money market fund industry, including the 2010 risk-limiting amendments to Rule 2a-7,[3] we are nevertheless concerned as to whether the policy options set forth in the Proposed Rule—namely, the introduction of (i) a floating net asset value ("**NAV**") requirement for certain classes of money market funds and (ii) liquidity fees and redemption gates—are alone sufficient to protect financial markets against the systemic risk posed by these funds. We would thus encourage the Commission to explore additional solutions, among others, an expansion of the Federal Reserve's lender of last resort power as well as the introduction of a public deposit-like guarantee program. Furthermore, we ask the Commission to consider our comments in conjunction with our letter of February 15, 2013,[4] addressed to the Financial Stability Oversight Council (the "**FSOC**").

[1] Investment Company Act of 1940, 15 U.S.C. § 80a-1 (2012).
[2] Securities Act of 1933, 15 U.S.C. § 77a (2012).
[3] 17 C.F.R. 270.2a-7 (2010).
[4] Letter from Comm. on Capital Mkts. Reg. to Neil S. Wolin, Acting Chairman, Fin. Stability Oversight Council (Feb. 15, 2013), *available at* http://capmktsreg.org/wp-content/uploads/2013/02/FSOC.floating.NAV_.comment.ltr_.pdf.

Alternative Potential Solutions to the Systemic Risk of Money Market Funds

We do not believe that either of the Commission's proposals fully addresses the risk of a run on institutional prime money market funds or the risk of contagion generally. Further, experience suggests that the traditional lender of last resort power or public deposit-like guarantees have been successful in mitigating the risk of contagious runs, as was the case in the resolution of the recent financial crisis. As the Commission notes, the run on money market funds experienced in the wake of the Lehman shock in September 2008 was ultimately contained by both of these measures.

The first measure utilized during the financial crisis was the U.S. Department of the Treasury's temporary guarantee program, which deployed the $50 billion Exchange Stabilization Fund to guarantee the investments of investors in participating money market funds. The second measure was the extension of credit by the Board of Governors of the Federal Reserve System to banks via the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility to finance the purchase of asset-backed commercial paper from money market funds, thus supporting the funds indirectly with central bank assistance. The Federal Reserve also announced a Commercial Paper Funding Facility, which supported issuers of commercial paper but did not purchase paper directly from money market funds.[5]

We agree with the Commission that "these programs successfully slowed redemptions in prime money market funds and provided additional liquidity to money market funds" and that "the disruptions to the short-term markets . . . could have continued for a longer period of time but for these programs."[6] We believe financial contagion was at the heart of the matter, and therefore encourage the Commission, together with other regulators, to explore solutions including expanding the Federal Reserve's lender of last resort power or developing a deposit-like guarantee program, both of which were effective when implemented during the crisis

Analysis of the Proposed Rule

The Proposed Rule sets forth two primary alternatives to amending Rule 2a-7[7] under the 1940 Act, either of which the Commission may adopt independently or in combination.[8]

Alternative #1: Floating NAV

Under the Commission's first alternative, prime institutional money market funds would no longer be eligible for two exemptions provided in Rule 2a-7 that currently allow funds to maintain a stable NAV, *i.e.*, to "sell and redeem [money market fund] shares at a stable share price without regard to small variations in the value of the securities that comprise its portfolio."[9] The first of these exemptions—amortized cost valuation—permits a fund to value its portfolio at

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[5] Money Market Fund Reform, 74 Fed. Reg. 32,688, 32,692 (proposed July 8, 2009) (File No. S7–11–09; RIN 3235 AK 33).
[6] Money Market Fund Reform; Amendments to Form PF; Proposed Rule, 78 Fed. Reg. 36,834, 36,844 (June 19, 2013).
[7] 17 C.F.R. 270.2a-7 (2010).
[8] In addition to the two alternatives outlined below, the Proposed Rule also includes amendments pertaining to portfolio diversification, stress testing, and information disclosure. *See* Proposed Rule, *supra* note 6, at 37,000; *id.* at 36,697; *id.* at 36,874.
[9] *Id*. at 36,835.

cost, plus or minus adjustments for amortization of premium or accumulation of discount.[10] The second—"penny-rounding"—is a method of pricing fund shares that allows NAV to be rounded to the nearest one percent (or one penny for funds targeting a $1.00 share price).[11]

The Commission's first alternative proposal would require prime institutional money market funds to "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.*, $1.0000),"[12] or in other words, adopt a "floating" NAV, with daily share prices generally tracking the mark-to-market value of portfolio assets. By contrast, under current Rule 2a-7, funds are required to calculate the market value of their portfolios on a regular basis and to compare this "shadow" NAV to their stable NAV share price. Under current law, "if the deviation between these two values exceeds ½ of 1 percent (50 basis points), the fund's board of directors must consider what action, if any, should be initiated by the board, including whether to re-price the fund's securities above or below the fund's $1.00 share price (an event colloquially known as 'breaking the buck')."[13] If adopted, the Proposed Rule's floating NAV alternative would obviate the need for "breaking the buck" announcements, as the NAV would at all times reflect the value of the fund's underlying assets.

Efficacy in Preventing Runs

Critics of floating NAV point out that even under a floating NAV system—where the price of fund shares theoretically reflects the market value of the fund's underlying assets—an investor fearing further price declines would still have an incentive to exit his investment. A recent study of European floating NAV funds provides empirical support for this contention: during the 2008 crisis, investors in European accumulating NAV and fixed NAV funds were equally likely to run.[14] Further, according to the Investment Company Institute, "French floating NAV dynamic money funds . . . lost about 40 percent of their assets over a three-month time span from July 2007 to September 2007."[15] Indeed, it is even plausible that imposition of a floating NAV system would *increase* the likelihood of run behavior, as the constant marking to market required under such a system could exacerbate the incidence of fire sales.[16] The Commission acknowledges in its Proposed Rule that a floating NAV "may not deter heavy redemptions from certain types of money market funds (*e.g.*, prime money market funds) in times of stress if shareholders engage in a flight to quality, liquidity or transparency."[17]

On the other hand, the fact that investors will still have an incentive to redeem if they believe the value of their investment will decline further should not come as a surprise—rather, this dynamic is true of any asset class. Supporters of the floating NAV suggest that the proposal provides a more predictable mechanism for markets to find a new equilibrium when the value of a

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[10] 17 C.F.R. 270.2a-7(a)(2) (2010).
[11] 17 C.F.R. 270.2a-7(a)(20) (2010).
[12] Proposed Rule, *supra* note 6, at 36,834.
[13] *Id*. at 36,836.
[14] Jeffrey N. Gordon & Christopher M. Gandia, *Money Market Funds Run Risk: Will Floating Net Asset Value Fix the Problem?* (Colum. L. & Econ. Working Paper, No. 426, Mar. 1, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2134995.
[15] Letter of Inv. Co. Inst. to Elizabeth M. Murphy, Secretary, Sec. & Exch. Comm'n (Jan. 10, 2011), *available at* http://ici.org/pdf/11_sec_pwg_com.pdf.
[16] Hanson, *supra* note **Error! Bookmark not defined.**, at 22.
[17] Proposed Rule, *supra* note 6, at 36,914.

fund investment declines. Furthermore, a floating NAV gives all investors the same opportunity to redeem. They contrast this approach with a fixed NAV, where the second mover is guaranteed to suffer disproportionate losses as a result of earlier redeemers receiving a NAV of $1.00, in excess of the actual value of their investments. It is this arbitrage opportunity that is most likely to provoke a run on a money market fund.

Transparency in Pricing

The Commission suggests that requiring institutional prime money market funds to float their NAV would "improve the transparency of pricing associated with money market funds."[18] Requiring such funds to convert to a floating NAV may be unnecessary to accomplish this goal, as numerous money market funds—including those sponsored by BlackRock, Charles Schwab, Federated Investors, Fidelity Investments, Goldman Sachs, J.P. Morgan, State Street Global Advisors, and Wells Fargo—already disclose their shadow NAV on a daily basis.[19] At the same time though, a requirement for floating NAV could ensure transparency consistently across all issuers.

Operational, Tax and Accounting Burdens and Costs

Another significant criticism of the floating NAV proposal is that it is likely to increase substantially the operational burdens of money market funds, both for investors (public and private) and sponsors who have come to rely on such funds as a critical component of their cash management strategies. The stable NAV feature has for decades served to minimize the accounting and recordkeeping costs associated with frequent investments in and redemptions from money market funds, including from a tax basis perspective. Although the Internal Revenue Service and U.S. Treasury have indicated an intention to reduce certain of these additional tax burdens, these efforts do not include numerous additional tax requirements that a floating NAV would impose on investors, including taxation and monitoring of wash sales and gains and losses generally. From an accounting perspective, stable NAV funds qualify as "cash equivalents." The Commission should ensure that the Financial Accounting Standards Board ("**FASB**") clarify floating value funds will similarly qualify as "cash equivalents" to avoid additional burdens on investors in marking to market the value of their investments, tracing costs and calculating gains and losses.

Requiring a floating NAV will also impose significant costs on market participants from a technological, business process, and accounting systems perspective. One industry commentator has suggested that "total up-front costs for U.S. MMF institutional investors to modify operations in order to comply with a floating NAV will be between $1.8 and $2 billion," with an additional "$2 to $2.5 billion (net present value)" in new ongoing operating costs.[20] Furthermore, a floating NAV gives rise to significant operational obstacles that will need to be addressed. For example, a stable NAV fund permits corporations and bank sweep accounts to effect same day settlement on

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[18] *Id.* at 36,849.

[19] *See, e.g.,* Daisy Maxey, *Money Funds' New Openness Unlikely to Stop Regulation*, WALL ST. J., (Jan. 30, 2013), *available at* http://online.wsj.com/article/SB10001424127887323701904578274041010311364.html.

[20] *Operational Implications of a Floating NAV across Money Market Fund Industry Key Stakeholders*, Ctr. for Capital Mkts. Competitiveness of the U.S. Chamber of Commerce 3 (Summer 2013), *available at* http://www.uschamber.com/sites/default/files/reports/CCMC_FloatingNAV.pdf.

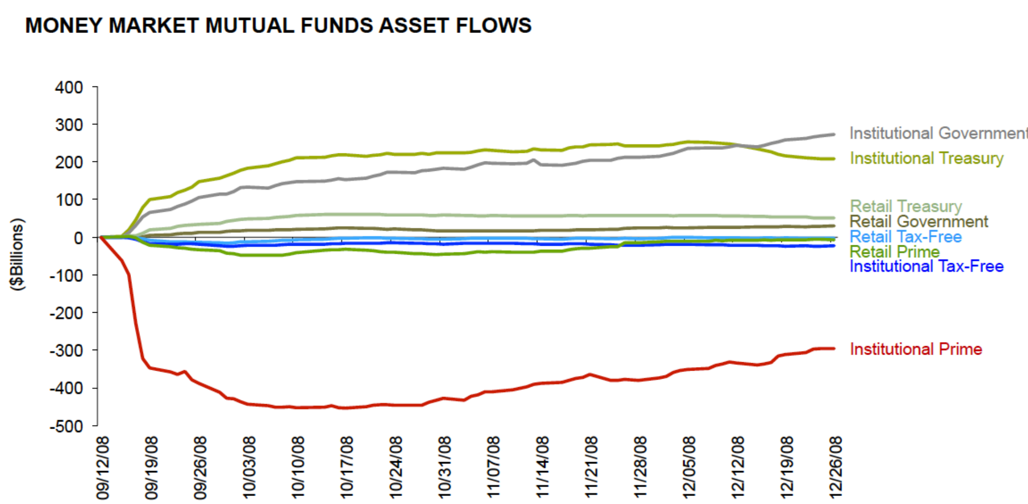
their redemptions. It is unclear how midday sweeps would work with a floating NAV when prices are determined at the end of the day.

The heightened administrative and compliance burdens associated with a floating NAV system, coupled with reduced certainty with respect to principal preservation and same-day liquidity, may serve to reduce significantly the attractiveness of money market funds as an investment and cash management vehicle for a wide range of corporate and public sector entities. Such investors may move their cash holdings from money market funds to less regulated short-term instruments, potentially reducing principal preservation, returns, liquidity, and asset diversification all at once, and importantly, increasing the possibilities of future runs. The Investment Company Institute has argued that stable NAV funds provide convenience and simplicity in terms of tax, accounting and recordkeeping. As evidence of investor preference, they cite a 16:1 ratio of investment in stable value money market funds versus floating value short-term bond funds, and also the scores of comment letters received by the Commission opposing floating NAV.[21]

Furthermore, the Committee notes that the Commission's lengthy cost-benefit analysis failed to estimate the aggregate cost of a floating NAV to institutional prime money market fund investors. We encourage the Commission to consider these costs prior to finalizing its proposal.

Limitations on the Proposal

The Committee supports limiting the proposed reforms to prime money market funds. Institutional prime money market funds were the only segment that suffered significant asset outflows during the 2008 financial crisis, with approximately $300 billion (or 14% of total assets) withdrawn during the week of September 15, 2008,[22] as the below graph of money market fund asset flows in late 2008 confirms:[23]



[21] *The Case for Stable NAV Money Market Funds*, INV. CO. INST. (Nov. 2010), *available at* http://www.ici.org/mmfs/positions/stable_nav/10_mmfs_caseforstablenav.

[22] *Report of the Money Market Working Group*, INV. CO. INST. 1, 62 (Mar. 17, 2009), *available at* http://www.ici.org/pdf/ppr_09_mmwg.pdf.

[23] *Money Market Mutual Funds Asset Flows*, iMONEYNET (July 29, 2013), *available at* http://www.imoneynet.com.

The Committee commends the Commission for having excluded government money market funds from its floating NAV proposal. Government money market funds are defined by the Proposed Rule as funds that invest "80% of . . . total assets in cash, government securities, or repurchase agreements that are collateralized fully."[24] The 2008 financial crisis clearly demonstrated that such funds do not pose the same risks as prime funds, as they experienced almost $200 billion in asset *inflows* during the week of September 15, 2008. It is important to note that investors who do not see the benefits of a floating NAV can use government money market funds for their cash management.

The Committee notes that the Proposed Rule would require municipal money market funds (*i.e.*, tax-exempt funds that invest in state and municipal obligations) to convert to a floating NAV. The Committee recommends that the Commission also exempt municipal money market funds from the floating NAV proposal, as municipal funds did not experience runs during the crisis, with less than 5% of total assets being withdrawn during the week of September 15, 2008.[25]

Although the Committee agrees with the Commission that retail money market funds should be excluded from the floating NAV requirement, we disagree with the Commission's approach to determining whether a money market fund is a retail or institutional fund. The Proposed Rule defines a retail fund as one that puts a $1 million ceiling on withdrawals and an institutional fund that places no such limit on withdrawals.[26] This is contrary to industry practice, as fund sponsors generally define a money market fund as retail or institutional depending on the identity of the investors rather than the size of withdrawals. Rather, we would suggest that the Commission should exempt from the floating NAV proposal funds limited to investments by individuals who provide social security numbers as part of the investment application process.

Alternative #2: Liquidity fees and redemption gates

The Commission's liquidity fee and redemption gate alternative is triggered by a fall in a fund's "weekly liquid assets" to below 15% of total assets. "Weekly liquid assets" is defined as "(i) cash; (ii) direct obligations of the U.S. Government; (iii) Government securities issued by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States, that are issued at a discount to the principal amount to be repaid at maturity and have a remaining maturity of 60 days or less; and (iv) securities that will mature or are subject to a demand feature that is exercisable and payable within five business days."[27] Following such decline, investor redemptions from the fund would be subject to a fixed "liquidity fee" of two percent, except where the fund's board of directors determines that imposition of such fee would not be in the best interests of the fund, and (ii) a fund's board, including a majority of independent directors, would be authorized temporarily to suspend redemptions from the fund, known as a "redemption gate." Under the Proposed Rule, any such gate must be lifted within 30 days, and no fund may institute a gate for more than 30 days in any 90-day period.[28] The Proposed Rule would also

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[24] Proposed Rule, *supra* note 6, at 36,854.
[25] *Weekly Total Net Assets and Number of Money Market Mutual Funds*, INV. CO. INST., (Sept. 2008), *available at* http://www.ici.org/research/stats.
[26] Proposed Rule, *supra* note 6, at 36,856.
[27] 17 C.F.R. 270.2a-7(a)(32) (2010).
[28] Proposed Rule, *supra* note 6, at 36,888.

impose heightened disclosure requirements, including a statement on Form N-1A of any occasion within the previous 10 years when the fund's weekly liquid assets fell below the 15% threshold and, in each such case, whether the board chose to impose a liquidity fee or gate.[29]

According to data assembled by Fidelity Investments,[30] money market funds currently hold liquidity in amounts far in excess of the requirements of either Rule 2a-7 or the proposed 15% weekly liquid assets threshold. For example, as of January 1, 2012, 42.1% of total fund assets were weekly liquid assets, exceeding the minimum requirements of Rule 2a-7 by 12.1% or $321 billion. Consequently, it is unlikely the liquidity fee and redemption gates would ever be triggered.

At the same time, we question whether the liquidity fee and redemption gate proposal would serve to check contagion, as the threat of such measures could conceivably accelerate redemptions as investors scramble to redeem their shares before the gates are lowered or a liquidation fee is assessed. In unstable market environments, investors may choose to redeem *en masse* in order to avoid the impending redemption restrictions. Indeed, even the Commission acknowledges that "the fees and gates proposal . . . would not fully eliminate the incentive to quickly redeem in times of stress, because redeeming shareholders would retain an economic advantage over shareholders that remain in a fund if they redeem when the costs of liquidity are high, but the fund has not yet imposed a fee or gate."[31]

Prior to the adoption of federally insured deposits, withdrawal suspensions were commonly used to combat bank runs in the United States.[32] While these suspensions were a response to fleeing depositors, they were also a cause of depositor flight. If past experience suggests that a bank or a bank regulator will limit withdrawals or redemptions, rational market participants will almost certainly attempt to withdraw their funds prior to their suspension, accelerating the run. While redemption restrictions on bank deposits, in the form of historical bank holidays, were somewhat successful during the Great Depression, they were also accompanied by deposit insurance, which likely achieved more in terms of reassuring depositors. Such public insurance is, of course, not currently available for money market fund investors.

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Thank you very much for your consideration of the Committee's opinion. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), at your convenience.

Respectfully submitted,

Robert Glenn Hubbard	John L. Thornton	Hal S. Scott
R. Glenn Hubbard	John L. Thornton	Hal S. Scott
CO-CHAIR	CO-CHAIR	DIRECTOR

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[29] *Id*. at 36,897.
[30] Letter from Fidelity Invs. to Elizabeth M. Murphy, Secretary, Sec. & Exch. Comm'n (Mar. 1, 2012), *available at* http://www.sec.gov/comments/4-619/4619-125.pdf.
[31] Proposed Rule, *supra* note 6, at 36,914.
[32] *See* William L. Silber, *Why Did FDR's Bank Holiday Succeed?*, FRBNY ECON. POL'Y REV. 19, 21–23 (July 2009), *available at* http://www.newyorkfed.org/research/epr/09v15n1/0907silb.pdf.