June 14, 2013

Re: Proposal for Money Market Fund Reform; File No. S7-03-13

The SEC's proposing release for money market fund reform cites my FSOC submission (File No. FSOC-2012-0003) calling for an extension of the diversification requirements of rule 2a-7 to include sector diversification (because bank-issued money market instruments carry credit risk that can be and has proven to be substantially correlated across issuers, and where bank-issued instruments have come to comprise over one-half of the dollar value of holdings of the typical prime fund). The Commission has nevertheless determined not to propose this modernization of its diversification requirement due, apparently, to ambiguity in defining sectors or industries. But the distinction between bank issuers and non-bank issuers is not ambiguous. Likewise, but more narrowly, the SEC would face no ambiguity in identifying issuers that are systemically important financial institutions, as the SEC can take this distinction as given. Accordingly, there actually is no practical impediment to having a hard cap (perhaps 10% of the value of net assets) on prime funds' aggregate holdings of money market instruments issued by SIFIs. It is hard to imagine a downside to such a hard cap, especially with a delayed or phased effectiveness.

Beyond that, I see no significant problems regarding the economics of either of the SEC's two proposed alternatives, considered alone or in combination. In particular, the proposal to (effectively) bifurcate prime funds by predominant clientele (retail or institutional) is unlikely to harm retail investors in money market funds. It is unlikely that bifurcation will harm retail investors because the fees and expenses charged owners of institutional share classes in mixed-clientele funds currently are so much lower than those charged retail share classes that it is doubtful that institutional investors now bear much (if any) of the fixed costs of operating a mixed-clientele prime fund. Accordingly, we can presume that owners of retail share classes are unlikely to bear meaningfully greater fixed costs of operations by virtue of bifurcation. This presumption is strong enough that industry commentators that might suggest otherwise should be expected to produce actual evidence (probably accounting data), to document any purported shifting of fixed costs to retail investors arising from the proposed bifurcation of prime funds into institutional versus predominantly retail funds.

Tellingly, as I documented in my FSOC submission, the great majority of prime funds currently have approximately homogeneous clienteles. This strongly implies that complete bifurcation is practicable for the remaining minority of prime funds with clienteles that remain predominantly mixed.

Robert Comment, Ph.D.

bobcomment@msn.com