Asset Management

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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20548-1090

Re: Money Market Fund Reform – File No. S7-11-09

Dear Ms. Murphy:

On behalf of TDAM USA Inc.,[1] we appreciate the opportunity to comment on the proposal by the U.S. Securities and Exchange Commission (the "SEC") to amend Rule 2a-7 under the Investment Company Act of 1940 and certain other rules that affect money market funds.[2] We support many of the proposals, and believe they are reasonably designed to strengthen the resiliency of money market funds during periods of market duress. The SEC has taken a comprehensive approach which should provide greater protection to investors.

I. Proposed Amendments to Rule 2a-7

The SEC has proposed amendments that would tighten the risk-limiting provisions of Rule 2a-7. We support most aspects of the proposed framework and do not believe it will unduly impair portfolio management. We do have several recommendations and concerns, and these are set forth below.

A. Liquidity

1. A Prohibition on Illiquid Securities Could Be Problematic

Under the proposal, money market funds would be precluded from acquiring securities unless, at the time acquired, they are liquid. A "liquid security" would be defined as a security that can be sold or disposed of in the ordinary course of business within seven days at approximately its amortized cost. The proposal would not prohibit funds from continuing to hold

[1] TDAM USA Inc. is the investment adviser to money market funds that comprise TD Asset Management USA Funds Inc., having more than $23 billion in assets under management as of July 31, 2009.

[2] See *Money Market Fund Reform*, SEC Release No. IC-28807 (June 30, 2009), 74 FR 32688 (July 8, 2009) (the "Release").

securities that become illiquid after their purchase. While we acknowledge the need to address liquidity risk, we believe a more workable approach would be to reduce the limit on illiquid securities to less than 10%.

The designation of a security as 'liquid' is a complicated process in which managers evaluate numerous factors. During periods of market stress, the characteristics of a security are subject to change and a security the manager initially determined to be liquid may become illiquid. A complete prohibition on the acquisition of an illiquid security will put pressure on the manager to demonstrate, in hindsight, that his or her initial liquidity determination was accurate. A prohibition may also be unnecessary, since the proposed daily and weekly liquidity requirements should have a more direct effect on liquidity risk. For these reasons, we recommend the limit on illiquid securities be lowered.

2. *The Definition of "Institutional Fund" Should Be Modified*

The SEC has proposed to establish separate liquidity requirements for retail and institutional funds.[3] We do not object to this proposal, since institutional investors potentially present liquidity risks that are distinct from those presented by retail investors and could subject money markets funds to substantially greater redemption pressure. The formulation of separate liquidity requirements for institutional and retail funds should ensure that *all* funds are able to satisfy redemption requests without depleting cash positions or selling securities at a loss. Furthermore, adopting liquidity requirements would impose upon money market funds an affirmative obligation to maintain liquidity that is sufficient to withstand redemptions, and this is a principle we do support.

However, the proposed definition of "institutional fund" is problematic when applied in certain contexts, and we ask that you refine the definition to facilitate its application. Under the proposal, an "institutional fund" would be

> any fund that the board of directors has determined, at least once each calendar year, is intended to be offered primarily to institutional investors or has the characteristics of such a fund, based on the (i) nature of the *record owners* of the fund's shares; (ii) minimum initial investment requirements; and (iii) historical cash flows that have resulted or expected cash flows that would result from purchases and redemptions. [Emphasis added.]

A "retail fund" would be any fund that the board has not determined within the calendar year is an "institutional fund".

We manage money market portfolios that are available as sweep options for clients of financial intermediaries. As the SEC notes in the Release, sweep fund accounts do not fit neatly

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[3] The proposed amendments would establish daily and weekly liquidity standards for retail and institutional funds. Specifically, the *daily liquidity requirements* would require each taxable, retail money market fund to invest, and each institutional money market fund to invest, 5% and 10% of its total assets, respectively, in cash, U.S. Treasury securities, or other securities the fund can reasonably expect to convert to cash in one day. The *weekly liquidity requirements* would require each retail money market fund (taxable and tax-exempt) to invest, and each institutional money market fund to invest, 15% and 30% of its total assets, respectively, in cash, U.S. Treasury securities, or other securities the fund can reasonably expect to convert to cash within five days.

into the 'retail' or 'institutional' category, but rather have features of both. Sweep fund accounts offer minimum investment amounts and provide cash flows that are comparable to retail funds, yet they resemble institutional funds in that there is only one record owner of fund shares - the financial intermediary -which holds these shares on behalf of its clients.

As noted above, in determining whether a fund is intended to be offered primarily to institutional investors (and is thus an "institutional fund") the proposal would require consideration of the "record owners" of fund shares. Based on examples provided in the Release, we believe that an institutional investor is intended to be a single, institutional decision-maker that exercises control over the investment. For many sweep funds, however, the "record owner" of fund shares is a broker-dealer which does *not* exercise control over the account. Specifically, a broker-dealer is prohibited from transferring customer accounts from one sweep fund into another without notifying its customers at least 30 days in advance.[4] Moreover, a practical consequence of the 30-day notice period is that it gives sweep funds ample time to raise liquidity - in a deliberate and orderly fashion - in order to satisfy the redemption request.

A sweep fund could more easily be designated as a "retail fund' (or, more precisely, as not an 'institutional fund') if the determination were based on the nature of the *beneficial owners* of the fund's shares rather than the "record owners" of fund shares. Accordingly, we ask that the SEC add this clarification to the proposed rule text.

3. *The General Liquidity Obligation is Unnecessary*

The SEC has proposed a general liquidity requirement which would impose upon a manager an ongoing obligation to hold liquid securities "sufficient to meet reasonably foreseeable redemption requests in light of the fund's obligations under Section 22(e) of the Investment Company Act and any commitments the fund has made to shareholders". While the objective of this requirement is laudable, we believe it is redundant and offers no additional benefit to money market fund investors. We believe that a money market fund's general liquidity obligations will be achieved through implementation of the daily and weekly liquidity requirements, which are designed to serve as liquidity minimums and will no doubt be adjusted upward as necessary.

We also have concerns about the vagueness of the proposed language. The general liquidity obligation would impose upon managers an obligation that is unquantifiable and would be difficult to test from a compliance perspective.

4. *Further Details About Stress Testing Are Necessary*

We are strongly in favor of a requirement that money market funds incorporate stress testing into their portfolio analysis. Armed with the results of various stress tests, managers would be better able to quickly and decisively respond to future market events. We would,

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[4] NASD Rule 2510(d)(2)(D) allows a broker-dealer to use negative response letters to effectuate a bulk exchange of money market sweep funds, subject to certain conditions. FINRA has issue interpretive guidance permitting a firm to effectuate a transfer without waiting 30 days, where a money market sweep fund announces that it intends to close or limit new fund share purchases but does not give the broker-dealer adequate notice. FINRA cautioned firms they may not rely on the guidance if they could have received the affirmative consent of their customers through reasonable and diligent efforts. See *Use of a Negative Response Under NASD Rule 2510(d)(2)(D) to Designate an Alternative Money Market Sweep Fund When Existing Sweep Fund Closes with Inadequate Notice,* FINRA Staff Interpretive Memo (May 15, 2008).

however, like to see further guidance regarding the details, assumptions and scenarios of the stress tests.

The proposal would require a money market fund to periodically stress test its portfolio in order to assess its ability to maintain a stable NAV upon the occurrence of one or more hypothetical events. The proposal would further require that testing be severe enough to cause the money market fund to break the dollar. There are numerous ways to break the dollar, with varying degrees of rigor and integrity, yet under the proposal managers would have substantial discretion to select their own test conditions. For example, interest rates move in a variety of ways, and one firm may test its fund against a parallel shift in interest rates while another firm may test against a non-parallel shift in interest rates. The same could be said of changes in credit spread as compared to credit yield curve spread. In administering these tests both firms will have broken the dollar, but will have done so under conditions of dissimilar rigor and complexity. To ensure funds test under conditions that are of equal rigor, we request more detail regarding the scenarios and assumptions managers should employ.

We firmly believe stress testing should be a critical component of each fund's risk management program, and recommend that all money market funds be tested and that they be tested with the same frequency. Although we acknowledge there are certain, limited situations where stress testing may be unnecessary, for example testing Treasury funds for downgrades and defaults associated with securities, we can identify no other exception that would be prudent. As a risk management tool, stress testing will strengthen each manager's sensitivity to changes in interest rates and the credit quality of its portfolios which, in turn, should enhance market discipline.

B. Portfolio Quality

1. Second Tier Securities Can Be Eliminated from Rule 2a-7

The SEC proposes to limit a money market fund's exposure to credit risk by prohibiting money market funds from investing in second tier securities. Specifically, the term "eligible security" would be re-defined to include securities that have received the highest (rather than the highest two) short-term debt ratings from a nationally recognized statistical rating organization ("NRSRO").

We agree that prohibiting investments in second tier securities will strengthen quality standards for money market funds. As stated in the Release, second tier securities have weaker credit profiles and present more risk than first tier securities. The proposal may have the additional benefit of encouraging issuers whose ratings are just below the first tier threshold to operate more conservatively, in order to earn the highest NRSRO credit rating and thus qualify as an "eligible security".

We do not expect that limiting money market funds to investments in first tier securities will cause widespread market disruption. There could be an adverse effect on the issuers of second tier securities which, faced with fewer funding options, will find it more expensive to borrow. Given the small size of the market for second tier securities, we believe the benefits of this proposal will far outweigh any disadvantages.

2. *Reference to NRSROs Should Be Maintained in Rule 2a-7*

The SEC requests further comment on its proposal to remove references to NRSRO credit ratings from Rule 2a-7.[5] Initially released in 2008, the proposal was intended to address concerns that references to credit ratings in Rule 2a-7 caused 'undue reliance' by market participants on the ratings. We commented in 2008, and reiterate, that we believe elimination of the ratings requirement from Rule 2a-7 is unnecessary to address these concerns and would weaken, not strengthen, the quality standards applicable to money market funds.

The quality provisions of Rule 2a-7 unambiguously prohibit 'undue reliance' on credit ratings. Specifically, the rule provides that a credit rating may not be the only, or even the principal, measure of an instrument's credit quality, since a money market fund may invest only in securities

> …that the fund's board of directors determines present minimal credit risk (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO) and that at the time are Acquisition Eligible Securities.

The quality provisions of Rule 2a-7 place primary emphasis on the need for careful credit review by the manager, under standards established and overseen by the fund's board. The credit rating serves as a baseline, or floor, against which the manager's independent credit review is conducted. Removal of this baseline would potentially permit managers to pursue unsafe and aggressive strategies in an effort to gain a yield advantage, and we strongly support the continued inclusion of NRSRO credit ratings in Rule 2a-7.

Instead, we recommend that regulatory reform be directed at enhancing transparency and accountability within the rating process, and are pleased the SEC recently adopted several initiatives in this regard.[6] We also suggest the following, additional area for improvement. NRSROs have a poor record of acting early in a long-term, deteriorating situation, which is a critical weakness in the process because investors can commit to purchasing a security of a company that is about to fail, without any warning from the rating agencies.

The SEC has requested comment on whether to permit fund boards to designate three (or more) NRSROs that the fund would look to for all purposes in determining whether a security is an eligible security. We do not favor such an approach, as it might effectively curtail the ability of a manager to access and consider information that is otherwise available and useful. It could put small NRSROs at a competitive disadvantage by leading to the cancellation of subscriptions, even where small NRSROs may have well developed capabilities with respect to certain types of investments.

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[5] See *References to Ratings of Nationally Recognized Statistical Rating Organizations*, SEC Release No. IC-28327 (July 1, 2008), 73 FR 40124 (July 11, 2008).

[6] See *Amendments to Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-59342 (February 2, 2009), 74 FR 6456 (February 9, 2009) (adopting rule amendments designed to increase transparency and disclosure, diminish conflicts and strengthen oversight).

C. Portfolio Maturity

1. Weighted Average Maturity Can Be Reduced

The SEC proposes to reduce the maximum weighted average maturity of a money market portfolio from 90 days to 60 days. We support this measure, since a shorter weighted average maturity will reduce exposure to interest rate risk and should provide greater assurance that money market funds will be able to maintain a more stable NAV. There will likely be a negative effect on yield, but we do not believe it will be significant enough to make the asset class less attractive to investors.

2. Weighted Average Life Will Provide Additional Protection

We also support the new, conservative maturity test which requires money market funds to maintain a weighted average life maturity of 120 days. Because the weighted average life will be calculated without regard to an instrument's interest rate reset date, it will limit the portion of a fund's portfolio that can be held in longer term adjustable-rate securities. One benefit of this new and strict measurement methodology is that it provides greater protection against credit and interest rate spread risk. Taken together, the weighted average life and weighted average maturity tests should provide even stronger protection against interest rate risk than currently afforded by Rule 2a-7.

3. Maturity Limit for Other Portfolio Securities is Unnecessary

We do not believe a reduction in the maximum maturity for non-Government securities from 397 days to 270 days will produce additional benefits, beyond the anticipated benefits of the proposed 60-day weighted average maturity and 120-day weighted average life requirements. In fact, reducing the maximum maturity of an individual security to 270 days may cause more harm than good. Debt issuers would need to refinance more often and would be exposed more frequently to market risk, further threatening market stability. Some debt issuers may determine not to issue securities of shorter duration at all and will migrate to other products, causing a potential shortage in quality short-term commercial paper.

I. Request for Comment on Additional Regulations

In addition to the specific reform proposals contained in the Release, the SEC is exploring the possibility of additional changes to the regulatory system which, it suggests, could further improve the ability of money market funds to withstand market risk. Specifically, the SEC seeks comment on whether money market funds should be required to float their NAVs and whether to mandate in-kind redemptions for certain, large redemption requests. We comment on each of these matters below.

A Floating Net Asset Value May Have Negative Consequences

The SEC is considering the elimination of a money market fund's ability to use the amortized cost method of valuation. In putting this matter out for comment, the SEC cited shareholder fairness as one of its concerns. As a preliminary matter, we agree that requiring

money market funds to issue and redeem their shares at market value, or to float their NAVs, would in certain respects advance shareholder fairness. We concur with the SEC's assessment that institutional investors are potentially more likely than retail investors to recognize arbitrage opportunities, and could be in a position to redeem shares for $1.00 per share when the market-based value per share is worth less. Redemptions such as these are detrimental to non-redeeming shareholders because they create unrealized losses in the portfolio which the remaining shareholders must absorb.

We also believe that requiring money market funds to float their NAVs would enhance transparency, since it would more clearly reflect the risks that are associated with money market funds. The amortized cost method of valuation may create the false impression that money market funds are insulated from market risk when in fact, at times, a fund is able to maintain a stable NAV solely because the investment manager or its affiliates have provided capital support, whether by purchasing illiquid assets, purchasing shares or providing other forms of credit support. Investment managers 'voluntarily' provide this support to protect investors from loss and to protect the reputation of the management firm. Investors in a stable NAV money market fund may not realize that there are indeed risks associated with the product, and that it is the investment manager and/or its affiliates that invariably assume these risks.

Although we unequivocally support reform initiatives that promote shareholder fairness and transparency, we are concerned that elimination of the amortized cost method of valuation for money market funds might be too drastic a response to recent market events. Investors value stable NAV money market funds because they provide numerous benefits, especially in terms of tax and tax-related recordkeeping. Investors in stable NAV funds do not need to track the timing of each purchase and sale for tax purposes, as they would for investments in floating NAV mutual funds. The imposition of tax rules on investors in stable NAV money market funds could in many cases be an enormous burden, since investors tend to trade money market fund shares frequently. Ultimately, we believe investors will reject the floating NAV because it will transform the product beyond recognition.

Furthermore, and contrary to the SECs intent, requiring money market funds to float the NAV may actually increase systemic risk. Large numbers of institutional investors, many of whom are constrained by corporate policies or state regulations which permit them to invest only in stable NAV funds, will likely divest from money market funds and search for other financial products. To meet this demand the industry may develop alternative stable NAV cash products which, if not regulated by the Investment Company Act of 1940, could further threaten market stability.

In-Kind Redemptions Should Be Encouraged

The SEC seeks comment on a requirement that money market funds satisfy redemption requests in excess of a certain size through in-kind redemptions. Without necessarily endorsing a proposal that in-kind redemptions become a requirement, we strongly encourage money market funds, particularly those with large numbers of institutional investors, to satisfy redemption requests in-kind. In-kind redemptions provide a redeeming shareholder with its proportionate share of portfolio securities. A money market fund that redeems in-kind would satisfy large redemption requests (such as those submitted by institutional investors) by distributing, rather than liquidating, portfolio securities, which would protect non-redeeming shareholders from the instability that can result from liquidating large amounts of portfolio securities. In addition to

mitigating liquidity risks, in-kind redemptions would ensure that the burdens associated with the liquidation of portfolio securities, including changing valuation and cost, are properly imposed upon the redeeming shareholder and not borne by the fund or by non-redeeming shareholders.

We do not think it would be feasible to set a threshold amount above which redemptions in-kind must be made, since whether a specific redemption poses a threat to the stability of a fund at any point in time depends on the type of fund and its liquidity, the fund's shareholders, and prevailing market conditions. Rather, the manager should determine on a case-by-case basis whether a particular redemption request should be satisfied in-kind. Since the market value of securities to be redeemed will likely be worth less than the amortized cost, we recommend the value of securities to be distributed be based on the amortized cost. In this way, the redeeming shareholder will realize the security's full value if the instrument is held to maturity and the money market fund will avoid breaking the dollar.

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We would like to thank the SEC for considering our comments on this important initiative. If you have any questions or would like any additional information, please contact the undersigned or Mark Bell at (212) 827-7052.

Sincerely,

Barbara Palk
President
TDAM USA Inc.

cc: Honorable Mary L. Schapiro, Chairman
Honorable Kathleen L. Casey, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner

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