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MUTUAL FUND DIRECTORS FORUM

*The* FORUM *for* FUND INDEPENDENT DIRECTORS

March 29, 2012

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549

Re: President's Working Group Report on Money Market Fund Reform, File No. 4-619

Dear Ms. Murphy:

As the Commission continues to consider potential proposals to further address perceived risks in the regulation and management of money market funds, the Mutual Fund Directors Forum ("Forum")[1] appreciates the opportunity to provide additional comments to help frame the issues that the Commission is considering.

Specifically, we urge the Commission to consider two critically important issues relevant to the costs and benefits of further regulation of money market funds: first, the loss of the benefit of independent director oversight of money market funds as the industry shrinks in response to structural changes in the product, and second, the systemic risks that will be created if investor cash flows from money market funds to other vehicles that are regulated differently or, in some cases, are unregulated.

Based upon press reports, statements of various staff and members of the Commission and the comments of other regulators, the Commission's ongoing consideration of fundamentally changing the manner in which money market funds are regulated is driven by a desire to reduce the systemic risk posed by those funds.[2] The risk of greatest concern appears to be that problems with a particular fund could produce a run on that fund, potentially causing a run against the entire industry and resulting in negative consequences for the capital markets and financial

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[1] The Forum, an independent, non-profit organization for investment company independent directors, is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. A significant number of the Forum's members are responsible for overseeing money market funds and so are highly interested in the ongoing debate regarding the appropriate regulation of money market funds. This letter has been approved by the Forum's Board of Directors.

[2] While recent discussion of money market funds does not always clearly define what systemic risk money market funds are supposed to pose to the broader financial system, and hence what type of risk additional regulation is intended to mitigate, the Report of the President's Working Group on Financial Markets: Money Market Reform ("PWG Report") asserted that industry-wide runs on money market funds "cause severe dislocations in short-term funding markets that curtail short-term financing for companies and financial institutions and that ultimately result in a decline in economic activity." PWG Report at 3.

system as a whole.[3] As we and other commentators have suggested, we believe that this risk is small, particularly in light of the Commission's 2010 amendments to rule 2a-7.

Instead, as we suggested in our prior letter,[4] we are concerned that changing the regulation of money market funds in a manner that makes them less attractive to their investors in and of itself poses a notable risk to our financial system. Money market funds provide investors with an important alternative to bank deposits (particularly checking accounts), provide an efficient means for individual and institutional investors to invest in the very short-term fixed income markets, and are important sources of credit for numerous governmental and corporate borrowers. The Commission must take special care to ensure that the potential benefits of further regulation will outweigh these significant benefits of the current system.[5]

It seems certain that fundamental change to the structure and regulation of money market funds will affect investor behavior. While the amount of investor monies that may flow out of money market funds in response to regulatory change can be debated, it seems almost certain that significant amounts of money will leave funds regulated under 2a-7.[6] For example, the institution of a floating NAV may make money market funds significantly less attractive to many retail and institutional investors.[7] Similarly, imposing a hold back on investors who wish to redeem their entire account may also render money market funds an unattractive alternative to many investors.[8] Finally, the imposition of capital requirements on money market funds will

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[3] Although not the focus of this letter, we also note the Commission should consider whether, instead of posing systemic risk, money market funds are instead the victims of risks and problems elsewhere in the financial system. For example, to the extent that runs are caused by quickly-arising, broad-based concerns about the credit quality of instruments typically held by money market funds, it is unclear how any of the reforms suggested in the PWG Report would reduce the risk of a run – in these circumstances, investors just want their money, will withdraw it, and will thus increase strains likely already existing in the underlying short-term debt markets in the same manner as occurred in 2008 and 2009. If this is the case, the only real impact of changing the structure of money market funds would be to change the timing and distribution among investors of investment losses.

[4] *See* the Forum's Comment Letter re President's Working Group on Money Market Fund Reform dated January 10, 2011 (available at http://www.sec.gov/comments/4-619/4619-25.pdf).

[5] Indeed, given that the money market funds are a key provider of credit to short-term borrowers and one of the risks that further reform is intended to address is the economic consequences of the loss of that credit during a run, it seems counterintuitive to mitigate that risk by reducing the amount of credit provided by money market funds as a general matter by making them less attractive to investors.

[6] *See* Fidelity Investments, "An Investor's Perspective: How individual and institutional investors view money market funds and current regulatory proposals designed to change money market funds" at 4-5 (outlining data showing that investors would likely respond to a floating rate NAV or liquidity restrictions by withdrawing funds from money market funds) (Feb. 3, 2012).

[7] Indeed, as even the PWG Report recognized, switching to a floating rate NAV could "reduce investor demand for MMFs and thus diminish their capacity to supply credit to businesses, financial institutions, state and local governments, and other borrowers who obtain financing in short-term debt markets." PWG Report at 20.

[8] BlackRock has recently explained why their institutional clients will not invest in money market funds with the redemption restrictions currently being discussed by regulators. *See*, "Money Markey Funds: The

increase the cost of running those funds, thereby lower their yields and, in many cases, drive investors to opt for other alternatives.

We are concerned that, in light of the almost certain changes to investor behavior, the Commission needs to focus significant attention on the potential of these types of reforms to lessen critical oversight of funds, provided both by fund directors and by regulators, if investor cash flows from money market funds to other vehicles that are regulated differently or, in some cases, are unregulated.

*Benefits of Director Oversight of Money Market Funds*

As the Commission is aware, in the United States, money market funds are registered investment companies and thus are fully subject to the Investment Company Act of 1940. A money market fund, therefore, has a board of trustees that owes a fiduciary duty to the shareholders of the fund. The board oversees the operations of the fund, including how the fund's investment strategy is implemented by its adviser, how the adviser manages risk, and how the fund is valued.

Because the role of boards of trustees is so fundamental to the system of regulation under the Act, it can be easy for those who focus predominantly on the fund industry to forget how unique that system is. Put simply, funds are essentially the only investment product that has a board of trustees interposed between the provider and the users of the product and whose sole duty runs to the investors.

Board oversight of money market funds has benefitted money market shareholders, and the Commission has also recognized the vital role played by boards under rule 2a-7. For example, as a result of the Commission's last round of regulatory reform, boards now have an additional formal role in reviewing stress testing of money market portfolios. Boards also help ensure that the Commission's tighter regulations governing liquidity, credit quality, and duration are appropriately implemented. In response to the 2010 amendments, boards have become increasingly involved in understanding the investor base of the specific funds that they oversee, and working with the adviser to understand how the nature of the investor base should be reflected in the fund's management of its liquidity. Further, because boards are now explicitly involved in making decisions if a fund gets into trouble, they thus have an important role to play in ensuring that all investors are treated fairly and equitably in a fund that is at risk of "breaking of the buck."

Investors obtain significant benefits from these board activities – benefits that will be lost if further regulation of money market funds drives investors to other cash management vehicles.

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Debate Continues" (March 2012). In addition, Federated Investors has also outlined reasons why a change of this type would render money market funds ineffective for many of the purposes for which they are currently used by corporate and other institutional investors. *See* Letter from John D. Hawke, Jr. on behalf of Federated Investors re President's Working Group Report on Money Market Reform (February 24, 2012) available at http://www.sec.gov/comments/4-619/4619-122.pdf.

*The Systemic Risks of Other Investment Products*

If further regulation renders money market funds a less attractive cash management vehicle, assets may instead be directed to bank deposits, cash pools exempt from regulation under section 3(c)(7) of the Act, other types of exempt cash pools, bank common trust funds and perhaps even wholly unregulated offshore cash pools. While the Commission has rarely needed to consider how investment patterns change in response to changing regulation and how investors may be affected when they move their money to differently regulated alternatives in response to regulatory change, the movement of money to these other products could have significant systemic risk implications.

As the Commission explores ways to reduce systemic risk, we believe that it is critical for it to consider how any further proposed changes to the regulation of money market funds will impact systemic risk in the system as a whole, not simply how it will affect the systemic risk of money market funds looked at in isolation. Moreover, there is reason to conclude that the systemic risks posed by some of these alternatives may be high. Most obviously, unregulated cash pools that are managed similarly to money market funds but lack the requirements of rule 2a-7 and board oversight are likely to pose much greater risks to the system while at the same time being much less transparent to regulators and investors (particularly in light of the recent changes to the disclosure obligations of money market funds). Similarly, a shift of significant amounts of cash to the banking system may have unintended and unpredictable consequences as well, particularly when increasing the concentration of assets in the banking system has been identified, in itself, as a source of systemic risk.

No matter what the extent of the risks posed by these alternatives, any increase in the systemic risk resulting from the flow of money to other investment vehicles is important and should be considered by the Commission before proposing or adopting further significant changes to the manner in which money market funds are regulated.

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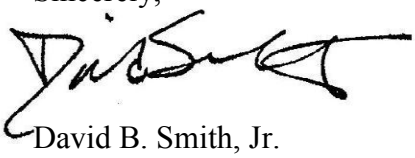
The Forum appreciates the opportunity to submit these supplemental comments and would welcome the opportunity to further discuss our views with the Commission and its staff. If you would like to discuss our comments further, please feel free to contact either me or Susan Wyderko, Executive Director of the Forum, at 202-507-4488.

Sincerely,



David B. Smith, Jr.
Executive Vice President and General Counsel