Treasury Strategies
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April 27, 2012

The Honorable Mary Schapiro
Chairman
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Cc: Elizabeth Murphy

Re: President's Working Group on Money Market Reform (File No. 4-619)

Dear Chairman Schapiro:

We would like to call your attention to Treasury Strategies' recent analysis of the consequences of requiring money market mutual funds ("MMFs") to impose a "holdback" on redemptions. Such a requirement would have numerous troubling consequences. As we have noted in the enclosed copy of our report, a holdback requirement would not discourage redemptions from a MMF but could actually precipitate runs, thus subverting the intended goals of financial reform.

In brief, the existence of a holdback would incentivize investors to look ahead in order to determine whether conditions may develop that would cause an MMF to experience distress. If so, investors would exit MMF holdings, and create selling pressures that would add to volatility and the perceptions of market distress.

For example, if a holdback had been in place during the summer of 2011, investors would have preemptively redeemed their MMF holdings as the budget impasse and Greek financial crisis lingered on, thereby potentially triggering a firestorm run.

While financial reform is intended to result in a safer financial system, a holdback requirement would raise operational and legal impediments to the use of MMFs, causing large corporations and investment managers to move assets to the largest banks, thus concentrating capital and increasing systemic risk.

In addition, our analysis reviews how a holdback would punish treasurers and other investors who use MMFs to manage liquidity, and disenfranchise fiduciary asset managers who will be compelled to avoid MMFs that tie up assets when they are needed. We urge the Commission to carefully consider our examination of these issues, and evaluate the potentially disastrous effects that a holdback requirement would have.

Sincerely,

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Partner

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Partner

Enclosed

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TREASURY STRATEGIES, INC.

PROPOSED

HOLDBACK REQUIREMENT

FOR

MONEY MARKET MUTUAL FUNDS:

Ineffective & Crippling Regulation

PROPOSED HOLDBACK REQUIREMENT FOR MONEY MARKET MUTUAL FUNDS: *Ineffective & Crippling Regulation*

In response to recent calls by regulators to impose a capital requirement on money market mutual funds, Treasury Strategies, Inc. has prepared the following analysis and critique. Treasury Strategies (TSI) is the world's leading Treasury consulting firm working with corporations and financial institutions in the areas of treasury, liquidity, and payments.

Regulators have periodically called for money market mutual fund (MMF) reforms in recent years, despite their nearly flawless track record. During their 40-year history there have only been two instances of any MMF investors incurring even a small loss. Although it has demonstrated remarkable reliability, the $2.6 trillion MMF industry is in danger of being dismantled by the current ill-considered reform proposals.

One ill-conceived proposal discussed by regulators is a holdback provision on redemptions. Although regulators have not shared specifics with the industry and the general public, the broad outlines are that 3% to 5% of each MMF redemption be withheld from the investor for a thirty-day period, thereby discouraging redemptions in the first place.

Regulators cite three primary objectives:

- Preventing a systemic breakdown stemming from a run on an MMF that spills over into the larger financial sector.
- Preventing an MMF investment from ever "breaking the buck" or losing value, which is thought to be a proximate cause of a systemic breakdown.
- Preventing a "first-mover" advantage for investors wishing to withdraw their funds ahead of other investors in a time of crisis.

The holdback provision proposal will not only **fail** to achieve regulators' objectives of preventing a run or loss, but will absolutely **destroy** the MMF industry entirely in the process. In this paper, we demonstrate that this proposal:

- Will create a "thirty-day look ahead" phenomenon that will trigger a firestorm run at the first sign of financial stress in an instrument in any market.
- Will not eliminate a first-mover advantage.
- Will result in a vast if not total reduction of assets in MMFs, crippling the industry and cutting off a primary source of credit for corporate and municipal borrowers.
- Will not treat all shareholders equally.

Beyond that, other key dangers of the proposal include:

- Maturity extension without yield increase
- Restricted liquidity for investors
- Disenfranchised fiduciaries
- Movement of funds into unregulated instruments and exacerbation of "too big to fail"
- Operational infeasibility
- Penalties for retail investors
- Ineffective solution in eliminating first-mover advantage
- Problems with omnibus accounts
- Restricted financing for borrowers

Treasury Strategies believes the holdback proposal will result in severe negative consequences for investors, fund advisors, businesses of all sizes, and the broader overall economy. We advocate that regulators abandon this proposal.

THE ANATOMY OF A FINANCIAL RUN

Before evaluating a proposal's effectiveness in preventing a run, it is important to understand the anatomy of a financial run. Financial institutions are susceptible to runs because they support highly liquid short-term liabilities with less liquid and longer-term assets. This maturity transformation is crucial to a well-functioning economy, because it facilitates the flow of funds from those with surplus to those with a shortage, in the form of deposits/investments and loans.

However, a maturity mismatch can be problematic when many investors want to withdraw funds over a short period of time. This is far more problematic with a bank than with a money fund. In a money fund, the difference between the average maturity of the assets and the liabilities can be measured in days or weeks. In a typical commercial bank portfolio, the difference is measured in months, if not years.

A run is caused by investors who believe if they wait too long to withdraw their money, they may lose some or all of it. It is this psychological aspect combined with people's natural aversion to loss that make runs so dangerous.

Three types of financial runs are relevant to financial institutions:

- Credit-driven runs occur as a result of a confirmed negative credit event in a security in which the institution invested; this leads investors to liquidate shares to limit possible losses.
- Liquidity-driven runs are precipitated by investors redeeming shares out of fear that, if they fail to do so immediately, they will be unable to do so later.
- Speculative runs occur as a result of rumors or speculation about what may or may not occur within a fund.

Although interrelated in terms of outcome, the proximate causes are quite different. Quite simply, the proximate cause of a credit-driven run is poor credit quality of the underlying assets. The proximate cause of a liquidity-driven run is a seizing up of the markets. The proximate cause of a speculative run is rumor based on a lack of transparency into the financial institution's assets and liabilities.

The reforms instituted in early 2010 by the SEC and the MMF industry have already adequately dealt with **each** of these three situations.

Type of Financial Run	Proximate Cause	2010 MMF Regulations
Credit Driven Run	Credit Loss	Tightened Credit Standards
Liquidity Driven Run	Market Seizing	Instituted Liquidity Requirement of 10% Next Day, 30% Weekly Shortened Maturity Structure
Speculative Run	Uncertainty/ Misinformation	Reporting of Holdings Reporting Shadow NAV

Source: Treasury Strategies, Inc.

THE TIMING OF A FINANCIAL RUN

It is also important to understand that there are two ways in which a financial run plays out:

- Firestorm runs occur in a panic environment in which investors rush cash out at any price, notwithstanding any barrier. In today's electronic world, these are likely to play out within hours or a day or two at most.
- Prolonged runs occur when investors fail to roll over maturing investments or reinvest in instruments upon which the institution had come to rely.

Given its nature and speed, it is unlikely that any intervention or barriers to exit will succeed in preventing the firestorm run. A holdback provision will be useless in this type of run since investors will most certainly want to exit at any cost. It is best to have in place the safeguards that prevent the proximate causes of the run. These are precisely the safeguards that went into effect for the money market fund industry with the Securities and Exchange Commission's Rule 2a-7 amendments in early 2010.

A prolonged run, on the other hand, occurs over an extended period of time. It is usually quite visible well ahead of time. For example, investors refuse to roll over their maturing commercial paper or holders of auction rate securities fail to bid at future auctions. Because of the slow nature of these runs, regulators have a number of tools at their disposal. However, efforts to "bar the door" have no usefulness, since these runs are not caused by investor withdrawals, but rather by investors refusing to reinvest.

FLAWED LOGIC OF THE HOLDBACK PROVISION

Although regulators have not shared specifics with the industry and the general public, the broad outlines are that 3 % to 5 % of each MMF redemption be withheld from the investor for a thirty day period, thereby discouraging redemptions in the first place. In theory, this holdback could be used to offset any losses the fund incurs within that thirty-day period.

First Mover Advantage and Exit Gates

Regulators justify the holdback provision idea by asserting it removes any first-mover advantage and encourages investors to remain invested in a troubled fund. However, given the psychological and fear-based nature of a firestorm run, any holdback provision is likely to be ineffective. Investors will likely flee a troubled fund, hoping to get as much cash as possible.

A review of a large body of research concerning bank runs resoundingly disputes the regulators' thesis that investor will remain invested in a troubled institution.[1] Academic research[2] and well as studies by the IMF[3] and the World Bank[4] show that one begun, panics will run their course until all parties are resolved.

For this same reason, "exit gates" do not work. Only in the "deus ex machina" case of the government directly intervening by declaring a bank holiday or by engineering a takeover, have financial panics been stopped before running their course. Suggestions that exit gates or fees would prevent or slow a run ignores 150 years of evidence.

The Thirty-Day Look Ahead

The holdback provision actually **creates a first mover advantage** that could, of itself, precipitate a run.

A thirty day holdback provision essentially requires investors to look ahead thirty days and ask whether it is possible for certain conditions to deteriorate to the point at which an institution might be in distress. If the answer is "yes" or "maybe", then the threat of a holdback encourages the investors to sell. This definitely creates a first mover advantage. It also precipitates a prolonged run in which assets leave the fund, at first slowly, accelerating into a full-fledged run.

Had this provision been in place during any number of recent events, investors would have invoked the thirty day look-ahead and exited perfectly healthy and well functioning MMFs. For example, during the summer of 2011, at the

[1] Huberto M. Ennis and Todd Keister, "Run Equilibria in the Green-Lin Model of Financial Intermediation," May 4 2009
Lee J. Alston, Wayne A. Grove, and David C. Wheelock, "Why Do Banks Fail? Evidence from the 1920s*," 1994
Clifford F. Thies and Daniel A. Gerlowski, "Deposit Insurance: A History of Failure," 1989

[2] Isabelle Distinguin, Tchudjane Kouassi, Amine Tarazi, "Bank Deposit Insurance, Moral Hazard and Market Discipline: Evidence from Central and Eastern Europe", June 2011

[3] Jeanne Gobat, "Banks: At the Heart of the Matter – Back to Basics, Finance & Development," March 2012

[4] Asli Demirgüç-Kunt, Edward J. Kane, and Luc Laeven, "Deposit Insurance Design and Implementation: Policy Lessons from Research and Practice*," June 19 2006

height of the European debt crisis and the U.S. budget impasse, investors could have pre-emptively sold their MMF investments in order to assure themselves of liquidity. August of 2011 would have seen the worst of both worlds: all of the first movers rewarded and their actions possibly triggering a firestorm run on the day of the U.S. sovereign downgrade.

Minimum Balance Requirement

Some regulators justify this proposal by comparing the holdback provision to a minimum balance requirement. This suggests ignorance of how minimum balance requirements operate, and also indicates a complete disconnect from the principles of sound corporate cash management.

As corporate treasurers know quite well, minimum balance accounts have no impact on funds availability. If depositors need access to their funds, they can withdraw all of their funds, at any time, even if the account operates with a minimum balance. This is why these accounts are called demand deposit accounts – the funds are available on demand. If there is a minimum balance parameter, falling below that balance generally results in the customer losing fee discounts – but it **never** means the funds are unavailable to the account holder.[5]

Thus, a critical factor in the holdback proposal is the impact on liquidity and, for many investors, access to the short-term operating funds. This proposal destroys the liquidity value MMFs provide to investors of all types and will certainly drive investment dollars into other alternatives. In fact, some investors may find better liquidity by investing in a developing country's subprime bond fund!

Emergency Situations

Another version of this proposal invokes the holdback during an "emergency situation." This has obvious and almost laughable drawbacks:

- First, this presupposes regulators are able to predict a run before it occurs. Even if this were possible, simply enacting this provision would likely precipitate a run, because it would signal fund distress.
- Secondly, it assumes a fund predicted to have a run would never be able to recover without invoking the emergency provision.
- Thirdly, if the emergency provision were enacted after the run was underway, it would not stop the run. Investors would continue to redeem shares rather than risk greater loss.

MATURITY EXTENSION WITHOUT YIELD INCREASE

The maturity premium of an investment is a foundational element of the capital markets. In a normal market environment with an upward sloping yield curve, an investment with longer maturity demands higher yield than an identical investment with shorter maturity.

[5] Most corporate minimum balance requirements are monthly averages. It is possible to fall below the minimum level multiple times in a month, without consequence, as long as the monthly average balance satises the requirement.

Imposition of a holdback provision restricts availability of some portion of the investor's MMF investment, effectively extending the maturity of that investment. This would happen with no corresponding increase in yield. Thus the holdback provision penalizes investors by failing to reward them for additional maturity risk. **As the size of the holdback provision increases, the yield penalty to investors increases.** This will cause investors to reduce their holdings dramatically.

Restricting a portion of the investment, without additional yield compensation, will indeed make investment in MMFs very unattractive. No other investment vehicle has such a restriction without compensating investors with additional yield, and investors will exit MMFs en masse as a result.

In addition, the holdback provision vastly complicates the maturity structure of an investor's overall holdings by creating an instrument that has an indeterminate maturity structure. Consider the corporate investor who invests and redeems daily with their MMF. At the end of one month, their MMF holdings would have amounts that mature in 30 days, 29 days, 28 days, … down to 2 days, in addition to some amount having daily maturity. The difference in complexity of maturity structure would make MMFs so unsuitable for short-term cash investments that corporate investors would most certainly exit.

RESTRICTED LIQUIDITY FOR INVESTORS

Corporate treasurers use MMFs for three primary reasons:

- Stability of principal
- Daily liquidity at par
- Diversification

The holdback provision effectively eliminates the daily liquidity feature from MMFs for these investors.

Instead of concentrating cash in the banking system and earning no interest, corporate investors look to MMFs as a way to earn a return while maintaining daily liquidity. Daily liquidity is vital. The invested dollars represent short-term, operating cash that treasurers access on a daily basis for purposes such as:

- Funding payroll
- Purchasing inventory
- Business expansion
- Covering trade payables

In fact, treasurers often transact with their MMFs, purchasing or redeeming shares, multiple times in a single week.

A holdback provision will make these investors hesitant to invest in MMFs because when they need operating cash, they may need ***all*** of it.

Given how often a company may transact with its MMFs, holdback amounts under some scenarios will quickly accumulate into a substantial portion of its MMF investments. With holdback funds unavailable when needed, a treasurer could be forced to borrow to cover cash needs, incurring interest expense which is undoubtedly greater than MMF yield.

In general, corporate treasurers are extremely risk-averse. Even the chance they may not have access to daily operating balances when needed will almost certainly drive them to abandon MMFs. Therefore, if this proposal were implemented, we would expect to see a prolonged run on MMFs – which is precisely what regulators claim to be striving to prevent – as investors redeploy cash into other instruments.

DISENFRANCHISED FIDUCIARIES

Many advisors have fiduciary responsibility to act in the best interest of their customers. When these fiduciaries consider that an investment in MMFs may tie up their customers' assets when they are most needed, they will be compelled to avoid MMFs.

Indeed, in many situations the fiduciary may be legally precluded from using a MMF with a holdback provision as an investment.

- **Escrow assets** could not be invested in a fund with a holdback, because all escrowed assets must be immediately released to one of the parties by the escrow agent upon the occurrence of a stipulated event.
- **Bond proceeds** could not be invested in a fund with a holdback because indenture trustees would be precluded from investing in an instrument that could reduce the amount of these proceeds or limit the availability of these funds.
- **Collateral funds** may not be eligible for investment in MMFs because the funds would not be entirely available on a next-day basis.
- **Pension and health plan** assets subject to the Employee Retirement Income Security Act (ERISA) could not be invested in MMFs because they would violate the exclusive benefit rule (redemption fee) or prevent a plan from becoming 404(c) eligible by the liquidity impairment.
- **Bankruptcy trustees** would be unable to use MMFs to invest assets from a bankruptcy proceeding, because they require immediate liquidity of trust assets to maximize the return of assets to creditors.
- **Trustees, charitable foundations, estates** and others would be prohibited from investing in an MMF that could impose a redemption fee or limit access to funds.
- **Municipalities** could be precluded from investing in MMFs subject to a redemption fee because their investment statutes commonly make reference to money fund investments being purchased and redeemed without the public entity incurring a cost or financial penalty in connection with the transaction.

Using an investment with a holdback would violate the fiduciary's duty to minimize cost and ensure access to the investor's money. If the holdback proposal were enacted, we could very well see a run on MMFs as fiduciaries, along with retail and corporate investors, redeem MMF shares and seek alternatives.

MOVEMENT OF FUNDS INTO UNREGULATED INVESTMENTS; EXACERBATION OF "TOO BIG TO FAIL"

Most corporate investment policies allow flexibility in investment choices, bounded by specific guidelines or restrictions. Firms consistently choose MMFs for their hallmarks of stability, liquidity, and diversification. Any proposal that diminishes these values will certainly drive investors to run in seek of investment alternatives.

As described above, the holdback provision significantly impacts the liquidity demanded by corporate investors for their short-term investments. Were it enacted, MMF investors would seek alternative investments for short-term needs.

Investors leaving MMFs will have three basic options:

- Riskier investments with higher yield
- Off-shore investments
- Bank deposits

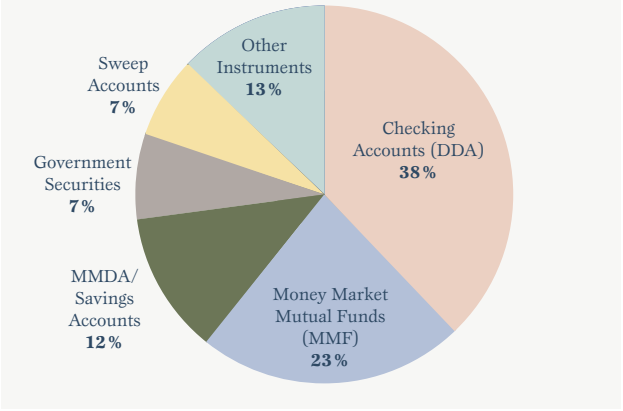
The first two options increase systemic risk, because large amounts of assets move from relatively safe MMFs into riskier and less regulated investments. It is far more difficult for regulators to track these less transparent asset flows and to manage the resulting dislocations.

The third option also increases systemic risk. It drastically expands asset concentration in the banking sector, exacerbating the "too big to fail" phenomenon.

Large corporations and institutional investors have investable funds that dwarf the balance sheets of all but the largest U.S. banks. These corporations place 23% of their liquidity in money market mutual funds. For corporations to redeploy these assets into bank deposits, they must concentrate their funds with the largest banks because smaller banks are unable to "digest" such large deposits. This will further concentrate risk with the largest financial institutions, exacerbating the "too big to fail" problem.

Furthermore, in the current deposit-intensive environment, very few financial institutions have the balance sheet needed to support a major inflow of deposits. At the largest banks, such potentially huge flows will strain their already bloated balance sheets.

% OF U.S. CORPORATE LIQUIDITY BY INSTRUMENT



Source: Treasury Strategies Quarterly Corporate Cash Report, December 2011

From the corporate treasurer's perspective, moving more funds into bank deposits is not without problems. Many treasurers minimize diversification risk by spreading deposits across multiple high credit quality financial institutions, among them MMFs. Being unable to use MMFs as a place to invest liquidity decreases overall short-term portfolio diversification options and elevates concentration and counterparty risks.

OPERATIONAL INFEASIBILITY

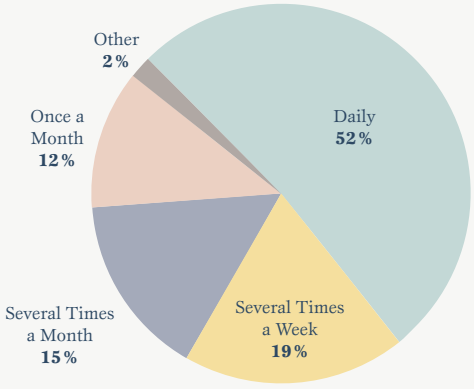
Consequences of the proposed MMF holdback provision render it operationally infeasible for several categories of MMF users. These problems include:

- Perpetually restricted cash for frequent MMF users
- Elimination and/or impairment of bank MMF sweep accounts

Perpetually Restricted Cash

The holdback provision will punish investors who use MMFs as a regular cash management tool. In a recent survey of corporate treasurers and investment decision-makers, over 70% of respondents say that they transact in MMFs multiple times per week. These investors make regular investments and redemptions in their MMFs, sometimes at multiple times during a single day.

CORPORATE INVESTOR MMF TRANSACTION FREQUENCY



Source: Treasury Strategies research, February 2012

While the holdback proposal, including the mechanics of how the holdback would be applied, has not been defined, any form will present severe operational complexities for investors. In the two scenarios described below, the hypothetical investors would face severe consequences in managing their liquidity needs due to the restricted funds. This is clearly unacceptable for a short-term investment and would make MMFs completely unusable for such investors.

The first scenario assumes the following:

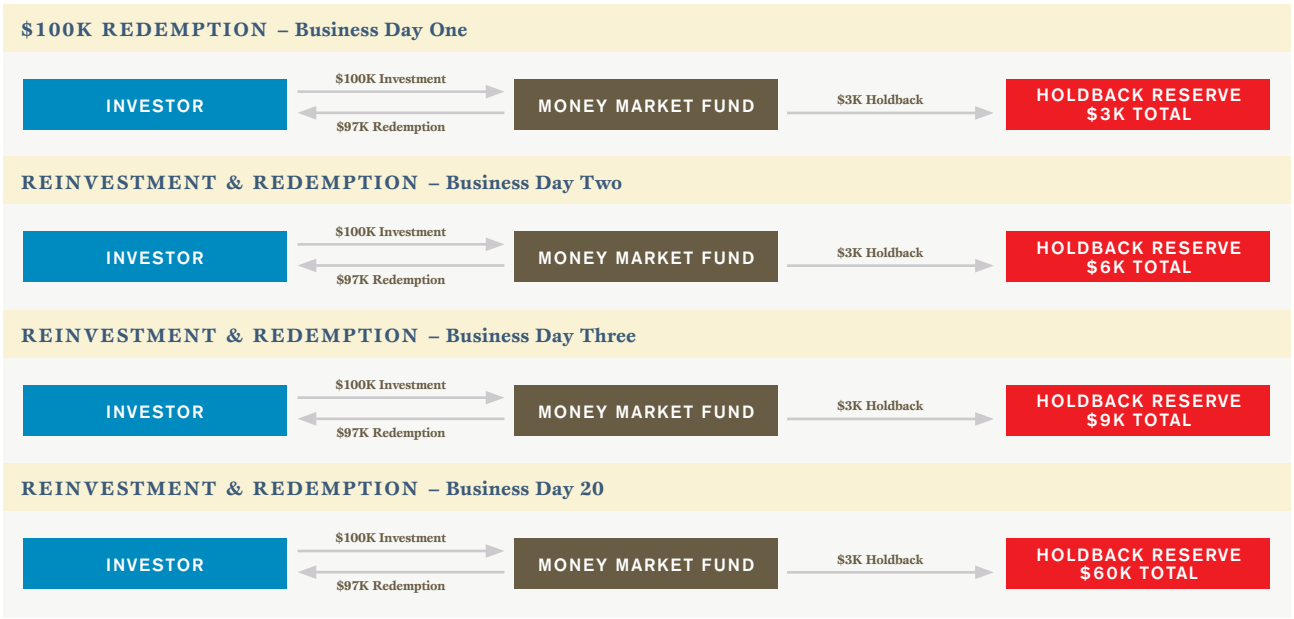
- A daily 3 %, 30-day redemption holdback.
- The company has an initial $100,000 investment, which they redeem in entirety on day one.
- On each subsequent day the company will redeem the entire prior day's investment to meet payroll, payables, etc.
- Also, at the end of each subsequent day the company will invest $100,000 back into the fund from that day's customer receipts.
- This happens for four weeks, 20 business days.

Table 1.1 – Redemption Holdback Impact on Hypothetical $100,000 Continued Investment

Business Days	Total Redemption Holdback Balance at the End of Each Week
1-5	$15,000
6-10	$30,000
11-15	$45,000
16-20	$60,000

As demonstrated above, for those investors who rely upon MMFs as a daily cash management tool, the utility of MMFs would be highly diminished under this proposal, because it would effectively lock up a significant portion (as much as 60 %!) of the organization's original cash investment over the four-week period.

Figure 1.1 – Redemption Holdback Impact on Hypothetical $100,000 Continued Investment



Under a second scenario depicted below, we see the impacts of imposing the redemption fee on businesses with uneven cash flows. Energy companies and property management firms come to mind. The scenario assumes the following:

- The company normally maintains a $100,000 balance in its MMF. It has peak cash flows of $1 million during the first week of the month, which are then redeemed on the 5th business day of each month, to pay expenses, purchase inventory, etc. (This scenario could also describe bond proceeds going into MMFs, equity issuance, asset sales, loan proceeds, etc.)
- A 3%, 30-day redemption holdback
- Four weeks, 20 business days in the month

Under this scenario, investors with cyclical cash flows would be severely punished with a much larger portion of their monthly average investment unavailable due to the holdback.

Figure 2.1 – Redemption Holdback Impact on Cyclical Businesses

Table 2.1 – Redemption Holdback Impact on Cyclical Investment

Week	Average MMF Investment Level	Total Redemption Holdback Balance at the End of Each Week	% of Redemption Holdback Balance Relative to Average MMF Investment Level
0	$100,000	$0	0%
1	$1,100,000	$30,000	3%
2	$130,000	$30,000	23%
3	$130,000	$30,000	23%
4	$130,000	$30,000	23%

Elimination of Bank Sweep Accounts

Corporations, fund managers, trusts, and brokers rely heavily on MMF sweep accounts, which automatically deploy cash into MMFs, and redeem shares from MMFs, all on a daily basis. The automated sweep accounts allow funds to remain invested for as long as possible, until they are required to cover expenses or other account outflows. The sweep account allows for more efficient use of the investor's liquidity and minimizes time spent managing account balances.

However, imposing a redemption holdback would effectively destroy the utility of this vehicle. As displayed in Table 1.1, the holdback on each redemption would significantly impact a corporate investor's liquidity. As a result, it would no longer be viable for a corporate treasurer to utilize the automatic sweep of excess cash to and from MMFs, because it would decrease available funds with each redemption.

Sweep account mechanics vary, but many sweeps would be rendered inoperable by imposition of a holdback rule. Therefore, we can expect this rule would not only destroy the viability of individually accessed MMFs for corporate users, but also the viability of bank MMF sweep accounts from a corporate treasurer's cash management toolkit.

An unintended consequence would be inflated bank balance sheets. Banks find MMF sweeps especially useful in moving excess liquidity off their balance sheets and into the capital markets. However, if MMF sweeps are operationally and financially destroyed by the holdback, banks would be left holding this cash on their balance sheets. This even further concentrates assets into the hands of the largest few banks, and stretches their capital.

PENALTIES FOR RETAIL INVESTORS

Beyond making MMFs unsuitable for corporate and institutional investors, this regulation will also negatively impact retail investors. Retail investors use MMFs as a way of earning modest interest on their savings while maintaining same-day liquidity. They rely on MMFs for a variety of purposes:

- Emergency savings
- Accumulating a down payment for a home
- Building college tuition assets
- Retirement funds
- Etc.

In many cases, the retail investor saves for something where the entire saved amount is required at a single point in time. The added complexity introduced by the holdback proposal would make MMFs a much less viable instrument for these purposes. Having even 3 % of the investment locked up for 30 days could result in a retail investor being unable to close on a house, meet an emergency cash need, or make a child's college tuition payment.

Consider the retail investor who is saving for a down payment on a home and has those savings in an MMF. The holdback provision would be completely infeasible. The investor would be faced with three options:

- Delay home purchase by several months until they save an additional 3%-5% to account for the holdback.
- Anticipate exactly when the funds will be needed for closing, in order to redeem at least 30 days in advance.
- Move the savings out of MMFs entirely.

INEFFECTIVE AGAINST THE FIRST-MOVER ADVANTAGE

While we do not yet know how the holdback proposal may be written, the holdback provision will certainly not eliminate any first-mover advantage. Furthermore, regulators will be left with the mathematical impossibility of treating all shareholders equally. Investors with significant investment balances in MMFs who anticipate a market disruption, or who become uncomfortable with the underlying holdings of the investment fund, would exit the fund to ensure that losses are no greater than the holdback.

By mandate, many institutional investors view safety of principal as their paramount short-term cash management objective. As a result, even with a holdback, investors would continue to have a first-mover incentive in order to limit any potential loss to the holdback amount of 3-5% of the investment. Indeed, they may have a fiduciary responsibility to exit. Remaining investors that were not among the first-movers could suffer additional losses. The run by the first group of investors and subsequent liquidation to fund the redemptions could decrease the underlying value of the fund holdings.

In an even more perverse example, investors may view any sign of market distress, even if totally unrelated to MMFs, as a signal to exit and beat the thirty-day clock. Investors learned in 2008 that market seizing in one asset class can spread to other asset classes. The thirty-day holdback would prompt them to exit at the first sign of distress in any asset class. In this case, **the holdback provision ensures that if any unrelated asset class seizes, the distress WILL spread to MMFs. That's creating contagion.**

THE PROBLEM OF OMNIBUS ACCOUNTS

Banks and brokers conduct much of their customer-related MMF activity through omnibus accounts. A bank or broker may hold just one account with an MMF for the benefit of hundreds or thousands of customers, netting their activity into a single trade each day.

If half of a bank's customers were investing in MMFs on a particular day and the other half were redeeming their MMFs, the net transaction between the bank and the fund might be zero. Thus, there would be no holdback since there was no trade!

Creating a Privileged Class of Investors While Reducing Transparency

Institutional investors will look to invest their entire MMF investment portfolio through omnibus accounts to take advantage of the opportunity to circumvent the holdback fee. Through the omnibus structure, it's possible that investors could redeem their positions without the bank needing to transact with the fund itself. There would be no holdback and the investor would have 100 % access to the funds.

This certainly provides an incentive for investors to trade through intermediaries rather than directly with the MMFs. Unfortunately, that would mean that the fund managers have less direct visibility of their customers. As a result, their ability to understand their customers' liquidity requirements would diminish.

The omnibus account's ability to net to zero each day is a function of having a very large number of customers with offsetting cash flows. It requires size and scale. Thus, this "privileged class" phenomenon would have the effect of further concentrating assets with the largest banks.

Taking this example even further, some additional adverse consequences arise:

- First, the MMFs would now have fewer, and much larger, shareholders since most investors would transact through omnibus accounts. That could make the MMF more susceptible to runs since each remaining account holder represents a larger portion of the fund. A single bank or broker deciding to move its account from MMF A to MMF B could precipitate a run on MMF A.
- Second, a large redemption could occur within an omnibus account, possibly subjecting non-redeeming shareholders to a holdback that is much greater than the nominal percentage.

Operational Complexity

Omnibus account sponsors would be faced with an increasingly complex, if not impossible, task of imposing redemption fees. As mentioned above, the omnibus account acts as an aggregator of purchase and redemption orders, resulting in one net purchase or redemption each day.

When the account is in a net redemption position, it will be subject to the holdback fee. Let's say that the holdback requirement is 3 %. If an omnibus account has aggregate investments of $80,000 and aggregate redemptions of $100,000, it places a single $20,000 redemption order and would be subject to a $600 3 % holdback. Does it spread that $600 across the $100,000 of redemptions resulting in a 0.6 % holdback? Or does it holdback 3 % of every redemption? And who benefits from the excess holdback? As a result, it will need to filter through the hundreds if not thousands of trades that make up the net position to determine what holdback to apply to the individual investor. To further complicate matters, they will likely be faced with scenarios where the same investor purchased and redeemed MMFs.

RESTRICTED FINANCING FOR BORROWERS

MMFs are one of the largest purchasers of commercial paper, which accounts for a significant source of funding for many highly-rated public companies, banks, and municipal entities. The wide-scale exit of investors from MMFs will negatively impact the broader money markets by contracting this part of the commercial paper market.

If investments in MMFs decline due to the holdback provision, the funds will purchase correspondingly less commercial paper and other corporate debt. Such constriction in the market for short-term financing will have many ripple effects.

First, this will mean higher costs for borrowers to secure short-term funding, if they are able to secure such funding at all. Companies, school systems, port authorities, hospitals, and many others would be impacted by the reduced availability of short-term financing.

Secondly, as these entities find fewer outlets for their debt, they will turn increasingly to banks for conventional financing. Besides being more costly, bank financing is not always easy to obtain, depending on the timing of the economic cycle. If bank debt were unavailable, companies would have to turn to even more expensive sources of financing including factoring and accounts receivable financing.

Finally, facing a smaller market for selling their mortgage securities and other packaged loans, banks would be less willing to lend to consumers, which would pressure housing industry recovery.

CONCLUSION

The stated objective of regulators is to reduce the likelihood of a systemic financial run. The modifications to Rule 2a-7 instituted in early 2010 adequately deal with the multiple proximate causes of a run. The negative effects of the holdback provision proposal, listed below, will undermine these changes and effectively destroy the viability of the MMF industry.

The holdback provision proposal will not only **fail** to achieve regulators' objectives of preventing a run or loss, but will absolutely **destroy** the MMF industry entirely in the process. In this paper, we demonstrated that this proposal:

- Will create a "thirty-day look ahead" phenomenon which will trigger a firestorm run at the first sign of financial stress in an instrument in any market.
- Will not eliminate a first-mover advantage.
- Will result in a vast, if not total reduction of assets in MMFs, crippling the industry and cutting off a primary source of credit for corporate and municipal borrowers.
- Will not treat all shareholders equally.

Specific dangers of the proposal include:

- Maturity extension without yield increase
- Restricted liquidity for investors
- Disenfranchised fiduciaries
- Movement of funds into unregulated instruments, and exacerbation of "too big to fail"
- Operational infeasibility
- Penalties for retail investors
- Ineffective solution in eliminating first-mover advantage
- Problems with omnibus accounts
- Restricted financing for borrowers

Treasury Strategies believes the holdback provision proposal will result in severe negative consequences for investors, fund advisors, businesses of all sizes, and the broader overall economy. We advocate that regulators abandon this proposal.

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