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May 25, 2012

VIA ELECTRONIC MAIL TO: MoneyMarket@iosco.org

Mr. Mohamed Ben Salem
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

Re: Money Market Fund Systemic Risk Analysis and Reform Options

Dear Mr. Salem,

Invesco Ltd. is a leading independent global investment management firm, with over $668 billion in assets under management as of April 30, 2012. Invesco Advisers, Inc., Invesco's primary U.S. investment advisory subsidiary, is registered with the U.S. Securities and Exchange Commission (the "SEC") and, along with its affiliates, has managed and advised money market funds and other cash investment vehicles for over 30 years. As of December 31, 2011, Invesco Advisers had approximately $58.7 billion in assets under management in its registered money market funds operated in compliance with Rule 2a-7 of the Investment Company Act of 1940, as amended ("Rule 2a-7") and approximately $5.3 billion in European money market fund assets under management.

We are writing to provide our views with respect to certain aspects of the Money Market Fund Systemic Risk Analysis and Reform Options Consultation Report dated 27 April 2012 (the "IOSCO Report") published by the International Organization of Securities Commissions ("IOSCO"). The IOSCO Report discusses potential reform options intended to reduce systemic risk generally and to enhance the stability of money market funds in particular. As a major sponsor of money market funds, Invesco strongly supports efforts to bolster the resiliency of these products, which for over four decades have provided a solid foundation for the preservation of capital, daily liquidity and market-based yield that investors have come to expect while also offering global portfolio credit diversification, ease of administration, efficiency in accounting and simplicity of tax reporting. Money market funds play a vital economic role as a source of credit and short-term financing to consumers, corporations, financial institutions and government entities around the world. For example, as of December 31, 2011, registered U.S. money market funds held approximately 42% of all outstanding short-term U.S. agency securities, 37% of commercial paper issuances, 22% of bank certificates of deposits and 16% of short-term U.S. Treasury securities.

Our interest in commenting is driven by our fiduciary responsibility to our money market fund shareholders and our concern that several of the policy options discussed in the IOSCO Report could have unintended and highly adverse consequences including:

- harming the orderly functioning or efficiency of credit markets by substantially reducing availability of credit to consumers, corporations, financial institutions and government borrowers;

- triggering a sudden, widespread shift of assets to less regulated vehicles that do not offer the protections afforded by regulated money market funds; and

- reducing the number of investment options available to investors.

We recognize that the goal of policymakers is to reduce further the vulnerability of the financial system, including money market funds, to systemic risk. We share this aim and have worked actively with both policymakers and our industry peers in the U.S. and Europe in recent years to enhance industry standards and practices in numerous areas, including the tri-party repurchase agreement market. Given the central importance of money market funds to short term credit markets, however, we believe it is critical for policymakers to recognize that disruption of these funds or a significant reduction in their asset base could have a severe destabilizing impact on issuers (including government issuers) and on the markets generally. As the IOSCO Report acknowledges, "The health of [money market funds] is important not only to their investors, but also to a large number of businesses and national and local governments that finance current operations through the issuance of short-term debt."[1] A large reduction in money market fund assets due to investor withdrawals would threaten a critical source of short-term financing for businesses, governments and other borrowers at a time when other sources of credit are likely to be constrained. Concurrently, the recent adoption of a variety of new regulatory capital requirements has led banks and other financial institutions around the world to re-evaluate the appropriate size of their balance sheets and future levels of credit extension. The pending implementation of these more stringent capital requirements could greatly magnify the systemic effects of any additional reduction in credit extended by money market funds due to a smaller asset base. We therefore strongly agree with IOSCO's observations that "policy options will have to be carefully weighed in the context of their potential impact on financial stability and market functioning."[2]

While we are pleased with the thoughtful and balanced approach to the potential policy options highlighted in the IOSCO Report, we are concerned that it fails to take into account fully the significant impact of the substantial regulatory reforms that have already been implemented in the United States with respect to both money market funds and the wider financial markets. As discussed below, there is clear evidence that these measures have greatly increased the intrinsic resiliency of money market funds by enhancing protections for investors, improving transparency for market participants and further

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[1] IOSCO Report, at 1.

[2] IOSCO Report, at 13.

strengthening the ability of money market funds to withstand periods of severe market stress. As a direct byproduct of these enhancements, the industry is better positioned today than at any time previously to protect investors from the extreme redemption pressures potentially associated with periods of extreme market volatility. We therefore believe it is critical for IOSCO and other policymakers to conduct a rigorous and comprehensive cost benefit analysis, taking into account the full impact of changes that have already been implemented and the risks associated with taking further action, prior to proposing any additional money market fund reforms.

I. Policymakers should thoroughly analyze the impact of the significant regulatory changes enacted since the financial crisis and the risks associated with further regulation before proposing additional changes to money market funds

Since its adoption, Rule 2a-7 has provided U.S. money market funds with a solid foundation of safety, liquidity, investment diversification, and a market-based rate of return. In the wake of the global financial crisis, however, there was widespread acknowledgement of the need to adjust the regulatory framework governing money market funds to reflect better the integral role they play in financial markets generally. In January 2010, following a period of public comment that included extensive discussions between industry representatives and regulators, the SEC promulgated comprehensive amendments to Rule 2a-7 relating to disclosure, portfolio maturity, liquidity, credit quality and other shareholder protections. These changes, which were overwhelmingly supported by fund sponsors and investors, were carefully designed to increase the resiliency and transparency of money market funds without altering their basic structure and operation.

While the IOSCO Report does describe the 2010 amendments to Rule 2a-7, it fails to consider adequately the substantial and growing evidence of the impact of these changes, whose efficacy was quickly demonstrated during periods of severe market stress following their implementation. For example, from June-August, 2011 markets were extremely volatile due to the dramatic escalation of the European banking crisis and the downgrade of U.S. sovereign debt. During this relatively brief period prime money market funds in the U.S. lost $172 billion, or 10.4%, of their assets. However, no fund experienced difficulty processing redemptions, maintaining a $1.00 NAV or satisfying the 10% daily and 30% weekly liquidity requirements mandated by the amended Rule 2a-7.[3] It is also instructive to examine the liquidity strains experienced by money market funds during the peak of the credit crisis in the week following the collapse of Lehman Brothers and the significant effects that the new liquidity fund requirements under Rule 2a-7 would have had during this period. As the Investment Company Institute has observed, "in December 2011, prime money market funds held daily and weekly liquid assets more than twice the level of outflows they experienced during the worst week in money market fund history."[4] As of December 2011, the Investment Company Institute ("ICI") reported that, in accordance with the revised Rule 2a-7 liquidity requirements, prime money market funds held over $1.43 trillion in assets and a minimum of $416 billion in daily liquidity and $660 billion in weekly liquidity.

[3] The IOSCO Report essentially relegates to a footnote the discussion of money market funds' successful weathering of this period of significant market stress. IOSCO Report, at 26.

[4] Comment letter to IOSCO Report submitted by the Investment Company Institute, at 9.

The vastly expanded disclosure obligations relating to money market fund portfolios are another critical element of the 2010 amendments to Rule 2a-7. This enhanced disclosure provides shareholders with voluminous, detailed and timely information regarding fund holdings and permits them to assess the fund's risk profile accurately at any point in time. In addition, the standardized format permits investors to make direct "apples-to-apples" comparisons between different funds. As a result, investors are better informed and less likely to trigger a run due to fear of the unknown. Another important addition to Rule 2a-7 is the provision authorizing a money market fund's directors to suspend redemptions if they determine that doing so is necessary in order to ensure the equitable treatment of investors following the decision to wind down a fund that has broken the buck. This "living will" provision provides the fund board with an important and highly effective tool to mitigate or eliminate the effects of an investor run on a distressed fund.

In addition to the new rules relating specifically to money market funds, it is important to take note of the numerous and substantial regulatory changes that have been or are in the process of being implemented by regulatory authorities around the globe to strengthen the integrity, transparency and soundness of financial markets generally. The period since the end of financial crisis has been among the most active in modern history for financial regulatory reform. It is therefore striking that the IOSCO Report contains, for example, only a single brief mention of the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act. The primary purpose of this legislation, which represents one of the most sweeping financial regulation efforts in U.S. history, is to identify and mitigate systemic risks to the global financial system such as those discussed in the IOSCO Report. Reforms relating to the operation of securitized products, derivatives markets and tri-party repurchase transactions are also important components of a coordinated effort to reduce systemic risk.

It is critical for policymakers to assess the combined effect of these and other reforms, many of which have not yet been fully implemented, before deciding whether additional, untested regulation is desirable. SEC Commissioner Daniel Gallagher expressed this view unequivocally recently when he observed that:

> "Without an adequate understanding of the current state of play, we are handicapped in our effort to define existing risks and measure their magnitude. Nor can we simply hand-wave and speak vaguely of addressing "systemic risk" or some other kind of protean problem. The risks and issues justifying a rulemaking must be specifically and thoughtfully defined in relation to the Commission's mission."[5]

[5] Speech given by SEC Commissioner Daniel M. Gallagher to U.S. Chamber of Commerce, December 14, 2011. In the same speech Commissioner Gallagher noted that "We *cannot* know what risks money market funds pose unless...we have a clearer understanding of the effects of the Commission's 2010 money market reforms. For some reason, much of the discussion surrounding the current need for money market reform sweeps aside the fact that the Commission has *already* responded to the 2008 crisis by making significant changes to Rule 2a-7. Notably, those amendments only became effective in May 2010...If the Commission moves forward with a proposal, the option of doing nothing until we have seriously analyzed the impact of last year's reforms must be given serious consideration. By pre-judging the outcome of this rulemaking -- that something, *anything* must be done as soon as possible, never mind the consequences – the Commission runs the

We strongly agree that proposing additional regulations without having analyzed fully the impact of the substantial steps already taken would be premature, a prospect that is particularly troubling given that such actions could have significant adverse effects on the fragile global economic recovery currently underway.

II. The partial or complete elimination of constant NAV money market funds would do little to prevent investor runs and would likely trigger large outflows from these funds.

As the IOSCO Report acknowledges, a stable net asset value ("NAV") is an integral element of most money market funds and is central to these funds' utility as an investment tool for investors. We strongly believe that eliminating the constant NAV ("CNAV"), which has been a defining feature of a majority of money market funds for over four decades, would increase rather than decrease the systemic risks that policy makers are attempting to mitigate. While imposing a variable NAV ("VNAV") regime for all money market funds might theoretically lessen somewhat the risk that investors would view them as guaranteed-principal products, it would do so at the cost of drastically decreasing their usefulness and appeal as an investment option and would likely only reallocate that risk to less regulated (or unregulated) investment vehicles.

Among the primary reasons for the overwhelming popularity of CNAV money market funds are the administrative, accounting and tax efficiencies that they offer investors, efficiencies that are directly linked to the funds' stable NAVs. If all money market funds were required to adopt VNAVs, investors could be required to determine cost basis and relevant gains and losses on each transaction, creating a substantial burden on those seeking to use the funds to manage their short-term liquidity needs. This is especially true given that money market fund investors generally engage in more frequent transactions than investors in long-term funds. Additionally, as noted in the IOSCO Report, many corporate or governmental investors would be prohibited by internal or statutory restrictions from investing in a VNAV money market fund. The continued popularity of CNAV money market funds as compared with similar VNAV products such as ultra-short bond funds—even in the face of ongoing historically low investment yields—supports the proposition that VNAV cash funds are not widely embraced by investors.[6] It is particularly notable that European investor demand for CNAV money market funds over VNAV funds has increased significantly since the financial crisis. Numerous surveys have confirmed that investors are strongly opposed to proposals to eliminate CNAV funds. For example, a recent Fidelity

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danger of skewing its analysis of any proposed regulatory changes. Any analysis we undertake will necessarily be flawed if we lack a rigorous sense of the current baseline against which to measure the effects of any proposed changes. Moreover, we have a legal obligation to thoroughly consider all reasonable alternatives, and that includes the alternative of doing nothing beyond those significant changes the Commission has undertaken just last year." [emphasis in original]

[6] As the IOSCO Report observes, CNAV funds represent approximately 80% market share of global money market funds. IOSCO Report, at 1. In addition, the ICI has noted that despite their continued low yields, U.S. money fund assets have grown from their levels immediately prior to the onset of the financial crisis. ICI Comment Letter, at 20.

Investments survey found that 89% of institutional money market fund investors and 74% of retail investors objected to mandating that the funds switch from CNAV to VNAV. Importantly, 59% of institutional investors and 47% of retail investors said that such a change would cause them to withdraw some or all of their assets from the funds.[7]

The contention in the IOSCO Report that "CNAV MMFs have contributed to create instability by giving investors the expectation of redeeming at par on the false belief that MMF shares are a risk-free cash equivalent"[8] is conclusory and unsupported by the facts, given that approximately two thirds of U.S. money market fund assets are held by highly sophisticated institutional investors who are certainly aware that money market funds, like any other investment product, are not a risk-free investment (a fact that is prominently disclosed throughout each fund's disclosure and marketing materials).[9]

It is important to acknowledge that few actions, if any, would eliminate the risk of a run on money market funds entirely. Money market funds are not, and were never intended to be, risk free instruments.[10] Like all investments money market funds are intrinsically exposed to risks including credit, interest rate, market, and operational risks. These risks are not limited to money market funds, however, as even deposits with banks, which have access to deposit insurance and access to a lender of last resort, are not immune from the risks associated with an investor run.

Faced with the prospect of CNAV funds converting to a VNAV regime, large investors, in particular, may be prone to transfer funds currently invested in CNAV money market funds to other, less regulated, vehicles that continue to offer stable. Alternatively, current CNAV investors might choose to move their assets into bank deposits, which would put significant pressure on the banking system by requiring additional capital to support those new deposits, particularly given the stringent capital requirements recently enacted as part of the Basel III regime.[11] For larger investors, including corporations and municipalities, these bank deposits would likely be uninsured and would substantially reduce the diversification of their cash management investments. Both money market funds and bank deposits are designed to preserve investors' capital and provide daily liquidity. However,

[7] "The Investor's Perspective: How individual and institutional investors view money market mutual funds and current regulatory proposals designed to change money funds." February 3, 2012.
[8] IOSCO Report, at 14
[9] Notably, the Fidelity Investments survey cited above found that 75% of retail money market fund investors understood that money market funds are not backed by a government guarantee.
[10] Indeed, SEC Commissioner Gallagher has noted that "I do not believe that it should be – nor can it be – the goal of the Commission to ensure that securities products are risk-free." Speech given by SEC Commissioner Daniel M. Gallagher to U.S. Chamber of Commerce, December 14, 2011.

[11] In a letter to U.S. Federal Reserve Chairman Ben Bernanke, one highly respected industry commentator noted that the recently discovered J.P. Morgan trading loss of approximately $2 billion could well be attributable in part to hedging activities undertaken by the bank in reaction to the high levels of cash it has on hand due its unwillingness to lend in light of these more stringent capital rules. *See* Letter from Melanie L. Fein to Ben S. Bernanke dated May 17, 2012. In the letter Ms. Fein notes that since the financial crisis, U.S. money market funds have lost approximately $1.4 trillion in assets, most of which have flowed to banks due to the unlimited deposit insurance temporarily being provided by the Federal Deposit Insurance Corporation for deposits in non-interest bearing accounts.

while each of these products exposes investors to credit risk, the credit risk borne by money market fund investors is different in nature than that related to bank deposits since money market fund portfolio investments utilize significantly less maturity-mismatching and, in direct contrast to banks, do not employ leverage. Furthermore, money market funds' underlying investments comprise a transparent portfolio of fungible high credit quality securities unlike the opaque assets and off-balance sheet commitments often carried by banks.

Finally, we do not believe that the implementation of a VNAV structure for all money market funds would reduce investors' propensity to redeem shares during periods of market stress. As the ICI and the IOSCO Report have noted, the experience of ultra-short bond funds, which may have investment strategies and portfolio characteristics similar to money market funds but maintain a floating net asset value, illustrates the redemption pressures that might face VNAV money market funds. During 2007-2008 period these ultra-short bond funds experienced an average decline of 2% in their net asset value but saw a decline in net assets of 50% in 2008 and 60% from their peak in 2007; European VNAV cash funds experienced a similar trend.[12] This was foreseeable to some degree since, as the IOSCO Report notes, "shareholders in a VNAV [money market fund], still have an incentive to run due to the limited liquidity in any [money market fund], which creates a higher share price for early redeemers, and thus a first mover advantage."[13]

We concur with the IOSCO Report's conclusion that "A sizeable shrinking of the [money market fund] industry would therefore leave many investors with fewer investment alternatives for their cash management and could direct a greater concentration of assets towards the banking sector or unregulated or less regulated substitute products."[14] We also share the concern expressed in the IOSCO Report that the imposition of a VNAV regime for money market funds could precipitate a destabilizing flood of preemptive withdrawals by investors seeking to guarantee the return of their principal. This would bring about the very result that the measure was intended to prevent in the first place: a run on funds triggering a liquidity crisis and potentially destabilizing financial markets through widespread, forced sales of portfolio holdings by money market funds.

III. Other potential changes considered in the IOSCO Report are not feasible operationally and would render money market funds unattractive to sponsors and investors.

Certain other potential changes discussed in the IOSCO Report, such as the proposal for a sponsor-funded NAV buffer or the requirement for sponsors to purchase a "first loss" equity share class from their funds, would impose significant additional costs on money market fund sponsors at a time when revenues associated with these funds are at historic lows due to the continuing low interest rate environment. The likely result would therefore

[12] *See* Investment Company Institute Report of the Money Market Working Group (March 17, 2009), at 105. The report notes that "[t]he experience in Europe of certain money and bond funds likewise demonstrates that floating net asset value funds can also face strong investor outflows during periods of market turmoil."
[13] IOSCO Report, at 14
[14] IOSCO Report, at 9.

be to drive existing sponsors out of the market and to prevent new competitors from entering. Furthermore, the myriad of operational, legal, regulatory and timing issues posed by these proposals, many of which are discussed in the IOSCO Report, render them essentially unworkable. Even more substantial operational issues would accompany the proposed "minimum balance requirement," which would restrict a money market fund investor from fully redeeming its interest in the fund. Not surprisingly, investors have also expressed a very strong resistance to these proposals and an intention to move out of money market funds if they were to be imposed. Approximately half of the retail clients surveyed by Fidelity said that they would decrease or eliminate their use of money market funds if a holdback feature were instituted and 70% objected to a redemption fee imposed during period of severe market stress.

IV. Conclusion

While we would support an extension to non-U.S. money market funds of the changes to Rule 2a-7 adopted in 2010, we believe that prior to proposing any additional money market regulations it is critical for policymakers to conduct a thoughtful and comprehensive analysis of the impact of the significant reforms made to date affecting money market funds and global financial system generally. Taking action prior to such an analysis would be premature and could seriously jeopardize the fragile global economic recovery. The analysis must therefore include a rigorous cost-benefit analysis balancing this and other risks against the incremental benefits that might be achieved by further reforms.

We appreciate the opportunity that we have been given to comment on this important matter and look forward to continuing to work with policymakers and others in the industry to ensure that money market funds remain a useful and important investment alternative for investors seeking a product that offers safety, liquidity and yield.

Sincerely,

Lyman Missimer
Head of Global Cash Management