Vanguard

P.O. Box 2600
Valley Forge, PA 19482-2600
610-669-6000

June 4, 2012

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File No. 4-619; Release No. IC-29497
President's Working Group Report on Money Market Fund Reform

Dear Ms. Murphy:

Enclosed please find comments that Vanguard recently submitted to the International Organization of Securities Commissions on its report regarding Money Market Fund Systemic Risk Analysis and Reform Options.

Sincerely,

/s/ Gus Sauter
Chief Investment Officer
Vanguard

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter, Commissioner

Eileen Rominger, Director, Division of Investment Management
Robert E. Plaze, Deputy Director, Division of Investment Management

Attachment: IOSCO Letter

Vanguard®

P.O. Box 2600
Valley Forge, PA 19482-2600
610-669-6000

May 28, 2012

Filed Electronically
Mr. Mohamed Ben Salem
International Organization of Securities Commissions ("IOSCO")
Technical Committee
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Money Market Fund Systemic Risk Analysis and Reform Options

Dear Committee Members:

The Vanguard Group, Inc. ("Vanguard")[1] appreciates the opportunity to comment on IOSCO's Money Market Fund Systemic Risk Analysis and Reform Options Consultation Report (the "Report"). Vanguard is an SEC-registered investment adviser that has managed money market mutual funds since 1981. On behalf of Vanguard fund shareholders, who currently invest approximately U.S. $197 billion in our money market funds, we have worked diligently over the last four years with our trade association, the Investment Company Institute, and various financial regulatory authorities to strengthen U.S. money market mutual funds' ability to withstand the type of extraordinary market conditions that existed in the fall of 2008.

As IOSCO begins to consider which money market fund reform measures it will recommend to the Financial Stability Board ("FSB"), we believe the recommendations must be informed by what occurred in 2008. First, only one money market fund "broke the buck." Shortly thereafter, in an environment where multiple financial institutions were failing, many institutional money market funds experienced large-scale redemptions and other money market funds faced reduced liquidity for the securities of otherwise credit-worthy issuers. Due to this market-wide illiquidity, some money market funds were not able to raise cash to satisfy investor redemptions. For all but one fund, the 2008 financial crisis was a liquidity—not credit—crisis, stemming from investors' lack of confidence in certain significant financial institutions and, particularly in the U.S., uncertainty about the Federal Reserve's willingness to act as a lender of last resort.

The 2008 financial crisis revealed a weakness in the then-prevailing U.S. money market fund regulations, which did not explicitly require liquidity thresholds for money market funds. As detailed in Appendix A, recent changes in U.S. money market fund regulations have greatly improved the funds' resiliency by addressing their ability to satisfy large redemption requests. These initiatives have made money market funds self-provisioning for liquidity, reducing the likelihood that a future systemic market disruption would threaten the liquidity of these funds and require government support.

[1] Vanguard offers more than 170 U.S. mutual funds with assets of approximately $1.8 trillion.

I. Executive Summary

Our comments to the Report are focused on three issues: (i) ensuring that IOSCO's recommendations are flexible and adaptable by the local securities regulators, who regulate various types of money market funds involving different types of debt issuers, in markets with distinct and dynamic conditions; (ii) reiterating Vanguard's opposition to the floating NAV; and (iii) reaffirming Vanguard's support for credit ratings in money market fund regulations. We address each of these issues in further detail below.

II. Request for Comments

A. IOSCO should recommend guiding principles for money market fund reform, not specific reform measures.

IOSCO has been tasked by the FSB to make recommendations on money market fund reforms that could mitigate the funds' "susceptibility to runs and other systemic risks."[2] Given IOSCO's role as an international coordinator of securities regulators, the Committee's recommendations could impact many types of money market funds with very different characteristics. Given the variety of money market funds, and the variety of issuers and markets in which those money market funds operate, we believe IOSCO should refrain from making specific reform recommendations. Instead, IOSCO should recommend certain broad reform principles, and its members should be encouraged to adopt specific reforms consistent with those principles.

To demonstrate the variation among money market funds, debt issuers and markets in which these funds operate, we offer the following examples. Most money market funds calculate their net asset value using amortized cost, which enables the funds to price their shares at a stable NAV. We will refer to these funds as CNAV funds. Most CNAV funds in the U.S. distribute income to investors on a daily or monthly basis. Other CNAV funds, however, do not distribute income, but rather, accumulate income. These CNAV funds will experience changes in net asset value as a result of the accumulation feature, notwithstanding the fact that the funds use amortized cost accounting. Other funds, however, have variable net asset values because the funds use mark-to-market accounting. We will refer to these funds as VNAV funds. VNAV funds may either distribute or accumulate income.

The issuers of debt purchased by money market funds may also vary widely. For example, in the U.S. and abroad, many issuers of money market fund instruments are corporations who seek to access the short-term credit market to finance various business functions and initiatives. In the U.S., however, states and municipalities may also issue debt, the interest on which is exempt from federal taxes, to fund projects such as the construction of schools, hospitals, roads, water and waste treatment facilities, convention centers, etc. The federal tax exemption on municipal debt creates what is called the "municipal bond market." Outside the U.S., such issuers and markets are less common.

Given the existing variation in structural features of money market funds, coupled with the different types of issuers and markets that may be impacted by any proposed IOSCO recommendations, Vanguard believes the Committee should adopt broad guiding principles to money market fund reform ("Guiding Principles").[3] IOSCO's

[2] *See* Report at p. 2.
[3] We note this approach is not unlike the approach recently taken by IOSCO with respect to ETFs.

members could then determine which specific reforms are best suited to uphold the Guiding Principles for the funds that they regulate. Vanguard recommends that the Committee adopt the following:

Guiding Principles

1. The need for reform should be considered in light of other financial reforms being undertaken in each country.

2. The reform measures should not destroy the utility or investor benefits of the product.

3. The reform measures should be narrowly tailored to avoid broader market disruptions.

We believe these Guiding Principles will help regulators strike the right balance for reform in light of all facts and circumstances relevant in their local financial markets. This approach will also enable IOSCO's member to customize and "right-size" reforms for the particular funds that they regulate, giving appropriate consideration to the downstream effects that such reforms may have on short-term debt issuers, capital markets, and importantly, investors.

B. Vanguard opposes the floating NAV for money market funds.

Vanguard strongly opposes any proposal that would require money market funds to effect shareholder transactions at a floating net asset value ("NAV") by eliminating their ability to use the amortized cost method of valuation. The certainty of the stable $1.00 NAV is a hallmark of a money market fund, and was not the cause of the problems experienced by some funds during the 2008 financial crisis.[4] The $1.00 NAV offers certainty, although not a guarantee, to investors: a dollar in, a dollar out. The $1.00 NAV also offers tax, accounting and recordkeeping simplicity.[5] A shift to a floating NAV would require significant, and expensive, changes to operational and recordkeeping systems for both funds and investors. Data and analysis provided to the SEC by the Investment Company Institute's Money Market Working Group in its March 2009 report ("Working Group Report") highlight our concerns: retail and institutional investors are likely to flee money market funds with floating NAVs, as they will lack the certainty and simplicity of the stable $1.00 NAV.[6] Some investors have already reacted strongly to the concept of a floating NAV, commenting that, the new structure would impede financing for critical infrastructure and public

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[4] The funds that experienced difficulties during the 2008 financial crisis had either (1) purchased and retained securities of questionable credit quality, or (2) managed their portfolios with inadequate liquidity. These funds did not experience stress due to the stable NAV.

[5] In the U.S., for example, all money market fund returns are distributed to shareholders as income. Investors, therefore, do not have the burden of timing purchases and sales for the purpose of a U.S. tax law known as the "wash sale" rule. In addition, shares of a floating NAV money market fund would have to be reclassified as "available-for sale" securities under relevant accounting rules. As a result, investors would have to expend considerable resources to mark-to-market the securities and calculate gains and losses. The floating NAV would also directly impact both institutional and retail investors in other ways. Institutional investors would not be able to calculate operating cash on hand until after the fund strikes its final NAV at the end of a business day, which would impede their ability to operate their businesses efficiently. Retail investors who utilize options such as check writing, bill pay, and ATM access through their money market funds would no longer be able to budget accurately for upcoming expenditures.

[6] See *Working Group Report* at http://www.ici.org/pdf/ppr_09_mmwg.pdf (pp. 105-107).

works projects, increase the cost of doing business for many states, municipalities and corporations, and disrupt cash management at both the municipal and corporate levels.[7] Vanguard believes that for these reasons investors will reject floating NAV money market funds and a large portion of their assets could flow into banks (with considerable consequences for concentrating systemic risk in the United States and putting taxpayers' dollars at risk) or into less-regulated alternatives, such as 3(c)7 cash management vehicles that would not be subject to regulations and largely unavailable to retail investors.

C. Vanguard supports the use of credit ratings to establish a minimum credit quality in money market fund regulations.

Under existing money market fund regulations, credit ratings serve as an *objective and necessary, but not sufficient,* qualification for purchasing a security. In this capacity, credit ratings provide a valuable baseline for analyzing a security's credit risk and provide investors with some assurance that their fund advisor is adhering to a minimum credit quality with respect to portfolio investments. Credit ratings are also a useful tool to prevent fund advisors from taking imprudent risks to increase yield. Although credit ratings may not always accurately reflect credit risk, removing these ratings from money market fund regulations would ignore the important role that ratings have played in reducing credit risk in money market fund portfolios over the past 40 years.

Vanguard understands the concern over the integrity of credit ratings and the potential for some advisors to over rely on them. This reliance is particularly concerning when the ratings are flawed, as was the case in several instances during the 2008 financial crisis. If, however, one considers the accuracy of credit ratings over the long term, egregious errors are the exception, not the norm. Unfortunately, removing credit ratings from money market fund regulations would not prevent fund advisors from making erroneous credit calls. In fact, removing credit ratings from money market fund regulations may cause investors to experience more frequent credit events in their money market funds. This is because fund advisors may ignore independent ratings and overestimate the accuracy of their own credit analysis. We believe it would be a mistake for the Committee to permit the credit rating errors that unfolded in 2008 to overshadow the credit rating agencies' impressive record of accurately assessing credit risk over four decades for the money market fund industry. For these reasons, we urge the Committee to support the retention of credit ratings in money market fund regulations.

[7] See comment letters submitted by Allegheny Conference on Community Development and Greater Pittsburgh Chamber of Commerce, dated April 24, 2012; American Public Power Association, Council of Development Finance Agencies, Council of Infrastructure Financing Authorities, Government Finance Officers Association, International City/County Management Association, International Municipal Lawyers Association, National Association of Counties, National Association of Health and Educational Facilities Financing Authorities, National Association of State Auditors, Comptrollers and Treasurers, National Association of State Treasurers, National Council of State Housing Agencies, National League of Cities and U.S. Conference of Mayors, dated March 8, 2012; Cincinnati/Northern Kentucky International Airport, dated January 7, 2011; Indiana Chamber of Commerce, dated March 20, 2012; Kentucky State Treasurer, Todd Hollenbach, dated January 10, 2011; National Association of State Treasurers, dated December 21, 2010; State of Utah, dated December 21, 2010; and Tennessee Municipal League, dated May 10, 2012, all filed with the SEC at *http://www.sec.gov/comments/4-619/4-619.shtml*.

We thank the Committee for the opportunity to comment on the Report. If you have any questions about Vanguard's comments or would like any additional information, please contact me or Laura Merianos, Principal, at (610) 669-2627.

Sincerely,
/s/ Gus Sauter
Chief Investment Officer
Vanguard

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

Eileen Rominger, Director, Division of Investment Management
Robert E. Plaze, Deputy Director, Division of Investment Management

APPENDIX A

Summary of 2010 changes to U.S. Money Market Fund Regulation

1. Daily and Weekly Liquidity Minimums. Revised Rule 2a-7 now requires all money market funds to hold at least 30% of their total assets in weekly liquid assets, and taxable money market funds to hold at least 10% of their total assets in daily liquid assets. The SEC noted in the Adopting Release that these daily and weekly liquidity requirements should allow funds to pay redeeming shareholders, even in market conditions similar to those that prevailed in September and October 2008.

2. "Know Your Customer" Procedures. In addition to the daily and weekly liquidity minimums, money market fund advisors are required under revised Rule 2a-7 to implement "know your customer" procedures. This new requirement assists portfolio managers in determining whether a fund may have additional liquidity needs beyond the minimums set forth in Rule 2a-7. The "know your customer" procedures will allow fund managers to identify customer concentration levels that could result in liquidity challenges for a fund, which was an issue for certain institutional money market funds in the 2008 financial crisis.

3. Portfolio Maturity. In order to limit the exposure of money market fund investors to interest rate risk and sensitivity to movement in credit spreads, revised Rule 2a-7 now limits money fund portfolios to a weighted-average maturity ("WAM") of 60 days or less, and a weighted-average life ("WAL") of 120 days or less.

4. Stress Testing. For the first time, money market fund advisors are required by revised Rule 2a-7 to stress test fund portfolios regularly to determine how they would perform in response to certain market stressors, including extraordinary redemption requests, changes in interest rates, and credit deterioration. These stress tests must also assume that a combination of these stress factors occurs simultaneously, and test results must be reported to the fund's board of directors. We believe stress testing is a useful tool to assist the advisor in managing a fund's potential liquidity needs. Vanguard has stress tested its money market fund portfolios since July 2009.

5. Portfolio Holdings Disclosure Requirements. Revised Rule 2a-7 requires each money market fund to post monthly its complete portfolio holdings on its website. In addition, each fund must file with the SEC a monthly report (Form N-MFP) containing even more detailed information about the fund and its holdings. We believe that the benefits of these detailed reporting requirements should not be overlooked. Increased stability will result from improved transparency and better understanding by investors, financial planners, investment advisers, and financial reporting outlets.

6. Suspension of Redemptions. New Rule 22e-3 under the Investment Company Act of 1940 permits money market fund boards to suspend redemptions and payment of redemption proceeds if a board concludes that a fund must liquidate. This rule allows a fund's governing body to execute its liquidation in a timely and orderly fashion, thereby curtailing any downward spiral on security prices as a result of the fund's liquidation. This additional power, coupled with the revisions to Rule 2a-7, enable money market funds to address market liquidity demands in ways they previously could not.