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January 10, 2011

Filed Electronically

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

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

Dear Ms. Murphy:

We appreciate the opportunity to provide our comments to the Securities and Exchange Commission (the "Commission") on the alternatives for money market fund reform set forth in the President's Working Group Report on Money Market Fund Reform (the "PWG Report"). Vanguard[1] is an SEC-registered investment adviser that has managed money market mutual funds since 1981. On behalf of our shareholders, who currently invest approximately $194 billion in our money market funds, we are deeply committed to working with the financial regulatory authorities to strengthen the money market industry's ability to withstand the stresses of the next financial crisis.

We appreciate the balanced and thoughtful discussion of the various money market fund reform alternatives set forth in the PWG Report. We believe the report appropriately underscores the complexity involved in further reducing money market funds' potential susceptibility to runs, and demonstrates the very real danger that the potential "cure" is worse than the "disease." It is important, therefore, that any reforms pursued by the Financial Stability Oversight Council (the "Council") carefully consider the consequences that such reforms may impose on the economy, financial markets, borrowers and investors. Careful and deliberate consideration of the downstream effects of any additional money market fund reform will help ensure that any changes will be positive and enduring, and will bolster rather than destroy a valuable cash management product for millions of investors and a much-needed source of financing for government, financial and corporate borrowers.

At the outset, we believe it is important to note that, for money market funds, the 2008 financial crisis was a *liquidity* crisis, not a credit crisis. During the Fall of 2008, many institutional money market funds experienced large-scale redemptions and other money market funds saw reduced liquidity (*i.e.*, the inability to find willing buyers and sellers for portfolio securities) for the securities of otherwise credit-

[1] Vanguard offers more than 160 U.S. mutual funds with aggregate assets of approximately $1.5 trillion.

worthy issuers. Due to this market-wide illiquidity, some money market funds were not able to raise cash to satisfy investor redemptions. The government's intervention at the time, specifically through programs like the AMLF, was designed to appropriately restore liquidity to the market.

The 2008 crisis revealed a weakness in the then-prevailing money market fund regulation, which did not explicitly require liquidity thresholds for money market funds. As detailed below, recent changes in money market fund regulation (which imposed new minimum liquidity levels for all money market funds) have greatly increased the funds' liquidity and ability to satisfy large redemption requests. The result of these initiatives is to make money market funds self-provisioned for liquidity, reducing the likelihood that a future systemic market disruption would threaten the liquidity of these funds and require government support. In addition, as more particularly discussed below, we believe the money market fund industry has developed a blueprint for a private liquidity facility to further support money market funds in need of additional liquidity if market-wide illiquidity conditions were to recur. Proposals for a floating NAV do nothing to make money market funds more robust in the face of adverse liquidity conditions. They merely change accounting mechanics and make investment in and management of money market funds more complex.

Revised Rule 2a-7 and Related Regulatory Changes Strengthen Funds' Liquidity

As acknowledged in the PWG Report, the Commission's recent amendments to Rule 2a-7 and certain other rules that govern money market funds under the Investment Company Act of 1940[2] have made money market funds more resilient to credit and liquidity pressures, and will help reduce the likelihood of runs.[3] We believe the amendments to Rule 2a-7 and related money market fund rules, which we strongly supported, significantly improve a fund's ability to withstand unusually high redemption activity.[4] In particular, we believe the following reforms have undoubtedly strengthened the liquidity of money market fund portfolios, as further described below:

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.[5] The Commission 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.[6]

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.[7] This new requirement assists portfolio managers in determining whether a fund may have additional liquidity needs beyond the Rule's minimums. 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 market 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

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[2] *See Money Market Fund Reform*, SEC Release No. IC-29132 (Feb. 23, 2010) (the "Adopting Release").
[3] PWG Report, Section 2(a).
[4] *See* Vanguard Comment Letter, *Money Market Fund Reform;* Release No. IC-28807; File No. S7-11-09 (Aug. 19, 2009), *available at http://www.sec.gov/comments/s7-11-09/s71109-35.pdf.*
[5] Rule 2a-7(c)(5)(iii) and Rule 2(a-7(c)(5)(ii), respectively.
[6] *See* Adopting Release at p. 57.
[7] Rule 2a-7(c)(5).

to a weighted-average maturity ("WAM") of 60 days or less, and a weighted-average life ("WAL") of 120 days or less.[8] Vanguard supported the Commission's efforts to limit the exposure of money market fund investors to these risks.

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.[9] 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.[10] In addition, each fund must file with the Commission a monthly report containing even more detailed information about the fund and its holdings.[11] 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.[12]

6. *Suspension of Redemptions.* New Rule 22e-3 under the 1940 Act 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.

We believe the Commission's new money market fund rules appropriately allow money market funds to continue to finance the short-term needs of private and public borrowers while mitigating the risk that money market fund liquidity pressures would produce severe market-wide illiquidity. As we have previously stated, we do not believe that the market-wide illiquidity that occurred in the 2008 market crisis resulted from money market fund activity, but rather from banking entities' unwillingness to accept each others' credit risk.[13] Nonetheless, we understand that the PWG, Council and Commission believe more should be done to further mitigate the potential structural vulnerabilities of money market funds to runs.

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[8] Rule 2a-7(b)(2)(ii)-(iii).
[9] Rule 2a-7(c)(10(v).
[10] Rule 2a-7(c)(12).
[11] Rule 30b1-7.
[12] Money market funds were required to file their initial reports on Form N-MFP by December 7, 2010. Each Form N-MFP contains, among other information, the market-based net asset value, or "shadow NAV," of its portfolio as of the last business day of the previous month. Under Rule 2a-7, a money market fund's shadow NAV may fluctuate up to 50 basis points from the $1.00 stable net asset value at which investors purchase or redeem shares in the fund. The initial Form N-MFPs will become publicly available on the Commission's website on January 31, 2011. In the interim, commentaries regarding the significance of the shadow NAV and money market funds in general have begun to appear in the financial press. *See, e.g.,* Crane Data, *Slight Deviations in Shadow NAV No Cause for Alarm Says S & P*, (Nov. 23, 2010), *available at* http://www.cranedata.com/archives/all-articles/3173/. Increased investor familiarity with concepts such as the shadow NAV of their fund, coupled with the detailed portfolio information available on the fund's website and in its Forms N-MFP, should further lessen the risk that a run on a money market fund could be precipitated by investor confusion or misinformation.
[13] *See* Vanguard Comment Letter to the Financial Stability Oversight Council re: *Advanced Notice of Proposed Rulemaking Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies* (FSOC-2010-0001) (Nov. 5, 2010), at 3, *available at http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0001-0033.1.*

Of the possible reforms outlined in the PWG Report, Vanguard believes that the creation of a private emergency liquidity facility for prime money market funds is the best alternative that directly addresses the liquidity issue and, therefore, would be the most effective and appropriate option to address the potential for a run. We believe the implementation of a private emergency liquidity facility will most effectively complement revised Rule 2a-7, further strengthening the solid regulatory framework that has protected investors in money market funds for approximately 40 years.

Vanguard Supports the Creation of a Private Liquidity Facility

Vanguard supports the creation of a private liquidity facility for several reasons. A private liquidity facility could provide the necessary liquidity to satisfy shareholder redemptions, which under extremely rare market conditions, could cause a fund to use its 30% liquidity reserves, and prevent the liquidity pressures experienced by one fund from spreading to another. Quite simply, it's a solution that addresses the potential problem. A liquidity facility capitalized by money market funds and their sponsors would satisfy the PWG's request that money market funds internalize the cost of liquidity[14] and would not put taxpayer dollars at risk. This solution also has the advantage of retaining the stable NAV, which in turn, retains the funds' appeal to investors seeking cash management options, which in turn, provides issuers like corporations, financial institutions, and governments with a reliable, low cost option for short-term financing. The creation of a private liquidity facility would not require bank-like capital requirements to be maintained by funds or their sponsors, which the PWG Report very clearly recognized involved significant challenges.[15] Importantly, the creation of a private liquidity facility would not cause dislocations in the financial markets, and would preserve money market funds as a source of relatively low-cost, short-term financing.

Our support for the private liquidity facility is premised on the following conditions:

1. The money market fund industry is permitted to maintain the stable NAV;
2. Funds and their sponsors are not required to maintain bank-like capital requirements;
3. Participation in the liquidity facility is mandatory for all prime money market funds;[16]
4. Cost of participation in the liquidity facility must be reasonable given prevailing market conditions; and
5. The liquidity facility is permitted to be capitalized over a reasonable time period.[17]

[14] See PWG Report, Executive Summary at p.3.

[15] See PWG Report, Section 3(g).

[16] Collectively, money market mutual funds currently manage approximately $3 trillion of assets. Prime money market funds (those funds which primarily purchase financial and corporate short-term debt) currently manage approximately $1.6 trillion of assets. During the 2008 financial crisis, institutional prime money market funds experienced greater than normal redemption activity, when approximately $300 billion in assets left these funds between September 15, 2008 and September 18, 2008. Vanguard supports the mandatory participation of all prime money market funds in the liquidity exchange bank because these funds invest in securities that are likely to pose the greatest credit and/or liquidity risk in the event of a widespread financial crisis. Money market funds that invest primarily in short-term government securities, such as Treasuries, government agencies and municipal credits are least likely to present comparable credit or liquidity concerns. These types of money market funds should be permitted to maintain the stable NAV in accordance with revised Rule 2a-7.

[17] Bank regulators have long recognized that building capital takes time. Most recently, the Basel Committee on Banking Supervision proposed a series of new bank capital and liquidity requirements, known as Basel III. These reforms, originally proposed in December 2009, provide for a gradual increase in capital buffers over a ten-year period. A bank designed to provide liquidity to money market funds during times of extreme financial stress should also be permitted to build its capital over time in order to avoid significant disruptions and dislocations of capital within the financial markets. While this liquidity bank is accumulating assets, prime money market funds could

Based on these conditions, we strongly support the Investment Company Institute's proposal for a private liquidity facility, and urge the Council to give the proposal very careful consideration. We believe the ICI's work performed to date on this liquidity facility, in consultation with members of the PWG, has been significant and should serve as the blueprint for the ultimate liquidity facility that is adopted by the industry. Undoubtedly, much more work needs to be done before the liquidity facility becomes a reality; however, Vanguard is committed to working with the ICI and financial market regulators to pursue this option.

Vanguard Opposes the Floating NAV

We reiterate our strong opposition to any proposal that would require money market funds to effect shareholder transactions at a floating NAV.[18] The $1.00 NAV offers certainty to investors: a dollar in, a dollar out. The $1.00 NAV also offers tax, accounting and recordkeeping simplicity.[19] 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 Commission by the ICI'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.[20] Ironically, the imposition of a floating NAV might actually spark a run that regulators are trying to prevent, as investors may be more price sensitive to an NAV that fluctuates. Some investors have already reacted strongly to the concept of a floating NAV, commenting that, even if they could get comfortable with the new structure, the tax, accounting and operational challenges would be a "nightmare."[21] Based on our discussions with investors we believe they will reject floating NAV money market funds and a large portion of these assets, to the extent they are owned by institutions or high net-worth individuals, would likely flow into less-regulated alternatives, such as unregistered domestic cash management vehicles or offshore investment funds.[22] These unregistered vehicles and offshore funds would not, however, be accessible by the small retail investor seeking a cash management alternative to the traditional banking account.

Once again we voice our concern that any proposal to introduce a floating NAV to money market funds could cause the funds to experience unprecedented instability and cash flow volatility. We believe

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increase their daily liquidity reserves from 10% to 15%. The daily liquidity requirement could be reduced to 12.5% when the liquidity bank reaches one-half of its capacity, and reduced back down to 10% when the bank reaches full capacity.

[18] We note that we are not alone in our opposition to the floating NAV. During the recent comment period on R. 2a-7 amendments, the Commission received more than 60 comment letters opposing the floating NAV.

[19] For example, because all money market fund returns are distributed to shareholders as income, the burden of timing purchases and sales for the purpose of the "wash sale" rule is lifted from investors. In addition, shares of a floating NAV money market fund would have to be reclassified as "available-for sale" securities under accounting rules. As a result, investors would have to expend considerable resources to mark the securities to market, calculate gains and losses, and pay the resulting tax liability for each transaction made in their money market account. 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 money market funds would no longer be able to budget accurately for upcoming expenditures. Finally, due to the certainty of the funds' NAV, it is often hard-coded into accounting and cash-tracking systems. See *Working Group Report, pp. 107-111.*

[20] See *Working Group Report,* pp. 105-107.

[21] See *Working Group Report,* p. 110.

[22] The PWG Report discusses the possibility for legislative or regulatory reforms to prohibit unregistered investment vehicles from providing a stable NAV product to investors. We do not believe such reforms would eliminate or deter the development of an offshore money market fund industry, which could increase systemic risk in the U.S. markets to the extent domestic institutions invest in such funds.

strongly that a smaller money market fund industry would have a substantially adverse impact on the broader economy. For all of these reasons, Vanguard urges the Council and the Commission to reject the concept of a floating NAV for money market funds.

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We commend the PWG, Council and Commission for their thoughtful consideration of money market reform options, and we appreciate the opportunity to comment on the PWG Report. If you have any questions about Vanguard's comments or would like any additional information, please contact Natalie Bej, Principal, at (610) 503-5693 or Laura Merianos, Senior Counsel, at (610) 669-2627.

Sincerely,

/s/ F. William McNabb III

Chairman and Chief Executive Officer
Vanguard

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

Jennifer B. McHugh, Acting Director, Division of Investment Management
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Financial Stability Oversight Council