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November 2, 2012

VIA HAND DELIVERY

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Economic Consequences of Proposals to Require Money Market Funds to "Float" Their NAV; File No. 4-619

Dear Chairman Schapiro:

Attached is an analysis of the potential adverse economic consequences of proposals to require money market mutual funds (Money Funds) to "float" their net asset values (NAVs). This analysis is derived principally from letters, surveys, reports and other data submitted to the Commission through its comment file on the President's Working Group Report on Money Market Mutual Fund Reform Options and its comment file on the 2010 amendments to Rule 2a-7.

The paper addresses the following points regarding the elimination of the stable NAV for Money Funds:

- Eliminating the stable NAV for Money Funds is unnecessary to address any investor misperceptions about the nature of Money Funds. Surveys and comment letters show that investors know and understand that Money Funds are investments that are "not FDIC insured" and "may lose value."

- A floating NAV would not reflect a measurably more "accurate" valuation of Money Fund shares than the amortized cost accounting method currently used by Money Funds. For prime Money Funds in particular, many portfolio instruments are fair valued (generally using matrix pricing) and, while rigorous and objective pricing criteria is utilized to approximate market value, the suggestion that a floating NAV would reflect a true "mark-to-market" value is a myth. In any event, data on Money Fund "shadow" NAVs over time demonstrates that variations in value from amortized cost valuations are minute.

- Requiring a floating NAV would do nothing to advance the regulatory goal of reducing or eliminating "runs." There is no data to support this proposition and, indeed, data from the recent financial crisis show just the opposite.

- Requiring a floating NAV, for the sake of showing minute variations in value that cancel out over time, would eliminate Money Funds as a viable cash management tool for many users by destroying their principal liquidity function. A wide range of Money Fund users have filed comment letters with the Commission making this point.

- Requiring a floating NAV, for the sake of showing minute variations in value that cancel out over time, would also impose significant operational, accounting and tax burdens on users of Money Funds and destroy their utility. Users have warned that a shift to a floating NAV would disrupt numerous business applications and would necessitate a significant retooling of accounting, trading and settlement systems, at significant costs. A floating NAV would create additional accounting and tax burdens for investors, further discouraging their use.

- Requiring a floating NAV would prevent certain investors who are subject to statutory prohibitions and investment restrictions from using Money Funds. Numerous corporate, government, and other institutional users are subject to such statutes or other restrictions that would prohibit them from investing in floating NAV funds.

- Because of these impediments and costs, requiring a floating NAV would substantially shrink the assets of Money Funds. Surveys suggest that half or more of all investors would either decrease or discontinue use of Money Funds with a floating NAV feature.

- Requiring a floating NAV would therefore contract the market for, and raise the cost of, short-term public and private debt financing while potentially destabilizing those markets. Money Funds hold substantial amounts of commercial paper and short-term state and local government debt, and a decrease in Money Funds' ability to purchase these instruments would increase financing costs for a range of corporations and state and local governments.

- Requiring a floating NAV would force current users to less regulated and less transparent products or to manage their own portfolios of money market instruments. These alternatives may be more susceptible to market conditions and market risks. As commentators have pointed out in letters to the

Commission, this is hardly consistent with efforts to reduce risk, increase transparency, and ensure greater market stability.

- Requiring Money Funds to utilize a floating NAV would accelerate the flow of assets to "Too Big to Fail" banks, further concentrating risk in that sector. Even bank regulators have acknowledged that a broad shift of institutional cash to the banking system could lead to a large increase in uninsured, "hot money" deposits. This certainly would increase, not decrease, systemic risk.

As far as we can tell, after reviewing the record developed by the Commission over the past three and a half years, there is no evidence of any benefits that would be derived from requiring Money Funds to use a floating NAV. However, commenters have raised ample concerns about significant harmful economic consequences that could flow from such a change, which we have summarized in the attached paper. We hope the Commission will give further study to these issues, utilizing data and applying rigorous economic analysis, before proposing amendments to its rules that would eliminate the stable NAV for Money Funds. We will assist you in this effort in whatever way you believe would be most helpful.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

Enclosure

cc: The Honorable Luis A. Aguilar
The Honorable Daniel Gallagher
The Honorable Troy A. Paredes
The Honorable Elisse B. Walter
The Honorable Timothy F. Geithner
The Honorable Ben Bernanke
The Honorable Thomas J. Curry
The Honorable Richard Cordray
The Honorable Martin J. Gruenberg
The Honorable Gary Gensler
The Honorable Edward DeMarco
The Honorable Debbie Matz
The Honorable Roy Woodall

Proposals for a Floating NAV for Money Market Mutual Funds: Harming Investors and the Economy

November 2, 2012

Prepared by Arnold & Porter LLP on behalf of Federated Investors, Inc.

Proposals for a Floating NAV for Money Market Mutual Funds: Harming Investors and the Economy

Thirty years ago, the Securities and Exchange Commission (SEC), after many years of debate and an 18-month notice and comment rulemaking, determined that money market mutual funds (Money Funds or MMFs) would continue to be permitted to use amortized cost accounting to value their shares and round share prices up or down by 1/2 cent to $1.00 per share, if (and only if) Money Funds met stringent risk-limiting conditions of Rule 2a-7 under the Investment Company Act.[1] These conditions have been strengthened over the years to require higher asset quality, shortened maturity, enhanced transparency, and liquidity standards sufficient to meet even extraordinarily high levels of shareholder redemptions.[2]

Amortized cost accounting is a method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount.[3] For example, for securities or other assets purchased at a discount, amortized cost accounting takes the historical cost of each portfolio asset, subtracts it from the par value at maturity, divides that difference by the number of days remaining to maturity to find a daily imputed interest amount, and adds to the value each day a daily amount of imputed interest until the maturity date. With very short-term assets, and substantial natural liquidity within the portfolio, cash is available to pay redeeming Money Fund investors through the normal maturity of portfolio investments. There should be no need to sell assets into the secondary markets to pay redeeming shareholders, and therefore any minor difference between the amortized cost of the asset and its current "market" price will never be realized.[4]

The stability, diversification, and high credit quality of Money Funds over the years has enabled millions of individuals, businesses, nonprofits, and state and local governments to invest significant portions of their liquid assets in these funds – with total shareholder balances today

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[1] 17 C.F.R. § 270.2a-7. *See* Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), 48 Fed. Reg. 32555 (July 18, 1983) (codified at 17 C.F.R. § 270.2a-7). At the time, those conditions: (1) limited the types of investments Money Funds could make to short-term, high quality debt instruments; (2) imposed on the board of directors of the Money Fund a special obligation to ensure that a stable price per share was maintained; and (3) required the board, in good faith, to determine that it was in the best interests of the Money Fund and its shareholders to maintain a stable net asset value (NAV) or price per share and to discontinue its use if the method ceased to reflect fairly the market-based NAV per share.

[2] Money Market Fund Reform, 75 Fed. Reg. 10060 (Mar. 4, 2010) (codified at 17 C.F.R. Parts 270 and 274).

[3] 17 C.F.R. § 270.2a-7(a)(2).

[4] Indeed, this is the basic assumption underlying amortized cost accounting under Generally Accepted Accounting Principles (GAAP). Accounting for Certain Investments in Debt and Equity Securities, Statement of Fin. Accounting Standards No. 115, § 7 (Financial Accounting Standards Bd. 1993). Of course, Money Funds may trade instruments from time to time to better take advantage of small opportunities for relative value.

exceeding $2.5 trillion.[5] Due to the diversification, transparency, and high credit quality of their portfolios, and the mandatory liquidity levels, Money Funds are a more conservative investment than other fixed income alternatives, and far more efficient for an investor than attempting to manage an individual portfolio of bonds. Even bank regulators acknowledge that, for large balances in excess of the $250,000 FDIC deposit insurance limits, Money Funds are safer than bank deposits, which represent undiversified and unsecured exposures to a bank.[6]

The key characteristics of Money Funds are the stable NAV used for pricing share purchases and redemptions, and the risk-limiting requirements of Rule 2a-7. Individual investors rely upon the convenience of the one dollar per share pricing, which is why investors throughout the U.S. have opposed proposals to require Money Funds to "float" their NAV. As the AARP has stated, "the requirement of floating net asset values would radically and detrimentally alter the role and function of money market funds, discourage the use of money market funds for individual investors, and disrupt the financial market landscape for investors."[7]

In addition, many institutional users of Money Funds – corporations, state and local governments, and trustees, cannot (by law or investment guidelines) or will not (because of cost, operational, tax, or accounting considerations) use a floating NAV Money Fund. Indeed, the one dollar per share pricing is critical to the utility of Money Funds for a variety of applications involving automated accounting and settlement systems and is incorporated into many automated systems and the interfaces used in these systems, including: bank trust accounting systems; corporate payroll processing; corporate and institutional operating cash balances; federal, state and local government cash balances; municipal bond trustee cash management systems; consumer receivable securitization cash processing; escrow processing; custody cash balances and investment manager cash balances; 401(k) and 403(b) employee benefit plan processing; broker-dealer and futures dealer customer cash balances; and cash management type accounts at banks and broker-dealers.[8]

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[5] Investment Company Institute (ICI), *Money Market Mutual Fund Assets, Week ending October 24, 2012* (Oct. 25, 2012), http://www.ici.org/research/stats/mmf/mm_10_25_12.

[6] Federal Reserve Bank of New York Staff Report, *The Minimum Balance at Risk: A Proposal to Mitigate the Systemic Risks Posed by Money Market Funds* at 52 (July 2012), http://www.federalreserve.gov/pubs/feds/2012/201247/201247pap.pdf ("Even bank deposits have safety disadvantages for large institutional investors whose cash holdings typically exceed by orders of magnitude the caps on deposit insurance coverage; for these investors, deposits are effectively large, unsecured exposures to a bank. MMF shares–which represent claims on diversified, transparent, tightly regulated portfolios–would continue to offer important safety advantages relative to bank deposits [even if the regulatory structure of Money Funds were altered].") (FRBNY Report).

[7] Letter from AARP to SEC (Sept. 8, 2009). Unless otherwise stated, all letters cited in this paper were filed in response to the SEC's Request for Comment on the President's Working Group Report on Money Market Fund Reform, File No. 4-619, http://www.sec.gov/comments/4-619/4-619.shtml (letters dated 2010 or later) or the SEC's Request for Comment on a Proposed Rule: Money Market Fund Reform, File No. S7-11-09, http://www.sec.gov/comments/s7-11-09/s71109.shtml (letters dated 2009).

[8] These uses are discussed extensively in the Appendix. Of course, Money Funds and their transfer agents are required to have the capacity to redeem and sell securities based on a net asset value reflecting current market conditions, which must include the ability to redeem and sell securities at prices that do not correspond to the stable NAV per share. 17 C.F.R. § 270.2a-7(c)(13).

Certain regulators nonetheless are seeking to eliminate the stable value feature of Money Funds and require Money Funds to "float" the value at which they sell and redeem shares. They are promoting this change, even while acknowledging that it could have severe, adverse and destabilizing effects on investors, borrowers, and the economy.

A recent report by the Federal Reserve Bank of New York stated:

> [B]ecause a floating NAV requirement would eliminate what appears to be a key attraction for many MMF investors, such a change might lead to a precipitous decline in MMF assets and in these funds' capacity to provide short-term funding. . . . [S]table-value investment vehicles would continue to pose systemic risks if assets migrate to other, less regulated, less transparent stable-NAV products (such as offshore MMFs and some private liquidity funds). Alternatively, if institutional investors move cash to banks, the banking system might experience a large increase in uninsured, "hot money" deposits.
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> [A] floating NAV might lead to a steep decline in investor demand for MMF shares and a migration of assets to less regulated vehicles that continue to offer stable NAVs. Moreover, even if MMFs with floating NAVs remain sizable, they might continue to be vulnerable to runs, since investors in distressed funds still would have strong incentives to redeem.[9]

A 2010 report by the President's Working Group warned that adopting a floating NAV would make Money Funds a less desirable or even useless product for certain kinds of investors, the redemptions from which may cause deleterious and unintended consequences for a variety of users and credit markets as a whole.[10] The report also said that the very shift to a floating NAV could cause major disruptions:

> MMFs are the dominant providers of some types of credit, such as commercial paper and short-term municipal debt, so a significant contraction of MMFs might cause particular difficulties for borrowers who rely on these instruments for financing. If the contraction were abrupt, redemptions might cause severe

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[9] FRBNY Report at 5, 54.

[10] Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options at 21 (Oct. 2010), http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf ("[S]ome investors face functional obstacles to placing certain assets in floating NAV funds. For example, internal investment guidelines may prevent corporate cash managers from investing in floating NAV funds, some state laws allow municipalities to invest only in stable-value funds, and fiduciary obligations may prevent institutional investors from investing client money in floating NAV funds. In addition, some investors may not tolerate the loss of accounting convenience and tax efficiencies that would result from a shift to a floating NAV, although these problems might be mitigated somewhat through regulatory or legislative actions.") (PWG Report).

disruptions for MMFs, the markets for the instruments the funds hold, and borrowers who tap those markets.[11]

A range of Money Fund users and industry participants also have warned that the process of switching to a floating NAV would destabilize the short-term credit markets[12] and create volatility.[13]

It therefore is astonishing that the Chairman of the SEC, who operates pursuant to statutory requirements that Commission's rules must consider efficiency, competition, and capital formation,[14] and the Secretary of the Treasury and Chair of the Financial Stability Oversight Council (FSOC), which must account for "costs to long-term economic growth" in making recommendations to other agencies to adopt rule changes pursuant to Section 120 of the Dodd-Frank Act,[15] continue to promote the elimination of Money Funds' stable NAV as a regulatory option, when such a change is predicted to increase the costs of borrowing, impede efficient cash management, increase systemic risk by shifting assets to less regulated markets or systemically important banks, and undermine long-term economic growth.[16] A regulator, advocating for a change that could have such enormous costs and far-reaching consequences, should have compelling evidence of the benefits of such a change. Indeed, the FSOC, in addition to statutory requirements compelling its consideration of costs to long-term economic growth, is subject to executive orders by the current and former administrations to undertake rigorous cost-benefit analyses when engaging in major regulatory actions.[17] But regulators have

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[11] PWG Report at 21.

[12] Letter from Cachematrix to SEC (Dec. 12, 2011); Letter from ICI to SEC (Jan. 10, 2011); Letter from National Association of State and Local Treasurers to SEC (Dec. 21, 2010); Letter from Invesco to SEC (Sept. 4, 2009).

[13] *See, e.g.*, Letter from American Association of State Colleges and Universities to SEC (Jan. 21, 2011); Letter from ICI to SEC (Jan. 10, 2011).

[14] *See* National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, § 106. The National Securities Market Improvement Act of 1996 added amendments to each of the major Federal Securities Laws (including the Investment Company Act) requiring the SEC to consider efficiency, competition, and capital formation whenever it is engaged in rulemaking that requires the agency to consider or determine whether an action is necessary or appropriate in the public interest. *See* Investment Company Act of 1940, § 2, 15 U.S.C. § 80a–2.

[15] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 120(b)(2)(A); 12 U.S.C. § 5330(b)(2)(A).

[16] These adverse consequences are detailed in numerous comment letters filed with the SEC, many of which are summarized in this memorandum.

[17] *See* Exec. Order No. 13563, 76 Fed. Reg. 3821 (Jan. 21, 2011) (reaffirming Exec. Order 12866, 58 Fed. Reg. 51735 (Oct. 4, 1993)) (EO 13563). EO 13563 does not apply to "independent regulatory agencies" as defined by 44 U.S.C. § 3502(5), which includes agencies such as the SEC, FRB, OCC, FDIC, and CFTC – although they are encouraged to follow it. The FSOC is not a listed agency under § 3502(5) and therefore is covered by EO 13563. Indeed, the FSOC has referenced EO 13563's standards in its rulemaking. *See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 64264, 64272 (proposed Oct. 18, 2011) (referencing Executive Orders 12866 and 13563 in the FSOC's rule release). The SEC also is subject to mandatory internal guidance requiring it to consider the economic consequences of any rulemaking. Division of Risk, Strategy, and Financial Innovation and Office of General Counsel, Securities & Exchange Commission, *Current Guidance on Economic Analysis in SEC Rulemakings* (Mar. 16, 2012).

no compelling data suggesting any benefits from forcing Money Fund to move to a floating NAV. In fact, they have no evidence at all.

Indeed, as a recent paper by three finance and economics professors has observed:

> Several papers have critically examined these additional [proposed] regulations: ICI (2009); the report from the President's Working Group on Financial Markets (2010); the Squam Lake Group report (2011); Fisch and Roiter (2011); Macey (2011); Duffie (2012); and McCabe, Capriani, Holscher, and Martin (2012). All of the papers point out problems with the [floating] NAV proposal. First, it would impose substantial costs on investors and push many–particularly institutional investors–to move their money into less regulated sectors of the market. Second, given the lack of an active secondary market for many of the assets held by MMFs, it would be difficult to price on a regular basis, making it difficult to operationalize the proposal. Third, a floating NAV does not change investors' incentives to remove their money quickly when they believe there has been a change in the riskiness of the fund. In other words, MMFs reporting floating NAVs can still experience runs.[18]

Regulators need to weigh fully whether the speculative benefits of the floating NAV proposal, as well as the other Money Fund reform proposals under consideration, are worth the cost of dramatically shrinking the Money Fund industry and directing investor funds to institutions and products that are less transparent and generate potentially higher systemic risks.

As discussed in this paper, which is derived principally from thousands of comment letters, reports and studies filed with the SEC, the elimination of the stable NAV for Money Funds –

(1) Is wholly unnecessary to address the perceptions of investors, who know and understand that Money Funds are investments that are "not FDIC insured" and "may lose value;"

(2) Would not reflect a measurably more "accurate" valuation of Money Fund shares than the amortized cost accounting method currently used by Money Funds;

(3) Would do nothing to advance the stated regulatory goal of eliminating or decreasing the risk of runs and, indeed, could precipitate runs;

(4) For the sake of showing minute variations in value that cancel out over time, would eliminate Money Funds as a viable cash management tool by destroying their principal liquidity function;

[18] Professor David W. Blackwell, Professor Kenneth R. Troske, and Professor Drew B. Winters, *Money Market Funds Since the 2010 Regulatory Reforms: More Liquidity, Increased Transparency, and Lower Credit Risk* (Fall 2012), http://www.uschamber.com/sites/default/files/reports/FinalpaperwithCover_smalltosend.pdf (citations for the papers referred to in this quote can be found in the References section of the paper).

(5) For the sake of showing minute variations in value that cancel out over time, would also impose significant operational, accounting and tax burdens on users of Money Funds and destroy their utility;

(6) Would altogether prevent certain investors who are subject to statutory prohibitions and investment restrictions from using Money Funds;

(7) Because of these impediments and costs, would substantially shrink the assets of Money Funds;

(8) Would therefore contract the market for, and raise the cost of, short-term public and private debt financing while potentially destabilizing those markets;

(9) Would force current Money Fund users to less regulated and less transparent products; and

(10) Would accelerate the flow of assets to "Too Big to Fail" banks, further concentrating risk in that sector.

(1) The elimination of the stable NAV is wholly unnecessary to address the perceptions of investors, who know and understand that Money Funds are investments that are "not FDIC insured" and "may lose value."

SEC Chairman Schapiro has stated that Money Fund investors "don't appreciate that these are investments, these are not cash instruments, they're investments and when they break the buck, the impetus to run is enormous."[19] She has said that a floating NAV would "reinforce what money market funds are – an investment product"[20] and would "cause shareholders to become accustomed to fluctuations in the funds' share prices, and thus less likely to redeem en masse if they fear a loss is imminent, as they do today."[21] She has further commented, "The stable $1.00 share price has fostered an expectation of safety, although money market funds are

[19] *Oversight of the Securities and Exchange Commission: Hearing Before the Subcomm. on Capital Markets and Government Sponsored Enterprises of the H. Comm. on Financial Services* (Apr. 25, 2012) (archive of hearing webcast), http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=290689.

[20] Chairman Mary L. Schapiro, Remarks at SIFMA's 2011 Annual Meeting (Nov. 7, 2011).

[21] *Perspectives on Money Market Mutual Fund Reforms*: *Hearing Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, 112th Cong. 12 (Jun. 21, 2012) (Testimony of Chairman Mary L. Schapiro), http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=bba4146c-6b7f-47d0-93bc-ebc73189c9c0. *See also* Chairman Mary L. Schapiro, Remarks at the Society of American Business Editors and Writers Annual Convention (Mar. 15, 2012) (A floating NAV would "desensitize investors to the occasional drop in value" of MMFs.).

subject to credit, interest-rate and liquidity risk. . . . As a result, when a fund breaks the dollar, investors lose confidence and rush to redeem."[22]

It's not appropriate for regulators to treat investors "like children." In a hearing before the Senate Committee on Banking, Housing, and Urban Affairs, the Treasurer of the State of Maryland responded to Chairman Schapiro:

> [O]n behalf of many of the investors . . . [w]e do read the prospectus and we know it's an investment. It's not a savings account. And the reforms of 2010 and the experience of 2008 I think has brought that home very clearly. So I think this treating us sort of like children is really not appropriate.[23]

The National Association of State and Local Treasurers made similar comments in a letter filed with the SEC, stating that it "does not accept the statement that investors believe that money market funds are 'risk free cash equivalents.' On the contrary, NAST believes that investors realize that money market funds have an inherent risk, albeit a small one."[24] An investor, in a comment letter to the SEC, stated, "I think you underestimate American's abilities to comprehend the investment risks that they're taking. And those of us that do understand the risks should not have to suffer poorer investments options . . . ."[25]

These views are borne out in surveys of retail investors. For example, Fidelity Investments, after conducting a survey of its retail customers, reported that 75% of retail investors surveyed understood that MMFs are not guaranteed by a government entity. Only 11% of those surveyed believed MMF were guaranteed, while 14% were unsure.[26]

The fact is that neither the SEC nor any other regulator has provided survey or other data supporting the view that investors believe there is "implicit" support for Money Funds or that they are unaware of the small fluctuations in underlying market value of Money Fund shares. In addition to surveys of retail investors, which tell us a great deal, the vast majority of Money Fund investors are institutional investors, and it simply is not credible to assert they do not understand the nature of Money Funds. Money Funds clearly disclose that they are "**Not FDIC**

[22] *Perspectives on Money Market Mutual Fund Reforms*: *Hearing Before the U.S. Senate Comm. on Banking, Housing, and Urban Affairs*, 112th Cong. 10 (Jun. 21, 2012) (Testimony of Chairman Mary L. Schapiro), http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=bba4146c-6b7f-47d0-93bc-ebc73189c9c0.

[23] *Oversight of the Securities and Exchange Commission: Hearing Before the Subcomm. on Capital Markets and Government Sponsored Enterprises of the H. Comm. on Financial Services* (Apr. 25, 2012) (archive of hearing webcast), http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=290689 (Testimony of Maryland State Treasurer Nancy Kopp in response to questions posed by Senator Toomey).

[24] Letter from National Association of State and Local Treasurers to SEC (Dec. 21, 2010) (internal citations omitted).

[25] Letter from Scott O'Reilly to SEC (Aug. 16, 2012).

[26] Letter from Fidelity Investments to SEC (Feb. 3, 2012).

Insured" and **"May Lose Value."**[27] The variable "shadow" NAV of each Money Fund and each individual instrument in the fund is reported monthly to the SEC, which makes it publicly available on its website, clearly reflecting the fluctuations (however minute) in the underlying valuation of each Money Fund.[28]

As the public comments demonstrate, Money Funds continue to be a highly transparent investment product, carrying very minimal but well-disclosed risk, with substantial liquidity designed to meet redemptions in a manner that will not result in a "fire sale" of securities. They are subject to a range of other restrictions designed to address investor protection and risk concerns, such as board oversight and reforms in the 2010 amendments permitting Money Fund directors to suspend redemptions when liquidating a fund to alleviate the "first mover" issue.[29]

(2) A floating NAV would not reflect a measurably more "accurate" valuation of Money Fund shares than the amortized cost accounting method currently used by Money Funds.

Chairman Schapiro in a recent statement argued that Money Funds should "float the NAV and use mark-to-market valuation like every other mutual fund."[30] Treasury Secretary Timothy Geithner, in his letter of September 27, argued that a floating NAV would "allow the value of investors' shares to track more closely the values of the underlying instruments held by MMFs and eliminate the significance of share price variation in the future."[31] This suggests a view that, if Money Funds redeemed shareholders securities at a floating or variable NAV, it would be a truer indication of the Money Fund's "mark-to-market" value. But, would it, really?

The Myth of "Marking-to-Market" to Arrive at a Floating NAV. What is left out of these statements by regulators – perhaps because they are uninformed as to the nature of the

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[27] 15 U.S.C. § 80a-34. *See also* 17 C.F.R. § 270.34b–1; 17 C.F.R. § 230.482 (requiring all Money Fund advertisements to include the following statement: "An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.").

[28] Money Funds, in turn, provide links from their websites to the portfolio information presented on the SEC's website.

[29] *See, e.g.,* Letter from Fidelity Investments to SEC at Exhibit 4 (Mar. 1, 2012); Letter from Independent Directors Council to SEC (Jan. 10, 2011) ("[P]olicymakers should keep in mind that all money market funds are overseen by a board of directors, composed primarily of independent directors. . . . Among other things, directors approve the procedures for periodic stress testing of the fund's ability to maintain a stable NAV based on hypothetical events. . . . Directors also would play a key role if a money market fund were at imminent risk of 'breaking the buck.' If directors make certain determinations, a fund may suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund. This critically important new authority is intended to reduce the vulnerability of investors to the harmful effects of a run on a fund and minimize the potential for disruption of the securities markets.").

[30] Mary Schapiro, Chairman, Securities and Exchange Commission, Statement on Money Market Fund Reform (Aug. 22, 2012), http://www.sec.gov/news/press/2012/2012-166.htm.

[31] Letter from Timothy F. Geithner, Secretary of the Treasury, to Members of the Financial Stability Oversight Council (Sept. 27, 2012), http://www.treasury.gov/connect/blog/Documents/SEC.Geithner.Letter.To.FSOC.pdf.

instruments held in Money Fund portfolios – is that there are no daily reported prices for many of the instruments held in a prime Money Fund portfolio.[32] Because of their short-term nature, they generally are purchased and held to maturity (which is the general basis under GAAP[33] for the use of amortized cost accounting used by Money Funds to value portfolio assets). In a lengthy analysis of the performance of stable and floating NAV funds, Professors Jill Fisch, of the University of Pennsylvania Law School, and Eric Roiter, of the Boston University School of Law, point out that "[v]ery short-term money market instruments like commercial paper or bank CDs ordinarily lack readily available market prices."[34]

Commercial paper and other instruments for which there are no readily available market prices are priced based on their "fair valuation" – a reasonable estimate of the price at which the instrument could be sold in a current trade. These are estimates, not "mark-to-market" prices. A Money Fund's board, like the board of any mutual fund, in valuing the fund's portfolio assets, must use the market value for securities or other assets for which market quotations are readily available, and with respect to other securities and assets, must use their "fair value as determined in good faith by the board of directors."[35] As Professors Fisch and Roiter point out, the SEC has provided extensive guidance on the issue.[36] But the SEC also has long acknowledged that there is no single "correct" fair value and, that "The same security held in the portfolios of different funds can be given different fair value prices at any one time, all of which can be reasonable estimates meeting the statutory standard."[37]

In practice, Money Funds have elaborate and rigorous procedures to obtain valuations for their portfolio assets and to measure deviations between the Money Fund's amortized cost price per share and the "current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions)."[38] SEC rules require that they do this. Virtually all Money Funds engage independent pricing services to get to a high degree of comfort that the valuations identified by these services for each instrument held in portfolio appropriately "reflects current market conditions," and Money Fund internal valuation experts closely monitor any deviations from the valuation using amortized cost accounting. Where there are variations, depending upon internal thresholds that may be reached, Money Fund procedures generally require involvement of internal valuation committees and in some circumstances the board.

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[32] Of course, for government Money Funds, there are ample market prices for Treasuries and agency securities.

[33] Accounting for Certain Investments in Debt and Equity Securities, Statement of Fin. Accounting Standards No. 115, § 7 (Fin. Accounting Standards Bd. 1993). *See also* the discussion of amortized cost as applied to Money Funds in Professor Dennis R. Beresford, *Amortized Cost is "Fair" for Money Market Funds* (Fall 2012), http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Money-Market-Funds_FINAL.layout.pdf.

[34] Jill Fisch & Eric Roiter, *A Floating NAV for Money Market Funds: Fix or Fantasy?*, Institute for Law and Economics at 7 (Aug. 2011) (filed as comment letter Dec. 2, 2011).

[35] 17 C.F.R. § 270.2a-4.

[36] Jill Fisch & Eric Roiter, *A Floating NAV for Money Market Funds: Fix or Fantasy?*, Institute for Law and Economics at n.22-23 (Aug. 2011) (filed as comment letter Dec. 2, 2011).

[37] *Id.* at 6.

[38] 17 C.F.R. § 270.2a-7(c)(8)(ii)(A).

But, the fact is that these pricing services do not always, because they cannot always, identify "mark-to-market" prices, because many of the instruments held in a prime Money Fund portfolio do not have reported trading prices on any given day. For those instruments that do not trade on a daily basis, these services generally use what is known as "matrix" pricing: the pricing service compares each individual instrument within the portfolio to a homogenous set of instruments in the market (e.g., because they have similar ratings, interest rates, maturities) and derives a valuation that it believes reflects current market conditions based upon similar instruments that have traded that day.[39] While matrix pricing is mechanistic and objective, different pricing services may arrive at very minute differences in prices for a portfolio asset, depending upon how they bucket it and the market prices used as reference points. Moreover, each Money Fund board has the ultimate responsibility to assure that valuation methods used (whether by a pricing service or otherwise) are appropriate. It is this valuation that Money Funds use to benchmark against the amortized cost valuations.[40] It is an important benchmark, but it is a type of fair valuation and, like amortized cost valuation, is not "mark-to-market."[41] Indeed, as discussed further below, because the valuations derived under this method are often identical to, or very similar to, valuations derived using amortized cost, amortized cost is a more efficient and reliable means of pricing Money Fund portfolio assets.

A Distinction without a Difference. Day to day, the "market" or "shadow NAV" of a Money Fund – however it is determined – deviates from the $1.00 per share arrived at through amortized cost accounting by only miniscule amounts, if at all. The Investment Company Institute (ICI), has produced several studies detailing this point. According to its analysis of Money Fund prices maintained even *prior* to the 2010 reforms, "Data from a sample of taxable money market funds covering one-quarter of U.S. taxable money market fund assets show that the average per-share market values for prime money market funds varied between $1.002 and $0.998 during the decade from 2000 to 2010."[42]

An analysis of more recent data submitted by the ICI to Congress demonstrates that the remarkable stability of Money Fund prices has continued under the 2010 reforms:

> [U]sing publicly available data from Form N-MFP reports that require money market funds to disclose their underlying mark-to-market share price, without using amortized cost pricing, ICI calculated changes in prime fund share prices on

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[39] Fair Value Measurement, Accounting Standards Update Topic 820-10-55-3C (Fin. Accounting Standards Bd. May 2011) ("Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.").

[40] These calculations and comparisons are done periodically as determined by the fund's board of directors, generally weekly if required by rating agencies, or every two weeks. Calculations should be more frequent in volatile market conditions.

[41] The same general approach has been adopted by the Financial Industry Regulatory Authority ("FINRA"), and approved by the SEC, as the standard for broker-dealers to price debt securities when there is no active trading market." FINRA Rule IM-2440-2; Securities Exchange Act Release No. 55638 (April 16, 2007), 77 Fed. Reg. 20150 (April 23, 2007).

[42] Letter from ICI to SEC (Feb. 16, 2012).

> a monthly basis for January 2011 to March 2012. Nearly all (96 percent) of the prime money market funds had an average absolute monthly change in their mark-to-market share prices of 1 basis point or less and all had an average absolute monthly change of less than 2 basis points.[43]

As these data demonstrate, the stable NAV using amortized cost closely tracks the "floating" NAV using other methods of valuation. They are usually identical (even before rounding the NAV to the nearest cent) and only occasionally deviate from one another by plus or minus a few one-hundredths of a cent.[44] To put this in perspective, a deviation of a hundredth of one percent is equal to $100 on a million dollars worth of Money Fund shares. Unless the Money Fund is suddenly liquidated, even that small price deviation is not translated into actual losses, because the underlying portfolio investments mature in short order and are repaid at par, which returns the shadow NAV to $1 per share. Due to the very high levels of liquid assets that Money Funds are required to hold under amended SEC Rule 2a-7, it is now even less likely that a Money Fund would need to sell portfolio assets before maturity to raise cash and recover less than par value.

As the Comptroller of the Currency recently has concluded in permitting bank short-term investment funds to use amortized cost accounting and round share prices to nearest cent, "because . . . investments are limited to shorter-term assets and those assets generally are held to maturity, differences between the amortized cost and mark-to-market value of the assets will be rare, absent atypical market conditions or an impaired asset."[45]

(3) A floating NAV would do nothing to advance the regulatory goal of reducing or eliminating "runs." There is no data to support this proposition and, indeed, the data show just the opposite.

Numerous comment letters in the SEC's comment file have pointed out that, although the primary justification for moving to a floating NAV is to reduce the "susceptibility" of the funds to runs, there is no empirical evidence to support this view.[46] Indeed, the evidence suggests just the opposite. As Professors Fisch and Roiter have written:

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[43] *Perspectives on Money Market Mutual Fund Reform: Hearing Before the U.S. Senate Committee on Banking, Housing and Urban Affairs,* 112th Cong. at 29-30 (Jun. 21, 2012) (testimony of Paul Schott Stevens, President, Investment Company Institute), http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=bba4146c-6b7f-47d0-93bc-ebc73189c9c0) (citing the publicly available data from the Form N-MFPs Money Funds are required to file each month with the SEC).

[44] ICI Research Report, Pricing of U.S. Money Market Funds (Jan. 2011).

[45] Short-Term Investment Funds, 77 Fed. Reg. 61230 (Oct. 9, 2012) (to be codified at 12 C.F.R. Part 9).

[46] Letter from John D. Hawke, Jr. to Financial Stability Oversight Council, filed with the SEC (Dec. 15, 2011); Letter from Fisch & Roiter to SEC (Dec. 2, 2011); Letter from Jacksonville Chamber to SEC (Jan. 31, 2011); Letter from Cincinnati Chamber to SEC (Jan. 13, 2011); Letter from ICI to SEC (Jan. 10, 2011); Letter from Wells Fargo Funds Management to SEC (Jan. 10, 2011); Letter from Crane Data LLC to SEC (Jan. 10, 2011); Letter from

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> Ultra-short bond funds are a near equivalent to money market funds but for the fact that they maintain a floating NAV. . . . While their share of assets pales in comparison to MMFs, ultra-short bond funds faced waves of redemptions comparable in respective magnitude to what MMFs faced. Indeed, contractions of ultra-short bond funds likely exacerbated the freeze in the short term credit markets. By the end of 2008, assets in these funds were 60% below their peak level in 2007. In Europe, both types of money market funds – those with stable NAVs and those with floating NAVs – have co-existed for years. Floating NAV money market funds suffered substantial redemptions during the credit crisis in 2008, leading more than a dozen of them to suspend redemptions temporarily and four of them to close altogether. French floating NAV money market funds lost about 40% of their assets during a three month period in the summer of 2007.[47]

Fidelity Investments also has pointed out the lack of "empirical evidence to support the belief that in a period of market turmoil, funds with [Variable] NAVs would be at lower risk of significant redemptions from shareholders. In fact, during the financial crisis, VNAV funds in Europe experienced redemption pressures similar to [Constant] NAV funds."[48] Another commenter argued, far from desensitizing investors to minor price movements, "investors may be more price sensitive to an NAV that fluctuates."[49]

As SEC Commissioners Gallagher and Paredes recently said in a statement critical of an SEC staff proposal requiring a floating NAV for Money Funds, "the necessary analysis has not been conducted to demonstrate that a floating NAV [or a capital buffer coupled with a holdback restriction] would be effective in crisis."[50] They pointed to the "predominant incentive of investors in a crisis to flee risk and move to safety," stating,

> As for the floating NAV proposal, even if there is no stable $1.00 NAV – i.e., even if, by definition, there is no "buck" to break – investors will still have an incentive to flee from risk during a crisis period such as 2008, because investors who redeem sooner rather than later during a period of financial distress will get out at a higher valuation.[51]

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SIFMA to SEC (Jan. 10, 2011); Letter from Institutional Money Market Funds Association to SEC (Jan. 10, 2011); Letter from SVB Financial Group to SEC (Jan. 10, 2011); Letter from Invesco Advisors to SEC (Jan. 10, 2011); Letter from Fidelity to SEC (Jan. 10, 2011).

[47] Letter from Fisch & Roiter to SEC (Dec. 2, 2011). *See also* Letter from Institutional Money Market Funds Association to SEC (Jan. 10, 2011).

[48] Letter from Fidelity Investments to IOSCO, filed with the SEC (May 30, 2012) (citing Stephen Jank and Michael Wedow, *Sturm und Drang in Money Market Funds: When Money Market Funds Cease to Be Narrow*, Deutsche Bundesbank Discussion Paper, Series 2: Banking and Financial Studies, No. 20/2008).

[49] Letter from Vanguard to SEC (Jan. 10, 2011).

[50] Daniel M. Gallagher and Troy A. Paredes, Commissioners, Securities and Exchange Commission, Statement on the Regulation of Money Market Funds (Aug. 28, 2012), http://www.sec.gov/news/speech/2012/spch082812dmgtap.htm.

[51] *Id.*

Several commenters warned that moving to a floating NAV could itself cause the very run regulators are seeking to avoid.[52] As the President's Working Group Report stated,

> MMFs' transition from stable to floating NAVs might itself be systemically risky. For example, if shareholders perceive a risk that a fund that is maintaining a $1 NAV under current rules has a market-based shadow NAV of less than $1, these investors may redeem shares preemptively to avoid potential losses when MMFs switch to floating NAVs. Shareholders who cannot tolerate floating NAVs probably also would redeem in advance. If large enough, redemptions could force some funds to sell assets and could make concerns about losses self-fulfilling.[53]

One investment adviser expressed similar concerns, warning that the shift "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."[54]

In order to justify requiring Money Funds to float their NAVs, the SEC will need to provide data demonstrating the benefits of such a change – namely, that the change would reduce the likelihood of Money Fund runs. If the SEC does not "support its predictive judgments," with respect to the impact of a floating NAV, it may find itself yet again on the losing end of another rule challenge.[55]

(4) A Floating NAV, for the sake of showing minute variations in value that cancel out over time, would eliminate Money Funds as a viable cash management tool by destroying their principal liquidity function.

Nearly every commenter who filed a letter with the SEC opposing the floating NAV wrote that forcing Money Funds to abandon the stable NAV would eliminate the Money Fund as a viable cash management tool by destroying its principal liquidity function. These commenters include both users and issuers, state and local government officials, local and regional chambers of commerce, asset managers, and the industry groups that represent them. Many users, both institutional and individual, stated that Money Funds, because of their stable NAV feature, are essential to their cash management strategies.[56]

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[52] Letter from Invesco to IOSCO, filed with SEC (May 25, 2012); Letter from ICI to SEC (Jan. 10, 2011); Letter from T. Rowe Price to SEC (Jan. 10, 2011); Letter from Invesco Advisors to SEC (Jan. 10, 2011); Letter from The Dreyfus Corporation to SEC (Jan. 10, 2011).

[53] PWG Report at 22.

[54] Letter from Invesco Advisors to SEC (Jan. 10, 2011).

[55] *See Business Roundtable v. SEC,* 647 F.3d 1144, 1149 (D.C. Cir. 2011).

[56] Letter from David Daniel to SEC (Aug. 21, 2012); Letter from Rick Fetterman to SEC (Aug. 15, 2012); Letter from Joe McNamara to SEC (Aug. 14, 2012); Letter from Rudy Mueller to SEC (Aug. 14, 2012); Letter from Hal

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As a group of 14 local, state, and national public agency associations stated, Money Funds "are a popular cash management tool because they are highly regulated, have minimal risk, and are easily booked."[57] While similarly extolling the benefits of stable NAV funds, the New Hampshire College & University Council warned of the adverse consequences of requiring Money Funds to shift to a floating NAV:

> These funds have consistently proven to be a safe, efficient, and effective cash management tool. Requiring a floating NAV would have negative implications for the utilization of money market mutual funds, as investors would be forced to

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Goldberg to SEC (Aug. 14, 2012); Letter from Denver Metro Chamber to SEC (July 20, 2012); Letter from Louisiana Retailers Association to SEC (July 19, 2012); Letter from Utah Association of Counties to SEC (Jun. 27, 2012); Letter from North Carolina Independent Colleges and Universities to SEC (Apr. 13, 2012); Letter from Association for Financial Professionals, Benefit Resource, Inc., Blue Cross Blue Shield of Massachusetts, CacheMatrix, Catholic Health Initiatives, California ISO, CareSource, Centerline Capital Group, Crawford & Company, Grass Valley USA LLC, Miami-Dade County Public Schools, Solix, Inc., University of Colorado – Treasurer's Office, and WellCare Health Plans, Inc. to SEC (Apr. 4, 2012) (Letter from Association for Financial Professionals and 13 other organizations); Letter from Indiana Chamber to SEC (Mar. 20, 2012); Letters from 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 Finance Authorities, National Association of Local Housing Financing Agencies, National Association of State Auditors, Comptrollers and Treasurers, National Association of State Treasurers, National Council of State Housing Agencies, National League of Cities, U.S. Conference of Mayors to SEC (Mar. 8, 2012) (14 National, State and Local Entities); Letter from Greater Raleigh Chamber to SEC (Feb. 28, 2012 and Jan. 31, 2011); Letter from Bob Maddox to SEC (Feb. 7, 2012); Letter from New Hampshire College & University Council to SEC (Jan. 12, 2012); Letter from Washington State Treasurer to SEC (Nov. 15, 2011); Letter from New Jersey Association of Counties (Jul. 11, 2011); Letter from Greater Albuquerque Chamber of Commerce to SEC (Feb. 7, 2011); Letter from Florida Department of Financial Services to SEC (Feb. 3, 2011); Letter from Jacksonville Chamber to SEC (Jan. 31, 2011); Letter from Association of Commerce and Industry, New Mexico to SEC (Jan. 31, 2011); Letter from Providence Chamber of Commerce to SEC (Jan. 31, 2011); Letter from Greater Durham Chamber of Commerce to SEC (Jan. 31, 2011); Letter from New Mexico Association of Counties to SEC (Jan. 28, 2011); Letter from Florida Chamber of Commerce to SEC (Jan. 28, 2011); Letter from North Carolina Chamber of Commerce to SEC (Jan. 25, 2011); Letter from American Association of State Colleges and Universities to SEC (Jan. 21, 2011); Letter from Texas Municipal League to SEC (Jan. 21, 2011); Letter from Utah State Treasurer to SEC (Jan. 20, 2011); Letter from New Jersey Chamber of Commerce to SEC (Jan. 18, 2011); Letter from Northern Rhode Island Chamber of Commerce to SEC (Jan. 15, 2011); Letter from the Mayor of Salt Lake City, Utah to SEC (Jan. 13, 2011); Letter from National Association of State and Local Treasurers to SEC (Dec. 21, 2010). *See also* Letter from Independent Directors Council & Mutual Fund Directors Forum to SEC (May 2, 2012); Letters from John D. Hawke, Jr. on behalf of Federated Investors (Mar. 19, 2012 and Dec. 15, 2011); Letter from SunGard Global Network to SEC (Mar. 16, 2012); Letter from DST Systems to SEC (Mar. 2, 2012); Letter from Cachematrix to SEC (Dec. 12, 2011); Letter from Fisch & Roiter to SEC (Dec. 2, 2011); Letter from Cachematrix to SEC (Apr. 29, 2011). *See also* Letter from 2254 individuals to SEC (Various dates).

[57] Letter from 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 Finance Authorities, National Association of Local Housing Financing Agencies, National Association of State Auditors, Comptrollers and Treasurers, National Association of State Treasurers, National Council of State Housing Agencies, National League of Cities, U.S. Conference of Mayors to SEC (Mar. 8, 2012).

> seek alternative products that are less regulated and provide less diversification. To that end, we are concerned a floating NAV would effectively eliminate money market mutual funds as a viable investment tool for public and private higher education institutions.[58]

(5) A Floating NAV, for the sake of showing minute variations in value that cancel out over time, also would impose significant operational, accounting and tax burdens on users of Money Funds and destroy their utility.

Users would lose key operational features only available with a stable NAV fund, and business systems would require significant overhaul. As commenters have explained, a number of features Money Funds currently offer would not be possible with a floating NAV. The investment advisor Invesco stated, "a stable share price simplifies cash management policies for investors and has made it possible for broker-dealers to make available to clients a wide range of features including ATM access, check writing, and ACH and fedwire transfers. These features are generally provided only for accounts with a stable NAV."[59] For example, according to ICI, Money Funds "typically offer retail investors same-day settlement on shares redeemed via 'wire transfers' (where redemption proceeds are wired to an investor's bank account via fedwire), whereas bond funds typically offer only next day settlement for wire transfers."[60]

Other commenters pointed out that the cost of overhauling accounting, trading, and settlement systems to accommodate the floating NAV would be substantial for those users able to stay in the Money Fund market.[61] Cachematrix, a software provider of online institutional trading systems for banks and financial institutions, stated,

> [A]n entire industry has programmed accounting, trading and settlement systems based on a stable share price. The cost for each bank to retool their sub-accounting systems to accommodate a fluctuating NAV could be in the millions of dollars. This does not take into account the costs that each bank would then pass on to the thousands of corporations that use money market trading systems.[62]

The stable share price of Money Funds currently simplifies corporate treasury operations. Treasurers know the $1.00 NAV in advance, and, as Vanguard pointed out, that amount often is hard-coded into companies' accounting and cash-tracking systems. Treasurers can then use a

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[58] Letter from New Hampshire College & University Council to SEC (Jan. 12, 2012).

[59] Letter from Invesco to SEC (Sept. 4, 2009).

[60] Letter from ICI to SEC (May 25, 2012).

[61] Letter from Louisiana Retailers Association to SEC (July 19, 2012); Letter from Allegheny Conference and Greater Pittsburgh Chamber to SEC (Apr. 24, 2012); Letter from Association for Financial Professionals and 13 other organizations to SEC (Apr. 4, 2012); Letter from John D. Hawke, Jr. to SEC (Mar. 19, 2012); Letter from ICI to SEC (Feb. 16, 2012); Letter from Cachematrix to SEC (Dec. 12, 2011); Letter from Invesco to SEC (Sept. 4, 2009).

[62] Letter from Cachematrix to SEC (Dec. 12, 2011).

Money Fund to fund transactions over the course of the day.[63] Bank sweep account systems with an option to invest in Money Funds often do the same.[64] As the American Bankers Association described the effect of the floating NAV on these operations,

> If the NAV floats, service providers would need to request that shares be redeemed prior to the close of the market (when the fund is priced), but the number of shares needed to be redeemed to fund the transaction would be uncertain. Estimating the number of shares needed to be redeemed will result in an end-of-day excess or shortfall. This leads to a potentially significant difficulty in calculating the end-of-day values. By contrast, a stable NAV provides certainty for funding the day's transactions. Similarly, municipal bond issuers who, under their indentures, are required to maintain reserves at a specified level can be assured that they will not have to advance cash to satisfy that reserve level because funds invested in MMFs will not fluctuate.[65]

If Money Funds are required to float their NAV, all of these systems would have to undergo the retooling Cachematrix described to accommodate the possibility of a minute change in a fund's NAV.

Regarding the operational implications of the tax and accounting treatment of floating NAV Money Funds generally, the ICI commented,

> Accounting standards setters aren't likely to grant cash-equivalent status to floating-value money market funds, which means institutions would have to track and reflect any fluctuations in shares' values on their books. Individuals and many institutional investors would have to regard every money market fund transaction as a potentially taxable event, and funds would have to build reporting systems to track gains and losses in the pennies. In short, the fact that money market funds could float means that investors, funds, and intermediaries have to be prepared that they *will* float. Changing the nature of these funds from stable to floating would force funds and investors to adapt, build new accounting systems, and overhaul their cash management–whether the funds' value actually fluctuates or not. The result would be heavy costs.[66]

A range of business functions would require costly overhaul. Commenters described how a floating NAV would disrupt numerous business applications that run on automated accounting and settlement systems designed for same-day settlement and rely upon a stable

[63] Letter from Vanguard to SEC (Jan. 10, 2011). *See also* Money Market Working Group, Investment Company Institute, *Report of the Money Market Working Group* at 109-10 (Mar. 17, 2009), http://www.ici.org/pdf/ppr_09_mmwg.pdf.

[64] *Id.*

[65] Letter from American Bankers Association to SEC (Jan. 10, 2011). *See also* Letter from American Bankers Association to SEC (Sept. 8, 2009).

[66] Letter from ICI to SEC (Apr. 13, 2012).

NAV.[67] The effect on business and public accounting processes would be far-reaching and at a minimum would include: trust accounting systems at bank trust departments; corporate payroll processing, corporate and institutional operating cash balances; federal, state and local government cash balances; municipal bond trustee cash management systems; consumer receivable securitization cash processing; escrow processing; custody cash balances and investment manager cash balances; 401(k) and 403(b) employee benefit plan processing; broker-dealer and futures dealer customer cash balances; and cash management type accounts at banks and broker-dealers. These processes would all have to undergo significant and costly retooling in the absence of stable NAV Money Funds.[68]

A floating NAV would create an additional accounting burden for users. As commenters have stated,[69] with a stable $1.00 NAV, Money Funds currently qualify as "cash equivalents" under accounting standards.[70] Because the NAV is fixed at $1.00 per share (absent an event that drives the fund's shadow NAV below $0.995 or above $1.005), there is no need for investors to recognize gains or losses for financial accounting purposes. With a floating NAV, different accounting standards would apply. Users would be required to reclassify their holdings of Money Funds, likely as Available-for-Sale securities, which must be held at fair value.[71] As the ICI has pointed out,

> Corporate treasurers would also have to track the costs of their shares and determine how to match purchases and redemptions for purposes of calculating gains and losses for accounting and tax purposes. Moreover, under the new treatment, companies could not enter and reconcile cash transactions nor calculate the precise amount of operating cash on hand until the money market fund's NAV

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[67] Letter from John D. Hawke, Jr. on behalf of Federated Investors to SEC (Mar. 19, 2012). *See generally* PWG Report at 21 (noting the "loss of accounting convenience and tax efficiencies" resulting from the move to a floating NAV).

[68] The Appendix discusses these uses in greater detail.

[69] Letter from American Benefits Council, American Society of Pension Professionals & Actuaries, The ERISA Industry Committee, Financial Services Institute, Investment Company Institute, National Association of Insurance and Financial Advisors, National Telecommunications Cooperative Association, Plan Sponsor Council of America, Securities Industry and Financial Markets Association, The Small Business Council of America, The Society for Human Resource Management, The Spark Institute, and the U.S. Chamber of Commerce to SEC (Aug. 21, 2012); Letter from Allegheny Conference and Greater Pittsburgh Chamber to SEC (Apr. 24, 2012); Letter from AFP to SEC (Jan. 10, 2011); Letter from Invesco to SEC (Sept. 4, 2009). *See also* Money Market Working Group, Investment Company Institute, *Report of the Money Market Working Group* at 107-08 (Mar. 17, 2009), http://www.ici.org/pdf/ppr_09_mmwg.pdf.

[70] *See* Statement of Cash Flows, Statement on Fin. Accounting Standards No. 95 (Fin. Accounting Standards Bd. 1987) ("[C]ash equivalents are short-term, highly liquid investments that are both: readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates . . . . Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an enterprise with banking operations).").

[71] *See* Accounting for Certain Investments in Debt and Equity Securities, Statement on Fin. Accounting Standards No. 115 (Fin. Accounting Standards Bd. 1993).

became known at the end of the day, creating additional disincentives for corporations to use money market funds for cash management purposes.[72]

Over two thousand users have written to the SEC to warn that the floating NAV would create an "accounting nightmare" for them.[73]

A floating NAV would create an additional tax burden for users. The stable NAV currently allows a Money Fund to distribute all returns to shareholders as income, which greatly reduces tax and accounting burdens for both retail and institutional investors. As several commenters have explained,[74] the stable NAV also relieves investors of having to consider the timing of purchases and sales of shares of Money Funds, as they must with variable NAV funds, to ensure compliance with the so-called "wash sale rule."[75] Money Funds transactions currently do not implicate the rule due to the funds' stable NAV.

As these commenters point out, if Money Funds were forced to adopt a floating NAV, investors would need to track the amount and timing of all purchases and sales, capital gains and losses, and share cost basis to ensure compliance with the rule. Investors already face these burdens in connection with investments in long-term mutual funds, but most investors do not trade in and out of long-term mutual funds with the same frequency as many do with Money Funds. Moreover, as the ICI explained, often the investments in long-term mutual funds are made within tax-advantaged accounts (*e.g.*, 401(k) plans), where such issues do not arise.[76] Thus, if Money Funds had a floating NAV, and all share sales become tax-reportable events, the result would be to magnify greatly the tax and recordkeeping burdens of investors who use their Money Funds for daily cash management purposes, all for the purpose of tracking fluctuations amounting to fractions of a cent.[77]

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72 Money Market Working Group, Investment Company Institute, *Report of the Money Market Working Group* at 107-08 (Mar. 17, 2009), http://www.ici.org/pdf/ppr_09_mmwg.pdf.

73 Letter from 2256 individuals to SEC (Various dates); Letter from David Daniel to SEC (Aug. 21, 2012); Letter from Rick Fetterman to SEC (Aug. 15, 2012); Letter from Joe McNamara to SEC (Aug. 14, 2012); Letter from Rudy Mueller to SEC (Aug. 14, 2012); Letter from Hal Goldberg to SEC (Aug. 14, 2012).

74 Letter from Vanguard to SEC (June 4, 2012); Letter from Allegheny Conference and Greater Pittsburgh Chamber to SEC (Apr. 24, 2012); Letter from ICI to SEC (Jan. 10, 2011); Letter from Voyageur Asset Management to SEC (Sept. 8, 2009). *See also* Money Market Working Group, Investment Company Institute, *Report of the Money Market Working Group* at 107-08 (Mar. 17, 2009), http://www.ici.org/pdf/ppr_09_mmwg.pdf.

75 Under this IRS rule, investors are prohibited from recognizing a loss on the sale of a security if they purchase a replacement security within the next 30 days (or for that matter, if the investor has purchased a replacement security in the 30 days prior to the sale that triggers the loss). Instead, the loss is added to the basis of the replacement security. The holding period for the sold stock is also added to the holding period of the replacement stock. 26 C.F.R. § 1.1091–1.

76 Letter from ICI to SEC (Jan. 10, 2011).

77 Multiple commenters warned that a floating NAV would cause each Money Fund sale a tax-reportable event. Letter from Donald Brundrett to SEC (Mar. 24, 2012); Letter from Indiana Chamber to SEC (Mar. 20, 2012); Letter from SunGard Global Network to SEC (Mar. 16, 2012); Letter from Washington State Treasurer to SEC (Nov. 15, 2011); Letter from Financial Services Institute to SEC (Jan. 10, 2011); Letter from FSC Securities Corporation to SEC (Jan. 10, 2011); Letter from Fidelity Investments to SEC (Jan. 10, 2011); Letter from Wells Fargo Funds

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(6) A Floating NAV would altogether prevent certain investors who are subject to statutory prohibitions and investment restrictions from using Money Funds.

Many commenters warned that a floating NAV would preclude certain investors, who are permitted to invest only in stable NAV funds, from investing in Money Funds.[78] The PWG Report explained the problem: "internal investment guidelines may prevent corporate cash managers from investing in floating NAV funds, some state laws allow municipalities to invest only in stable-value funds, and fiduciary obligations may prevent institutional investors from investing client money in floating NAV funds."[79]

Undertaking to size the potential disruption to institutional investors (who include Fortune 500 corporations, states, localities, and major fund managers), Treasury Strategies, a treasury management consulting firm, found that 33% of corporate, government, and other institutional users surveyed currently are subject to investment policies, laws, or other restrictions prohibiting them from investing in floating NAV products.[80]

A joint letter from twelve national, state and local entities, including the Government Finance Officers Association, the National Association of State Auditors, Comptrollers and Treasurers, and the U.S. Conference of Mayors, elaborated on the potential disruption:

> [M]any governments have specific policies that mandate stable values, and money market funds are to be used for their short-term investments due to the fixed

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Management to SEC (Jan. 10, 2011); Letter from Treasury Strategies to SEC (Jan. 10, 2011); Letter from Royal Alliance Associates to SEC (Jan. 7, 2011); Letter from Letter from SagePoint Financial to SEC (Jan. 7, 2011). *See also* PWG Report at 21 (noting the "loss of accounting convenience and tax efficiencies" resulting from the move to a floating NAV).

78 Letter from Denver Metro Chamber to SEC (July 20, 2012); Letter from Louisiana Retailers Association to SEC (July 19, 2012); Letter from Indiana County Treasurers Association to SEC (Apr. 25, 2012); Letter from Allegheny Conference and Greater Pittsburgh Chamber to SEC (Apr. 24, 2012); Letters from ICI to SEC (Apr. 19, 2012 and Jan. 10, 2011); Letter from Association for Financial Professionals and 13 other organizations; Letter from Metropolitan Mayors Caucus to SEC (Mar. 28, 2012); Letter from 14 National, State and Local Entities to SEC (Mar. 8, 2012); Letter from Texas Association of Business to SEC (Feb. 27, 2012); Letter from John D. Hawke, Jr. to Financial Stability Oversight Council, filed with the SEC (Dec. 15, 2011); Letter from Fisch & Roiter to SEC (Dec. 2, 2011); Letter from the Financial Services Roundtable to SEC (Jun. 30, 2011); Letter from Colorado County Treasurers' Association to SEC (Jun. 21, 2011); Letter from Jacksonville Chamber to SEC (Jan. 31, 2011); Letter from Greater Boston Chamber of Commerce to SEC (Jan. 28, 2011); Letter from Texas Municipal League to SEC (Jan. 21, 2011); Letter from 12 National, State and Local Entities to SEC (Jan. 10, 2011); Letter from Fidelity Investments to SEC (Jan. 10, 2011); Letter from FSC Securities Corporation to SEC (Jan. 10, 2011); Letter from Royal Alliance Associates to SEC (Jan. 7, 2011); Letter from SagePoint Financial to SEC (Jan. 7, 2011); Letter from Port of Houston Authority to SEC (Jan. 6, 2011); Letter from Tom Welch to SEC (Dec. 26, 2010).

79 PWG Report at 21.

80 Letter from ICI to SEC (Apr. 19, 2012) (providing a survey of corporate institutional investors conducted by Treasury Strategies).

> NAV. MMFs are a popular cash management tool because they are highly regulated, have minimal risk, and are easily booked. If the SEC were to adopt a floating NAV for MMFs, the organizations [co-signing this letter] expect that many, if not all, of their members would divest a significant percentage of their MMFs.[81]

(7) A Floating NAV, because of the operational burdens, costs, and other impediments, would substantially shrink the assets of Money Funds.

The impact of the burdens, costs and other impediments of a floating NAV in shrinking the assets of Money Funds is borne out in surveys of users:

- Fidelity Investments, the largest Money Fund manager in the United States, surveyed both its institutional and retail Money Fund investors. Of retail investors surveyed, 74% stated a preference to keep the stable NAV, and 47% said they would decrease or discontinue use of Money Funds if they adopted a floating NAV. Of institutional investors surveyed, 89% stated a preference to keep the stable NAV, while 57% said they would decrease or discontinue use of Money Funds if they adopted a floating NAV.[82]
- In a wide ranging survey of institutional Money Fund users commissioned by the ICI, Treasury Strategies found that forcing Money Funds to adopt floating NAVs would drive a large portion of current users out of the Money Fund market. Of the more than 200 corporate, government, and other institutional users of Money Funds surveyed, 79% said they would decrease or stop using Money Funds if the fund had a floating NAV. Of that number, 44% said they would stop using Money Funds entirely, and a full 72% said they would decrease use by more than half.[83]

(8) A Floating NAV would therefore contract the market for, and raise the cost of, short-term public and private debt financing while potentially destabilizing those markets.

Dozens of commenters stated that forcing Money Funds to adopt a floating NAV, thereby eliminating or reducing the utility of Money Funds for many users, would contract the market

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[81] Letter from American Public Power Association, Council of Development Finance Agencies, Council of Infrastructure Financing Authorities, Government Finance Officers Association, International City/County Managers Association International Municipal Lawyers Association, National Association of Counties, National Association of Local Housing Financing Agencies, National Association of State Auditors, Comptrollers and Treasurers, National Association of State Treasurers, National League of Cities and U.S. Conference of Mayors to SEC (Jan. 10, 2011) (12 National, State and Local Entities).

[82] Letter from Fidelity Investments to SEC (Feb. 3, 2012).

[83] Letter from ICI to SEC (Apr. 19, 2012) (providing a survey of corporate institutional investors conducted by Treasury Strategies).

for, and raise the costs of, short-term public and private debt financing.[84] Some of these commenters noted that Money Funds hold almost 40% of outstanding commercial paper, roughly

[84] Letter from 33 Members of Congress to SEC (May 1, 2012), http://www.preservemoneymarketfunds.org/wp-content/uploads/2012/05/Congress_Letter_to_SEC_5-1-12_13359658551.pdf. This letter, from 33 Members of the House of Representatives, is particularly significant in light of the experiences of its various signatories, all of whom served as officials of state or local governments and in the letter express their views of the importance of MMFs to such entities. The following Members of Congress signed the letter: Congressman Richard E. Neal (D-MA), Congressman Tom Reed (R-NY), Congressman James P. Moran (D-VA), Congressman Frank C. Guinta (R-NH), Congressman Gerald E. Connolly (D-VA), Congressman David Schweikert (R-AZ), Congressman Michael E. Capuano (D-MA), Congressman Steve Chabot (R-OH), Congressman Gary Peters (D-MI), Congressman Aaron Schock (R-IL), Congressman Jim Himes (D-CT), Congressman Phil Roe, MD (R-TN), Congressman David Cicilline (D-RI), Congressman Mike Coffman (R-CO), Congressman Henry Cuellar (D-TX), Congresswoman Lynn Jenkins (R-KS), Congressman John Carney (D-DE), Congresswoman Cynthia Lummis (R-WY), Congressman Brian Higgins (D-NY), Congressman James B. Renacci (R-OH), Congressman Martin Heinrich (D-NM), Congressman Adam Kinzinger (R-IL), Congressman Albio Sires (D-NJ), Congressman Kenny Marchant (R-TX), Congressman Bill Pascrell (D-NJ), Congressman Steve Stivers (R-OH), Congressman John Larson (D-CT), Congressman Bill Posey (R-FL), Congressman Sam Farr (D-CA), Congressman Jeff Fortenberry (R-NE), Congressman Todd Rokita (R-IN), Congressman Mike Fitzpatrick (D-PA), and Congressman Mike Kelly (R-PA). *See also* Letter from Michael B. Hancock, Mayor of Denver, to SEC (July 25, 2012); Letter from Stephanie Rawlings-Blake, Mayor of Baltimore, to SEC (July 20, 2012); Letter from Louisiana Retailers Association to SEC (July 19, 2012); Letter from Utah Association of Counties to SEC (Jun. 27, 2012); Letter from New York State Association of Counties to SEC (Jun. 20, 2012); Letter from 33 Members of Congress to SEC (May 1, 2012); Letter from Allegheny Conference and Greater Pittsburgh Chamber to SEC (Apr. 24, 2012); Letter from Association for Financial Professionals and 13 other organizations to SEC (Apr. 4, 2012); Letter from Mutual Fund Directors Forum to SEC (Mar. 29, 2012); Letter from Metropolitan Mayors Caucus to SEC (Mar. 28, 2012); Letter from Indiana Chamber to SEC (Mar. 20, 2012); Letter from 14 National, State and Local Entities to SEC (Mar. 8, 2012); Letter from Texas Association of Business to SEC (Feb. 27, 2012); Letter from Northern Kentucky Chamber of Commerce to SEC (Jan. 20, 2012); Letter from John D. Hawke, Jr. to Financial Stability Oversight Council, filed with SEC (Dec. 15, 2011); Letter from New Jersey Association of Counties (Jul. 11, 2011); Letter from the Financial Services Roundtable to SEC (Jun. 30, 2011); Letters from Utah League of Cities and Towns to SEC (May 10, 2012 and Jan. 11, 2011); Letter from Greater Albuquerque Chamber of Commerce to SEC (Feb. 7, 2011); Letter from New Jersey Business & Industry Association to SEC (Feb. 7, 2011); Letter from Florida Department of Financial Services to SEC (Feb. 3, 2011); Letter from Jacksonville Chamber to SEC (Jan. 31, 2011); Letter from Greater Raleigh Chamber to SEC (Jan. 31, 2011); Letter from Association of Commerce and Industry, New Mexico to SEC (Jan. 31, 2011); Letter from Providence Chamber of Commerce to SEC (Jan. 31, 2011); Letter from Greater Durham Chamber of Commerce to SEC (Jan. 31, 2011); Letter from New Mexico Association of Counties to SEC (Jan. 28, 2011); Letter from Greater Boston Chamber of Commerce to SEC (Jan. 28, 2011); Letter from Florida Chamber of Commerce to SEC (Jan. 28, 2011); Letter from Rhode Island Economic Development Corporation to SEC (Jan. 26, 2011); Letter from North Carolina Chamber of Commerce to SEC (Jan. 25, 2011); Letter from American Association of State Colleges and Universities to SEC (Jan. 21, 2011); Letter from Texas Municipal League to SEC (Jan. 21, 2011); Letter from New Jersey Chamber of Commerce (Jan. 18, 2011); Letter from Northern Rhode Island Chamber of Commerce to SEC (Jan. 15, 2011); Letter from New York Business Council to SEC (Jan. 14, 2011); Letter from the Mayor of Salt Lake City, Utah to SEC (Jan. 13, 2011); Letter from Cincinnati Chamber to SEC (Jan. 13, 2011); Letter from J.P. Morgan Asset Management to SEC (Jan. 10, 2011); Letter from Kentucky State Treasurer to SEC (Jan. 10, 2011); Letter from 12 National, State and Local Entities to SEC (Jan. 10, 2011); Letter from Agilent Technologies, Inc., Air Products & Chemicals, Inc., Association for Financial Professionals, The Boeing Company, Cadence Design Systems, CVS Caremark Corporation, Devon Energy, Dominion Resources, Inc., Eastman Chemical Company, Eli Lilly & Company, Financial Executives International's Committee on Corporate Treasury, FMC Corporation, Institutional Cash Distributors, Kentucky Chamber of Commerce, Kraft Foods Global, Inc., National Association of Corporate Treasurers, New Hampshire Business and Industry Association, Nissan North America Inc., Pacific Gas and Electric Company, Safeway Inc., Weatherford International, Ltd., U.S. Chamber of Commerce to SEC (Jan. 10, 2011) (Letter from 22 Issuers and Associations); Letter from FSC Securities Corporation to SEC (Jan. 10, 2011); Letter from SIFMA to SEC (Jan. 10, 2011); Letter

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two-thirds of short-term state and local government debt, and significant portions of outstanding short-term Treasury and federal agency securities.[85] In addition, corporate and other institutional investors may also decide to invest directly in money market instruments, thus concentrating their risk and necessitating an increase in in-house expertise.

A letter co-signed by 22 diverse companies and organizations, representing a broad range of industries and entities that rely on Money Funds to support their capital raising and investment needs by purchasing their commercial paper, warned that:

> American business will lose one of its most important sources of short-term funding if money market funds are forced to abandon their stable per-share value, whether directly or indirectly . . . . With such a change, the expected flight of investors from these funds will severely impair the ability of companies to raise capital in the U.S. and undermine efforts to strengthen the American economy.
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> . . .
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> There are no immediate substitutes for money market funds in this financing role. Bank lending cannot fill this funding gap unless banks raise substantial new capital. Unregulated private pools might see an opportunity to expand, but encouraging investors to migrate to these vehicles hardly seems consistent with efforts to reduce risk, increase transparency, and ensure greater market stability. Mandating a floating NAV would make short-term financing for American business less efficient and far more costly, ensuring a severe setback for an economy emerging from recession.[86]

A letter signed by 33 Members of Congress who are all former state and local officials further stated, "Any reduction in demand for money market funds would reduce demand for the securities issued by state and local governments and purchased by Money Funds. As a result, states and municipalities would be deprived of a critical funding source and would be faced with increasing debt issuance costs."[87] The PWG Report acknowledged that a floating NAV "might reduce investor demand for MMFs and thus diminish their capacity to supply credit to businesses, financial institutions, state and local governments, and other borrowers who obtain

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from Associated Industries of Florida to SEC (Jan. 10, 2011); Letter from Invesco Advisors to SEC (Jan. 10, 2011); Letter from Fidelity Investments to SEC (Jan. 10, 2011); Letter from Kentucky Chamber of Commerce to SEC (Jan. 10, 2011); Letter from Dallas Regional Chamber to SEC (Jan. 10, 2011); Letter from Professor Jonathan Macey to SEC (Jan. 8, 2011); Letter from Royal Alliance Associates to SEC (Jan. 7, 2011); Letter from SagePoint Financial to SEC (Jan. 7, 2011); Letter from Cincinnati/Northern Kentucky International Airport to SEC (Jan. 7, 2011); Letter from Port of Houston Authority to SEC (Jan. 6, 2011); Letter from National Association of State and Local Treasurers to SEC (Dec. 21, 2010).

[85] This data originally appeared in the PWG Report at 7.

[86] Letter from 22 Issuers and Associations to SEC (Jan. 10, 2011).

[87] Letter from 33 Members of Congress to SEC (May 1, 2012).

financing in short-term debt markets."[88] Fidelity Investments estimated that for municipal issuers, the amount of annual interest paid by these entities to fund their operations would increase by billions of dollars if Money Funds ceased to be significant purchasers, and that the federal government similarly would have to pay billions more in annual interest to finance its short-term debt.[89]

(9) A floating NAV would force current Money Fund users to less regulated and less transparent products.

Commenters, including current and former state and local government officials, warned that forcing Money Funds to move to a floating NAV would leave resource-strapped public treasurers without the safely managed investment option of Money Funds.[90] One group of fourteen national, state and local entities, representing thousands of municipalities, agencies, and officials throughout the U.S. warned that if the SEC required Money Funds to float their NAVs, it would force many of their members to look at "competing products that could be more susceptible to market conditions, more difficult to account for and manage, and may pose market risk. That would contrast sharply with the SEC's goals, particularly since many of those competing products don't provide investors with the same transparency and comprehensive regulatory protections as MMMFs."[91]

Numerous additional commenters warned that a floating NAV for Money Funds would motivate investors to shift assets to riskier or unregulated cash-management vehicles once Money Funds no longer meet the liquidity requirements of institutional and retail investors using Money Funds for their short-term cash management needs.[92] The Kentucky Chamber of

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[88] PWG Report at 21.

[89] Letter from Fidelity Investments to SEC (Jan. 10, 2011).

[90] Letter from 33 Members of Congress to SEC (May 1, 2012); Letter from Indiana County Treasurers Association to SEC (Apr. 25, 2012); Letter from Metropolitan Mayors Caucus to SEC(Mar. 28, 2012); Letters from 14 National, State and Local Entities to SEC (Mar. 8, 2012); Letter from Washington State Treasurer to SEC (Nov. 15, 2011); Letter from 12 National, State and Local Entities to SEC (Jan. 10, 2011).

[91] Letter from 14 National State and Local Entities to SEC (Mar. 8, 2012).

[92] Letter from Michael B. Hancock, Mayor of Denver, to SEC (July 25, 2012); Letter from Stephanie Rawlings-Blake, Mayor of Baltimore, to SEC (July 20, 2012); Letter from New York State Association of Counties to SEC (Jun. 20, 2012); Letters from Vanguard to SEC (Jun. 4, 2012 and Jan. 10, 2011); Letter from Charles Schwab to IOSCO, filed with SEC (May 31, 2012); Letter from Invesco to IOSCO, filed with SEC (May 25, 2012); Letter from Independent Directors Council & Mutual Fund Directors Forum to SEC (May 2, 2012); Letter from 33 Members of Congress to SEC (May 1, 2012); Letter from Association for Financial Professionals and 13 other organizations to SEC (Apr. 4, 2012); Letters from Mutual Fund Directors Forum to SEC (Mar. 29, 2012 and Jan. 10, 2011); Letter from Texas Association of Business to SEC (Feb. 27, 2012); Letter from State Street Corporation to SEC (Feb. 24, 2012); Letter from ICI to SEC (Feb. 16, 2012); Letter from Northern Kentucky Chamber of Commerce to SEC (Jan. 20, 2012); Letter from the Financial Services Roundtable to SEC (Jun. 30, 2011); Letter from New Jersey Business & Industry Association to SEC (Feb. 7, 2011); Letter from New Hampshire College and University Council to SEC (Jan. 21, 2011); Letter from American Association of State Colleges and Universities to SEC (Jan. 21, 2011); Letter from New York Business Council to SEC (Jan. 14, 2011); Letter from Financial Services Institute to SEC (Jan. 10, 2011); Letter from J.P. Morgan Asset Management to SEC (Jan. 10, 2011); Letter from Fidelity Investments to SEC

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Commerce, representing over 2,000 businesses and 250,000 workers, noted that a regulatory change that would drive investors to less-regulated funds "is hardly consistent with efforts to reduce risk, increase market transparency and ensure greater market stability."[93] The PWG Report stated the problem as follows:

> [E]limination of MMFs' stable NAVs may cause investors to shift assets to stable NAV substitutes that are vulnerable to runs but subject to less regulation than MMFs. In particular, many institutional investors might move assets to less regulated or unregulated cash management vehicles, such as offshore MMFs, enhanced cash funds, and other stable value vehicles that hold portfolios similar to those of MMFs but are not subject to the [Investment Company Act's] restrictions on MMFs.[94]

(10) A floating NAV would accelerate the flow of assets to "Too Big to Fail" banks, further concentrating risk in that sector.

Commenters argued that a reduction in Money Fund holdings would push many investors to banks, exacerbating the banks' need for capital and concentrating risks in that sector.[95] The Mutual Fund Directors Forum warned, "[A] shift of significant amounts of cash to the banking system may have unintended and unpredictable consequences," and stated "[A]ny increase in the systemic risk resulting from the flow of money to other investment vehicles is important and should be considered by the Commission before proposing or adopting further significant changes to the manner in which money market funds are regulated."[96] Regulators themselves have noted that a broad shift of institutional cash to the banking system could lead to a large increase in uninsured, "hot money" deposits.[97]

In their analysis of the performance of stable and floating NAV funds, Fisch and Roiter pointed out that "[e]liminating MMFs as an alternative to bank deposits means greater concentration of risk in the one sector of our financial system that history has indisputably shown

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(Jan. 10, 2011); Letter from European Fund and Asset Management Association to SEC (Jan. 10, 2011); Letter from SIFMA to SEC (Jan. 10, 2011); Letter from SVB Financial Group to SEC (Jan. 10, 2011); Letter from Kentucky State Treasurer to SEC (Jan. 10, 2011); Letter from Independent Directors Council to SEC (Jan. 10, 2011); Letter from Invesco Advisors to SEC (Jan. 10, 2011); Letter from Wells Fargo Funds Management to SEC (Jan. 10, 2011); Letter from Goldman Sachs Asset Management (Jan. 10, 2011); Letter from National Association of State and Local Treasurers to SEC (Dec. 21, 2010).

[93] Letter from Northern Kentucky Chamber of Commerce to SEC (Jan. 20, 2012).

[94] PWG Report at 21-22.

[95] Letter from Independent Directors Council and Mutual Fund Directors Forum to SEC (May 2, 2012); Letter from Fidelity Investments to IOSCO, filed with SEC (May 30, 2012); Letter from the Financial Services Roundtable to SEC (Jun. 30, 2011); Letter from New York Business Council to SEC (Jan. 14, 2011).

[96] Letter from Mutual Fund Directors Forum to SEC (Mar. 29, 2012).

[97] FRBNY Report at 6.

to be most prone to systemic risk, the banks."[98] One large asset manager questioned whether banks could perform the funding role that Money Funds currently do, stating, "It is our belief that banks have neither the infrastructure nor the profit incentive based on minimum leverage capital requirements to provide short-term funding to the economy in the way that money market funds do through the purchase of commercial paper and other short-term debt instruments."[99] Further, commenters noted that any large scale shift of assets to banks would strain the federal safety net, to the extent those deposits are insured by the FDIC.[100]

[98] Letter from Fisch & Roiter to SEC at 31 (Dec. 2, 2011).

[99] Letter from BlackRock to SEC (Jan. 10, 2011).

[100] Letters from Fidelity Investments to IOSCO, filed with SEC (May 30, 2012); Letter from Fidelity Investments to SEC (Jan. 10, 2011); Letter from Invesco to SEC (Jan. 10, 2011); Letter from Professor Jonathan Macey to SEC (Jan. 8, 2011).

Appendix

Impact on Specialized Systems That Use Money Funds to Hold Temporary Liquidity Balances

The Money Fund business developed during a period in which a wide range of businesses moved from archaic manual systems to automated systems for processing the posting and settlement of various types of transactions. As a result, use of stable value Money Funds to hold short-term liquidity was incorporated into many of the accounting systems and the automated interfaces used in these systems. Examples, which are discussed in more detail below, include trust accounting systems at bank trust departments, corporate payroll processing, corporate and institutional operating cash balances, federal, state and local government cash balances, municipal bond trustee cash management systems, consumer receivable securitization cash processing, escrow processing, custody cash balances and investment manager cash balances, 401(k) and 403(b) employee benefit plan processing, broker-dealer and futures dealer customer cash balances, and cash management type accounts at banks and broker-dealers.

The systems changes that have been implemented in many different businesses over the past four decades have greatly reduced (i) the time required to post and settle transactions, (ii) the personnel required to post and settle transactions (and thus the overhead costs associated with those functions), (iii) the errors associated with posting and settling those transactions, (iv) the "fails" involved in settling those transactions, (v) the size and length of time outstanding of the "float," "due to," and "due from" balances tied up in processing of transactions, and (vi) the counterparty default risk associated with transactions between and among companies. These changes have had the net result over the past four decades of reducing risk and increasing the efficiency of many business activities and greatly reducing the amount of funding required for businesses to conduct transaction processing.

Many of these systems have as a key element the use of Money Funds to hold short-term liquidity in connection with settlement of the transactions. The features of Money Funds that are ideal for holding temporary balances in these systems include (1) stable $1 per-share value during the time the transaction is being processed to allow certainty of the day of the exact dollar amounts that are being processed between different counterparty accounting systems so that the amount due and the amount paid do not diverge even by a few cents during the time in which the transaction is being processed, (2) same-day settlement capability (T+0 processing) which is possible only because of the use of amortized cost by Money Funds, (3) high credit quality and underlying portfolio issuer diversification which reduces risk of insolvency during the time the transaction is being processed, and (4) operation within a highly-automated secure computer environment that allows for 24/7 no downtime interfaces with accounting and data processing systems of all parties to the transactions.

The use of amortized cost and the resulting stable NAV are crucial features of Money Funds that allow them to work with automated processing systems. Amortized cost allows the use of a stable $1 per-share pricing by money funds. The valuation method accretes one additional day's worth of imputed interest on each portfolio asset each day using factors and information known in advance. This means that, absent a material credit event during the day that drops NAV below 99.5 cents per share, at 6:00 a.m., the system operators know what a share will be worth at 6:00 p.m. It will be priced at exactly $1.00 per share. If Money Funds were required to use continuously floating NAV, the exact price of a share as of the close of the day would not be known until after the markets close that day. Floating NAV funds must determine the purchase or redemption price of a share using the market-closing prices of the portfolio securities that are not known until the next close of markets *after* that purchase or redemption order is placed.[101]

In other words, if Money Funds used a floating NAV, the system operator would not know until 4:00 p.m. whether a share would be worth $1.00001 or $0.99999 at the end of the day. When the automated system learned in the morning that it must purchase or liquidate Money Fund shares to process a payment of say, $10,000,000 that afternoon, and placed that order, it would not be clear at the time the order was placed exactly how many Money Fund shares would have to be liquidated to reach that exact amount. It might be a few cents more or less at the end of the day than anticipated. This few extra or short pennies would be a discrepancy that would need to be manually reconciled and the difference trued up before the transaction could be finished. Manual processing would mean more staffing requirement, more costs associated with staffing the function, and errors and delays in completing the process.

Furthermore, because the purchase and redemption price would not be known earlier, and the market-closing prices from after the purchase or redemption order was placed must be used to set the price for the purchase or redemption order, the settlement payment could not occur the same day the order is placed (T+0), but instead is made the next business day (T+1). This means one party to the transaction owes the other money for one more day (three if it is a weekend, four if a holiday weekend). Both parties would carry the unsettled transaction as an open position for one extra day and each party would be exposed for that time to the risk that its counterparty would default during the extra day, or that the bank holding the cash overnight (or over the weekend) would fail. For a bank involved in making a payment in anticipation of an incoming funds transfer as part of these processing systems, this change from same-day to next-day processing of money fund redemptions would turn intra-day overdrafts into overnight overdrafts, resulting in much greater default and funding risks to the bank. This extra day's float would mean more risk in the system and a larger average float balance that each party must carry and finance.

The net result of a floating NAV would be to make Money Funds not useful to hold the large, short-term cash balances used in these automated transaction processing systems across a wide variety of businesses and applications. A generation's worth of work in automating settlement systems, shortening settlement times, and limiting counterparty risk would be undermined. At a minimum this would require systems to be re-programmed on a wide scale, involving substantial personnel, time and years to complete. This would be comparable in some ways to the Y-2K effort, although the effort would be concentrated at fewer firms, but more work required at each affected firm to redesign and reprogram their processing and accounting systems. Completion of the systems would take many years and hundreds of millions of dollars to complete across a wide range of businesses and applications for which stable value money funds currently are used to hold short-term liquidity. Until these systems could be redesigned,

[101] 17 C.F.R. §§ 270.2a-4, 270.22c-1.

reconfigured and rebuilt, processing of transactions would essentially be back to the manual processes that existed in the early 1970s.

If Money Funds no longer provide a business solution for holding short-term cash balances for each of these various processing functions, something else would need to be used. The vehicles that formerly held these pending balances before Money Funds filled this need included credit balances at the commercial counterparty (due to and due from amounts at a commercial company, or free credit balances at a broker), bank short-term investment funds, corporate variable amount notes, and bank deposits. These vehicles have fallen out of use for this purpose or might no longer be available, and each carries with it much greater and more concentrated default risks.

Examples of some of the transaction processing systems that use Money Funds to hold short-term cash balances are set forth below, along with a description of how Money Funds fill a business need of that particular system.

Bank Trust Accounting Systems. Bank trust departments are responsible for receiving, tracking, accounting for, holding in custody, investing, and paying out cash balances for large numbers of trust accounts. This cash includes balances from many different trust and fiduciary accounts. It represents cash received from the proceeds of sales of securities or other assets, dividends and interest on client investments, and new balances placed in trust. The cash is held briefly pending distribution to beneficial owners, payment of expenses and taxes on behalf of clients, and payments for purchases of securities and other assets for client fiduciary accounts. At any given time, the balance for any one client account may be very large or very small, but in the aggregate the trust department as a whole represents a very large, short-term cash balance. Trust departments have an obligation to keep trust assets productive, minimize the time cash balances remain uninvested, and seek a competitive return on cash balances consistent with prudent investment principles.[102]

Tracking, investing and accounting for these cash balances is a complex effort, due to the large numbers of fiduciary accounts which must be tracked, the many and varied inbound and outbound streams of cash, the need to plan and manage payments and distributions for the various client accounts, tax considerations, the non-uniform provisions of the many different trust instruments that govern the requirements of each different account, and the complex and overlapping requirements of state and federal laws governing fiduciary accounts. Fiduciary laws in many jurisdictions designate certain types of assets as permitted investments for trusts and certain other fiduciary accounts. Money Funds have been recognized as permitted fiduciary investments in many states.[103] A change to the regulatory requirements for Money Funds that precluded Money Funds from using amortized cost or seeking to maintain a stable net asset value per share could require state fiduciary statutes to be amended by state legislatures to permit the continued use of Money Funds to hold trust cash balances in certain states.

[102] 12 C.F.R. § 9.10.

[103] *See, e.g.*, Ala. Code § 19-4A-3; Cal. Prob. Code § 9730; Fla. Stat. Ann. § 736.0816;.

Among the many complexities of applicable fiduciary laws is a requirement in many jurisdictions to track and separately account for principal and income on each account, and requirements on diversification and in what assets a particular type of fiduciary account can be invested, as well as restrictions on conflicts of interest by the trustee bank.

Most bank trust departments operate on trust accounting systems provided by one of ten large national vendors. These automated, computer-based systems are designed to maintain records of client accounts, generate internal and external reports used by the trust department, as well as tax records and client statements, and interact with the investment and cash management programs of the bank on an automated basis.

In the past, trust departments generally held trust cash either on deposit with the commercial side of the bank, or in a "short term investment fund" maintained by the trust department. Both of these alternatives had significant operational problems. If placed on deposit with the commercial side of the bank, the fiduciary account deposit generally must be collateralized by high quality bonds,[104] and must bear a competitive rate of interest.[105] Depositing with the commercial side presents a conflict of interest that must be carefully managed and maintained only for a short period.[106] This presents further complications under the reserve requirements of Regulation D, which require reserves to be placed by the bank with the Federal Reserve equal to 10% of a "demand deposit" portion of these cash balances.[107] The combination of these factors makes it impractical in many cases for the commercial side of the bank to accept fiduciary deposits.

Short-term investment funds (or STIFs) present other challenges as a cash management vehicle for trust department cash. STIFs are a form of bank common trust fund invested in relatively short-term high quality debt instruments,[108] and only certain types of bona fide fiduciary account balances from the bank that maintains the STIF and its affiliated banks can be placed in them. Revocable grantor trusts, investment management and custody accounts, IRA and pension and employee benefit plan assets cannot be placed with the other trust assets in a STIF due to requirements of the Investment Company Act exemption within which STIFs operate.[109] This results in a relatively small investable balance for each STIF (compared to Money Funds) and therefore a substantial challenge in keeping the portfolio of the STIF fully

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104 *See* 12 U.S.C. § 92a(d); 12 C.F.R. § 9.10.

105 12 C.F.R. § 9.10; *Md. Nat'l Bank v. Cumins*, 322 Md. 570, 588 A.2d 1205 (Md. 1991); *Van de Kamp v. Bank of Am. Nat'l Trust & Savs. Ass'n*, 251 Cal. Rptr. 530, 538 (Cal. Ct. App. 1988); *In re Orrantia's Estate*, 285 P. 266 (Ariz. 1930); *New England Trust Co. v. Triggs*, 135 N.E.2d 541 (Mass. 1956); *In re Doyle's Will*, 79 N.Y.S.2d 695 (N.Y. Surr. Ct. 1948); *In re Haigh's Estate*, 133 Misc. 240, 232 N.Y.S. 322 (N.Y. Surr. Ct. 1928); *Reid v. Reid*, 85 A. 85 (Pa. 1912).

106 *Id*.

107 12 C.F.R. § 204.

108 12 C.F.R. § 9.18(b)(4)(ii)(B).

109 Investment Company Act 3(c)(3) (exemption for bank common trust funds), 3(c)(11) (exemption for bank collective funds for pension and employee benefit plans); *In the Matter of Commercial Bank and Marvin C. Abeene*, SEC Rel. 33-7116 (Dec. 6, 1994).

invested in a diverse pool of high quality assets while matching the timing of cash flow requirements dictated by trust account investments in and redemptions from the STIF.[110]

One of the first major uses of Money Funds was to hold these trust department temporary cash balances. Money Funds provided a useful solution to bank trust departments which allowed them to invest balances of fiduciary accounts for short periods of times in an asset permitted by state fiduciary laws and trust instruments, at a competitive yield in a liquid, diverse pool of high quality debt instruments. Because a Money Fund can accept investors from many different banks' trust departments as well as other types of retail or institutional investors, a Money Fund can be much larger than a STIF and can accordingly achieve more portfolio diversification, better management of liquidity needs, and lower operating costs per dollar of assets, as compared to a STIF, and pay higher returns with less concentration of risk to trust accounts than a bank deposit. Use of amortized cost permits a Money Fund to anticipate NAV and share prices at the beginning of the day for the entire day (subject to the remote possibility that there will be an unexpected substantial credit event during the day that drops NAV below 99.5 cents per share), rather than needing to wait until after the close of the trading markets at 4 pm to know end-of-day NAV. This means the price of a Money Fund share can be anticipated at 6 am when the processing day begins.

Trust accounting systems interface with many different external systems on a daily basis. These include interfaces with systems of broker-dealer firms through which the trust department executes purchases and sales of securities for fiduciary accounts, systems providing notification of dividend and interest payments received through securities clearinghouses and payment agent banks, and systems for receiving and sending incoming and outbound payments through the banking system on behalf of fiduciary accounts. These electronic data communications generally involve a bilateral exchange of pending payment amounts stated in dollars and cents, which are followed subsequently by deliveries of those amounts.

In order to reduce errors and cash shortfalls, trust accounting systems typically post a debit to the cash position in the account immediately before or simultaneously with the placement of an order to purchase a security, which is transformed into a redemption order for shares of the Money Fund to generate cash to pay, the next day, for the security being purchased.[111] These accounting systems require a predictable Money Fund NAV share value at the time the redemption order is placed for (i) the cash position to match the cash needed to settle the purchase order and (ii) the ending balance reflected as available in the Money Fund to be accurate for processing any other transactions in the customer account that day.

Predictability in the per share price of Money Funds is critical to the operation of trust accounting systems, allowing them to be more fully automated (rather than relying on manual processes and the staffing costs, delays and errors associated with manual posting and processing of transactions and cash balances), allowing an exact sweep of cash balances to the penny, and

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[110] *See* Martin E. Lybecker, *Regulation of Bank Trust Department Investment Activities: Eight Gaps, Seven Remedies, Part II*, 91 Banking L.J. 6 12-14 (1974); Martin E. Lybecker, *Regulation of Bank Trust Department Investment Activities*, 82 Yale L.J. 977, 984-86 (1973).

[111] *See* Letter from ASC to Eugene F. Maloney (Oct. 16, 2008) (on file with recipient).

permitting same day processing of cash payments. This permits same day (T+0) or next day (T+1) settlement of portfolio securities transactions for fiduciary accounts, which in turn reduces the amount of settlement cash, “due to” and “due from” “float” in the trust department and overnight overdrafts and out-of-balance trust accounts. This, in turn, means less counterparty risk and shorter time for client fiduciary assets to be less than fully invested.

Federated has been informed by the vendors of each of the major trust accounting systems that their systems are not designed to process cash balances using Money Funds with a continuously floating NAV. Forcing Money Funds to move to a continuously floating NAV would make Money Funds incompatible with the major trust accounting systems. Until these trust accounting systems could be redesigned and reprogrammed either to accept a continuously floating NAV (assuming it could be done at all and trust departments would accept it) or use some other vehicle to hold cash balances, trust departments would essentially be forced to use more manual processing, returning them essentially to the 1970s.

Corporate Payroll Processing. Most companies pay their employees either twice per month or every two weeks. Generally, pay is disbursed to all employees on the same days. The pay is either distributed in a direct deposit to an account previously designated by the employee, or in a physical paycheck given to the employee. The aggregate amount of money involved in each payroll disbursement is very large. The bigger the company, and the larger its employee base, the larger is the aggregate amount of cash involved. The corporate treasury department manages its cash availability through a variety of short-term investments that are sufficiently liquid to address scheduled payments that must be made. Payroll is a very large and recurrent payment amount.

Pending distribution to employees, the cash must sit somewhere. Large companies commonly use third-party vendors to handle payroll processing, but employers are not eager to incur the credit risk of such vendors on payroll balances, even for a short period of time. For a given pay period, the aggregate payroll amount for a large company is many millions of dollars, well in excess of the standard $250,000 FDIC deposit insurance limits (which limits are only temporarily suspended on noninterest bearing demand deposits until year-end 2012). If the entire balance is placed on deposit at a bank, and the bank fails, the company is at risk of losing a large portion of the payroll balance in excess of $250,000. Companies with large payrolls are understandably anxious about limiting their loss exposure in the event of the insolvency of a bank. From the bank’s perspective, many banks are not eager to take on multi-million dollar deposit balances for periods of a few days each month, because there are costs involved with having those balances on the bank’s balance sheet and the bank is not able to profitably invest the cash for such a short period of time.

As an alternative, many large employers place cash pending distribution of payroll into Money Funds, with an automated sweep into the payment system and vendor used by the employer. A Money Fund knows in advance, through communications with the employer and experience, how much money is coming in and out and when it will arrive and depart, and is able to profitably invest the proceeds through the Money Fund’s portfolio for a few days in short term instruments, carefully managing the cash position of the Money Fund with advance knowledge of the amounts and schedules of the payroll arrival and disbursement.

Key features that allow Money Funds to work to hold short-term balances for corporate payrolls pending distribution include the use of amortized cost and a stable NAV of $1 per share, which allows for a predictable value of share prices throughout the day (rather than needing to wait for end-of-day market close prices to know share prices and processing of purchases and redemptions after 4:00 p.m.) and same-day processing of investments and redemptions of shares. The bank that is processing the payroll distributions makes payments as checks and other items are presented through the banking system, and is able to redeem shares of the Money Fund and receive payment on a same day basis and avoid an overnight overdraft. If Money Funds were required to use a continuously floating NAV, purchases and redemptions would need to be processed on a next-day basis. This would require either (i) that large balances be redeemed and held as cash overnight or over a period of days as items are presented to the bank, creating an exposure by the employer to the credit risk of the bank for large amounts of money, or (ii) leaving the bank exposed to the risks associated with overnight overdrafts pending receipt of cash from the Money Fund or directly from the employer.

Moreover, if a continuously floating NAV is required for Money Funds, on a multi-million dollar balance, the value of the Money Fund shares would move around a small amount, such that the payment sent by the employer and held in the Money Fund for a few days would be a few dollars over or a few dollars short of the gross payroll amount each payroll period. This, in turn, would require more manual processing, creating more delays and errors, and significantly undermining the usefulness of Money Funds to employers, banks and payroll processors.

Corporate and Institutional Operating Cash Balances. In addition to payroll balances, companies have other payments received, as well as incoming cash from operations, and closely manage those cash balances in order to meet their payment obligations as they occur. Large companies typically have a corporate treasury management function to handle the liquidity needs and short-term investment of the company's assets.

The balances involved at a company at any given time can be very large. Due to low (or zero) interest rates on short-term corporate deposits and the risk of bank failure when balances are in excess of the $250,000 FDIC deposit insurance limits, leaving large amounts of cash on deposit at a bank is not a good alternative. Although the FDIC deposit insurance coverage on non-interest bearing demand deposits has been temporarily increased to an unlimited amount until December 31, 2012, that remains a short-term and not a highly attractive solution for corporate treasurers for holding large cash balances.[112]

Traditionally, larger corporate treasury departments managed cash balances by holding separately managed portfolios of direct investments in commercial paper, treasury bills, and other high quality short-term debt instruments. Many corporate treasurers have found it more efficient to invest a portion of those short-term balances in Money Funds. This allows for professional management at a lower cost of a diverse portfolio with greater liquidity than the

[112] The statutory deadline was imposed by Section 343 of the DFA and is codified in 12 U.S.C. 1821(a). As discussed below in Section II-D, further extension of unlimited deposit insurance would be inconsistent with the goal of reducing the size of the Federal safety net and would also further fuel the growth of the largest banks.

company's treasury desk could accomplish on its own. In this context, Money Funds are an alternative to an individually-managed portfolio of securities.

Use of amortized cost accounting which has resulted in nearly all circumstances over the past 35 years in a stable NAV of $1 per share provides a simple means for Money Fund balances to be integrated into the internal accounting and cash management systems used in corporate treasury departments. Same day processing of Money Fund share purchases and redemptions, which is not possible with a floating NAV Money Fund, allows Money Funds to be used more efficiently by corporate treasurers and permits a more automated interface among the internal accounting systems used by the corporate treasury department, the banks through which the company sends and receives payments, and the Money Fund's transfer agent. This, in turn, reduces float in the system, overnight overdrafts by the corporation's banks and the balances of the corporation with its banks in excess of FDIC deposit insurance limits.

Federal, State, Local Government Cash Balances. Like businesses, governments have cash management needs. Many state, local and federal government bodies use Money Funds as an efficient means to invest short term liquidity balances. Governments have payrolls to pay and operating cash balances to invest for short and medium periods of time. Government cash balances often are tied to tax payment cycles and expenditures tied to fiscal year budgets. Investment of the balances is subject to a myriad of state and local government requirements on investment of government assets, and in some cases to Internal Revenue Service requirements. These state and local laws commonly include lists of permitted investments that specifically authorize investments in Money Funds, defined in terms of a fund that seeks to maintain a stable net asset value per share.[113] A change to the regulatory requirements for Money Funds that precluded Money Funds from using amortized cost or seeking to maintain a stable net asset value per share would require many state and local government statutes to be amended by the state legislature to permit the continued use of Money Funds by the state or local government.

Although placing the funds on deposit at a bank is an alternative, government deposits frequently are required to be collateralized with high quality bonds,[114] which make them expensive for the bank to hold. Another alternative is for the state or local government to attempt to manage a portfolio of direct investments in individual money market instruments, although this is a more expensive, higher risk and ultimately less liquid means of investing cash balances of state and local governments than investing in Money Funds. An unintended consequence to a movement away from amortized cost and a stable value of $1 per share would be to diminish the ability of state and local governments to use Money Funds and to force them into less liquid, more expensive, higher risk alternatives for investment of cash portfolios.

Municipal Bond Trustee Cash Management Systems. State and local governments raise money for general operations and for specific projects through the issuance of municipal bonds. Each bond issuance has an indenture with a bank as bond indenture trustee and payment

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[113] *See, e.g.*, N.J. STAT. ANN. § 18A:20-37; S.C. CODE ANN.§§ 6-5-10(6), 12-45-220; Tex. Gov't Code Ann. § 2256.014 (West); COLO. REV. STAT. § 24-75-601; CONN. GEN. STATS. § 7-400(1)(B); MICH. COMP. LAW. §§ 129.91, 129.93; Op. Ind. A.G. No. 96-3 (Sept. 5, 1996).

[114] 12 U.S.C. §§ 1821(a)(2), 1823(e)(2).

agent to handle various aspects of the bonds' issuance, payment of interest and ultimate retirement. Substantial cash balances flow through the bond trustee and paying agent bank, with which cash payment must be made on time every time pursuant to the contractual terms of the bonds to avoid default. In many cases, the credit quality and credit rating of the bond issuance is tied to a very carefully developed cash management program designed to assure that there will be cash available to make scheduled interest payments and sinking fund retirements of the bonds. The trust indenture of the bond, as well as state and local government laws and IRS requirements dictate certain aspects of how and into what types of assets the cash balances can be invested pending payment or distribution.

Leaving large amounts of cash on deposit at a bank results in a concentration of credit exposure that in some cases is not acceptable to bondholders. In addition, because the liquidity balances flow through the bond trustee and payment agent over relatively short periods of time, a bank may not be able to profitably invest the cash on a short term basis. As a result, Money Funds are used in many cases to hold portions of the short term liquidity pending payment or distribution on scheduled dates.

Use of amortized cost accounting and a stable NAV of $1 dollar per share allows Money Fund balances to be integrated into the accounting systems used in the corporate trust department of the bank that serves as bond trustee. Same day processing of Money Fund share purchases and redemptions, which is not possible with a floating NAV Money Fund, allows Money Funds to be used more efficiently by the bond trustee and payment agent. This, in turn, reduces float in the system, overnight overdrafts by the payment agent bank and the balances of the issuer with its bank in excess of FDIC deposit insurance limits.

A trust company president described the importance of Money Funds with a stable NAV of $1 per share to the investment of cash amounts associated with municipal bonds as follows:

> Until the advent of money market mutual funds, state and local government entities investing bond proceeds for infrastructure projects were extremely limited in scope to the manner in which bond proceeds could be invested. The work that we did collectively to have state statutes passed to allow a broader investment product array by utilizing money market funds as "permitted investments" has allowed for the minimization of market risk . . . .
>
> If for some reason the maintenance of a stable $1.00 value by money market mutual funds is at risk, we will see a mass exodus of investors from the institutional side of the business, such as Reliance Trust Company. This exodus will expose all investors to increased processing costs, substantially greater risk and liability, limited choices of investment vehicles primarily because of statutory restrictions and far greater exposure to credit risk.[115]

[115] Letter from Anthony A. Guthrie, President, Reliance Trust Company to Eugene F. Maloney, Federated Investors, Inc. (Oct. 17, 2008) (on file with recipient).

Consumer Receivable Securitization Cash Processing. The structures used for issuance of mortgage-backed bonds and other securitizations of consumer receivables share some of the attributes and cash management needs of municipal revenue bonds, but the cash flows are far more complicated and less predictable. Many of the structures require an initial cash balance and additional retention, build-up and hold back of significant amounts of cash from payments received on the underlying consumer receivables as a "prefunded account" in order to assure timely payment of the senior tranches of the securitization.[116] These cash hold-backs serve some of the same purposes as a back-stop letter of credit from a bank, which may also be in place in addition to the cash hold-back. The prefunded account reduces the likelihood of the need to draw on the letter of credit and the potential size of that draw. Money Funds are used as a more efficient and lower risk alternative to direct investment by the indenture trustee of the prefunded balances in a portfolio of individual money market instruments.

Money Funds are used in some cases to hold portions of these cash balances, for essentially the same reasons described above -- Money Funds limit counterparty risk exposure to any one bank, and the stable NAV permits same day processing of share redemptions and more convenient inclusion of balances in the complex accounting systems needed to track payments and disbursements in these securitization structures.

The permitted instruments into which cash balances can be invested generally are specified in the trust indenture and other governing documents of the structure and cannot readily be changed after the securitization structure is launched and its securities sold to investors. Changing the regulatory attributes of Money Funds could compromise their role in holding short-term liquid assets in securitization structures.

Escrow Processing. Money is placed in escrow in connection with a variety of transactions ranging from the purchase of a home to corporate acquisitions. The basic purpose is similar -- to place a cash balance into the hands of an independent party to make a payment on a contractually specified amount when certain conditions are met. The amounts per customer may be a few thousand dollars for mortgage escrows to hold tax and insurance payments, or billions of dollars in a corporate M&A transaction. The funds may be held for a few hours, days or months. The amounts held by an escrow agent commonly exceed deposit insurance limits of $250,000. If pass-through deposit insurance treatment is not available, or if the amounts per ultimate beneficial owner exceed $250,000, allowing the escrow agent to place the escrow balance in a bank deposit may not be an acceptable risk to the parties. Escrow agreements commonly allow the parties to direct the escrow balances be held in shares of a designated Money Fund, as a way of limiting counterparty risk.

Money Funds are useful for this purpose because they do not represent the credit risk of a single issuer, but instead represent a diversified pool of high-quality short term debt obligations of many underlying issuers. In addition, because the value of the shares do not fluctuate, the escrow agent can hold an amount representing exactly what must be paid if the conditions to completion are met and the escrow amounts paid out on settlement. For escrows on purchases of

[116] *See Federated Investors, Inc.*, SEC Staff Letter 1997 SEC No-Act LEXIS 716 (July 8, 1997).

companies with many shareholders, the accounting systems needed to assure exactly the correct amounts are paid to the proper shareholders are complex. Similarly, escrow agents that process mortgage-related tax and insurance escrows use complex automated accounting systems that must track and account for a large number of consumer escrow accounts each with different balances and payment amounts.

The use of amortized cost permits the share price of a Money Fund to be anticipated in the morning (because the daily amortization factors are known for each portfolio security) for the day, rather than known only after the closing of the markets at 4:00 p.m. This permits a share price to be used at a stable dollar amount throughout the day by the automated accounting and payment processing systems used by escrow agents. Moreover, the use of amortized cost also permits same-day settlement of purchases and redemptions of Money Fund shares. These two features – a stable share price throughout the day and same-day settlement – are key to the utility of Money Funds to hold temporary cash balances for escrow agents. If Money Funds were required to use a continuously floating NAV, they would not be as useful to escrow agents, the escrow agents' accounting systems would need to be redesigned and reprogrammed to accommodate a floating NAV, and payment cycles would be delayed by a day. If escrow agents continued to use Money Funds at all, there would be one extra day to closing required, and that delay means one extra day of counterparty risk. In addition, the cash balance would likely need to sit in a bank account overnight, adding the risk of bank failure during that period.

Custody Cash Balances and Investment Manager Cash Balances. Banks serve as custodians for securities accounts of commercial and individual customers. Securities purchases and sales orders are placed by the customer (or its investment adviser)[117] with a securities broker and the custodian bank is notified of the transaction. The custodian bank communicates settlement instructions with the broker-dealer. Custodial cash is commonly invested in Money Fund shares, in part because the cash balances commonly exceed the $250,000 FDIC deposit insurance limit. When it receives instructions to deliver cash to a broker-dealer to settle a transaction, the custodian bank redeems shares of the Money Fund. Same-day settlement of Money Fund shares (T+0) permits the cash to be available to settle the securities transactions the next day (T+1). With a continuously floating NAV, there would be an additional business day required to redeem Money Fund shares, which would move the settlement cycle for the securities transaction back one day (T+2).

401(k) and 403(b) Employee Benefit Plan Processing. Private employers over the past few decades have shifted from defined benefit retirement plans to defined contribution plans due to the high costs and potentially large unfunded liabilities associated with defined contribution plans. Two common and highly popular forms of participant-directed defined contribution plans are 401(k) and 403(b) plans, which draw their names from provisions of the Internal Revenue Code. Among the requirements applicable to these plans under the Department of Labor rules implementing the Employee Retirement Income Security Act (ERISA) are that, in order to limit the liability of plan trustees, a stable value option be included as part of the plan to hold cash

[117] *See* 17 C.F.R. § 275.206(4)-2 (customer accounts of registered investment advisers required to be held in custody of bank or broker-dealer).

contributions for which a participant has not yet provided investment instructions.[118] Money Funds are an investment option eligible to meet this requirement for up to 120 days.

In addition, cash balances in participant accounts must be segregated from the assets of the plan trustee and held during brief periods of time when a plan participant is changing the investment allocation of the participant's account. Money Funds serve this purpose within 401(k) and 403(b) plans.

The use of amortized cost and $1 per-share pricing at Money Funds allows for same-day settlement, and allows the value of shares to be known throughout the day. If Money Funds were required to use a continuously floating NAV, it might further delay the settlement of transactions and share prices could fluctuate very slightly and would not be known with certainty until after 4:00 p.m. each business day. This would limit the utility of Money Funds for use with the automated accounting and processing systems used by vendors that provide 401(k) and 403(b) plans, and if Money Funds continued to be used at all, would increase settlement times by at least one day, increase float in the system, require a process for reconciling and truing up order amounts to reflect small variations in the value of Money Fund balances and require a significant redesign and reprogramming of the accounting and processing systems used by 401(k) and 403(b) plans to accept a floating NAV Money Fund to hold temporary cash balances.

Broker-Dealer and Futures Dealer Customer Cash Balances. Customer accounts at securities broker-dealers carry cash balances that are used to make payments on amounts owed by the customer on purchases of securities. This cash belongs to the brokerage customer. Cash flows into the brokerage account through cash amounts added to the account by the customer, dividends and interest on investments held in the account, and from the proceeds of sales of securities.

If the brokerage customer's cash balance is not invested in something, it sits as a "free credit balance" which is simply a "due to" amount owed to the customer by the brokerage firm. To protect customers against the risk of a failure of the broker-dealer firm (and ultimately the SIPC which guarantees customer cash balances up to $250,000 per account), the broker-dealer is required to hold bank deposits or certain types of securities in a segregated account for the exclusive benefit of its customers, in an amount at least equal to the net unencumbered amounts of customer "free credit balances."[119]

As an alternative to holding customer cash as free credit balance liabilities of the broker-dealer, brokerage firms normally provide a cash sweep program by which customer cash balances are "swept" into investments in shares of Money Funds which are then owned by the customer but held in custody through the broker-dealer. Investment of the cash balances into Money Fund shares segregates these customer assets from the assets of the broker-dealer and removes them from the balance sheet liabilities of the broker-dealer.

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[118] *See* 29 C.F.R. § 2550.404c-5 (Department of Labor Qualified Default Investment Alternative Regulations).

[119] 17 C.F.R. § 240.15c3-3.

Because Money Fund redemptions settle same day (T+0), cash is available very quickly to pay for customer purchases of securities, or to receive incoming cash from the sale by the customer of a security. This same day cash availability is important to avoid customer "fails," and to assure compliance with the margin rule requirements applicable to brokerage accounts which require cash availability in the account when a customer places an order in a customer cash account and margin collateral coverage in a customer margin account.[120] In addition, the use of amortized cost and a stable NAV of $1 per share allows efficient processing of cash balances by the accounting system of the broker-dealer throughout the transaction processing cycle at a known and predictable amount, and communication with the accounting systems of the transfer agent of the Money Fund. This allows the use of Money Funds as a means to hold cash balances within the automated accounting and transaction processing systems used by the broker-dealers, which in turn reduces settlement times, pending transaction float balances and fails, and the counterparty risk in the system.

Similarly, rules of the Commodity Futures Trading Commission ("CFTC") require the segregation of customer cash balances at a futures firm used to pay for (and provide margin collateral for) futures transactions place by a customer.[121] Money Funds serve the same function at futures firms as they serve at securities broker-dealers -- hold customer cash balances, and to collateralize amounts due or potentially due on futures positions of the customer held through the futures firm. The CFTC reaffirmed the continued appropriateness of Money Funds to hold customer liquidity balances in December 2011 after careful review and a lengthy rulemaking proceeding.[122] The CFTC determined through this process that Money Funds satisfy the statutory objective that "customer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers … and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk"[123] as well as the Regulation 1.25 prudential standard that all permitted investments be "consistent with the objectives of preserving principal and maintaining liquidity."[124]

Broker-dealers and futures dealers are subject to regulatory requirements specifying the types of assets that the entity can own and the types of assets that can serve as collateral or be used to invest client cash balances. Many of these regulatory provisions specifically include as a permitted investment Money Fund shares that seek to maintain a stable net asset value per share.[125]

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[120] *See* Regulation T, 12 C.F.R. pt. 220. The margin rule treats Money Funds shares essentially as the equivalent of cash for this purpose.

[121] 17 C.F.R. § 1.20.

[122] CFTC, *Investment of Customer Funds and Funds Held in an Account for Foreign Futures*, 76 Fed. Reg. 78775 (Dec. 5, 2011) ("CFTC 2011 Release").

[123] CFTC 2011 Release at 5.

[124] *Id.* at 6, citing 17 C.F.R. § 1.25(b).

[125] N.Y. Mercantile Exchange Letter to Mr. Richard Recker, Federated Securities Corp. (May 18, 2001); Options Clearing Corp. Memorandum to all Clearing Members (Feb. 18, 2005).

The ability of securities broker-dealers and futures commission merchants to shorten settlement times and reduce the systemic risks associated with unsettled transactions has been facilitated by the ability of Money Funds to process purchases and redemptions of shares on a same day (T+0) basis, which in turn is only possible as a result of using the amortized cost method of accounting. Requiring Money Funds to use a continuously floating NAV would require them to move to next-day settlement and lengthen settlement times of securities transactions by at least one day. The securities industry has spent the past 35 years shortening settlement times to in order to reduce systemic risk. Using Money Funds to hold short-term cash balances in connection with the transaction settlement process has been an integral part of how that was accomplished. An unintended consequence of the movement of Money Funds to a continuously floating NAV (or the elimination altogether of Money Funds) would be longer securities transaction settlement cycles and an increase in systemic risk.

Cash-Management Type Accounts at Banks and Broker-Dealers. Brokerage firms and banks offer "cash management" type accounts that permit customers to access cash balances in their brokerage accounts by check or debit card. Millions of retail customers find these accounts to be convenient. Cash balances in these accounts are held either in Money Funds or in brokered deposits at banks. Checks and debit cards are processed by a bank for the brokerage firm. The payments of these items are funded by cash received from redemptions of Money Fund shares held in the customer's brokerage account. The bank runs nightly files of items presented for payment, which triggers a redemption of Money Fund shares. The bank advances payment on the items after confirming electronically Money Fund shares are being redeemed to repay the bank on the advance of Funds. The cash from the redemptions is then sent to the bank.

Processing the transactions is done on an automated basis, requiring a series of electronic data exchanges among the bank that issues the debit card and processes the checks, the brokerage firm that carries the customer's brokerage account, and the transfer agent of the Money Fund which processes the redemption requests and forwards payment to the bank.

Use of amortized cost and stable value of $1 per share is crucial to processing these accounts because it permits same-day processing of Money Fund share redemptions. This allows the bank to limit its credit exposure and avoid overdrafts and "NSF" or "bounced" checks. Use of a predictable $1 per share value is also critical to the interface among the accounting systems. The systems are programmed to work on a stable value of $1 per share. A continuously floating NAV would result in transactions being a few pennies over or short each day, which would require manual processing of the transactions. In the alternative, if the accounting systems were reprogrammed to address a continuously floating NAV by submitting the redemption request as a dollar amount rather than a number of Money Fund shares, the account balance remaining after a Money Fund share redemption is processed would be off by a few pennies per day, requiring inclusion of a larger buffer balance in the customer's account to ensure a sufficient available cash balance to avoid fails and overdrafts in subsequent transactions by the customer in the account, and additional work by the customer to keep track of available balances in the account.

For debit cards, there is a two step-process notification and payment of items is separated by a few days. First, at point of sale, the merchant sends an electronic signal through the banking system that the customer is buying something at a certain price, and the available balance is confirmed and a hold placed on that balance at the Money Fund. A few hours or days later, the merchant submits the debits for payment through the banking system, which submits the items for payment to the bank that issued the debit card and, which makes the payments. The bank then sends a signal to redeem the Money Fund shares that are on hold, to repay the bank for the advance. If the Money Fund shares continuously floated up and down in price between the time between when the hold was placed and the shares redeemed, the payments would be off a little bit each time, requiring manual processing. If same day settlement of Money Fund redemptions were not available, the bank would not be reimbursed on the same day that it advanced payment on the debit card items. Same-day cash would not be available to the entity "sourcing" the transaction. This would require cash funding flow changes throughout the funding chain and could require some participants in the process to carry an overnight overdraft until the cash arrives the next business day. Additionally, as entities authorizing debit/POS/ATM transactions based on an "Available Balance" data delivered to them by the transfer agent or brokerage platform, that balance could be slightly off as the shares representing that balance change based on end-of-day floating NAV pricing. Currently, these workflows and systems all assume a stable NAV of $1 per share throughout the chain of processing and same day processing of Money Fund share redemptions. Any change to that assumption will require a retooling of the workflow and cashflow timing to accommodate cash availability and delivery.

Banks offer a substantially similar product without the brokerage account. In the bank version, the bank offers a checking account with a debit card and ATM access, with balances above a set dollar minimum (which often is $0) swept into shares of a Money Fund.[126] The bank pays items after they are presented and after verifying there are enough Money Fund shares owned by the Customer. The bank places an order to redeem Money Fund shares to repay the advance.

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[126] *See* 1934 Act § 3(a)(4)(B)(v) (Money Fund sweep account exemption for banks in definition of securities "broker"), Regulation R, 12 C.F.R. § 218.741, 17 C.F.R. § 247.741 (same).