Paul A. Volcker
[redacted]

11 February 2011

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

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

Dear Ms. Murphy:

The widespread run on money market funds during the financial crisis illustrates the risk that is present in large financial institutions that operate with little or no capital and supervision, yet provide the very maturity transformation and liquidity "service" expected from our regulated, well capitalized banking system. When the crisis hit, certain sponsors of Money Market Mutual Funds - banks, investment banks, insurance companies and asset management firms - injected significant amounts of capital into their Funds to preserve the par value of customers' investments.

The purpose was both to protect the reputations of their respective firms and limit the contagious panic of investors withdrawing money at a rapid rate. Several of these sponsoring institutions, facing a shortage of capital and liquidity due to these and other losses during the crisis, received support from different government facilities including the TARP. The Prime Reserve Fund, which operated independently, was the main direct recipient of government assistance via unprecedented use of the Exchange Stabilization Fund of the U. S. Treasury. Massive Federal Reserve purchases of commercial paper were driven by the need to protect MMMFs. Among these were well managed Funds that experienced a shortage of liquidity, and of course Funds that invested in poor quality securities. [1]

The risk in these Funds has been compounded by the addition of cash management services, including withdrawal of fund principal on demand at par, thereby closely mimicking the services provided by regulated commercial banks. While the recent amendments to Rule 2a-7 are a necessary first step towards increasing MMMF liquidity, I believe that a clear distinction should be drawn between our regulated commercial banks offering the right to

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[1] Moody's report, <u>Sponsor Support Key to Money market Funds</u>, August 9, 2010. According to Moody's a total of 62 MMMF's received parental support during the crisis.

withdraw funds on demand at par, and mutual funds that invest in credit instruments without comparable capital and liquidity requirements. As things stand, investors, particularly retail investors, may not be sensitive to this distinction, and the recent rescue of MMMFs by massive government assistance is a clear instance of moral hazard.

It seems to me an obvious and straightforward remedy to this situation is to provide for two distinct categories of MMMFs:

MMMFs that desire to offer their clients bank-like transaction services, including withdrawal of funds from accounts at par, and promises of maintaining a constant or stable net asset value (NAV), should either be required to organize themselves as special purpose banks or submit themselves to capital and supervisory requirements and FDIC-type insurance on the funds under deposit. These "Stable NAV" MMMFs would then be allowed to market themselves as offering redemption at par.

MMMFs that do not wish to follow this track can remain MMMFs but would not be authorized to market themselves as offering redemption at par; rather they could present themselves as a conservative, low risk, liquid investment product. These funds would not be allowed to use amortized cost pricing on the securities in their portfolio, with the implied result being a floating NAV. There would be no assurances that money in these accounts could be withdrawn at par. One idea set out in the President's Working Group Report that has merit is that the traditional $1.00 par value of these "Floating NAV" Money Market Funds be increased to $10.00, to allow better visibility of price changes in the underlying securities.

There is a theme throughout the President's Working Group Report on MMMFs with which I disagree, but is relevant to the future health of our financial system. The Report seems to suggest that if MMMFs were capitalized and regulated, money will flow out of these Funds predominantly to less regulated or unregulated "substitutes". On the contrary, I feel the natural and predominant destination for investors that seek secure, stable value, interest bearing financial products is the banking system. The yield spread between bank savings products and MMMF-redemption-at-par products would obviously tighten or be eliminated with capital, insurance and regulatory costs becoming a part of a stable NAV MMMF's cost structure. Thus an important potential additional benefit to the financial system as a result of applying new regulations of this type to MMMFs would be a banking system funded by an increased amount of stable, lower cost, deposits. This is not an insignificant factor to consider at a time when banking participation will be important to a restructuring of the residential mortgage market.

One benefit of age is, on occasion, having been present at a time relevant to today's debate. In my case I was at the Federal Reserve when MMMFs were born. It was obvious at the time that these products were created to skirt banking regulations – a clear instance of regulatory arbitrage. The first of these Funds to require a bailout by a corporate parent in order to avoid "breaking the buck" was in 1980. Since then an additional 145 more such bailouts have occurred, several of which directly or indirectly required governmental support[2]. Prudent

[2] Moody's report, Sponsor Support Key to Money market Funds, August 9, 2010.

regulation of MMMFs is an important part of comprehensive financial reform, as both the Group of 30 and later the Treasury's White Paper so clearly had outlined[3].

Sincerely,

Paul A. Volcker

[3] The Group of Thirty: Financial Reform, A Framework for Financial Stability, January 2009. The United States Treasury: Financial Regulatory Reform: A New Foundation, June 2009.