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January 15, 2013

The Honorable Elisse B. Walter
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

The Honorable Luis A. Aguliar
Commissioner
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

The Honorable Daniel M. Gallagher
Commissioner
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

The Honorable Troy A. Paredes
Commissioner
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: FSOC's Proposed Recommendations Regarding Money Market Fund Reform

Dear Chairman Walter, Commissioner Aguliar, Commissioner Gallagher, and Commissioner Paredes:

Enclosed please find Vanguard's comments in response to FSOC's Proposed Recommendations Regarding Money Market Mutual Fund Reform. We look forward to working with you and the SEC staff to strengthen money market funds for the benefit and further protection of investors.

Sincerely,

Laura Merianos

Laura Merianos,
Principal
Vanguard

encl.

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January 15, 2013

Financial Stability Oversight Council
Attention: Amias Gerety
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Submitted via internet: http://www.regulations.gov

RE: Financial Stability Oversight Council Proposed Recommendations Regarding Money Market Mutual Fund Reform (FSOC-2012-0003)

Dear Financial Stability Oversight Council:

We appreciate the opportunity to provide comments to the Financial Stability Oversight Council ("FSOC" or the "Council") on the proposed recommendations regarding money market mutual fund reform (the "Proposal").[1] Vanguard[2] is an SEC-registered investment adviser that has managed money market mutual funds ("MMFs") since 1981. On behalf of our shareholders, who currently invest approximately $200 billion in our money market funds, we are deeply committed to working with the financial regulatory authorities to strengthen the money market industry for the benefit and further protection of investors.

Vanguard believes MMFs provide an important choice for investors' cash management needs. Investors may invest in a MMF, which accepts a minimal amount of investment risk in return for market yields, or open a federally insured bank account that guarantees up to $250,000 in principal protection in exchange for lower yields. We encourage regulators to find a reform solution that continues to allow investors, particularly retail investors, the discretion to make this choice.

Over the past four years, Vanguard has been actively involved in researching and evaluating potential MMF reform options. We were strong proponents of the SEC's amendments to Rule 2a-7 that were implemented in 2010. We believe these changes positioned many MMFs to be self-provisioning for liquidity, thereby reducing the likelihood that a future systemic market disruption would threaten these funds. We understand, however, that regulators remain concerned that these amendments may not sufficiently address the risks that MMFs, under highly unusual market conditions, may impose on the broader financial markets.[3] We agree that more could be done by the SEC to address these risks, but the solutions must be narrowly and carefully tailored to the relevant funds. Regulators must also be

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[1] 77 Fed. Reg. 69455 (Nov. 19, 2012); Financial Stability Oversight Council, "Proposed Recommendations Regarding Money Market Mutual Fund Reform" (2012), available at http://www.treasury.gov/initiatives/fsoc/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform%20-%20November%2013,%202012.pdf.

[2] Vanguard offers more than 170 U.S. mutual funds with aggregate assets of approximately $2.0 trillion.

[3] We note that in the 40-year history of MMFs, only two funds (both institutional) have failed to return $1.00 per share. Of those two instances only the failure of The Reserve Primary Fund in 2008, which occurred in the worst financial crisis since the Great Depression, was accompanied by significant redemptions in other institutional MMFs.

mindful of the unintended consequences that draconian reform measures may have on the capital markets and investors. Such considerations must inform any final recommendation on this matter.

Part I of this letter provides a summary of our main arguments. Part II notes some general observations about FSOC's approach to the Proposal. Part III explains our proposal for additional reforms tailored to "prime" MMFs and a potential path forward to distinguish institutional and retail MMFs.

I. Executive Summary

Currently, the SEC is the only agency with the appropriate statutory authority to recommend additional MMF reforms. FSOC should not make specific MMF reform recommendations to the SEC at this time, but should permit the agency, as the primary regulator of the capital markets and MMFs, to proceed with its statutory authority to consider reasonable reforms narrowly tailored to address FSOC's concerns, if they are supported by facts.

Any additional reforms proposed by the SEC should be limited to those MMFs that invest primarily in securities issued by banks, other financial institutions, or operating companies ("Prime MMFs") and should include a requirement for the boards of directors of all Prime MMFs to impose a standby liquidity fee of 1-3% when a fund's weekly liquidity has fallen below 15%. To the extent regulators have remaining concerns about institutional Prime MMFs, the Council could make additional recommendations to the SEC about how the risks posed by such institutional funds could be further mitigated. By focusing additional reform measures on institutional Prime MMFs, regulators will be able to appropriately address the most concerning risks while retaining Treasury, government and tax-exempt money market funds in their current form for the retail investor.

II. Observations about FSOC's Proposal

A. FSOC Should Not Make Recommendations to the SEC at this Time.

The SEC is the appropriate agency to determine which additional reforms should be implemented for MMFs. FSOC has recognized as much when it stated "The SEC, by virtue of its institutional expertise and statutory authority, is best positioned to implement reforms to address the risks that MMFs present to the economy."[4] Although the SEC did not propose additional reforms in August 2012, some of the SEC's Commissioners have indicated a willingness to consider additional reforms, provided that such reforms could be informed by an SEC staff analysis on the efficacy of the 2010 Rule 2a-7 amendments.[5] In November 2012, the SEC's Division of Risk, Strategy and Financial

[4] *See* Proposal at 15.

[5] *See* statement issued by Commissioner Luis A. Aguilar (August 23, 2012) at http://www.sec.gov/news/speech/2012/spch082312laa.htm (stating that MMF reforms must be considered together with potential structural changes to the entire cash management industry, and informed by an SEC staff analysis of the 2010 Rule 2a-7 amendments); *see also*, statement issued by Commissioners Daniel M. Gallagher and Troy A. Paredes (August 28, 2012) at http://www.sec.gov/news/speech/2012/spch082812dmgtap.htm (stating the need for further analysis on the 2010 Rule 2a-7 amendments and the need for a MMF reform proposal to solicit input on the efficacy of redemption "gates" to halt a run).

Innovation published such analysis ("SEC Staff Report")[6] and now the SEC is in a position to proceed with its statutory authority to consider additional reforms. Given these developments, and the confusion that could occur should two regulators move forward with different proposals, we request that FSOC not make specific MMF reform recommendations to the SEC at this time.[7]

B. FSOC Should Not Address Systemic Risk by Reducing the Size of the MMF Industry.

We believe FSOC's three recommendations: (i) float the NAV; (ii) retain 1% capital buffers with a minimum balance at risk ("MBR") for accounts above $100,000; or (iii) retain a 3% capital buffer with the ability to reduce such buffer through other risk-mitigating measures, attempt to reduce "systemic risk" by addressing the industry's size. Each of the three recommendations would significantly reduce the appeal of MMFs, which would curtail the size of the industry. FSOC has quite clearly stated as much in its Proposal when it said, "reforms that would provide meaningful mitigation of the risks posed by MMFs would likely reduce their appeal to investors by altering one or more of their attractive features."[8] We believe regulators should give more consideration to reform options that could reasonably address their more pressing concerns while retaining the key features of MMFs, particularly for the retail investor. FSOC's approach, to reduce MMFs' appeal to investors, is also inconsistent with the spirit of the Money Market Reform Options report issued in 2009 by the President's Working Group on Financial Markets ("PWG Report").[9] The PWG Report, which was drafted by many of the regulatory agencies comprising FSOC, espoused the benefits of reform measures that would "internalize the cost of liquidity... and provide appropriate incentives for MMFs and their investors."[10] The PWG Report also cautioned FSOC against trying to prevent any individual MMF from ever "breaking the buck," as such an approach would not be a practical policy objective.[11] We agree. Reform measures, such as capital buffers, which attempt to address idiosyncratic credit risk by providing a cushion against which small losses can be absorbed are not practical because they raise complex tax, accounting, and source of capital concerns. Capital buffers are also likely to carry unintended consequences, as some funds may purchase riskier, higher-yielding securities to compensate for the reduction in yield. As a result, capital buffers are likely to provide investors with a false sense of security.

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[6] *See* SEC Staff Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, Division of Risk, Strategy, and Financial Innovation, November 30, 2012 available at http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf.

[7] As a technical matter, we believe FSOC lacks the authority to make any MMF recommendations to the SEC until the Board of Governors of the Federal Reserve System adopts certain definitional rules.

[8] *See* Proposal at 29.

[9] *See* PWG Report at http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf.

[10] *Id.* at 24.

[11] *Id.* at 4. With the exception of the Reserve Primary Fund, the SEC Staff Report found that financial distress at one MMF does not necessarily result in disruptive redemptions at other MMFs, and suggested that "idiosyncratic portfolio losses may not cause abnormally large redemptions in other money market funds." SEC Staff Report, Executive Summary. This finding underscores the point that FSOC should not focus on reform solutions that target such idiosyncratic losses.

C. The Proposal's Recommendations Present Significant Operational, Tax and Regulatory Challenges for MMFs and, if Implemented, are Likely to Result in Unintended Consequences.

In previous comment letters, we have stated our thoughts about the floating NAV and capital requirements in MMFs.[12] We wish to reiterate those comments, and underscore our concern that FSOC's reform measures will incentivize financial innovation that will cater to the needs of sophisticated investors seeking MMF alternatives, which are likely to be unregulated and not subject to the rigorous reporting and disclosure requirements of regulated MMFs. Retail investors, however, will have no choice but to resort to a bank account for their cash management needs. Investors without choice will result in investors with fewer savings. A shift in assets from MMFs to bank accounts will not eliminate "systemic risk," but simply reallocate it. The findings in the recent SEC Staff Report confirm that large cash movements from the MMF industry to the banking industry would increase the amount of assets held in FDIC-insured accounts, and further concentrate risk in the banks.[13] We do not think these results are in keeping with FSOC's mission to mitigate systemic risk. Instead, we encourage FSOC and the SEC to consider reform measures that continue to provide investors with meaningful choice for their cash management needs **and** reduce the disruptions that can arise when certain MMFs experience extremely rare, destabilizing redemptions.

We are also deeply concerned that capital will not make MMFs more resilient to losses and less susceptible to runs. In theory, we agree that a capital buffer in a MMF does provide the fund with some capacity to absorb losses due to credit deterioration, default, or interest rate changes. In practice, however, we believe the opposite may be true. FSOC and the SEC should not underestimate the unintended effects of a capital buffer. At the end of the day, capital buffers reduce total returns for investors in MMFs. A permanent, built-in reduction to returns may result in funds purchasing investments that are higher-yielding and more prone to default. These securities may also experience more severe credit deterioration than the securities currently held in portfolios. The impact of such default or credit deterioration may be greater than a fund's capital buffer. Today, a fund's ability to

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[12] *See* Vanguard letter to the SEC, dated August 19, 2009 (regarding proposed amendments to Rule 2a-7 and comments on additional reform measures); Vanguard letter to the SEC, dated January 10, 2011 (discussing MMF reform options set forth in the PWG Report); and Vanguard letter to IOSCO, dated May 28, 2012 (discussing concerns about the floating NAV in response to IOSCO's report regarding Money Market Fund Systemic Risk Analysis and Reform Options). We note that corporate treasurers, state and municipal issuers, and members of Congress previously have expressed their concerns about the types of reform measures contemplated by the Proposal. *See* Letter, dated May 1, 2012, to SEC Chairman Schapiro from 33 members of Congress (expressing concern over potential proposals that would change the way money market mutual funds are regulated); *see also*, Letter, dated November 4, 2011, to SEC Chairman Schapiro from Senators Michael F. Bennet, Patrick J. Toomey, Mike Crapo, Jon Tester, Mark Kirk and Robert Menendez (discussing concerns about the proposal to float the NAV or impose inappropriate bank-like requirements on MMFs); Memorandum, dated May 4, 2012, from the Office of the Chairman of the SEC regarding a May 2, 2012 telephone conference with the U.S. Chamber of Commerce and certain corporate treasurers, during which the corporate treasurers expressed concerns about reforms to money market funds that would either eliminate the stable NAV, impose capital requirements, or establish redemption holdbacks; Letter, dated January 10, 2011, from American Public Power Association, et al. to the SEC (noting the concerns of issuers, treasurers, and mayors about changes that would alter the nature of MMFs potentially depriving state and local governments of much-needed capital); Letter, dated May 31, 2012, from Access Technology Systems, et al. to SEC Chairman Schapiro (discussing the concerns of numerous organizations and businesses that further regulatory changes to MMFs under discussion at the SEC would disrupt the value and utility of MMFs).
[13] *See* SEC Staff Report at 45.

reach for yield is restricted by Rule 2a-7. Under existing Rule 2a-7, MMFs must adhere to very strict minimum credit rating requirements, as determined by credit rating agencies, and are limited in the amount of second tier securities[14] they may acquire. The Dodd-Frank Act, however, has required all federal agencies to reexamine their rules and eliminate all references to ratings obtained from rating agencies. Although the SEC has not yet removed Rule 2a-7's credit rating requirements, it is possible that the agency will do so in the future. We believe a capital buffer, coupled with the removal of credit ratings from MMF rules, may result in the worst possible combination of reforms. We urge regulators not to adopt reform measures, which in combination with other factors, may encourage funds to reach for yield and increase the very risks that the reforms were intended to mitigate.

The concept of an MBR for investors with account balances in excess of $100,000 presents new concerns and challenges. First and foremost, the idea of a delayed receipt of redemption proceeds on a regular basis for those investors with account balances above $100,000 will likely cause investors to use less complicated and more liquid cash management options, or maintain balances well below $100,000. A proliferation of small account balances will drive up the costs to administer MMFs. Even if a fund had no account balances above $100,000,[15] fund sponsors would still need to undertake costly and resource-intensive changes to accommodate systems upgrades, and implement new ACH, wire transfer, and check writing processes on funds subject to MBR requirements. The MBR would also raise tax concerns. For example, an investor with a MMF balance in excess of $100,000 that is held in an IRA account subject to required minimum distributions might redeem an amount that would be subject to the 30-day holding period. If the 30-day holding period caused the investor's withdrawal amount to cross over a tax year, he could be subject to penalties for failure to take the required distributions. These concerns could be further complicated if, during the 30-day holding period, the MMF "broke the buck" and distributed less than the expected required minimum withdrawal amount. These examples highlight just some of the reasons why fund sponsors are unlikely to support reform measures that contemplate an MBR. Even if the industry could work toward a favorable resolution on each of these and other issues, investors are more likely to use cash management options that are less complicated and more liquid.

D. The Proposal Should Apply Only to Prime MMFs.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provides FSOC with the ability to make recommendations to a regulatory agency to apply new or heightened standards for a financial activity conducted by nonbank financial companies, if FSOC determines that the "conduct, scope, nature, size, scale, concentration or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit or other problems spreading among bank holding companies or nonbank financial companies, financial markets of the United States...."[16] The Proposal is FSOC's first step in making such a recommendation to the SEC for MMF reform. Although the Proposal comments on the interconnectedness and risks inherent in Prime, and particularly, institutional Prime MMFs, we believe it fails to establish that such interconnectedness and risks are

[14] A "second tier" security is any security that has received the second highest short-term credit rating issued by a credit rating agency. Rule 2a-7 limits the amount of second tier securities a fund may acquire to 3%.
[15] Our fund data shows that our MMFs, which cater to the retail investor, have many accounts that would exceed the $100,000 threshold.
[16] Dodd-Frank Act §120(a).

inherent in all MMFs.[17] For this reason we recommend that the Proposal, if submitted to the SEC, apply only to Prime MMFs.

FSOC's Proposal states that MMFs hold significant amounts of certificates of deposit, commercial paper, asset-backed securities, repurchase agreements and other securities issued by banks, bank holding companies and other financial institutions.[18] We believe this statement is true of Prime MMFs, but does not accurately describe the holdings of Treasury, government or municipal money market funds. The Proposal goes on to state that most MMF holdings represent exposure to some of the largest U.S. financial firms, which often have important ties to other companies and organizations.[19] Again, this statement is true of Prime MMFs. The Proposal concludes that MMFs, therefore, have the potential to transmit stress to the broader U.S. financial markets. We believe this conclusion is overly broad, and is not true with respect to Treasury, government and tax-exempt MMFs. Instead, regulators should seek to focus their attention on Prime MMFs, which are the types of funds that have concentrated exposure to the U.S. financial firms that are essential for the availability of credit and liquidity in the U.S. financial markets. At best, we believe the Proposal demonstrates that the nexus between the investments of Prime MMFs and the financial sector has the potential, in highly unusual circumstances, to contribute to (but not create) some broader disruptions in the financial markets when a large percentage of Prime MMF assets are quickly redeemed by investors seeking greater safety.

We are particularly concerned that FSOC is unwilling to recognize the profound differences among Treasury and government MMFs, on the one hand, and Prime MMFs, on the other. Either the primary regulator of systemic risk is severely misinformed about the credit quality and liquidity of Treasury and government securities, or the regulator's approach is a disingenuous effort to elicit admissions of systemic risk for Prime MMFs. Either way, Treasury and government MMFs should not be subject to additional reform measures given that the Proposal acknowledges that these MMFs did not experience disruptive redemptions during the 2008 financial crisis, and in fact, tend to attract net inflows during times of market stress.

The Proposal also discusses how tax-exempt MMFs can have exposure to some of the same financial firms as Prime MMFs. For example, the Proposal notes that as of September 30, 2012, "three large U.S. banks provided liquidity or credit support for approximately $100 billion in securities held by MMFs, and European financial institutions provided liquidity or credit support for more than $115 billion in such securities."[20] The Proposal then notes that many of these liquidity enhancements and credit support agreements are provided for state and local government obligations, as well as other tax-exempt issuers, and these securities are held by many tax-exempt MMFs.[21] Although this is true, the behavior of investors in tax-exempt MMFs and Prime funds during the financial crisis of 2008 couldn't be more different. As Appendix A illustrates, the top 25 institutional Prime MMFs experienced, on average, a decline in net assets of 10% from September 9-16, 2008. During the following week, the same top 25 institutional Prime MMFs experienced an average net asset decline of 24%. During the same two-week

[17] We also disagree with those who have suggested that MMFs caused the market-wide illiquidity that occurred in September 2008. MMFs suffered from illiquid market conditions that were caused from banking entities' unwillingness to accept each others' credit risk due to fears stemming from widespread bank failures.
[18] *See* Proposal at 22.
[19] Id.
[20] Id. at 23.
[21] Id.

period, the 10 largest tax-exempt MMFs experienced an average decline in net assets of 1.3% and 3.6%, respectively.

We think the difference in investor behavior between institutional Prime MMFs and tax-exempt MMFs can be explained by the composition of the shareholder base and the structural differences in the securities that these funds hold. Institutional Prime funds tend to be large funds with a high concentration of sophisticated institutional investors, who tend to invest large amounts of cash, and are likely to move significant sums in short order. Tax-exempt MMFs are typically smaller in size and consist largely of retail investors, who tend to have smaller account balances than institutional investors and normally do not redeem assets quickly from the funds. With respect to the types of securities held by each of these funds, institutional Prime funds hold taxable securities with primary exposure to the financial firm issuing such security. When the credit quality of the issuer deteriorates, these funds are exposed to that deterioration and can remove such exposure only by selling the security. The issuer of the security cannot be replaced. Tax-exempt MMFs, however, hold securities with primary exposure to a state, municipality or other tax-exempt issuer. The exposure to a financial firm providing credit enhancement or liquidity for the security is ancillary in that, under normal circumstances, it is in place to improve the liquidity and overall credit quality of a tax-exempt MMF security. In the event that is no longer the case, the municipal issuer has the ability, and is often incented, to substitute or remove the enhancement without financial loss to the MMF.[22] For this reason, we do not believe tax-exempt MMFs have the same nexus with financial firms as Prime MMFs, and do not believe that redemptions from tax-exempt MMFs have the potential to produce the same type of disruption to the broader financial markets.[23]

III. <u>If FSOC Proceeds with its Proposal to the SEC, Such Proposal Should Require a Standby Liquidity Fee for All Prime MMFs. To the Extent FSOC Believes Institutional Prime MMFs Require More Stringent Measures, FSOC Could Make Recommendations Specific to Such Funds.</u>

A. All Prime MMFs Should Be Required To Impose a Standby Liquidity Fee.[24]

The key to preventing a run on Prime MMFs from contributing to broader dislocations in the financial markets during a widespread crisis is to ensure that these funds have adequate liquidity, and have the ability to slow redemptions when a fund's liquidity becomes scarce. We believe a standby liquidity fee ("SLF") is an effective tool to accomplish both of these objectives.

Our proposal for an SLF would be used in conjunction with a stable $1 NAV, without capital buffers or MBR. This reform approach was developed in December 2011 through the input of various industry members in response to regulators' requests to see MMFs internalize the cost of liquidity, and is mentioned in the Proposal under Part D, "Request for Comment on Other Reforms." The SLF would work as follows:

[22] Since 2008, we have also observed an increase in municipal issuers providing self-liquidity for their securities.
[23] In addition, we note that tax-exempt MMFs generally have very liquid portfolios because of the nature of their securities.
[24] For purposes of the SLF requirement, we would define Prime MMFs as any MMF that did not hold more than 80% of its assets in U.S. Treasury, U.S. government, or U.S. municipal securities.

1) During normal redemption activity, the SLF would not be applied to investor redemptions. We define normal redemption activity as any day in which a Prime MMF's redemption activity does not cause the fund to have less than 15% weekly liquidity.[25]
2) Once a fund's weekly liquidity has fallen below 15%, redemptions would be suspended temporarily to permit the fund to impose a non-refundable SLF. Upon reopening, all redemptions would be subject to the fee until the fund's board of directors determined that the fee was no longer necessary for the protection of long-term investors in the fund.[26]
3) We recommend a fee in the amount of 1-3%. We believe a fee in this amount will serve as an adequate deterrent to investors who may attempt to flee a fund out of fear, but would still allow those investors who have a need to access their cash the ability to redeem a portion of their holdings. Importantly, this approach is consistent with the desire previously articulated by various regulators to have MMFs and their investors internalize the cost of liquidity. The SLF does just that. The fee would represent a premium that a redeeming investor would pay to the fund when a fund's liquidity was scarce. This premium could be used to enhance the fund's weekly liquidity levels or restore a faltering NAV.

We understand that some have suggested that the SLF might prompt the run that the fee is intended to prevent. We believe this concern would be effectively addressed through the daily disclosure of a fund's weekly liquidity level. The daily disclosure will serve as an effective tool to force investment advisors, particularly those managing funds with highly concentrated shareholder bases, to manage their funds with adequate liquidity to prevent the SLF from ever being triggered.

We believe the SLF offers several important advantages over the three main recommendations set forth in the Proposal. First and foremost, the SLF will encourage advisors and investors to self-police to avoid triggering the fee. Advisors, as described above, will have incentives to manage their funds with ample liquidity. An institutional investor will likely consider whether its investment alone, if redeemed, could cause the fund to trigger the fee. These investors are likely to reduce their MMF holdings to decrease the probability that the SLF is triggered due to their redemption activity. The SLF also has the advantage of being easy and cost-efficient to implement, and would not require significant changes in a fund's daily operations. The SLF is simply a redemption fee (i.e., an internalized cost of liquidity) imposed upon those shareholders who request liquidity when a fund's liquidity is scarce. Mutual funds already have the technology and infrastructure to impose such fees. Moreover, the fee does not discriminate against any investment advisor's business model. It is a fee that can be imposed by bank-sponsored and nonbank-sponsored MMFs. The SLF would also be easy for fund investors to understand, and the funds' weekly liquidity levels would be easy to disclose. Importantly, we believe the SLF is a reform measure that would have little to no impact on the short-term credit markets.

[25] We note that Rule 2a-7 requires all MMFs to maintain 30% weekly liquidity. The Rule, however, contemplates that a fund may dip below such 30% threshold. If this happens, the fund is required to restore its weekly liquidity by investing only in securities that mature in seven days or less.

[26] We note that at any time an SLF is in place, a fund's board of directors could also decide to delay payment of redemptions for up to seven days, which would give the fund time to restore its weekly liquidity. A fund could also draw on lines of liquidity, if available, or an investment advisor, pursuant to SEC Rule 17a-9, could purchase a security out of the fund's portfolio. In addition, a board of directors could also decide, pursuant to SEC Rule 22e-3, to suspend redemptions and liquidate the fund.

If the SEC were to impose a SLF on all Prime MMFs, we believe retail Prime funds would not be capable of contributing to broader financial market disruptions. If, however, regulators remained concerned about the ability of institutional Prime MMFs to contribute to dislocations notwithstanding the SLF, we recommend that further reform measures, such as additional liquidity, more frequent disclosure, or other options, be targeted to those funds.

B. Regulators Should Distinguish Retail and Institutional Prime MMFs Based On Account Balances.

FSOC's Proposal correctly recognizes that the Prime MMF industry is composed of two segments: (i) the retail Prime MMF, whose investors are largely individuals with relatively small account balances compared to a fund's total assets and (ii) the institutional Prime MMF, whose investors are institutions with account balances that represent a large portion of a fund's total assets. The Proposal goes on to state that it was the institutional Prime MMFs that experienced the disruptive redemption activity during the financial crisis of 2008, and raises concerns that institutional investors may have become even more reactive and run-prone since that time.[27] The PWG Report also noted this behavior when it stated:

> In addition, institutional investors are typically more sophisticated than retail investors in obtaining and analyzing information about MMF portfolios and risks, have larger amounts at stake, and hence are quicker to respond to events that may threaten the stable NAV. In fact, institutional MMFs have historically experienced much more volatile flows than retail funds. During the run on MMFs in September 2008, institutional funds accounted for more than 90 percent of the net redemptions from prime MMFs.[28]

The PWG Report went on to conclude "If MMFs had attracted primarily a retail investor base rather than an institutional base, investors might be slower to respond to strains on a MMF."[29] We agree with these observations. Our own experience underscores the observation made in the PWG report. During the week of September 16, 2008, our Prime MMF experienced redemptions of approximately 1.8%, which is inclusive of the retail investors who invest in our fund through their employers' retirement plans or through college savings accounts. When redemption decisions are made by multiple individuals with relatively small account balances compared to a fund's overall size, a fund is unlikely to experience disruptive redemption activity. Consequently, that fund is unlikely to contribute to dislocations in the broader financial markets.

Much has been made of the difficultly in defining retail and institutional funds, and we agree that there are significant challenges in doing so based upon an account registration. While there may be no perfect way to distinguish between every retail and institutional investor, we believe there are good ways to do so. An account balance threshold is one way to distinguish a retail and institutional investor and there are several benefits to such an approach. First, the account balance would be an objective and simple way for all investment advisors to know what type of fund they are managing.

[27] *See* Proposal at 27-28.
[28] *See* PWG Report at 11.
[29] Id.

The fund's shareholder base would not be able to become more or less institutional over time as investors came in and out of the fund. For this reason, investors would also be clear about whether their fund was an institutional or retail MMF. The account balance approach would also be relatively easy to administer from an operational and compliance perspective.

If regulators decided that it was necessary to further reform institutional Prime MMFs, we suggest an account balance in excess of $5M would be a good way to distinguish these funds from retail Prime MMFs.[30] Most retail investors have account balances well below $5M, and most institutional investors maintain balances well above this threshold. The $5M mark also would allow retail MMFs to accommodate the high-net worth individuals, who tend to have larger than average MMF account balances, but who behave no differently than the retail investors with much smaller account balances. Moreover, given that Prime funds tend to have tens of billions of dollars under management, a maximum account size of $5M would represent a very small portion of any fund's overall assets. Even if a Prime fund's entire shareholder base had account balances of $5M, it is not plausible that such shareholders, if they redeemed their entire accounts, would cause the fund to experience disruptive redemptions.[31]

A different and somewhat complicated way to distinguish retail and institutional funds is based on a shareholder concentration limit. Regulators could require retail Prime MMFs' investors to hold no more than a pre-determined percentage of a fund's total assets. This approach would allow for larger account balances as the fund grew, while minimizing the risk that a few investors could cause the fund to experience a destabilizing run. This approach, however, favors the largest funds at the expense of smaller and start-up funds, which will struggle to amass assets without breaching the concentration limit.

Whatever approach regulators take, we will have to make changes to our retail Prime MMF. We are willing to do so, even though we do not believe any Vanguard fund presents systemic risk. We are willing to do so because we believe it is in the best interest of investors to retain MMFs as a safe, low-cost option for their cash management needs. In providing these comments, we wish to underscore the importance of maintaining the availability of Prime MMFs for retirement and college savings plans. It is necessary for these plans to have a low-risk, low-cost option as investors near retirement or college, and our Prime MMF is a core holding in many of the largest retirement and college savings plans in the U.S. These plans hold the assets of millions of individual investors, all of whom would need to redeem their holdings in order for the entire retirement or college savings accounts to be redeemed out of our fund. Our experience demonstrates that these retail investors react no more quickly than our retail investors who hold our Prime MMF through a taxable account. For these reasons, regulators should exclude a Prime MMF's retirement and college savings plan-level holdings from any account balance or shareholder concentration limits that may be imposed.

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[30] We also note that institutional MMFs often provide investors with intraday liquidity, which requires the funds to strike their NAVs multiple times a day. This is an operational feature that can also be used to differentiate institutional from retail MMFs.

[31] Vanguard's Prime MMF, which caters to retail investors, currently has approximately $122B in assets under management. If each shareholder in our fund had a $5M account balance, each shareholder would represent 0.004% of the fund's total assets.

We appreciate the opportunity to provide FSOC with our thoughts and concerns on this issue. If you have any questions about Vanguard's comments or would like any additional information, please contact Laura Merianos, Principal, at (610) 669-2627.

Sincerely,

/s/ F. William McNabb III

Chairman and Chief Executive Officer
Vanguard

cc: The Honorable Timothy F. Geithner
Secretary of the Treasury, Chairman of the Financial Stability Oversight Council
U.S. Department of the Treasury

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
U.S. Department of the Treasury

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

The Honorable Elisse B. Walter
Chairman
Securities and Exchange Commission

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission

The Honorable Deborah Matz
Chairman
National Credit Union Administration

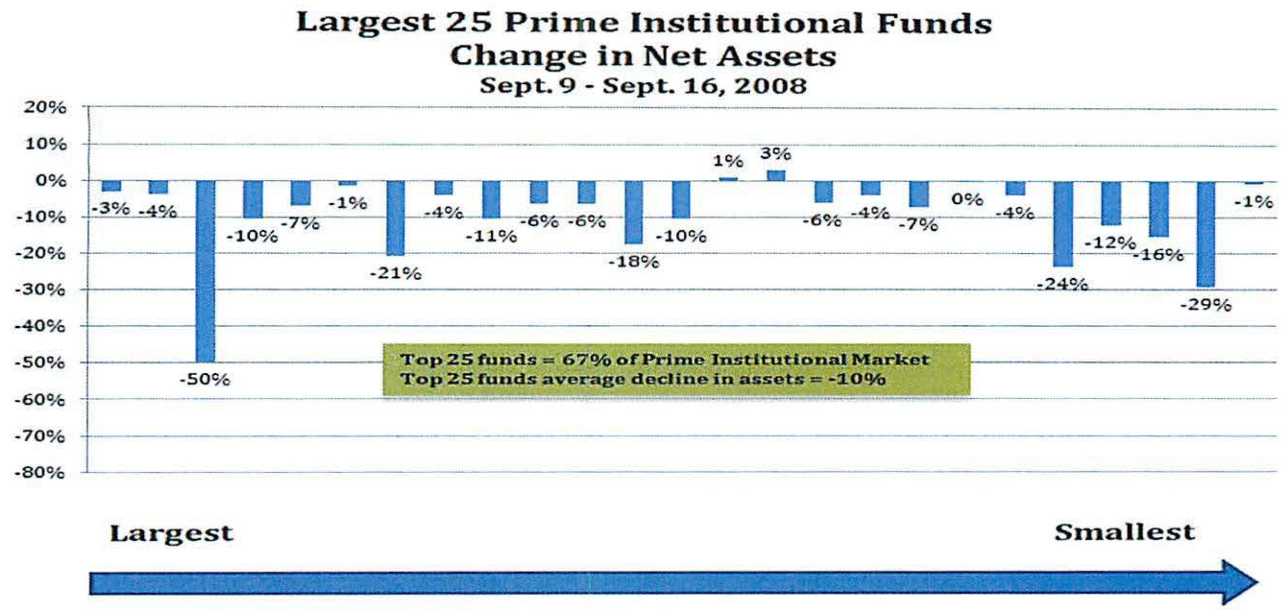
S. Roy Woodall
Independent Member
Financial Stability Oversight Council

The Honorable Luis A. Aguilar
Commissioner
Securities and Exchange Commission

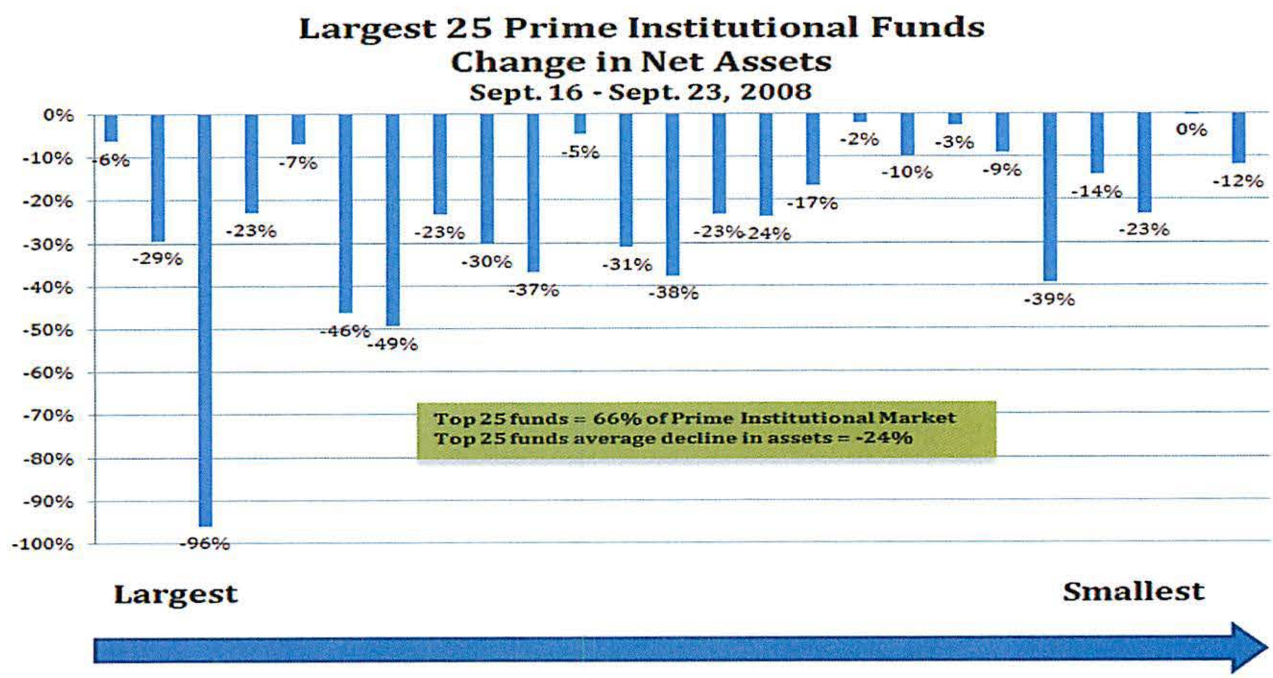
The Honorable Troy A. Paredes
Commissioner
Securities and Exchange Commission

The Honorable Daniel M. Gallagher
Commissioner
Securities and Exchange Commission

Appendix A

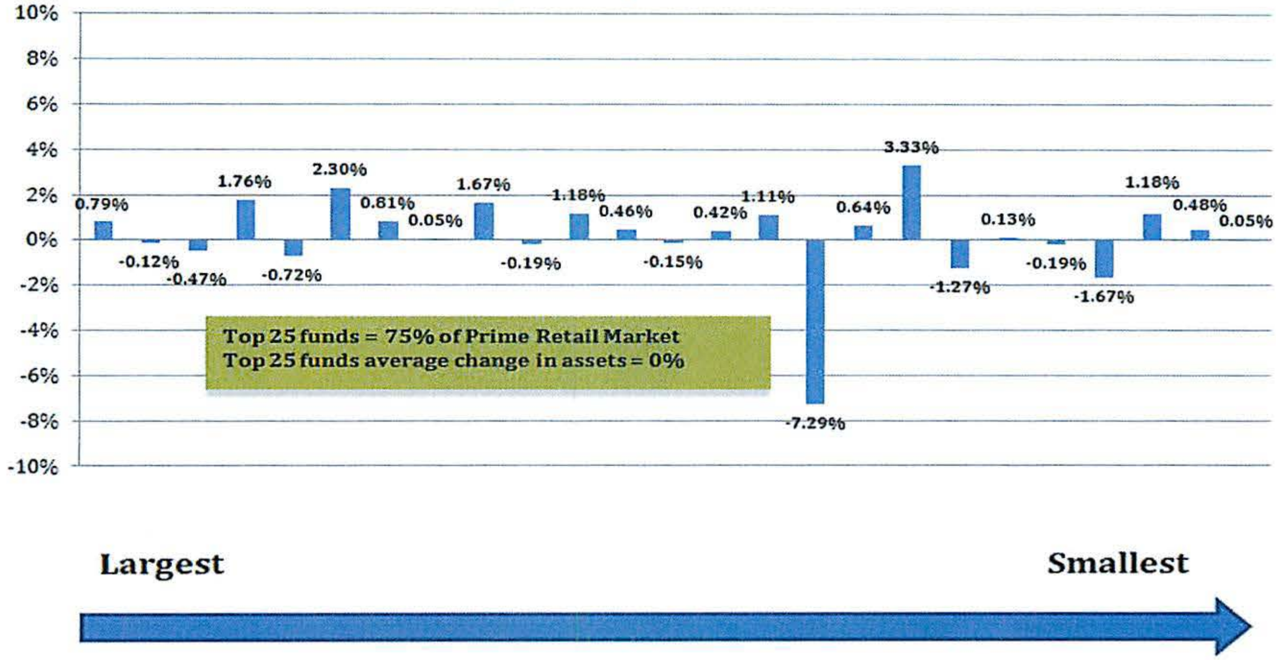


Source: iMoneyNet



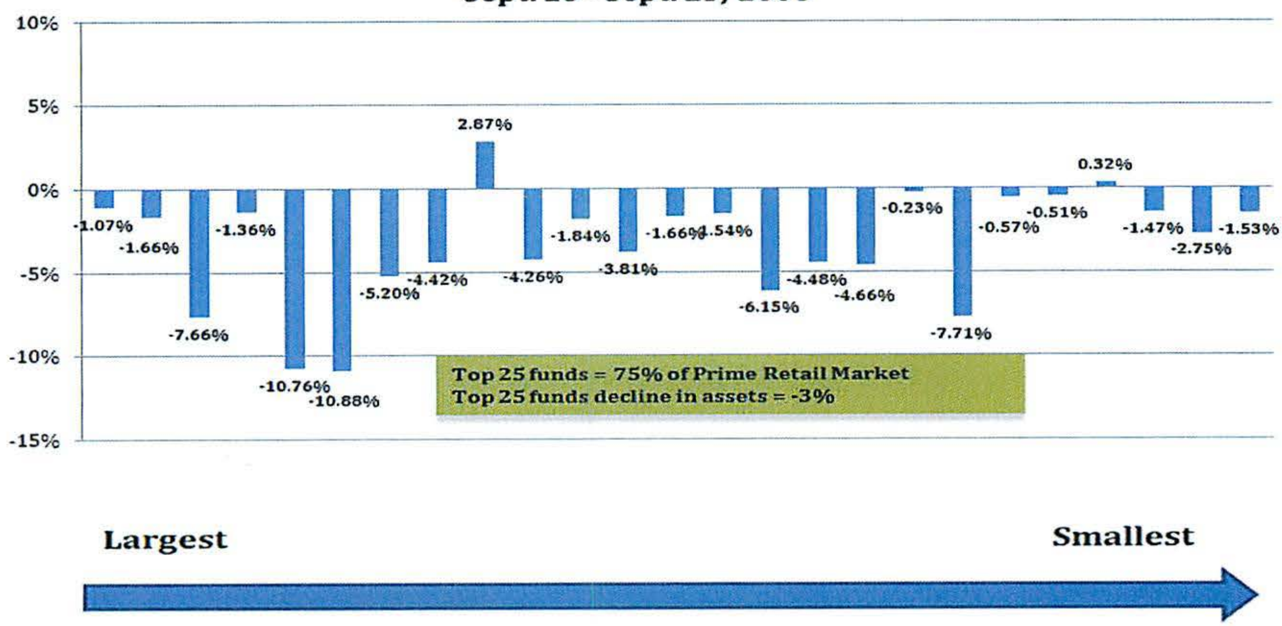
Source: iMoneyNet

Largest 25 Prime Retail Funds
Change in Net Assets
Sept. 9 - Sept. 16, 2008

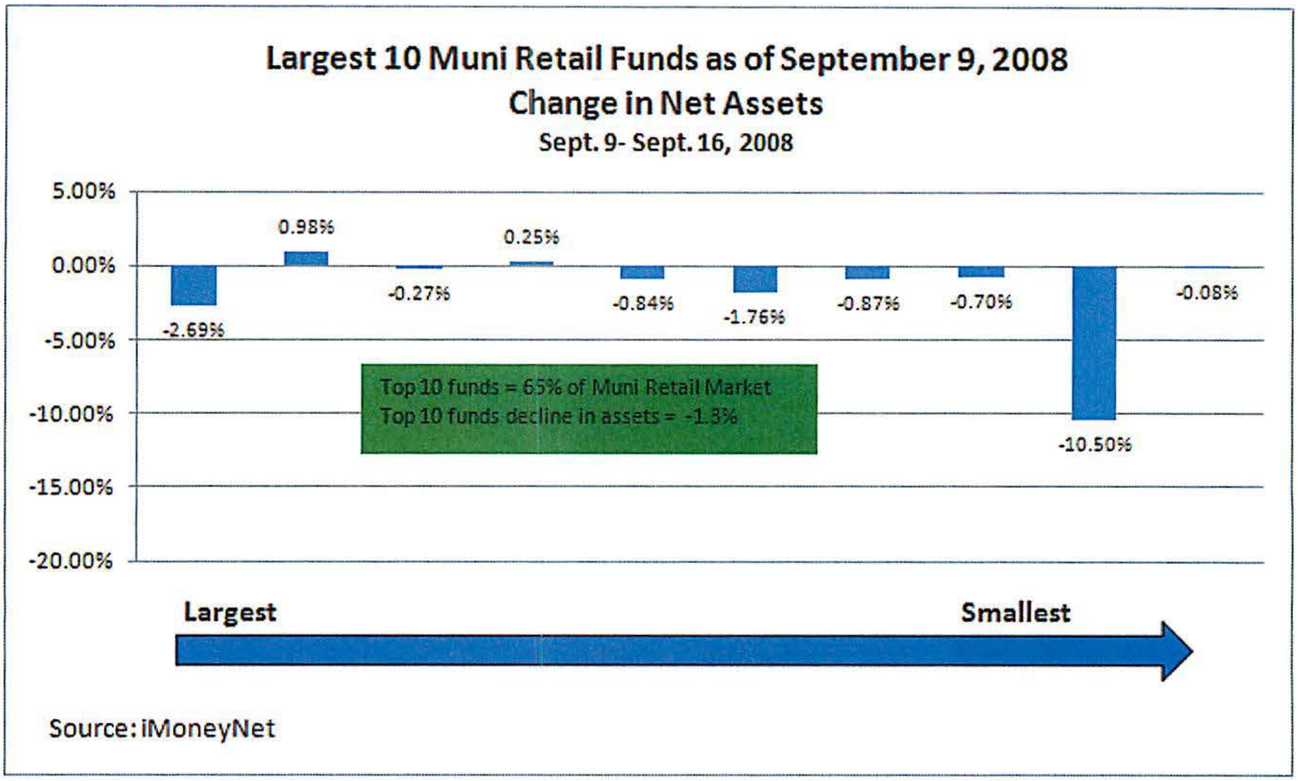


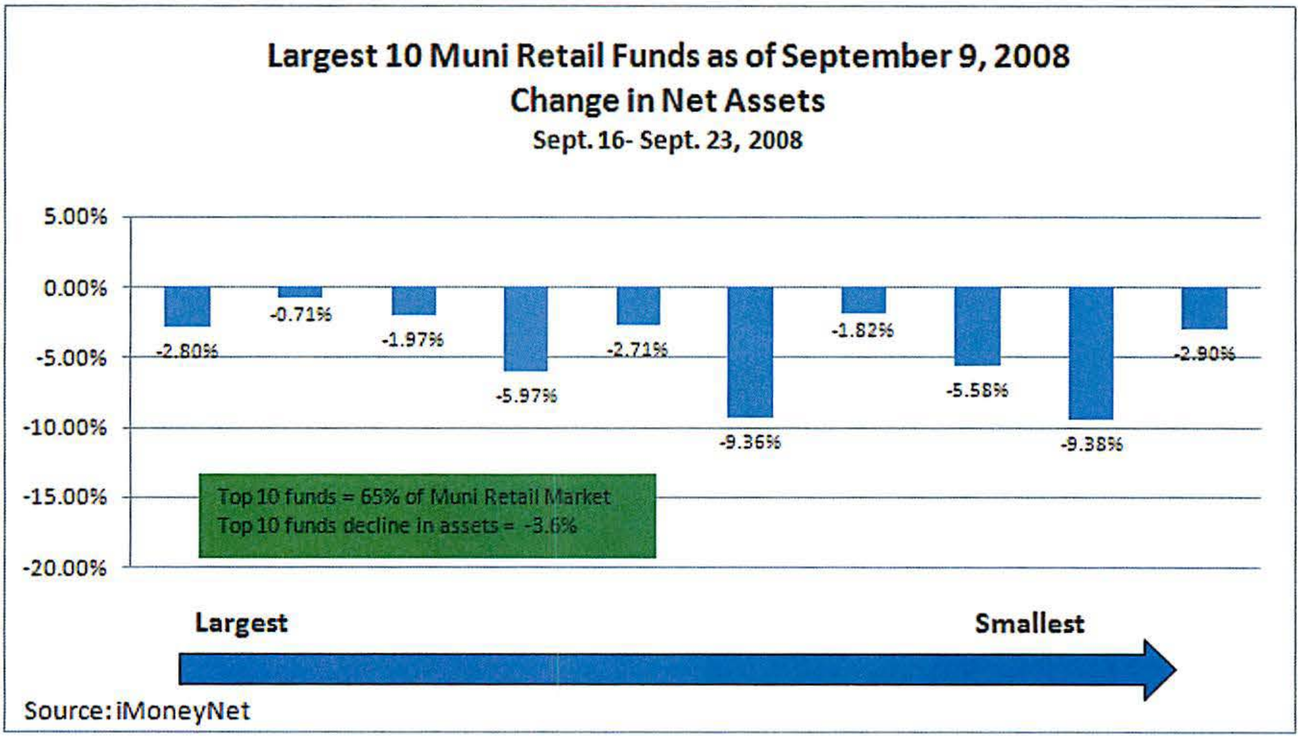
Source: iMoneyNet

Largest 25 Prime Retail Funds
Change in Net Assets
Sept. 16 - Sept. 23, 2008



Source: iMoneyNet





Source: iMoneyNet