September 12, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Electronic Filing

RE: Money Market Fund Reform; Amendments to Form PF (File No. S7-03-13)

Dear Ms. Murphy:

Charles Schwab Investment Management ("Schwab")[1] appreciates the opportunity to provide comments on the Securities and Exchange Commission's ("Commission" or "SEC") June 2013 proposal, "Money Market Fund Reform; Amendments to Form PF" (the "proposal").[2]

Schwab is one of the largest managers of money market fund assets in the United States, with 3 million money market fund accounts and $168 billion in assets under management as of June 30, 2013. The overwhelming majority of Schwab's fund offerings are used by retail investors who use money market funds to manage their cash. Even in the current environment, with historically-low yields on money market funds, our retail clients continue to value the convenience of this product.

Approximately 88% of Schwab's money market fund assets are in sweep funds, with the balance in purchased funds. Sweep accounts automatically invest idle cash balances while providing investors with convenience, liquidity and yield. These sweep accounts facilitate trading in brokerage accounts, allowing individuals to seamlessly buy and sell stocks, bonds, and mutual funds. Individuals also can write checks, pay bills electronically and use debit cards on these accounts. In the context of the proposed money market fund reforms, sweep accounts present a number of unique challenges, which we will highlight in this letter.

The proposed rules are the culmination of a multi-year effort by the Commission and the money market fund industry to find a balanced approach to reform. Schwab applauds the Commission for taking the time necessary to build consensus within the agency, for conducting the necessary research to support the proposed rules, and for its willingness to engage in substantive dialogue with Schwab and other industry participants during the process. We also appreciate the

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[1] Founded in 1989, Charles Schwab Investment Management, Inc. (CSIM), a subsidiary of The Charles Schwab Corporation, is one of the nation's largest asset management companies with $221 billion in assets under management as of June 30, 2013. It is among the country's largest money market fund managers and is the third-largest provider of retail index funds. In addition to managing Schwab's proprietary funds, CSIM provides oversight for the institutional-style, sub-advised Laudus Fund family. CSIM currently manages 76 mutual funds, two separate account portfolios, and 21 exchange-traded funds.

[2] "Money Market Fund Reform: Amendments to Form PF." 78 Fed. Reg. 36834. June 19, 2013.

Commission's clear signal that one of its goals is, in the words of Chairman Mary Jo White, "to preserve the economic benefits of the product."[3]

The Commission has, in our view, made a good faith effort to strike an appropriate balance that will increase investor confidence in money market funds while also ensuring that the product retains its critically important role as a valued cash management tool for individual investors, corporations, municipalities, states and non-profit organizations. While we generally support the SEC's proposal, we believe the proposed rule has a number of significant flaws that need resolution before the rule is finalized. We also have concerns that the costs of the proposal, both in terms of the cost of implementation and with regard to the impact on the larger financial system, may outweigh the benefits. We offer the following comments in an attempt to strengthen the proposal and better achieve the desired balance.

Executive Summary

Schwab generally supports the SEC's proposed money market fund reforms and recommends that the final rule combine the two alternatives proposed, subject to the recommended changes outlined in this letter, for maximum effectiveness: requiring institutional prime funds to have a floating net asset value (NAV), and allowing a fund's board to impose liquidity fees and gating of all prime, municipal and government money market funds whenever the board believes doing so is in the best interest of the fund. Not surprisingly for a 698-page rule proposal, we have a significant number of concerns about the proposed rule, and we make a number of suggestions for changes that we believe would make the rule less burdensome to implement without compromising the rule's effectiveness. While we detail all of those recommendations in the following pages, we want to highlight those which we believe to be most critical:

1. **We recommend that the daily redemption limit for retail investors, which serves as the dividing line between "institutional investors" and "retail investors," be increased from $1 million to $5 million per business day.** The $1 million redemption limit could significantly impact retail investors by triggering unexpected violations of the threshold and presenting a host of operational challenges. Those challenges, as well as the likelihood of inadvertent violations of the threshold, decrease markedly at the $5 million level. We also recommend that the Commission create a "Large Trade Order Notification" system that would allow retail investors to redeem more than the maximum daily redemption amount provided they have requested and received approval from the fund for such a transaction at least three days in advance.

2. **We recommend that the daily redemption limit be applied on a per-account basis, rather than on a per-shareholder basis.** We do not believe there is any realistic way to track a particular shareholder in real time to a total of $1 million (or, as we recommend, $5 million) in redemptions across multiple accounts, particularly if those accounts are of different types (e.g., a retail brokerage account, a 529 college savings account, and a 401(k) employer-sponsored retirement account). While we recognize

[3] "Regulation in a Global Financial System." Speech by SEC Chairman Mary Jo White before the Investment Company Institute General Membership Meeting, May 1, 2013. Available at: http://www.sec.gov/News/Speech/Detail/Speech/1365171515952

that this allows investors an opportunity to "game" the system by opening multiple accounts, we share the Commission's view that virtually any distinction between institutional and retail investors could potentially lead to "gaming behavior."[4] We believe that very few investors will want to go through the trouble of opening and managing multiple accounts for that purpose.

3. **We recommend that municipal (tax-exempt) money market funds be exempted from the floating NAV proposal.** Our data illustrates that owners of municipal money market funds are overwhelmingly retail investors and their past behavior in times of market stress indicates there is less risk of a run in these funds. Municipal money market funds are also much more liquid than prime funds, and data shows that even at the height of the 2008 financial crisis, these funds were exceptionally resilient. Moreover, municipal funds are home to only about 10% of the assets under management across all money market funds. We do not believe that municipal funds pose a systemic risk.

4. **We request that the rule confirm the treatment of registered investment advisers in the context of the definition of "retail" and "institutional" investor.** Investment advisers have discretion to trade on behalf of their clients, and most advisers bundle the trades of their underlying clients into a single trade. Investment advisers are neither shareholders of record nor beneficial owners and, therefore, under the proposed rule would not be subject to the proposed redemption limit. However, investment advisers also are not "omnibus account holders," as defined in the proposed rule, and therefore are not expressly exempt from that limit. Investment advisers typically custody the assets of their underlying clients with financial intermediaries trading through omnibus accounts. We do not believe that the proposed rule would or should require that the redemption limit apply to registered investment advisers, provided the financial intermediary applies the redemption limit to the advisers' underlying clients, or the adviser otherwise commits to the fund to do so itself. However, because the proposed rule does not expressly address the treatment of registered investment advisers, we request that the Commission confirm this reading and application of the proposed rule.

5. **We recommend that retirement accounts (Individual Retirement Accounts and employer-sponsored 401(k) and similar plans) and educational accounts such as 529 plans be exempted from the rule.** These types of investment vehicles are used exclusively by individuals and serve no purpose for institutional investors. Under the Employee Retirement Security Act (ERISA), plan sponsors have a fiduciary duty to plan participants that would be undermined by either alternative in the proposal. Moreover, the operational complexity that would result from attempting to apply the proposed rules to retirement accounts would be so great that the effect would be to make it nearly impossible to use money market funds in these types of accounts.

6. **We recommend that the tax issues identified by the Commission in its proposal be resolved by the appropriate regulator <u>prior</u> to the rule taking effect.** We support

[4] 78 Fed. Reg. at 36858.

exempting shareholders of a floating NAV money market fund from being required to report gains and losses unless the gains or losses exceed 50 basis points.

7. **While generally supporting the Commission's proposed reforms to money market fund diversification requirements and the proposed enhancements to disclosure, Schwab has a number of recommendations for changes to these areas of the proposal.** We oppose the proposed enhanced stress-testing requirements, because we believe that they will be difficult to comply with and provide little added benefit for understanding the risks in a money market fund.

Finally, it is critically important to observe that Schwab has expended considerable effort attempting to determine the costs of implementing the proposed rule and **has concluded that the Commission has vastly underestimated those costs in its analysis**. We believe the costs are so significant as to warrant careful consideration by the Commission of whether those costs outweigh the benefits of the proposed rule. The Commission should consider not only the implementation costs that each industry participant will incur to modify its systems and procedures to comply with the rule, but also the larger repercussions the proposed changes to the money market fund industry will have on the broader financial system.

The proposed rule, even if the Commission were to adopt every one of Schwab's recommendations for modifications, could still have an enormous impact on individual investors, on money market funds generally, on the stability of the financial system and on the economy as a whole. We urge the Commission to consider and evaluate the unintended consequences before a final rule is issued. We believe, for example, that if investors flee prime funds for government funds during a transition to a new regulatory regime, this could spark the kind of systemically-risky run that the rules themselves are intended to prevent. And we question whether there is adequate capacity in non-prime money market funds and other types of cash-management products to absorb the potential outflows from prime money market funds that will result from the changes contemplated by the Commission in its proposed rule. We also believe that the proposal has the potential to transfer risk to other parts of the financial system by increasing the amount of assets in either less-regulated products or in bank products. The ramifications of what amounts to a fundamental overhaul of a $2.6 trillion industry need to be carefully considered by the Commission before its members vote for final approval of this rule.

In the following pages, we will expand upon these quick overviews of our recommendations, and, where appropriate, provide data from our own funds to support our perspective. We hope the Commission finds these insights valuable as it considers modifications to the proposed rule.

Alternative One – Floating NAV for Institutional Prime Funds

In the proposing release, the Commission calls for requiring certain institutional prime money market funds to move from a stable NAV to a floating NAV, while permitting retail prime money market funds and funds that "maintain at least 80% of their total assets in cash, government securities, or repurchase agreements that are collateralized fully"[5] (in other words,

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[5] 78 Fed. Reg. at 36854.

Treasury money market funds and Government money market funds) to retain their stable $1-per-share price. Schwab appreciates the Commission's focus on this narrower solution, as we have long opposed a broad floating NAV for all money market funds as a lethal blow to the product. We believe that what limited risk there is of a run in a money market fund lies with institutional investors, the "informed investors" referred to in the proposal.[6] Chairman White articulated this view concisely in her opening statement at the Commission's Open Meeting at which it voted unanimously to propose the rule: "This floating NAV proposal specifically targets the funds where the problems during the financial crisis occurred: institutional, prime money market funds."[7]

As noted in our Comment Letter to the Financial Stability Oversight Council earlier this year, "our position on the issue of the floating NAV has evolved."[8] While we continue to oppose a broadly-applied floating NAV for the entire money market fund industry, we believe a targeted solution such as the one put forward by the Commission would make the product less susceptible to destabilizing runs yet preserve this critically important product for retail investors. A floating NAV would reduce the "first-mover advantage." Runs in money market funds can be triggered when institutional investors who have the ability to redeem large amounts of shares believe that a fund may be in danger of seeing its share price fall below $1 per share and they redeem their shares. There is an incentive to be first to redeem because investors who are slower to redeem have a higher chance of getting less than $1 per share return on their investment if the fund's share price does "break the buck." We agree with the Commission's assessment that a floating NAV would reduce the incentive to redeem shares and would result in greater appreciation of the risks in money market funds by making gains and losses more apparent to investors. As the President's Working Group noted in its 2010 report on money market funds, "Moving to a floating NAV would help remove the perception that MMFs are risk-free and reduce investors' incentives to redeem shares from distressed funds."[9]

The Commission's proposal has the goal of segregating institutional investors from retail investors, which we believe would reduce the chance that retail investors, who tend to be slower to react to market events, will absorb a disproportionate share of the losses if a fund breaks the buck. Former SEC Chairman Mary Schapiro, in testimony before the Senate Committee on Banking, Housing and Urban Affairs in 2012, outlined this scenario:

> …[E]arly redeemers tend to be institutional investors with substantial amounts at stake who can commit resources to watch their investments carefully and who have access to

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[6] This is not to say that retail investors are not "informed investors." Indeed, many retail investors are extremely informed. But, generally speaking, retail investors have small enough balances in money market funds that their movements in or out of a fund do not constitute a "run." And, as our data shows, retail clients tend not to react as quickly as institutional investors to market events.

[7] White, Mary Jo, "Opening Statement at the SEC Open Meeting," June 5, 2013. Available at: http://www.sec.gov/News/Speech/Detail/Speech/1365171575546#.UhFnBz_ZPDY.

[8] Comment letter from Charles Schwab Investment Management, Inc., to the Financial Stability Oversight Council on the "Proposed Recommendations Regarding Money Market Mutual Fund Reform (Docket Number FSOC-2012-0003)," January 17, 2013 ("Schwab FSOC Letter"), 2. Available at: http://www.regulations.gov/#!documentDetail;D=FSOC-2012-0003-0055

[9] "President's Working Group Report on Money Market Fund Reform," (Release No. IC-29497; File No. 4-619), November 3, 2010, at 4. Available at: http://www.sec.gov/rules/other/2010/ic-29497.pdf.

> technology to redeem quickly. This can provide an advantage over retail investors who are not able to monitor the fund's portfolio as closely. As a consequence, a run on a fund will result in a wealth transfer from retail investors (including small business) to institutional investors.[10]

By segregating institutional and retail investors, this issue is eliminated.

Importantly, we also agree with the Commission's assessment that the floating NAV will not deter all runs in money market funds. The Commission notes in the proposed rule that

> …the floating NAV alternative is not intended to deter redemptions that constitute rational risk management by shareholders or that reflect a general incentive to avoid loss. Instead, it is designed to increase transparency, and thus investor awareness, of money market fund risks and dis-incentivize redemption activity that can result from informed investors attempting to exploit the possibility of redeeming shares at their stable share price even if the portfolio has suffered a loss.[11]

We endorse this view. Where the Commission once appeared to have an unrealistic goal in mind for money market fund reform – namely, eliminating any possibility of a run – there is now an acknowledgement that such a goal is impossible. No regulatory solution short of banning an entire product can eliminate the risk of a run, and the floating NAV is no perfect panacea. If a crisis is bad enough, investors in a floating NAV fund will run, even at the risk of getting less than $1 per share return. But the targeted floating NAV proposal the Commission has put forward accomplishes the critical goal: reducing the risk of a run and reducing the impact such a run would have on retail investors.

Distinguishing Between "Retail" and "Institutional" Investors

Perhaps the most complex aspect of the Commission's first alternative is determining how to distinguish between retail and institutional investors. As the Commission is aware, Schwab proposed earlier this year a mechanism to make this distinction based not on a dollar figure, but on concentration risk.[12] We appreciate the Commission's serious consideration of our proposal[13] and acknowledge some of the operational difficulties that the Commission points out. While we continue to believe that distinguishing between retail and institutional investors would be most accurate if the focus was on concentration risk, the Commission's rule proposal settled on a simpler distinction: a daily redemption limit of $1 million (the "Redemption Limit"). Therefore, our comments will focus on a redemption limit. We have a number of recommendations in this area.

[10] Chairman Mary L. Schapiro, "Testimony on Perspectives on Money Market Mutual Fund Reform," Senate Committee on Banking, Housing and Urban Affairs, June 21, 2012. Available at: http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489510.
[11] 78 Fed. Reg. at 36850.
[12] Schwab FSOC Letter, at 7.
[13] See discussion of various shareholder concentration approaches in 78 Fed. Reg. at 36863.

First, we believe the $1 million Redemption Limit is too low and we recommend that the limit be increased to $5 million. Our concern is for operational complexities and the negative client experience that will result if the limit is set too low. If the client experience is poor or has complexities, clients will move out of retail prime funds into government funds in large numbers. We do not think that market has the capacity to accommodate significant and wholesale movements out of prime funds into government funds without creating potential instability in the markets. Prime retail money market funds with a daily redemption limit need to maintain most of the value proposition of today's money fund or clients will abandon the product. At a threshold of $5 million, this value proposition for retail investors can be better maintained, yet this threshold is still low enough that it would not include institutional investors.

While the Redemption Limit is proposed to be $1 million, practically speaking, it will be far less. Schwab would not want clients to become inadvertently tangled in the daily redemption limit, so it is highly likely that we would develop a system to monitor balances and alert clients as they approach the threshold. It's not yet clear where we would set that alert – perhaps $750,000, or even $500,000. But at some point, we would alert the client that they are approaching the threshold at which they would no longer be able to withdraw all of their money at once – a feature that is probably the most important one to retail clients. We would offer alternatives, such as a government money market fund, and encourage the investor to make use of these alternatives.

But if the client did not move to an alternative and his or her balance in a prime money market fund exceeded the threshold, the client experience would turn sour quite quickly. There are numerous circumstances in which a retail investor might find himself needing to move more than $1 million out of money market fund in a single day. The Commission's proposal notes some: "a retail investor may make large redemption requests when closing out their account, rebalancing their investment portfolio, paying their tax bills, or making a large purchase such as the down payment on a house."[14] To that list, we would add other examples, including the sale or purchase of a small business and the transfer of assets from one firm to another.

The example of transferring assets from one firm to another is a useful illustration of how cumbersome the rule could be for clients. A client with a $50 million portfolio, including $5 million in a prime money market fund, decides to transfer that portfolio from Financial Services Company X to Schwab. Under the current proposal, the client could only sell out of his position in the prime money market fund in $1 million increments, a process that would take 5 business days. That cash would then be transferred to Schwab, where we would sweep that cash into a money market fund that night. If the cash was swept into a prime fund, the new client would not be able to diversify right away; rather, he would again be limited to $1 million daily redemptions in order to then purchase shares of a stock, bond, mutual fund or other investment product. This kind of client experience is simply untenable. To avoid such a scenario, Schwab would undoubtedly prohibit the incoming cash from being swept into a prime money market fund and would instead sweep the cash into a Treasury or government money market fund, potentially at a lower yield.

[14] 78 Fed. Reg. at 36859.

Schwab's heavy use of money market funds as the sweep vehicle presents a host of other challenges. Given that a client can use a variety of mechanisms to access the funds in his sweep account, including writing a check, withdrawing cash at an automatic teller machine, and using a debit card to make a purchase, it is not clear how a client whose aggregated activities exceed the redemption limit during a given day should be treated. For example, if a client with $1.5 million in prime money market fund assets makes an online purchase of $995,000 worth of shares in a stock, and on the same day his $10,000 donation check to his alma mater clears, he pays three bills totaling $750 via electronic bill payment, and withdraws $100 in cash at an ATM, he has exceeded the daily redemption limit by $5,850. Schwab will be required to reject certain of these client transactions to ensure compliance with the daily dollar threshold, resulting in an unsatisfactory client experience and likely negative external impacts to the client that derive from the canceled cash transactions. Moreover, a client will have to self-monitor his cumulative money fund withdrawals for a given day, which could be overwhelmingly complicated as it could include pending withdrawals from previous days' activity, the clearing of previously written checks, and the settlement of executed trades across all of the shareholder's accounts.

In the proposal, the Commission notes that it ultimately selected the $1 million daily redemption limit, after considering a range of other limits, including $250,000 and $5 million, because "such a daily limit is high enough that it should continue to make money market funds a viable and desirable cash management tool for retail investors, but is low enough that it should not suit the operational needs of institutions."[15] We believe the same would be true at a daily redemption limit of $5 million. But we believe the chances of a retail client inadvertently crossing the threshold are much lower.

We agree with the Commission's premise that a daily redemption limit, whether set at $1 million or $5 million, will effectively exclude institutional investors. Our own research, however, found that even higher-wealth retail investors would likely avoid prime money market funds if a redemption limit is imposed. In a small sample-size survey, we discussed the issue with a number of Schwab financial consultants who had clients who made large withdrawals from prime money market funds in the first quarter of 2013. Virtually every one indicated that they not only believed that their clients would not invest in a prime money market fund that had a daily redemption limit or a floating NAV, but that they felt it was their obligation to advise their clients not to do so, regardless of how close the client's balance was to the daily redemption limit. One responder stated, "My first reaction would be to call all of my clients to move them to government or Treasury money market funds." We had similar conversations with a number of investment advisers, all of whom agreed that they would recommend that their clients find other investment alternatives, including government and Treasury money market funds, rather than risk the possibility of inadvertently crossing the redemption threshold.

Whether these concerns would ameliorate over time is uncertain. As interest rates return to more normal levels and yields on prime money market funds rise, it is likely that investors seeking higher yields will return to prime funds even with redemption restrictions. But in the current interest rate environment, we expect significant redemptions from funds with a daily redemption limit.

[15] 78 Fed. Reg. at 36859.

Need for a "Large Trade Order Notification" System

As the Commission notes in its proposed rule, and as we noted above, "retail investors may still want to redeem more than $1 million in a single day."[16] Schwab appreciates that the Commission recognizes that any proposed daily redemption limit will, on occasion, put ordinary retail investors into a difficult situation, and we are pleased that the Commission chose to request comments on how to resolve this issue. Schwab strongly supports the addition of a mechanism for retail investors to redeem more than $1 million (or more than whatever daily redemption limit the Commission ultimately settles upon in the final rule) in a single day, provided the investor gives advance notice of their intent to do so. We call this a "Large Trade Order Notification" system, or LTON. We believe this is an important addition to the rule because it benefits retail investors and will help alleviate investor anxiety when an unusual circumstance arises – a house sale, a small business sale, a transfer of assets from one firm to another, or other event that warrants a significant movement of cash in and out of a money market fund – while also allowing the fund manager enough time to prepare for the larger-than-usual redemption without affecting the fund or other investors. Schwab is particularly supportive of this provision because the overwhelming majority of our money fund assets are in sweep funds.

We recommend that the Commission adopt an LTON that requires the investor to provide the fund with information about his or her intention to redeem in excess of the daily redemption limit, including the amount of the redemption and the date of the redemption, with a minimum of three business days advance notice.[17] We believe that there should be no limit on the amount of the redemption, but that the fund manager should be granted the discretion to reject all or part of the redemption request if the request is so large as to potentially put the fund at an inappropriate level of risk. For example, a fund manager could decide to decline a redemption request if it would cause the fund to fall below the required 30% weekly liquidity level under Rule 2a-7 or otherwise have an adverse impact on the fund. We suggest giving the fund manager broad discretion on this point.

Information about the process for a Large Trade Order Notification should be outlined in the fund's prospectus, including clear disclosure that any request for a LTON is agreed to at the discretion of the fund's manager. We further recommend that the Commission provide broad discretion to the fund to determine the mechanics by which an investor could submit a LTON request. Again, the mechanics would be clearly conveyed to the fund's investors through the prospectus.

Account Owner vs. Beneficial Owner

The Commission's proposal envisions the daily redemption limit for a retail prime money market fund to be applied to the "shareholder of record"[18] or, in the case of omnibus accounts,

[16] 78 Fed. Reg. at 36860.
[17] Under this proposal, we would anticipate that it would be permissible for an investor to provide a redemption date that is more than three days in the future. For example, if the investor knew two weeks in advance that he or she would need to make a redemption the day before the closing date of a house purchase, the investor could provide that information to the fund the full two weeks in advance.
[18] 78 Fed. Reg. at 36858.

"beneficial owner."[19] We do not believe there is any realistic way to ensure an investor is complying with an aggregate daily redemption limit across multiple account types. For example, at Schwab, an investor may own shares of the same money market fund in a standard brokerage account, in a joint account with his spouse, in an Individual Retirement Account, in an employer-sponsored 401(k) plan, in a custodial account for a child, and in a 529 college savings plan account. Information about these various accounts are kept on different systems across affiliates of The Charles Schwab Corporation. While Schwab prides itself on being able to offer a client a single view on our web site of all of his accounts, that is not the same as trying to apply an aggregate redemption limit across all of those account types in real time over the course of a trading day.

As a result, Schwab recommends that the daily redemption limit be applied by account. We recognize that this means that an individual could redeem $1 million in a brokerage account (or $5 million under Schwab's proposed redemption limit) on the same day that he redeems $250,000 from the same fund held in a retirement account, but we think it highly unlikely that clients will be doing so in an overt attempt to bypass the redemption restriction. A client could also open multiple accounts and keep slightly less than $1 million in each. As the Commission acknowledges, though, virtually any distinction between retail and institutional investors could invite gaming. We think the inconvenience of opening and maintaining multiple accounts will be a deterrent to most people, and that the actual instances of circumventing the rule in this manner will be few.

Alternative Methods for Distinguishing Between Retail and Institutional Investors

We note that the Commission is seeking comment on other mechanisms to distinguish between retail and institutional clients, including shareholder characteristics such as a Social Security number (SSN) or an Employer Identification Number (EIN). Identifying a retail investor as an investor who has an SSN is an option that has garnered significant attention in the industry. At a high level, there is an appealing simplicity to this approach, and there is no question that it would be far less challenging – and therefore far less expensive – to design systems to identify a "retail" investor using this criteria. However, we also believe that there are serious drawbacks to this approach, most notably, as the Commission points out in the proposing release, "social security numbers do not necessarily correlate to an individual and taxpayer identification numbers do not necessarily correlate to a business."[20] Non-United States investors do not have SSNs, for example. Most estates and trusts that have income required to be reported on IRS Form 1041 have EINs, but these types of accounts are overwhelmingly opened by individuals and benefit individuals. They are clearly "retail" accounts, as there would be no reason for an institution to have such an account. But many of these accounts would be excluded unnecessarily if SSN is the sole criteria used to distinguish between retail and institutional investors.

In addition, there are circumstances in which the fund may not be able to determine whether each investor has an SSN or an EIN. If investors hold shares of the fund through an omnibus account, for example, the fund would not have the ability to determine whether each shareholder has an SSN. At Schwab, the circumstances in which the fund would either be unable to determine

[19] 78 Fed. Reg. at 36861.
[20] 78 Fed. Reg. at 36864.

whether the investor has an SSN, or in which the investor is clearly a retail investor but does not have an SSN, would be numerous. Our analysis shows that 27% of our prime and municipal money market fund assets are in accounts that do not have SSNs as the primary taxpayer identification, with the largest portions of those assets in living trusts and pension trusts. As a result, a significant percentage of the assets in our prime money market funds would be inappropriately categorized as "institutional" assets and would be ineligible for investing in a stable NAV prime money market fund. We do not believe this would be an appropriate outcome.

One possible way to mitigate this issue is for the Commission, in its final rule, to identify types of accounts that are inherently retail, and include those account types as part of the definition of "retail investor." Elsewhere in this letter, we recommend that retirement accounts and college savings accounts, which are clearly retail accounts, be excluded from the rule, and we could expand that list by including custodial accounts, living trusts, and other types of trust accounts that are used by individuals. We believe the idea of distinguishing between retail and institutional investors on the basis of shareholder characteristics would only have merit if the characteristic measured was account type.

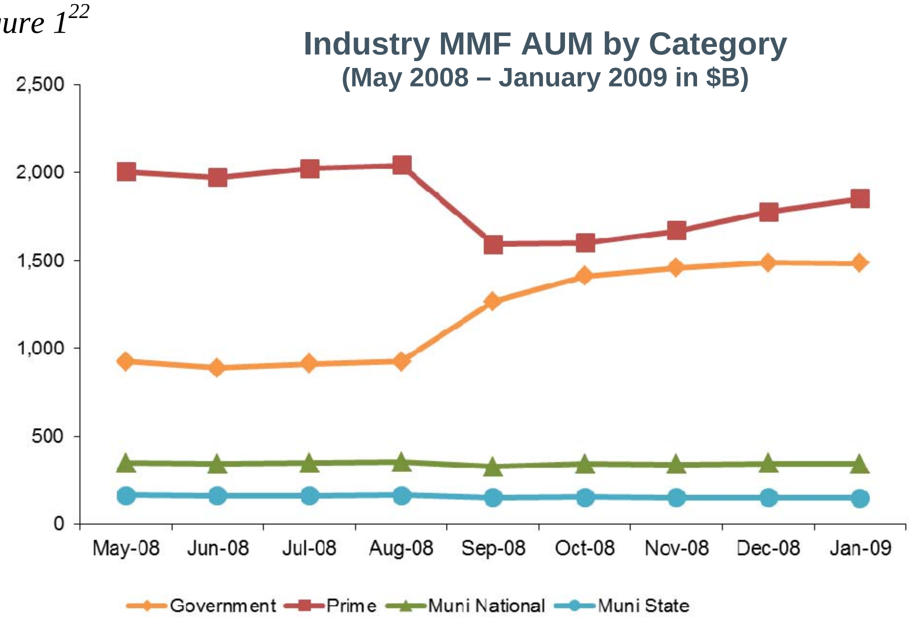
Exception for Municipal (Tax-Exempt) Money Market Funds

Schwab believes strongly that municipal (tax-exempt) money market funds should be exempted from the floating NAV requirement. In the proposal, the Commission observes that "most money market funds that invest in municipal securities (tax-exempt funds) are intended for retail investors, because the tax advantages of those securities are only applicable to individual investors, and accordingly, a retail exemption would likely result in most such funds seeking to qualify for the proposed exemption."[21] While we agree with the premise that investors in a tax-exempt money market fund are overwhelmingly "individual investors," we do not believe that all of those investors would qualify as "retail investors" under the Commission's Redemption Limit (or even under Schwab's recommended increase to the daily redemption limit requirement that distinguishes retail investors from institutional investors). We urge the Commission, for a variety of reasons, to specifically exempt tax-exempt money market funds from the proposal.

A key reason to exempt tax-exempt money market funds from the proposal is that these funds are much more liquid than other prime funds and are significantly less susceptible to runs. An examination of the performance of municipal money market funds during the 2008 financial crisis underscores this point. As seen in Figure 1, municipal money market funds – both national funds and state-specific funds – were remarkably stable during the financial crisis, particularly when compared with prime funds.

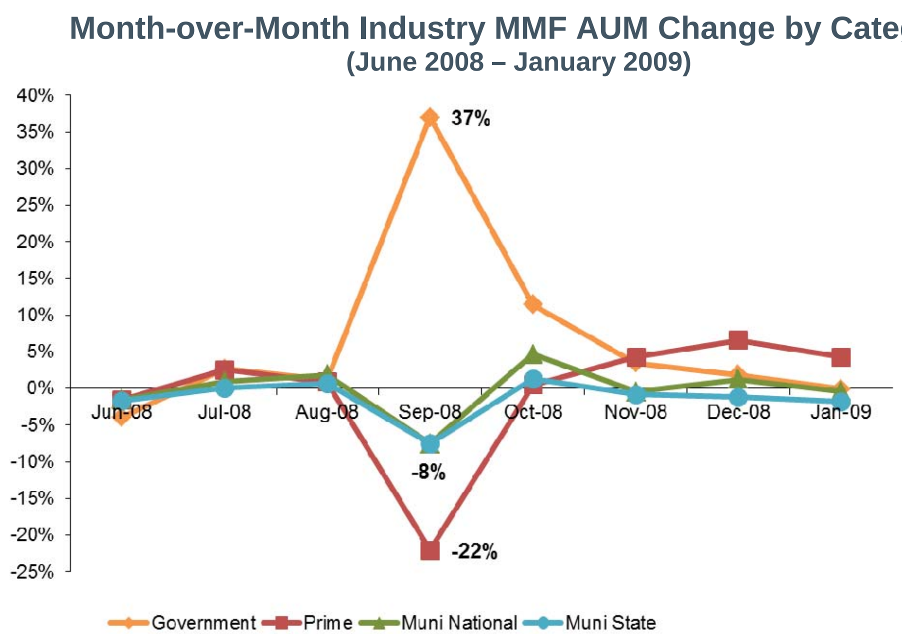
[21] 78 Fed. Reg. at 36860.

Figure 1[22]



In Figure 2, which shows the month-over-month change in assets under management in different types of funds from June 2008 through January 2009, we can see that during the worst month of the crisis – September 2008 – municipal money market funds dropped only 8% industrywide, as compared to a 22% drop in assets in prime funds.

Figure 2



[22] Data for Figures 1 and 2 compiled using end-of-month assets under management data from iMoneyNet (www.iMoneyNet.com)

The experience with Schwab's proprietary municipal money market funds during the crisis shows that these funds are particularly resilient. Schwab's largest tax-exempt fund is the nationally-diversified Schwab Municipal Money Fund Portfolio, which in August 2008 accounted for nearly half of all municipal money market fund assets under management at Schwab. Between August 2008 and December 2008, the largest weekly outflow the fund experienced was 5.1% of assets – far below the minimum weekly liquidity requirement of 30%. Only one of Schwab's eight municipal money market funds experienced an outflow of greater than 10% in any week during the crisis, still well below the weekly liquidity requirement. Indeed, Schwab's municipal money market funds typically hold much more than the required 30% in weekly liquidity; for the first seven months of 2013, Schwab's Municipal Money Fund (SWXXX) held weekly liquid assets ranging from 68% to 72% of total assets.

Another compelling reason to exempt tax-exempt money market funds from the proposed reforms is that the product as a whole does not pose a systemic risk. Municipal money market funds comprise just over 10% of total money market fund assets -- $267.06 billion out of a total of $2.622 trillion as of August 14, 2013.[23] Despite its relatively small size, the municipal money market is critically important to the financing of state and local governments because the money fund industry is the largest investor in short-term municipal securities. We do not believe that a product of this size, yet with outsized importance to the economy, warrants the complex and costly operational challenges that would be presented by trying to comply with the daily redemption limit envisioned by the Commission's proposal. We urge the Commission not to rely on the current rule proposal's assumption that most tax-exempt funds would qualify for the retail money market fund exception to the floating NAV, and instead specifically exempt municipal money market funds from the proposal.

Finally, we note that the Commission has asked for comment on whether tax-exempt funds should be required to meet a 10% daily liquidity requirement as a prerequisite for qualifying for the retail exemption.[24] Given the relatively small changes in assets during the 2008 financial crisis, as depicted above, we do not believe such a requirement is necessary. The universe of tax-exempt daily liquidity is small. Unlike corporate issuers, most municipal entities are not natural issuers of daily liquid securities, in that most do not have enough assets on their balance sheets to meet daily liquidity demands and must rely instead on third parties to provide liquidity. In addition, municipal funds, as discussed above, hold much more in weekly liquid assets than the existing 30% requirement. Consequently, they have a large inventory of securities to sell for par plus accrued interest when a fund anticipates an increase in redemptions. This is what happened in 2008, which underscored that even in an extreme environment, municipal funds already have the flexibility needed to absorb redemptions. Given the limited inventory of daily liquid assets, a 10% daily liquidity requirement would make tax-exempt funds unnecessarily difficult to manage and operate, with little or no reward for investors.

[23] "Money Market Mutual Fund Assets," a weekly report compiled by the Investment Company Institute, August 15, 2013. Available at: http://www.ici.org/research/stats/mmf/mm_08_15_13.
[24] 78 Fed. Reg. at 36860.

Basis Point Rounding

The Commission proposes that money market funds that have a floating NAV be required to use "basis point rounding," in which shares are priced and transacted at the fourth decimal place. As the Commission is well aware, all other mutual funds (which, of course, have floating NAVs), are required to round to the nearest tenth of a penny, or three decimal places. We believe the Commission should drop the requirement for basis point rounding because it would require costly systems modifications for little benefit to investors and, in fact, is likely to confuse investors.

Currently, all systems at Schwab are designed to round to the third decimal place. Building the capacity to *transact* at a fourth decimal place would require a costly restructuring of the system. The Commission correctly notes in its release that "a number of money market funds recently elected to voluntarily report daily shadow NAVs at this level of precision"[25] – Schwab among them. But reporting the daily shadow NAV at four decimal places and pricing and transacting at that point are two different issues. We disagree with the Commission's assertion that there will be no "overly burdensome costs arising from fund pricing shares using 'basis point' rounding."[26]

More importantly, we do not see that this cost would produce any real benefit to investors. There is no clear policy reason for treating money market funds differently than other types of mutual funds. Any fund that prices to four decimal places will show more "volatility" than one that prices to two or three decimal places. But this volatility is artificial and misleading. A basis point change in price to a money market fund – from $1.0000 to $1.0001 – does not change the $1 per share value.

We believe that basis point rounding will lead investors to think that a basis point change in the price of a money market fund is a meaningful change in the value of their shares. The growing availability of the daily shadow NAV to the fourth decimal place is educational and useful to investors – and adequate for providing the level of information the Commission seeks. But requiring transactions and pricing at that level of detail strikes us as unreasonable. The Commission should consider requiring all firms to report their daily shadow NAVs on their web site as a compromise solution.

Treatment of Registered Investment Advisers (RIAs)

The Charles Schwab Corporation's Advisor Services business provides trading, custody, technology, practice management and other support services to nearly 7,000 registered investment advisers. Registered investment advisors are not shareholders of record, and thus, by the terms of the proposed rule the Redemption Limit would not and should not apply; rather, the proposed rule would require that the Redemption Limit be applied to the investment adviser's underlying clients, either by the financial intermediary that custodies the underlying clients' assets or the investment adviser itself. Registered investment advisers typically bundle the transactions of their many retail clients into a single transaction, much in the same way that a financial intermediary holding an omnibus account bundles trades of its underlying customers.

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[25] 78 Fed. Reg. at 36853.
[26] 78 Fed. Reg. at 36853.

A registered investment advisor, however, is not an "omnibus account holder" as defined under the proposed rule.

We do not believe it is or should be the Commission's intent to apply the Redemption Limit to registered investment advisers. Retail investors who choose to engage the services of a registered investment adviser should not be excluded from retail funds in which they otherwise would be permitted to invest. Indeed, if registered investment advisers are subject to the redemption limit, it would be penalizing the retail client who has elected to outsource their investment management to a professional rather than handle it themselves. We are concerned, however, that because the proposed rule does not expressly consider the treatment of registered investment advisers, there could be a lack of clarity as to its application relative to these advisers. As such, we respectfully ask that the Commission confirm our understanding of the proposed rule as it relates to registered investment advisers.

Tax Treatment of Floating NAV Money Market Funds

We share the widely-held view that the tax implications of moving to a floating NAV are significant and need to be resolved *before* the rule takes effect. Shareholders in a floating NAV fund would experience small gains or losses on the sale of their shares and would be required to track those gains and losses for determining their tax burden. Schwab agrees with the Commission's assertion that "given the relatively small fluctuations in value that we anticipate would occur in floating NAV money market funds…any changes in tax burdens likely would be minimal."[27] However, regardless of how minimal the tax burden is to the taxpayer, the taxpayer and his broker-dealer will need to track these changes. Given that clients may make hundreds of transactions within a money market fund every year, the burden on tracking this information seems wildly out of proportion with the potential revenue gain for the Treasury.

We applaud the efforts of the Commission to work with the Department of the Treasury and the Internal Revenue Service on this issue. Earlier this year, the Treasury Department issued a proposed Revenue Procedure[28] that addresses one aspect of the tax implications for a floating NAV fund – the wash sale rule. The proposal includes a *de minimis* exception from the loss disallowance rule if the loss is less than 0.5% of the taxpayer's basis. While we support this proposal, we note that it does not eliminate the requirement to track compliance with the wash sale rule. We recommend that the IRS simply exempt floating NAV money market funds from the wash sales reporting rules.

With regard to the reporting of gains and losses, some of the issues could be ameliorated if the IRS were to issue guidance allowing net information reporting by funds and summary income reporting by shareholders. But, again, these steps do not relieve funds of the burden of tracking literally hundreds of thousands of transactions per day and reporting gains and losses to investors. At Schwab, between March 16, 2013, and June 25, 2013, we conducted an average of 365,000 sweep transactions per day, with a peak day of 1.1 million sweep transactions. The

[27] 78 Fed. Reg. at 36868.
[28] "Application of Wash Sale Rules to Money Market Fund Shares," Internal Revenue Service Notice 2013-48. Available at: http://www.irs.gov/pub/irs-drop/n-13-48.pdf.

burden of tracking and reporting the gains and losses within each of those transactions presents a systems issue that would be prohibitively expensive to develop and implement.

To illustrate the *de minimis* gains and losses at stake, we analyzed our largest money market fund, the Cash Reserves Fund (SWSXX) to estimate the net gain or loss realized by shareholders who redeemed during a particular period. Since Schwab began calculating daily mark-to-market NAV of the fund in March 2013, there has been little price fluctuation. Between March 25, 2013, and July 23, 2013, the range of the daily NAV of this fund spanned $1.000132 to $1.000179. With that narrow of a fluctuation, the daily gains and losses offset one another, resulting in a negligible gain over the time period. As of July 23, 2013, the fund had more than $37 billion in assets and more than 700,000 investors. That infinitesimal gain is spread out among each of those investors. In other words, on a per-investor basis, the net gain was a fraction of a penny – an amount that could not be remitted to the Treasury anyway.

Given the operational burdens of tracking and reporting this information and the negligible impact to the Treasury in terms of revenue, we urge the Commission to continue working with the IRS to eliminate this tracking altogether unless the gain or loss on any transaction exceeds 50 basis points. This approach would harmonize the rules with current rules for constant NAV funds.

Alternative Two – Standby Liquidity Fees and Gates

The Commission proposes, as an alternative to the floating NAV for institutional prime money market funds, imposing two provisions for money market funds that encounter distress. Funds would be allowed to continue to transact at a stable, $1-per-share price under normal conditions, but when the weekly liquid assets of a non-government money market fund drop below 15% of the total assets, the fund would be *required* to institute a liquidity fee and would be *permitted* to impose a redemption gate.

Schwab's recommendation is that the Commission should permit the fund's board to impose either a liquidity fee or redemption gates whenever it determines that doing so is in the best interest of the fund and its shareholders. Instead of having the 15% weekly liquidity level as the trigger for an imposition of fees and/or gates, the proposal should require the fund's board to meet when the fund's weekly liquidity hits 15%, if it has not already done so. The fund must then issue a public statement from the board indicating that it has met as required, that it has determined that redemption gates and/or liquidity fees are to be imposed or not imposed, and its reasons for the decision it has made.

We believe that gating and redemption fees can be a powerful tool if a fund is under serious stress and heading towards liquidation. In such a scenario, these tools would help facilitate an orderly liquidation and ensure that shareholders are treated fairly, as there would be less opportunity for first mover advantage. We believe that this is the only circumstance in which it would be reasonable to impose gates and/or fees, as we have a hard time seeing how any fund that actually imposed fees and or redemption gates would ever be able to recover and be a viable fund again. Investor trust in that fund would be lost. We see the fees and gating proposal, then, as an interim step toward orderly liquidation of a fund.

We also believe that the board should have more discretion over when to impose gates and/or fees, rather than having a mandatory trigger of reaching 15% weekly liquidity. There are situations in which a fund could be under stress without reaching the proposed trigger point. For instance, the liquidity of a fund could be high, but a default of a creditor in the portfolio could put the fund in a highly-stressed scenario. In such a situation, the board might believe it is in the best interest of the shareholders to gate the fund and impose liquidity fees. It should have the ability to do so.

Moreover, a hard trigger could lead to "pre-emptive" runs on funds as they approach the weekly liquidity threshold. With the increased transparency of money market funds, investors can keep close track of a fund's weekly liquidity levels. Sophisticated investors will likely redeem from the fund as it approaches the 15% weekly liquidity trigger, though it is not clear at what point they will begin redeeming – it could be 20%, or 18%, or some other number. The result could be a run that sends the fund more rapidly below the trigger point, from which we have already asserted the likelihood of recovery is minimal. By giving the board discretion to impose fees and/or gates at any time, this risk is mitigated. Moreover, since there is no certain point at which fees or gates must be imposed, it lessens the likelihood of a run.

We agree with the Commission that liquidity fees would add an important disincentive to early redeemers. As discussed earlier, a key concern of the Commission is that early redeemers have an advantage over other investors when a fund is under stress, since they will get a full return on their investment and later redeemers may not. A liquidity fee would force early redeemers to pay for the costs of their redemption, without knowing whether the fund was actually going to experience losses or not. This is a powerful disincentive.

While we agree that the proposed liquidity fee of 2% would be a strong disincentive to redeem during a crisis, we also support the provision in the rule proposal to allow the fund board to increase or decrease this fee if it determines that circumstances warrant such action. The latter provision gives the board needed flexibility.

We also note that there are several operational challenges, particularly for sweep funds, that arise with the possibility of fees and/or gating, which further supports providing the board discretion to impose fees and gates rather than subjecting funds to a hard trigger. As envisioned by the Commission, once a fund imposes a liquidity fee, that fee would be taken out of each client transaction. However, at Schwab, our money market fund sweep clients are able to use debit cards, make withdrawals of cash at automatic teller machines, write checks, and use electronic bill pay to access their money market fund assets.

If a mandated liquidity fee is imposed on a fund during the course of the day, and the client makes a series of transactions that day, we would have to impose the liquidity fee on each transaction retroactively. For example, if the client writes a check tied to his or her sweep fund holdings to make a $100 purchase at the grocery store and uses a debit card to buy a $4 cup of coffee at Starbucks, at the end of the day Schwab would have to impose a $2.08 liquidity fee on those transactions. The funds could be withdrawn from the client's remaining balance in the fund and the client notified of the fee, but this would be a cumbersome and time-consuming

process. Alternatively, Schwab could bounce the check, which could potentially trigger additional fees, not to mention frustrate the client.

The Commission notes in its proposal that it chose to require the fee, rather than make it fully discretionary, because of concerns that "a purely discretionary trigger creates the risk that a fund board may be reluctant to impose restrictions, even when they would benefit the fund and the short-term financing markets."[29] We believe that this view represents a distinct lack of trust in the fund's board to do what is right, and to have the authority to make decisions that are in the best interest of the fund, its shareholders and the larger economy. As noted above, imposing fees or gates is, in our view, tantamount to commencing an orderly liquidation of the fund. But not every instance of a drop in weekly liquidity will warrant such drastic action. We urge the Commission to empower fund boards to impose liquidity fees and/or redemption gates whenever it believes doing so is in the best interest of the fund, and to require the board to meet and determine whether or not fees and/or gates are warranted if the fund hits 15% weekly liquidity and the board has not already taken any action.

Exemption for Retirement and Education Accounts

In the proposed rule's section on "Omnibus Account Issues," the Commission raises the issue of retirement accounts with the question, "Should we treat certain intermediaries differently than others, perhaps allowing higher or unlimited redemptions for investors who invest through certain types of intermediaries such as retirement plans?"[30] Our answer is "yes." We believe that retirement and education accounts should either be allowed unlimited redemptions, or, perhaps more simply, exempted entirely from both alternatives in the proposal. Accounts such as Individual Retirement Accounts ("IRAs"), employer-sponsored defined contribution retirement plans (such as 401(k) plans and 403(b) plans), and 529 college savings plans are designed for individuals and serve no purpose for institutional investors. We believe the risks in these types of accounts are minimal.

Defined contribution plan sponsors often select money market funds as a capital preservation fund investment alternative. In virtually all plans, this is the only stable NAV investment option. Some plans even <u>require</u> a stable NAV investment option within the capital preservation category.

The major issues for ERISA accounts, however, arise with the Commission's Alternative Two, which contemplates imposing liquidity fees and redemption gates in certain circumstances. The proposal has a number of unintended consequences for retirement plan participants and sponsors, including:

- *Potential violations of Minimum Required Distribution rules.* Participants in qualified retirement plans and Individual Retirement Accounts generally must begin receiving distributions by April 1 following the year in which the participant or IRA holder reaches age 70 ½. Failure to make the distribution may result in disqualification for the retirement plan or IRA and excise taxes for the participant or IRA holder.   The

[29] 78 Fed. Reg. at 36884.
[30] 78 Fed. Reg. at 36862.

imposition of a redemption gate may cause the plan or the IRA to fail to make a timely distribution if all or some of the assets from which the distribution needs to be taken are held in a money market fund that has a gate in place.

- *Potential taxation as a result of inability to process refunds in a timely fashion.* The tax code requires defined contribution plans to run non-discrimination tests each year to demonstrate that the contributions under the plan do not discriminate unfairly in favor of highly compensated employees. The tax code also limits the amount that an individual may contribute to a plan or to an IRA during a tax year. When a plan fails its non-discrimination test, or when a participant or IRA account holder contributes more than the deferral limit in effect for the tax year, the plan or IRA, as applicable, must refund contributions (plus earnings) to the affected participants within a certain time period. The failure to make timely refunds may result in an excise tax to the defined contribution plan sponsor as well as additional tax to the participant, and in the case of an IRA, a 6% excise tax. Where the sources of funds for these payments are money market funds, the imposition of a redemption gate might interfere with meeting applicable deadlines and subject plan sponsors, participants and IRA account holders to unplanned taxation.

- *Potential conflicts with Qualified Default Investment Alternative (QDIA) rules.* ERISA Section 404(c)(5) provides relief from fiduciary liability for passive (or default) investment elections by participants into "qualified default investment alternatives." QDIAs may not impose "any restrictions, liquidation or exchange fees, redemption fees and similar expenses charged in connection with the liquidation of, or transfer from," the QDIA for the first 90 days. To the extent that a money market fund is included as part of a QDIA (which is not uncommon), the imposition of a gate and/or a liquidity fee within the first 90 days of a participant's investment would likely void QDIA fiduciary relief.

- *Problems arising in Plan Conversions.* When a retirement plan sponsor changes service providers, it usually follows that the plan sponsor also elects to replace one or more of the investment alternatives in the plan. The eliminated investment alternative(s) are typically liquidated and proceeds of the liquidation are held temporarily – usually in a money market fund – until they are transferred to the new trustee, which itself usually then holds the assets in a money market fund until they are invested in the new plan investment option(s). The imposition of a redemption gate and/or liquidity fee during any part of this process could substantially interfere with participants' investment elections and with the plan sponsor's fiduciary obligation to select the most prudent investment alternatives.

These are just some examples of the multitude of issues that would arise if retirement plans are subject to the Commission's proposed rule. Similar complexities arise in education accounts, such as 529 plans. We believe that many plan sponsors would avoid these issues by simply declining to use any money market fund that has even the potential of being subject to liquidity fees and/or redemption gates. A movement by retirement plans away from prime money market funds and into money market funds not subject to the proposed rules, such as Treasury or government funds, would further exacerbate the concentration within those types of funds. If plan sponsors did not believe that such funds were adequate for the plan's needs, it could increase desire for other types of stable-value products, in an environment where the supply of

such funds is diminishing. In addition, a plan sponsor's selection of a government money market fund as the cash sweep vehicle for a plan would not necessarily be the most appropriate vehicle for retirement plan assets that are already tax-exempt while held in the plan's trust.

As a result of the complexities that arise in the context of an employer-sponsored plan, IRA or an education account, we recommend that these types of accounts be exempted from both alternatives in the Commission's proposed reforms.

Combining Alternative One and Two

Schwab supports combining the two alternatives proposed by the Commission – with the recommended changes outlined in this letter – into a single final rule because the two alternatives together provide a larger set of tools to deter runs in money market funds. The first alternative applies only to institutional prime money market funds. The second alternative, the liquidity and gating proposal, would be available as an option, should the fund board determine it is necessary, to prime, municipal and government money market funds. Together, we believe the two alternatives cover a broader array of products and could prove effective at deterring destabilizing runs.

Enhanced Disclosure Requirements

Generally, Schwab believes that more disclosure and transparency is better for individual investors. Of course, all regulators struggle with achieving an appropriate balance between providing the right amount of information to investors to help them make informed investing decisions and overwhelming investors with so much disclosure that they do not read or absorb any of it. It is Schwab's view that the Commission's call for enhanced disclosure has, for the most part, achieved the proper balance, with the exception of some elements of the rule proposal where we believe that the cost and complexity of producing the information far outweighs the benefits to investors or to the Commission. Proposed disclosures around instances of sponsor support would provide investors with useful context for analyzing the stability of the fund, though we would note that not all instances of sponsor support are indicative of a fund under even mild stress, let alone nearing the point of breaking the buck. Requiring daily disclosure of a fund's current net asset value, which Schwab began voluntarily making available in February 2013, would be a very valuable tool for investors.

There are elements of the proposed disclosure requirements, however, that we believe are <u>not</u> appropriate. Our recommendations are as follows:

- *Eliminate the requirement to provide new information on Form N-MFP with respect to each portfolio holding.*

    The Commission proposes requiring the reporting of the total principal amount, the purchase date, the yield at purchase, the yield as of the Form N-MFP reporting date, and the purchase price, for each security in the portfolio.[31] The information would have to be disclosed separately for each lot purchased, and would apply both to lots held in the

[31] 78 Fed. Reg. at 36942.

portfolio and to any security sold during the reporting period. We question the value of this information from a fund oversight perspective.

In theory, we agree with the Commission's assertion that an "incidental benefit" of the disclosure is that it could facilitate price discovery. But in practice, given the volume of information one would need to sift through and the availability of other pricing sources, we do not believe that such reporting would be meaningfully additive. Any potential benefit would be far outweighed by the costs of providing this information on a monthly basis for the literally thousands of securities and lots thereof that a money market fund may hold in its portfolio at that moment. To meet the Form N-MFP deadline of five business days following the end of the month, the process would need to be fully automated (at significant expense) and there would be little, if any, time for the fund or its advisor to confirm the accuracy of the information.

- *Eliminate the requirement to disclose whether any person paid or waived all or part of the fund's operating expense or management fee.*

In the proposal, the Commission notes that "information about expense waivers will help us understand potential strains on a fund's investment adviser."[32] Waivers, however, are just one piece of the adviser's financial picture, and disclosure of this information could lead to an incorrect impression of an adviser's condition. An adviser that is waiving all or a substantial part of its money fund management fee is not necessarily under financial stress, and there is no way either the Commission or an investor could accurately discern an adviser's financial condition through this particular piece of information. Indeed, in recent years, Schwab and numerous other firms have waived fees to ensure that investors are getting a positive return in a low interest-rate environment.

Moreover, the proposed disclosure is misleading in that it requires disclosure of the amount of the expense payment or fee waiver in dollars. An adviser of a smaller fund complex that is waiving a portion of its management fee may be in far worse financial condition than an adviser of a larger fund complex, as the former has fewer financial resources to support its operations. Yet the proposed disclosure may lead investors to the opposite conclusion: that the adviser waiving the greater dollar amount is in greater financial stress. The reality is that it is quite likely that neither firm is in financial distress. Disclosure of this information appears to us likely to spawn unnecessary investor anxiety where none should be.

- *Eliminate the requirement to disclose the total percentage of shares outstanding held by the 20 largest shareholders of record.*

The Commission states in the rule proposal that "this information would help us (and investors) identify funds with significant potential risk stemming from shareholder concentration, and evaluate the likelihood that a significant market or credit event might

[32] 78 Fed. Reg. at 36943.

result in a run on the fund or the imposition of a liquidity fee or gate."[33] We believe, however, that there is strong potential for this information to be misleading.

Many money market funds are made available through one or more omnibus accounts maintained by financial intermediaries, as shareholder of record on behalf of each of their underlying clients. The omnibus accounts reflect the aggregate position of the financial intermediary's individual clients. These are typically quite large, representing hundreds or even thousands of clients. As a result, the financial intermediary will often end up reported as a significant holder of fund shares. This could lead to a misperception of the actual concentration risk in the fund. A fund that caters primarily to omnibus account holders could look as though it has significant concentration (when in fact, no one investor has any significant number of shares at all), while a fund made up mostly of direct purchases by shareholders could appear to have a much lower concentration. As a result, we do not believe this information will be helpful to investors or the Commission.

- *The filing deadline for Form N-MFP should be lengthened from 5 days after the end of the month to 10 days after the end of the month.*

Notwithstanding our recommendation to eliminate certain new disclosure requirements from the proposed rule, the proposal would require the addition of a significant amount of information to the form. Currently, Schwab receives information necessary to complete the form up until the third business day after the end of the month, leaving the firm with just two business days to complete and file the form with the Commission. With the addition of new disclosure requirements, we believe the deadline for compliance should be extended. We recommend a 10-day reporting deadline rather than the current 5-day deadline to ensure that the adviser has sufficient time to gather, review, and confirm the accuracy of the information being reported.

- *The filing deadline for the requirement on the new Form N-CR to disclose information related to default or insolvency should be lengthened from one business day after the event occurs to four business days after the event occurs.*

Some of the requested information can be provided in one business day, such as the securities affected, the date or dates on which the default or event of insolvency occurred, the value of the affected securities, and the percentage of the fund's total assets represented by the affected security. But we believe it is unreasonable to require a fund's board to determine in a single day what actions it should take in response to the event. Additional time may be necessary to formulate a meaningful response. The addition of three business days to complete that process and report it on the form strikes us as a more reasonable requirement.

- *The requirement to disclose on a daily basis (i) the percentage of the fund's total assets that are invested in daily and weekly liquid assets as of the end of the previous business day; (ii) the fund's net inflows and outflows as of the end of the previous day; and (iii)*

[33] 78 Fed. Reg. at 36943.

"a schedule, chart, graph or other depiction on [the fund's] Web site showing historical information about its investments in daily liquid assets and weekly liquid assets, as well as the fund's net inflows or outflows"[34] should be amended to require this information to be disclosed on a weekly basis.

Schwab does not believe that the disclosure of this information on a daily basis will provide meaningful value to investors because a single day's fluctuation in daily and weekly liquid assets or net inflows and outflows from one day to the next is not indicative of a trend on which an investor should make an investment decision or assessment about a money fund. Providing this information on a weekly basis, while showing the breakdown for each day of the previous week, provides a more complete depiction of current trends. Weekly disclosure would mitigate the inappropriate emphasis an investor might otherwise place on a single day of fluctuation.

Our recommendation provides investors with the same level of detailed information as the Commission's rule proposal but at a substantially reduced cost. Having to update this information, review it, confirm its accuracy and publish it on the fund's Web site on a daily basis will result in significant additional costs, but with little or no benefit to investors.

Finally, the Commission requests comment on increasing the frequency of filing Form N-MFP from monthly to weekly. We strongly oppose increasing the frequency of this filing. The filing requires considerable time to gather the information, analyze the data, ensure its accuracy and prepare the form. Moving from a monthly filing to a weekly filing would more than quadruple the number of times this form would need to be prepared and dramatically increase the costs associated with preparing the form. We do not believe those costs and administrative burden justify increasing the frequency of this reporting.

Proposed Diversification Requirements

The proposal contains three significant reforms to the diversification requirements in Rule 2a-7. While we understand and support the goal of ensuring that money market funds limit their risk exposure, we have concerns about the proposed requirements and the impact they could have on money market fund operations and on shareholders.

The proposal would require money market funds to aggregate their exposures to affiliated entities for the purposes of complying with Rule 2a-7's 5% issuer diversification limit. Schwab currently has access to adequate information sufficient to identify affiliated issuers at the time of purchase; we do not believe that there would be any difficulty in complying with the rule's definition of affiliated issuer.

However, we do have significant concerns with the impact the requirement could have on the broader markets. The proposal makes a number of assumptions about how money market fund portfolio managers would react to this new requirement, but ultimately the Commission concludes that it "cannot predict or quantify the precise effects this proposal would have on

[34] 78 Fed. Reg. at 36927.

competition, efficiency or capital formation."[35] One of the uncertainties the Commission cites is that the impact would "depend on whether there are alternative investments the money market fund could choose…[and] the amount of yield the issuers of the alternative investments would be required to pay as compared to the amount they would have paid absent our proposal."[36] We believe this is an important issue that could lead to the inability to purchase high-quality securities that, but for the new requirement, would be available for purchase by a money market fund. As a result, money market funds could be forced to purchase securities of issuers with credit ratings lower than those of the affiliated issuers. Realistically, there is a finite supply of securities that could be used to replace affiliated issuer positions above 5%. If the result of the proposed rule is that funds must purchase lower-quality securities, it is the investor who suffers, with no corresponding enhancement in the overall credit quality of the fund.

We recommend that the Commission modify its proposal to increase the 5% affiliated issuer diversification requirement to 10%. We believe this would ensure smoother operation of the money market fund industry while providing an adequate backstop that prevents over-concentration in affiliated issuers. Moreover, this would align the affiliate issuer diversification requirement with the proposed asset-backed securities 10% guarantor diversification requirement.

We support the proposed 10% guarantor diversification requirement but are confused by how this proposal works in conjunction with the 5% affiliated issuer diversification requirement. Do the two proposals work together, capping exposure to affiliated issuers and ABS sponsors at 5% in aggregate? Or is the intention of the Commission to treat affiliated ABS sponsors separately, allowing 5% exposure to affiliated issuers and 10% exposure to ABS sponsors regardless of the sponsor's affiliation to other issuers? We recommend the Commission clarify this issue.

Finally, we support elimination of the so-called "25% basket," as we agree that no fund should be invested up to 25% in any one entity, but recommend that state-specific municipal money market funds be allowed to continue using the basket with the following modification: that within the 25% basket no single guarantor or demand feature provider could represent more than 15% of the state-specific fund's assets. This would still allow the fund to invest in two guarantors or demand feature providers in excess of 10% but still remain within the 25% overall limit. Our recommendation addresses concerns that these types of funds are often strained by a lack of a supply and credit quality which would be exacerbated by the complete elimination of the "25% basket."

Proposed Enhancements to Stress Testing

Schwab has been a strong supporter of the stress testing requirements that were included in the 2010 amendments to Rule 2a-7. A robust stress-testing mechanism is an important safeguard that aids money market fund boards in assessing the risks to which a fund is exposed. The 2010 amendments required that funds adopt procedures for testing of several hypothetical events, and gave the fund's board and manager the freedom to establish additional scenarios or refine the provided scenarios for testing. The Commission, concerned about the disparity in the quality of

[35] 78 Fed. Reg. at 36957.
[36] 78 Fed. Reg. at 36957.

stress tests among funds and in the effectiveness of the materials produced to explain the results to the fund's board,[37] has proposed a series of enhancements. While we agree in principle with the core intent of the proposal – to strengthen the information available to fund boards in order to assess the risks in money market funds – we believe that the proposal is costly, impracticable in parts, and, in some cases, fails to enhance that core intent. The level of analytics required by the proposal strikes us as highly ambitious and relies on a series of assumptions that will be very difficult to make.

The proposal has some differences depending on which of the alternatives is ultimately included in the final rule, but generally the approaches are similar. In both cases, the proposal would augment current stress test requirements with a more dynamic test of weekly liquidity. But the enhanced test requires estimation of data that is not directly observable, such as redemption contagion and security level price correlations.

To be fully compliant with the proposal, estimates will be needed of the correlations between security prices and risk factors; downgrade and default correlations among issuers; spread changes as dependent on credit events; and the behavior of customers in times of market stress. All of these new requirements would require significant amounts of conjecture, such that we believe they would be of little use to the fund's board. The last point, in particular, is nearly impossible to predict. We also believe that the current state of price discovery in this market is insufficient to support the level of analysis required by the proposal.

Schwab, like other firms in the industry, have built significant stress-testing capability to comply with the 2010 amendments to Rule 2a-7. While the Commission cites a lack of uniformity across firms with the stress-testing requirements, it does not offer any evidence that there is a lack of quality in the stress testing. Firms have adopted stress-testing models that best suit the particular nature of their funds, and those procedures, which have been in place for only three years, are proving effective. We believe the stress-testing enhancements in the proposal add little to the current regime, and may cause additional uncertainty for investors because of the large amount of subjective estimates that would be required. We recommend that the Commission drop these additional requirements from the proposal.

Cost Analysis of Complying with the Proposed Rule

As required by law, the Commission has included in its proposed reforms an analysis of the costs of compliance. We find the Commission's conclusions to significantly underestimate those costs. In some areas, the Commission's estimates are low by multiple orders of magnitude. We cite below some representative examples of the anticipated costs of the proposed reforms.

One area in which we believe the Commission has not adequately considered the cost of its proposal is in the development of a floating NAV institutional prime money market fund. The Commission staff's estimate for the systems modifications necessary to support a floating NAV money market fund in the proposal ranges from $1.2 million to $2.3 million.[38] By contrast,

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[37] 78 Fed. Reg. at 36967.
[38] 78 Fed. Reg. at 36871.

given the complexities of developing the operational capability to support our sweep features, we estimate that the one-time cost will exceed $10 million.

We also believe that the Commission has not adequately considered the costs of educating and training employees to understand the new rules, nor the costs of communicating the rule changes to clients. We estimate these costs to be in a range of at least $4 million in advance of the new rules taking effect, and at least $500,000 in annual costs thereafter. The Commission's proposal does not include a specific estimate of education, training and client communication costs. Rather, the proposal embeds these costs as part of its estimates of the costs of developing the systems to support floating NAV funds, daily redemption limits, gates and fees, and other aspects of the proposal. We believe this leads to a serious underestimation of the communications and education challenges that funds will face if these rules were to be approved.

We would also note that the US Chamber of Commerce recently issued a white paper examining the operational implications of the floating NAV proposal on institutional investors. They concluded that "total up-front costs for U.S. MMF institutional investors to modify operations in order to comply with a floating NAV will be between $1.8 and $2 billion. Further, we estimate that new imposed annual operating costs will be $2 to $2.5 billion (net present value)."[39]

Potential Repercussions of Money Market Fund Reform

The purpose of the Commission's efforts to quantify the cost of compliance with the proposed rule is to aid the Commission in determining whether those costs are outweighed by the benefits of the rule. While Schwab generally supports the SEC's reform efforts, especially in the context of other proposals that have been floated, we would be remiss not to point out that the reforms being proposed would bring about fundamental changes to money market funds, at significant cost, and that those changes have potentially significant repercussions on the larger financial system that warrant careful consideration by the Commission. Among the most significant is the degree to which the proposal would reduce the number and size of prime money market funds by driving those assets elsewhere. We believe many institutional investors will not be interested in a product that has a floating NAV. Moreover, we believe that many retail investors will not want to use a stable-value prime money market fund if they have even a remote chance of being unable to redeem all their shares at once, as this is one of the most important features of money market funds to retail investors. As a result, we expect the assets in prime money market funds to decrease dramatically if the rule is finalized in essentially the same form as proposed. A recent white paper issued by Barclays estimates that institutional prime fund balances could decrease by as much as 40%.[40] It is not clear that would be a desirable outcome.

The question then becomes what is the impact on other products if prime money market funds experience a sharp decline in assets. In particular, we believe the impact on government money market funds will be significant. Government money market funds would undoubtedly absorb the majority of the assets that move out of prime money market funds if a daily redemption limit

[39] US Chamber of Commerce Center for Capital Markets Competitiveness, "Operational Implications of a Floating NAV Across Money Market Fund Industry Key Stakeholders", Summer 2013, p. 3. Available at http://www.uschamber.com/sites/default/files/reports/CCMC_FloatingNAV.pdf.

[40] Abate, Joseph. "US Money Markets Tactical Retreat?," August 15, 2013.

were to be imposed on the latter. For illustrative purposes, assume that all of the assets of clients whose current holdings in a prime money market fund exceed $1 million move those assets to a government fund.[41] We estimate that, were a $1 million daily redemption limit be imposed on Schwab prime money market funds, the Schwab Government Money Market Fund (SWGXX) could see a 156% increase in size – from $18.1 billion to $46.2 billion in assets under management. We arrived at this figure by adding the total assets of clients with prime sweep fund balances greater than $1 million, the total assets of clients with municipal sweep fund balances greater than $1 million, and retirement plans with purchased money market fund assets greater than $1 million. The result was $27.9 billion in "displaced assets" moving from prime and municipal funds to the government fund.[42] And this does not take into account any assets held by investors who hold less than $1 million in a prime or municipal fund, but choose to move their assets because of concerns of running up against the redemption limit in the future.

Such a shift of assets from Schwab's prime and municipal money market fund products to the government money market fund would immediately make the latter the 6th largest money fund in the United States, and would dwarf the largest government money market funds currently in the marketplace. Competitors' funds would undoubtedly grow in size, likely in the same, if not greater, proportion. This raises a fundamental question: do government money market funds have the capacity to handle this amount of inflows? Portfolio managers of government money market funds would likely find themselves in a frantic competition to purchase a dwindling supply of securities. The combination of tight supply, high demand and low interest rates will continue to put pressure on government funds. It will become increasingly challenging for these funds to maintain a positive rate of return for investors.

It is entirely possible that yields on all government securities could go to zero or slightly above, which would be below the bare minimum operating cost for many government and US Treasury money market funds. If this were to occur, which we believe is likely, fund sponsors would either have to provide direct sponsor support to pay for the third-party operating costs (e.g., custodian fees, trading commissions) or liquidate the funds.

The declining supply of US Treasury and government Rule 2a-7 eligible securities is already occurring today, and the unintended flight to these securities if the proposed reforms are adopted will further exacerbate the problem. Specifically, the supply of US Treasury Bills has declined by 25% from its peak of $2.03 trillion in March 2009 to $1.57 trillion in June 2013 while the supply of Government-Sponsored Enterprise Discount Notes has gone down 58% from $1.076 trillion in December 2008 to $457 billion in June 2013.

With respect to Treasury Bills, the US Treasury is strategically extending the weighted average maturity of its debt, and as a result, the supply of money market fund-eligible Treasury Bills is

[41] We recognize, of course, that some of those assets would move to Treasury money market funds, some to bank products and some to other cash-management vehicles.

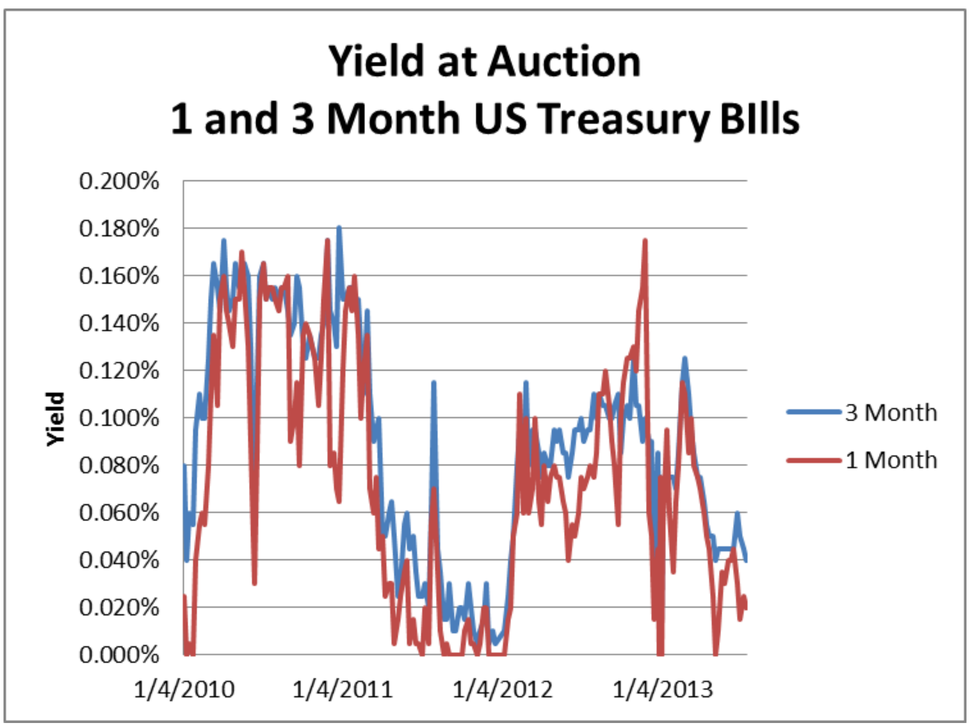
[42] Note that the assumptions in this example contemplate the SEC's proposal being adopted as proposed – in other words, with a $1 million redemption limit for both prime and municipal money market funds. Of course, elsewhere in this letter, we argue that the $1 million redemption limit should be increased to $5 million for prime funds, and the redemption limit on municipal funds should be eliminated entirely. Such changes to the proposal would markedly reduce the total amount of "displaced assets" and have a much smaller impact on the size of the government fund.

expected to decline even further. As Assistant Secretary of the Treasury for Financial Markets Matt Rutherford recently stated at a conference on money funds:

> And as many of you know the broad contours of that strategy really haven't changed since 2009. We remain on a path to continue to extend the weighted average maturity of our debt. At the depths of the financial crisis this figure was right around 48 months, and today it has risen to about 65 months. Given the uncertainty in fiscal forecasts we don't explicitly set a target for where we expect the average maturity to go to. However, I would say that I expect a gradual increase in the average maturity over the next several years. As you know, extending the WAM of our debt has led to a decline in the stock of Treasury bills.[43]

Finally, in times of market stress, yields on T-Bills typically used by Treasury and Government money funds have gone to zero or near zero. For instance, during September 2011, following the Congressional debate over increasing the debt ceiling and the subsequent downgrading of US debt by one rating agency, 1 Month T-Bills were issued at 0.000% for five successive auctions while the 3 Month T-Bills had rates ranging from 0.01% to 0.03% at auction. Unfortunately, this was not an isolated incident as Figure 3 illustrates.

Figure 3[44]



[43] "Treasury's Rutherford on Reforms, FRNs, Stability," *Money Fund Intelligence*, July 2013, p. 2
[44] Based on data available from Department of the Treasury Resource Center, http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/default.aspx

Alternatively, assets could flow to other types of products, such as bank products or ultra-short funds and exchanged-traded funds. None of these products are regulated by Rule 2a-7. Many of the largest banks are likely to be reluctant to absorb these dollars because of the impact on their capital ratios, the lack of short-term investment options, and the fact that they must pay deposit insurance based on their assets.

Another potential concern is that the transition to a new regulatory regime for money market funds could itself spark a destabilizing run of the very kind the rules are intended to prevent. We expect that, if the Commission finalizes a rule calling for institutional prime funds to have a floating NAV, there will be a quick exodus by institutional investors from prime funds to government funds or other products that do not have the new restrictions. This could lead to worry by other investors that the large redemptions are either indicative of a problem in the fund or will lead to liquidity concerns within the fund as it seeks to meet those redemptions – and those investors could then also seek to redeem.

We believe it is incumbent upon the Commission to carefully weigh these potential impacts on the broader financial system as it considers a final rule.

Conclusion

Schwab applauds the efforts of the Commission to find a reasonable solution to the long-running debate over money market fund reform. Overall, we believe the Commission has constructed a framework for reform that balances strong disincentives for early redeemers to trigger a run with the need to preserve the value proposition of money market funds for individual investors. The rule targets the reform where it is needed most: institutional prime funds. By exempting retail investors from the floating NAV, the Commission is acknowledging both that the product is of critical importance to retail investors and that these investors are not likely to cause a run. We believe that this proposal, when combined with increasing the ability of fund boards to impose redemption gates and/or liquidity fees to facilitate orderly liquidation of a distressed fund, will produce a stronger, more robust money market fund industry that warrants investor confidence and ensures the preservation of this product for generations to come. We also stress that many of the Commission's recommendations in the areas of disclosure and diversification add considerable value and rigor to the proposal, and should not be overlooked in importance.

We appreciate the proposal's openness to stakeholder comments. The sheer number of questions posed by the Commission in the proposal underscores the complexity of what is being proposed. We offer in this letter a number of suggested changes – and we are keenly aware that some are very significant changes – that we believe will make the rule easier to implement and substantially reduce the opportunities for retail investors to inadvertently run afoul of its provisions. The key to the future of money market funds is ensuring that retail investors do not find the new regulations to be so burdensome that the product's value is undermined. Our proposed changes – particularly the recommended increase in the daily redemption limit; the suggested exemptions for municipal money market funds, retirement accounts and education accounts; the clarification that only the underlying clients of a registered investment adviser, and not the adviser itself, are subject to the Redemption Limit; and the clarification of the tax

treatment of gains and losses – are all designed to ensure that the retail clients are impacted as little as necessary.

Thank you very much for the opportunity to offer our perspective on this critically important issue. We would be pleased to respond to questions or provide any additional information that would help the Commission come to a final conclusion.

Sincerely,

Marie Chandoha,
President, Charles Schwab Investment Management

cc: Mary Jo White, Chairman, Securities and Exchange Commission
Luis A. Aguilar, Commissioner, Securities and Exchange Commission
Daniel M. Gallagher, Commissioner, Securities and Exchange Commission
Kara M. Stein, Commissioner, Securities and Exchange Commission
Michael S. Piwowar, Commissioner, Securities and Exchange Commission

Norm Champ, Director, Division of Investment Management, Securities and Exchange Commission
Sarah G. ten Siethoff, Senior Special Counsel, Division of Investment Management, Securities and Exchange Commission