BLACKROCK

September 12, 2013

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

Via internet: http://www.sec.gov/rules/proposed.shtml

RE: Money Market Fund Reform; Amendments to Form PF (Release No. IC-30551; File No. S7-03-13)

Dear Ms. Murphy:

BlackRock, Inc. ("BlackRock") is pleased to have the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on the proposals for Money Market Fund Reform (the "Proposed Rule").[1] We commend the Commission for issuing a thoughtful set of proposals that address many of the concerns raised by us and other market participants in the money market fund ("MMF") reform debate. As outlined in the Proposed Rule, several other critical issues need to be considered and addressed prior to adoption of any final rules. Our letter identifies some of the challenges associated with the proposed structural changes and recommends potential solutions.

About BlackRock

BlackRock is one of the world's leading asset management firms, managing approximately $3.857 trillion (as of June 30, 2013) on behalf of institutional and individual clients worldwide, including governments, pension funds and corporations. BlackRock and its predecessor companies have been involved in the management of MMFs since 1973, and today, BlackRock manages approximately $192.6 billion (as of June 30, 2013) in Rule 2a-7 MMF assets regulated by the Commission. BlackRock also manages substantial cash management assets in bank collective funds regulated by the Office of the Comptroller of the Currency and in Undertakings for Collective Investment in Transferable Securities products regulated by the European Securities and Markets Authority. Our success in building this business came not because we always offer the highest yield; we have grown because we have earned our clients' trust through multiple interest rate cycles and a wide variety of market events.

We believe cash management is a distinct investment category, different from other fixed income strategies. We understand the importance of putting safety and liquidity first, not as a marketing message, but as the foundation of our investment philosophy. At BlackRock, we have investment, credit research and risk management personnel and processes that are dedicated to our liquidity business. These teams work collaboratively

[1] Money Market Fund Reform; Amendments to Form PF, 78 Fed. Reg. 36834 (June 19, 2013); *or see* Money Market Fund Reform; Amendments to Form PF, Release No. IC-30551 (June 5, 2013), *available at* http://www.sec.gov/rules/proposed/2013/33-9408.pdf ("SEC 2013 Proposal").

to develop and maintain proprietary approved lists, and only securities on those lists are eligible for purchase in our MMF portfolios. This process goes beyond an assessment of whether a particular security will mature at par; it is a rigorous analysis of multiple facets of the instrument and its issuer, including how it is likely to perform under many different conditions and scenarios.

The Path to the Proposed Rule

The Commission and the industry have struggled to find the best way to strengthen the regulatory structure of MMFs since the financial crisis of 2008 and the historic "breaking of the buck" by the Reserve Primary Fund. We and our clients remain immensely grateful for the work of the Commission and various other Government agencies during and following the financial crisis in 2008. The swift, decisive and collective actions taken by multiple agencies were essential in restoring confidence and order to the markets.

After the 2008 crisis, we and others in the industry worked collaboratively with the Commission to modify Rule 2a-7 under the Investment Company Act of 1940, as amended (the "Investment Company Act"), to enhance the liquidity and safety of MMFs; the result was the implementation of reforms in 2010 (referred to herein as the "2010 MMF Reforms") that imposed tighter restrictions on MMFs' portfolio maturity, credit quality and liquidity guidelines, expanded portfolio disclosure requirements and increased transparency to investors.[2] Furthermore, we recognize the benefits of protecting MMF investors and the broader financial system.

One of the many challenges in the dialogue around MMF reform subsequent to the 2010 MMF Reforms has been identifying which issues could and should be solved through regulatory reform. We commend the Commission for acknowledging in the Proposed Rule that the key issue to be solved by further MMF reform is "stopping the run" while preserving, as much as possible, the benefits of MMFs.[3] MMFs play a unique role in the economy by providing short-term funding to commercial and municipal borrowers through purchases of commercial paper and other short-term debt while providing short-term investments and liquidity to a broad array of institutional and retail investors. Adopting regulatory reform that focuses on the specific issues of "run risk" while narrowing the scope to the most susceptible funds and preserving the benefits of MMFs is critical.

[2] Money Market Fund Reform, Investment Company Act Release No. IC-29132 (Feb. 23, 2010), 75 Fed. Reg. 10600 (Mar. 4, 2010) ("2010 Adopting Release").

[3] SEC 2013 Proposal, *supra* 1, at p. 11 ("Each alternative seeks to preserve the ability of money market funds to function as an effective and efficient cash management tool for investors, but also address certain features in money market funds that can make them susceptible to heavy redemptions, provide them with better tools to manage and mitigate potential contagion from high levels of redemptions, and increase the transparency of their risks."); *Id*. at 14 ("The combination of several features of money market funds can create an incentive for their shareholders to redeem shares heavily in periods of financial stress, as discussed in greater detail in the RSFI Study."); *Id.* at 12 ("The combination of principal stability, liquidity, and short-term yields offered by money market funds, which is unlike that offered by other types of mutual funds, has made money market funds popular cash management vehicles for both retail and institutional investors . . . ."); *Id.* at 12 ("Money market funds, due to their popularity with investors, have become an important source of financing in certain segments of the short-term financing markets . . . .").

From the outset, we endorsed the idea of attempting to solve for systemic risk issues when considering additional reform proposals.[4] In particular, we have focused on the "run risk" and have engaged in this dialogue with regulators, clients and issuers in a serious and constructive manner for several years. In a number of papers and comment letters, we have indicated that any additional reforms that are adopted for MMFs should provide a mechanism for halting mass client redemptions while preserving the benefits of MMFs as both a liquidity management tool for investors and as a critical source of short term funding in the capital markets.[5] In our letter to the Financial Stability Oversight Council dated December 13, 2012, we explicitly explored both floating net asset value ("NAV") and standby liquidity fees and gates, each of which present challenges but warrant serious consideration.

Informed by the thorough study performed by the Commission's staff[6], the Commission outlines three potential structural reforms in the Proposed Rule to address the concerns around "stopping the run" while attempting to preserve the benefits MMFs provide for investors and the short term funding markets. As discussed in more detail in this letter, the Commission is proposing:

1. *Floating Net Asset Value*. Requires Institutional Prime MMFs to have a floating NAV by removing the special exemption that currently allows MMFs to utilize amortized cost accounting and/or penny rounding to maintain a stable NAV.
2. *Standby Liquidity Fees and Gates*. Continues to allow MMFs to transact at a stable NAV under normal conditions but (1) requires certain MMFs to institute a liquidity fee in certain circumstances and (2) permits a MMF to impose a gate in certain circumstances.
3. *Potential Combination of Standby Liquidity Fees and Gates and Floating Net Asset Value*. Combines both proposals (1) and (2) above.

The Commission also proposes a number of other technical operational proposals to reform MMFs.

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[4] *See* BlackRock ViewPoint: Money Market Funds, A Proposal for a Capitalized Special Purpose Entity, February 7, 2010 (discussing the best way to reduce the likelihood that MMFs could represent a systemic risk to the U.S. financial markets in the future), *available at* https://www2.blackrock.com/webcore/litService/search/getDocument.seam?venue=PUB_IND&source=GLOBAL&contentId=1111124986.

[5] *See id*; *see also* BlackRock ViewPoint: Money Market Fund Reform, Discussion of Reform Proposals, January 2011, *available at* *https://www2.blackrock.com/webcore/litService/search/getDocument.seam?venue=PUB_IND&source=GLOBAL&contentId=1111128669*; *see* Letter from Barbara Novick, Vice Chairman, BlackRock, Inc., and Richard Hoerner, Head of Global Cash Management, BlackRock, Inc., to the Financial Stability Oversight Council (Dec. 13, 2012), *available at* *https://www.blackrock.com/cash/literature/press-release/blackrock-response-to-fsoc-recommendations.pdf* ("BlackRock FSOC Letter").

[6] *See* Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, a report by the staff of the Division of Risk, Strategy, and Financial Innovation (Nov. 30, 2012), *available at* http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf. ("RSFI Study"); *see also* Report of the President's Working Group on Financial Markets, *Money Market Fund Reform Options* (Oct. 2010), *available at* http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf; *see also* President's Working Group Report on Money Market Fund Reform, Investment Company Act Release No. 29497 (Nov. 3, 2010), 75 Fed. Reg. 68636 (Nov. 8, 2010).

Summary

This letter focuses on four key aspects of the Proposed Rule:

- The benefits and challenges of the structural approaches in the Proposed Rule;
- An exemption for all Municipal MMFs;
- Defining retail and institutional clients; and
- A series of technical operational issues.

Our discussion and analysis addresses each of these aspects while keeping in mind the primary goal of preserving the benefits of MMFs and the functioning of the short term funding markets while providing a mechanism for managing potential mass redemptions in a MMF.

BlackRock supports a number of the proposals in the Proposed Rule including:

- Focusing on Prime MMFs for the Floating Net Asset Value ("FNAV") proposal, while exempting Government MMFs;
- Proposing standby liquidity fees and gates as a standalone proposal for consideration;
- Increasing transparency to investors through MMF portfolio information disclosures; and
- Increasing stress testing for funds.

We continue to believe, however, that the following challenges remain with the Proposed Rule:

- The combined structural proposal, requiring FNAV and standby liquidity fees and gates, is not workable for investors;
- The focus of any final rule (FNAV or standby liquidity fees and gates) should be only on Prime MMFs;
- All Municipal MMFs should be exempted like Government MMFs;
- Ten basis point rounding should be used by FNAV MMFs; and
- The definition of "retail" funds as proposed is not adequate and needs to be redefined.

In each section, we provide recommendations to address these challenges that we believe will make the proposals in the Proposed Rule more palatable to investors, thus better preserving the benefits of the funds for both investors and borrowers.

In several cases, our recommendations require clear guidance from other entities (e.g., the Financial Accounting Standards Board ("FASB"), Internal Revenue Service ("IRS") and U.S. Commodity Futures Trading Commission ("CFTC")) to reduce uncertainty. Depending on the guidance, investor preferences may change. Consequently, we strongly encourage cross-agency collaboration to resolve these Issues as soon as practical.

Benefits and Challenges of the Structural Approaches in the Proposed Rule

Input from End Investors

Throughout the MMF reform debate we have been proponents of finding a solution that preserves the benefits of MMFs for investors and have engaged in a dialogue with end investors to understand their needs and preferences.[7] To help inform our response on the Proposed Rule, we sought our clients' collective input in July 2013. We did this in two primary ways: through an online survey completed by a number of our clients and through in-depth conversations with clients.

Our survey was completed by 66 end investors across a variety of industries throughout the United States who have money invested in BlackRock MMFs. Corporations represented 68% of our survey respondents, 11% were insurance companies, 9% government entities and 12% classified themselves as "other". The majority of respondents to our survey (approximately 87%) use MMFs for corporate treasury activities. We sought to ascertain our clients' reaction to the proposals in the Proposed Rule by reviewing each of the structural proposals (FNAV, standby liquidity fees and gates, as well as the third proposal of combining the two), and asking a series of questions regarding each of these proposals.

In addition to the survey, we sought input from our clients on the Proposed Rule by holding direct conversations with over 100 clients in the month of July across a wide subset of end investors from financial intermediaries to corporate treasurers.

While our client responses varied, the one consistent theme in both the survey and the client dialogues was the extreme aversion to the proposal of combining FNAV and standby liquidity fees and gates. We also consistently heard a need for ready access to their funds. Additionally, our conversations with clients and our survey results revealed several areas of concern, primarily around the impact any of the structural changes to MMFs might have on our clients' daily operations and the significant adjustments they may have to make to adapt to each of the proposals. Many clients had a number of questions around the proposals. Clients questioned, for example, the functionality of the standby liquidity fees and gates and sought information on how this compared with how MMFs operate under Rule 2a-7 today. Many clients inquired about the likelihood that the adoption of a floating NAV would also be coupled with clarification by the Commission and the FASB that these MMF shares would continue to qualify as "cash equivalents". Clients also raised concerns about the impact on supply, yields and portfolio construction each proposal would have.

As we address each of the structural approaches the Commission has proposed below, we indicate the results of our client survey and conversations.

Floating Net Asset Value

Under the first alternative proposal, MMFs other than Government and retail MMFs would be required to float their NAV.[8] The Commission proposed this structural approach "primarily to address the incentive of money market fund shareholders to redeem shares in times of fund and market stress based on the fund's valuation and pricing methods…"[9]

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[7] *See* BlackRock FSOC Letter, *supra* 5.
[8] *See* SEC 2013 Proposal, *supra* 1, at 45.
[9] *Id.* at 47.

and because a floating NAV "should also improve the transparency of pricing associated with money market funds."[10] The Commission believes that this proposal would allow investors to be better informed and therefore would deter investor redemptions that were not based on rational risk management.

The FNAV proposal is simple and understandable to investors. It gives investors unrestricted access to liquidity, albeit at the expense of a potential loss in principal. This constant access to liquidity is important to certain investors.

If this proposal were adopted, however, our client survey showed approximately 48% of respondents who currently invest in a Prime institutional MMF would no longer use a Prime institutional MMF. Some investors must have a stable NAV MMF to invest in; 55% of our respondents indicated that zero loss tolerance was the reason they would no longer be able to use this type of fund. Clients also indicated that they would no longer be able to use this product if it did not qualify as a cash equivalent for accounting purposes (57%) or tax reasons (21%).[11]

As noted below, there are a series of accounting, tax and other challenges associated with FNAV, all of which impact the utility of the product for end investors. Some issues can be mitigated, which would be beneficial. Whenever possible, we include recommendations to address these issues.

1. *The characterization of FNAV MMF shares as "cash equivalents".* It is important to investors that an FNAV MMF qualify as a "cash equivalent" for financial reporting purposes under accounting standards. Currently, investors are allowed to record MMFs as a "cash equivalent" without having to monitor and report on the daily fluctuations in the value of their portfolio. If FNAV MMFs were not able to be treated as a "cash equivalent" it would require the modification of accounting systems to track their mark to market value and record unrealized gains/losses regardless of how small the movement in value may be. Our survey showed that accounting complexities were the principal reason investors would not use FNAV MMFs. Additionally, many investment guidelines, loan covenants and other documents refer to "cash and cash equivalents". If FNAV MMFs do not qualify as "cash equivalents" many end-investors may be prohibited from investing in them (without amending their guidelines and some documents cannot be amended from a practical perspective). It is important that the Commission and the FASB adopt a definition of cash equivalents that will provide flexibility when there are market events or other conditions that require imposition of temporary gates or a liquidity fee. We recommend that the Commission and FASB consider clarifying that MMFs meet the definition of a cash equivalent unless (a) at the measurement date, an investor would be restricted from redeeming for more than a temporary period or (b) it is likely that fluctuations in the amount of cash to be received on redemption compared to the current measurement date amount would be more than insignificant. To the extent a fee would be imposed upon redemptions and the investor expects to pay the fee, an amount equal to the potential fee would not be considered a cash equivalent.

[10] *Id.*

[11] Percentages add up to greater than 100%, as our survey permitted clients to check more than one reason why a proposal would result in less demand for the product.

2. *The tax treatment of FNAV MMF shares.* From a practical standpoint, an FNAV fund generates taxable gains and losses with each subscription and redemption, creating administrative burdens for investors. Fluctuations around $1.0000 will be frequent but small (see Exhibit A on page 17). MMF investors currently do not have to be concerned about tax lot accounting or reporting of gains or losses on redemptions, as all transactions are at $1.00. Investors need additional relief from the U.S. Treasury and the IRS exempting gains and losses on FNAV MMFs to reduce the administrative burden. Given that the fluctuations in FNAV MMFs shares will likely be small and the NAV can go both above and below $1.00, such an exemption should be revenue neutral in terms of broader fiscal issues and tax policy.

   Alternatively, the Commission has indicated that the U.S. Treasury and the IRS are considering guidance to allow net information reporting by the funds of realized gains and losses for sales of all mutual fund shares and to allow summary income tax reporting by shareholders.[12] We would recommend this relief be granted, however we note that net information reporting would not benefit the vast majority of shareholders in institutional MMFs who do not receive tax information reporting. Therefore, the burden of tracking and calculating these amounts for the large volume of money market transactions would fall on them. To alleviate this burden, we would also recommend that tax information reporting be required to corporations, financial institutions and others who do not receive tax information reporting currently. Additionally, such recipients often have fiscal year ends that do not correspond with calendar year tax reporting. If this relief is granted, we would propose that such shareholders be allowed to defer the reporting of their FNAV MMFs gains and losses by including in their tax returns the amounts reported to them for the calendar year ended within their fiscal year.[13] As previously stated, such gains/losses are expected to be small, so there would not be a significant revenue impact resulting from any deferral.

   While we appreciate that the IRS has proposed exempting de minimis losses under the wash sale rules of Section 1091 of the Internal Revenue Code, this action is not sufficient. Under this proposal, funds, intermediaries and shareholders would still need to do substantially more recordkeeping than they do today to ensure that they identify wash sales and confirm that they meet the de minimis criteria. This undertaking will be extremely burdensome given the volume of transactions in MMFs. We recommend that the IRS provide an exemption from the wash sale rules for FNAV MMF shares. Redemptions from MMFs do not give rise to the concerns that the wash sale provision was designed to address and any losses that may be disallowed under the rules would likely be insignificant. The cost to shareholders to track these sales to determine if they meet the de minimis criteria will not be outweighed by any benefit gained in applying the wash sale rules.

3. *The inability to provide end investors intra-day liquidity.* In our experience, MMF investors utilize intra-day redemptions as part of their cash management activities. In fact, our survey showed that 53% of investors would reduce their use of MMFs and 42% would stop using them completely if MMFs could no longer provide intra-

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[12] *See* SEC 2013 Proposal, *supra* 1, at 117.
[13] This is similar to the rules for inclusion of partnership income where the taxpayer and the partnership do not have the same taxable years. (IRC Section 706(a)).

day redemptions. Intra-day liquidity would likely not be available in an FNAV environment. Striking the NAV multiple times during a day while needing to value each of the securities with market-based valuations presents both operational and cost issues. If FNAV MMFs were to strike their NAV more than once in a day, these funds may be subject to additional costs, as the pricing agencies would require payment for the multiple quotes and accounting agents would require additional compensation for calculating multiple NAVs. As our survey results showed, not having the ability to redeem investors intra-day would lead to less use of these funds by certain investors.

4. *The ability to continue to provide late fund closings.* FNAV MMFs may not be able to accommodate late closing funds under the FNAV proposal unless the federal wire system were to remain open later. A fund would need to value all of its securities each night after the close of the fund to strike the NAV and only after that time would the fund be in the position to wire redemption proceeds. This inability to close late would impact investors who use MMFs as sweep vehicles and these investors would likely seek another vehicle to invest in on a nightly basis.

5. *Questioning the impact of FNAV on runs*. We don't believe that an FNAV MMF would decrease the incentive for investors to redeem shares in times of stress, nor do we believe that the additional transparency, if any, that a floating NAV would provide, would limit runs. In our experience, clients decide to redeem from a MMF in times of crisis based on their assessment of the quality of assets, duration of assets and liquidity levels and their assessment of whether those are deteriorating in an unusually dramatic way.[14]

   Given the increased transparency of mark-to-market NAVs that many MMFs have made available, along with the availability of a MMFs percent of daily and weekly liquid assets, which some funds have already voluntarily made available, investors today have better information about MMF portfolios than they did in 2008. If the Commission's proposed transparency rules are adopted, this will give investors more information on a fund's portfolio that would help them assess the quality, duration and liquidity of a portfolio.

   The Commission notes, and we agree, that investors making decisions based on these factors could still redeem from a MMF even if the MMF had an FNAV. Economists speculate about the potential first mover advantage in a stable NAV fund. We, and academics who have studied this, believe that in FNAV MMFs, the potential for a first mover advantage is still present.[15] Because MMFs will sell their most liquid assets first to support redemptions, the remaining investors will be left with a riskier, less liquid portfolio. Investors who are assessing quality, duration and liquidity will be incentivized to redeem early from an FNAV MMF because any

[14] *See* RSFI Study, *supra* 6, at 4 ("The incentive for investors to redeem shares ahead of other investors is heightened by liquidity concerns.").

[15] *Id*. at 10 (academic studies show "empirical evidence that the sale of illiquid assets to meet redemption requests impairs future performance in all mutual funds, creating incentives to redeem ahead of other investors"); *see* Qi Chen, Itay Goldstein, and Wei Jiang, "Payoff Complementarities and Financial Fragility: Evidence from Mutual Fund Outflows", 2010, *Journal of Financial Economics*, V 97, 239-262.

loss would immediately be reflected in the floating NAV and the assets remaining in the portfolio could be riskier or less liquid.

If the Commission adopts this proposal, resolving these issues, particularly the accounting and tax issues, prior to issuance of a final FNAV rule will be critical in preserving the appeal of MMFs for investors.

Standby Liquidity Fees and Gates

This proposal requires MMFs to institute a liquidity fee[16] if a MMF's weekly liquid assets fall below 15% of its total assets, and would permit a MMF Board to impose a temporary suspension of redemptions (a "gate").[17] This proposal would apply to all MMFs, retail or institutional, other than Government MMFs.[18] This proposal would also allow MMFs to continue to use the penny rounding method of pricing but would not permit the use of the amortized cost method of valuation, which we discuss below under "Amortization" and "Basis Point Rounding".

In our assessment, this proposal would achieve the Commission's stated goals for additional reform; however, our client survey showed that approximately 49% of our clients who currently invest in a Prime institutional MMF would no longer invest in MMFs that had standby liquidity fees and gates and 37% who currently invest in a Prime institutional MMF would reduce their allocation to these funds. The vast majority (83%) indicated that their need for unrestricted access to liquidity was the major reason why this proposal is not appealing. We believe that any gating or liquidity fee rule will require significant investor education. From our discussions with clients, investors are confused about the current powers of Boards and how they would change. Given that the concept is to provide liquidity (albeit at a cost), we believe investor education could change their responses. As discussed below, several issues need to be addressed before investors can fully assess this option.

Standby liquidity fees and gates would "stop the run" in crisis scenarios. If a systemic run were underway, and every fund experienced a dramatic run combined with reduced market liquidity as we saw in 2008, liquidity fees would be imposed quickly to protect investors. Once a liquidity fee is implemented, a run would not continue as investor behavior would reflect new economic incentives. This proposal gives investors a choice, based on straight-forward economic incentives. Investors that truly need liquidity (e.g., to meet specific payments) or investors who simply decide they want their cash can get it; however, they must pay a fee for this access. Those investors choosing to access their cash will pay a fee which is comparable to the situation they would face if they owned another cash instrument (such as commercial paper) and decided they must sell into a

[16] Under this proposal, the liquidity fee of 2% would be paid to the MMF by redeeming shareholders. The fee could not be charged if the MMF's Board determines that the fee is not in the best interest of the MMF or could be reduced if the Board determines that a lesser fee is in the best interest of the MMF. *See* SEC 2013 Proposal, *supra* 1, at 45, 153.

[17] SEC 2013 Proposal, *supra* 1, at 45; *see also id*. at 173 (noting that "[a]ny money market fund that imposes a gate would need to lift that gate within 30 days and a money market fund could not impose a gate for more than 30 days in any 90-day period.").

[18] *Id.* at 65 (defining Government MMFs as ". . . money market funds that maintain at least 80% of their total assets in cash, government securities, or repurchase agreements that are collateralized fully.")

distressed market situation.[19] On the other hand, if an investor can wait for their liquidity, they are not disadvantaged by remaining in the MMF because redeeming investors would typically pay a fee in excess of the discount of the mark-to-market and remaining investors would stand to benefit from any excess fees paid by redeemers. Rather than a first-mover advantage, the financial incentives of standby liquidity fees would encourage the behavior desired, so that those who do not need their cash remain in a fund and do not exacerbate a crisis situation.[20]

Second, the proposal would allow MMFs to continue to operate as they do today during normal market conditions (e.g. intra-day and late day settlements), thus, generally preserving the benefits of MMFs. Investors would be able to enjoy the benefits of a diversified portfolio rather than be forced into concentrated investments such as bank deposits and money market instruments, or investments that are not cash equivalents. Continuing diversification is good for the investor and helps preserve the functioning of the short-term funding markets.

Third, this proposal, coupled with the Commission's proposals for increased transparency on fund holdings in the Proposed Rule, would incentivize fund managers to avoid triggering the liquidity fees. Just as the dollar-weighted average maturity and dollar-weighted average life limits changed fund manager behavior after the 2010 MMF Reforms,[21] the presence of liquidity thresholds should also change fund manager behavior. A MMF manager will focus on managing both assets and liabilities to avoid triggering a liquidity fee or gate. On the liability side, a MMF manager will be required to know the underlying clients in their fund and model their behavior to anticipate cash flow needs under various scenarios. In the event a MMF manager sees increased redemption behavior or sees reduced liquidity in the markets, the MMF manager will be incentivized under this proposal to address potential problems as early as possible.

As noted below, there are several areas that need clarification in considering this proposed option. Whenever possible, we include recommendations to address these issues.

1. *This proposal should be limited to Prime MMFs.* As we discuss in the next section, if this rule is adopted it should be clear that Government MMFs and Municipal MMFs should not be required to implement liquidity fees and gates.

2. *The tax treatment of shares with liquidity fees and gates*. If the Commission adopts this proposal, clarification from the IRS or the Treasury will need to be

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[19] We note, however, this fee might be more than the amount by which the NAV would actually fluctuate if the fund had been an FNAV fund, thus costing investors more to get out.

[20] It is worth noting that this is not just a hypothetical solution, but, in fact, a similar model was used in 2007 to solve the problem with the Florida Local Government Investment Pool ("LGIP"). This fund had experienced severe withdrawals leaving the fund with mostly longer maturity (9 to 12 months) instruments. The Trustees halted redemptions and when they reopened the LGIP, a mandatory redemption fee provided a financial incentive which encouraged many investors to stay invested. Over the course of a year, the LGIP was able to meet the redemptions requested and during that time most of the underlying securities matured eliminating the need for ongoing redemption fees. In the LGIP case, some investors chose to take their cash early and some waited, just as one might expect given the incentives.

[21] *See* RSFI Study, *supra* 6, Executive Summary ("The most important finding from the models is that the probability of breaking the buck declined after the 2010 reform assuming a fund had been at the maximum allowable WAM.").

obtained that the liquidity fees are treated as a reduction of gross proceeds to shareholders on redemption of their shares and are not income or gain to the fund. Such treatment will allow the fund to retain the fees in support of its $1.00 NAV rather than requiring the fund to distribute these amounts. Investment Company Act Rule 22c-2 redemption fees (which are akin to the liquidity fees) are typically treated as such for book and tax purposes but the IRS has never issued formal guidance on the treatment of redemption fees.[22]

Retaining liquidity fees could cause a MMF's NAV to break the buck on the upside over time requiring the MMF to make a distribution to avoid the situation. Such distribution would most likely be a return of capital since the fees did not create earnings and profits when received by the fund to support a taxable distribution. Consequently, each shareholder's basis would be reduced below $1.00 causing them to realize a gain on disposition of their shares at $1.00 stable NAV. In order to avoid potential basis tracking and reporting by the fund or its intermediaries if this were to occur, we recommend that the IRS or the Treasury issue guidance that when a stable value MMF is required to make a payment of excess liquidity fees in order to avoid breaking the buck, the fund would be deemed to have sufficient earnings and profits to treat the distribution as a taxable dividend. Although the shareholders would have to pay tax at ordinary income rates on such a distribution, the burden of basis tracking, gain recognition, and reporting would be eliminated.

3. *<u>The discretionary nature of the gate</u>.* The proposal would permit MMF Boards to impose a gate once a MMF's weekly liquid assets fall below 15% of its total assets, if the Board believes a gate is in the best interest of the MMF.[23] Without an objective trigger for the gate, investors would have less certainty about the liquidity of their investment. We would recommend a mandatory gate once weekly liquid assets fall below 15% of its total assets. The gate would prevent additional investor withdrawals until the MMF could be reopened with the liquidity fee. It would also provide service providers time to implement the liquidity fee. We would anticipate that the closing of the MMF would be brief, generally not more than one business day. Making the gate mandatory removes any questions of conflicts of interest or hesitancy to take action.

   In addition to the mandatory gate, in extraordinary circumstances, we would also recommend that a MMF's Board have the ability to impose a gate before weekly liquid assets fell below 15% of total assets if the Board believed this was in the best interest of the MMF. In this scenario, the gate may be in place longer than one business day and may be in place for up to 30 days. We believe these circumstances would be rare but would provide MMF Boards the ability to protect investors by stopping any further redemptions.

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[22] *See* SEC 2013 Proposal, *supra* 1, at 206 ("We understand that our proposed liquidity fee, if adopted, would be treated for tax purposes consistently with the way that funds and shareholders treat redemption fees under rule 22c-2.").
[23] *Id.* at 173 ("Any money market fund that imposes a gate would need to lift that gate within 30 days and a money market fund could not impose a gate for more than 30 days in any 90-day period.")

4. *The characterization of MMF shares with standby liquidity fees and gates as "cash equivalents".* As we discussed above, it is very important to investors that MMF shares continue to qualify as a "cash equivalent" for financial reporting purposes under FASB and other accounting standards.[24] Our survey showed that accounting complexities were also a reason why investors were concerned about this proposal. Please see our recommendation above under "Floating Net Asset Value" with respect to clarifying the definition of "cash equivalents".

5. *The size of the liquidity fee (1% vs. 2%).* We recommend that the liquidity fee that would be charged be 1% rather than 2%. We believe that the 1% fee would deter redemptions and still permit a MMF to recoup the costs of liquidity it may have had to bear from the redemptions and will repair the fund if it has incurred losses.[25] We would also recommend that a MMF not be open with a liquidity fee for more than 30 days. Thirty days give the MMF time to try to replenish liquidity to required levels, through sale of or maturity of portfolio holdings. If after 30 days the liquidity is not repaired, the MMF should go into liquidation. In addition, we recommend giving the Board discretion to increase the liquidity fee up to 2% in the rare circumstances when it would be in the best interest of the MMF.

6. *The ability to use MMFs as collateral and the ability for MMFs to be used for "customer money".* MMFs may not be able to be used as "cash collateral" by investors for posting to various exchanges and counterparties for a variety of transactions if there is a potential for a gate to be imposed. In addition, it is not clear under the Commodity Futures Trading Commission rules whether futures commission merchants would be able to continue to invest customer funds in these MMFs, as it is not clear if the shares of these funds would be considered "readily accessible" and "highly liquid" (i.e., convertible to cash within one business day without material discount).[26]

7. *Need time for investor education and implementations.* If the Commission adopts the liquidity fee and gates proposal, the Commission should provide time for investor education. The current proposal gives MMFs one year after the rule is finalized to implement this proposal. We think at least two years should be given so that MMFs can not only prepare operationally but also provide time to educate investors on how the revised rule works and on tax

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[24] An industry group met with the Commission and FASB staff on September 4 and 6, respectively, to discuss ways to clarify the definition of "cash equivalent" with respect to the proposal.

[25] We analyzed sales trades in a representative Prime MMF during the week of September 15, 2008 to calculate the value of the portfolio under a liquidation scenario. Our analysis shows a 1% redemption fee covers the costs of accessing liquidity during this representative period of market turmoil. The 1% fee would have provided a cushion sufficient to protect MMFs from contagion and systemic risk, but would not insulate portfolios from credit losses.

[26] We believe the inclusion of MMFs as permitted investments under CFTC Regulation 1.25 (17 CFR 1.25) provides important benefits in protecting customer segregated funds. *See* Letter from Richard Hoerner, Managing Director, BlackRock, Inc., and Simon Mendelson, Managing Director, BlackRock, Inc., to Mr. David A. Stawick, Secretary, Commodity Futures Trading Commission (Dec. 3, 2010), *available at* http://www.blackrock.com/corporate/en-us/literature/whitepaper/investment-of-customer-funds-and-funds-held-for-foreign-futures-and-options-letter-cftc.pdf.

and accounting implications. This additional time will also allow the FASB and the IRS to finalize any change driven by the Commission's final rule.

If the Commission adopts this proposal, the resolution of these issues will be critical as investors determine whether to continue to use this product.

Potential Combination of Standby Liquidity Fees and Gates and A Floating Net Asset Value

If one of the stated objectives of the further reforms is to preserve the benefits of MMFs and have a viable product for investors to use, this proposal is not workable. A rational investor would not purchase a MMF, with the strict portfolio requirements of Rule 2a-7, that has both a floating NAV and has the prospect of a liquidity fee and gate.

As we have already noted in this letter, certain investors require a stable NAV in a MMF product.[27] Other investors need continuous access to their funds and cannot use a MMF that has gates and fees. As a result, if both of these proposals are combined and required in a single fund, the number of investors that would be eliminated from using the product is too great—leaving only a small number who would find this product viable. Our responses to our client survey highlighted this issue indicating that many clients would no longer use Prime MMFs at the levels that they use them today. Approximately 69% of clients who responded to our survey who currently invest in Prime Institutional MMFs indicated they would not use a Prime MMF with these requirements, while another 31% who currently invest in Prime Institutional MMFs indicated they would reduce their allocation to Prime MMFs with these requirements.

Responses	Floating NAV	Standby Liquidity Fees and Gates	Combination
Yes, at current allocation	15%	14%	0%
Yes, but at reduced allocation	**37%**	**37%**	**31%**
No, unable to use product	**48%**	**49%**	**69%**

Given these indications, Prime MMFs would no longer be viable and clients would redeploy their cash assets into Government MMFs, direct investments and bank deposits.

In today's market, we would be concerned with the ability for Government MMFs to be able to support the influx of these assets. There would likely not be enough supply of government securities and repurchase agreements to accommodate all investors who would redeem out of Prime MMFs. The short-term funding markets would also be affected, as there would be a significant decrease in short-term funding to anyone but the U.S. Government. Those assets moving to bank deposits raise additional issues regarding "too big to fail" and investors having large, unsecured, non-diversified exposure to a small number of banks.

[27] For example, insurance companies who use shares to fund annuities require a stable NAV MMF product.

We would strongly urge the Commission not to adopt a proposal that would combine standby liquidity fees and gates and a floating net asset value as features of the MMF as this combination would raise the likelihood that Prime MMFs would no longer be offered, with significant impact on investors, issuers and the short-term funding markets.

Exemption for all Municipal Money Market Funds

Rather than try to shoe horn Municipal MMFs into the retail exemption in the Proposed Rule, we recommend that all Municipal MMFs be treated the same as Government MMFs, thereby being exempt from the proposed structural approaches discussed above.

Municipal MMFs total approximately $263 billion, representing approximately 10% of total U.S. money market fund assets.[28] Approximately thirty percent or $78 billion of Municipal MMF assets are classified as institutional.[29] The investment universe for Municipal MMFs is mostly comprised of one-day and seven-day variable rate demand notes ("VRDNs").[30] As a result, Municipal MMFs are very liquid.[31] There is also little difference in portfolio holdings between retail and institutional Municipal MMFs.

Institutional Municipal MMFs did not have the heavy redemptions experienced by Prime institutional MMFs during the 2008 crisis.[32] Between September 9, 2008 and September 23, 2008, institutional Municipal MMFs' redemptions equaled 11% of fund assets versus 29% for institutional Prime MMFs'.[33] VRDNs performed as expected during the crisis in 2008. Holders of VRDNs, including Municipal MMFs, were able to exercise the demand feature without any problems; consequently these funds did not have the same liquidity issues that Prime MMFs faced.[34] Municipal MMFs did not see significant redemptions during the uncertain markets of 2011 either.[35] Additionally, the Municipal MMF market was not destabilized by the recent bankruptcy filings of certain municipalities, including Detroit in July 2013.[36]

Additionally, investors are attracted to Municipal MMFs given the tax-exempt qualities of the income generated by these funds. There is less opportunity for retail investors who would no longer use FNAV funds or MMFs with standby liquidity fees and gates to

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[28] iMoneyNet, *Money Market Insight*, Vol. 25, No. 8 August 2013, *available at* https://webster.bfm.com/publish/pimc/mmi.pdf ("iMoneyNet").
[29] *Id.*
[30] *Id. (*As of 8/19/13, the average of Municipal MMFs' VRDN holdings was 78% of funds' assets. (Source: iMoneyNet Money Fund Report 8/23/13)). The percent of holdings in 7-days or less for state Municipal MMFs is 72% and for national MMFs is 70% as of August 19, 2013.
[31] Because of the liquidity of Municipal MMF holdings, we would be supportive of them being required to maintain 10% daily liquid assets.
[32] See RSFI Study, *supra* 6, at 7-11 (Government MMFs historically have experienced inflows, rather than outflows, in times of stress due to flights to quality, liquidity, and transparency). Additionally, despite the fact that the Reserve Funds suspended redemptions from all 14 of their Municipal MMFs in September of 2008, this did not trigger broad-based, destabilizing outflows from other Municipal MMFs.
[33] iMoneyNet, MoneyFundAnalyzer as of 09/04/13.
[34] iMoneyNet, MoneyFundAnalyzer (During the month of September 2008, Municipal MMFs maintained an asset weighted WAM of 35 days or less).
[35] iMoneyNet MoneyFundAnalyzer as of 09/04/13 (During the period of 05/02/11 – 12/26/11, Municipal MMFs' assets were down 5% while Prime MMFs' assets were down 13%).
[36] iMoneyNet MoneyFundAnalyzer as of 09/04/13 (During the period of 06/03/13 – 07/29/13, Michigan State Specific Municipal MMFs' assets increased by 1%.).

redeploy their assets in investments that would provide the same stability, liquidity and tax-exempt yield offered in Municipal MMFs.

Municipal MMFs are critically important in providing short-term funding for state and local entities. State and local governments rely on short term money market borrowing to pay their employees and to fund capital projects. Importantly, we do not believe municipal issuers have the same access to bank loans or other sources of funding and will be negatively impacted by reduced demand for Municipal MMFs.

Exempting Municipal MMFs from any final rule, like Government MMFs, would benefit investors and municipal issuers, with no significant increase in systemic risk.

Defining Retail and Institutional Investors

If the Commission exempts "retail" funds from certain of the proposals, we believe that "retail" should be defined by the type of investor investing the funds. Retail MMFs should be limited to investors with a social security number, and participant-directed retirement plans. This definition creates a front-end qualifying test that is operationally easier to implement as the test is only performed once when an investor opens an account or is given access to a fund. The current proposed definition creates ongoing operational testing and additional, unnecessary costs for monitoring.

There has been substantial discussion of the behavior of "institutional" versus "retail" clients and the definition of "retail" and "institutional" can be blurred. Defining a retail fund by the amount of assets a shareholder is permitted to redeem in a single day creates an artificial definition. Investors who may be considered "retail investors" increasingly act through institutional advisors who manage and invest their assets. Defining retail money market funds by limits on redemptions is operationally difficult and could lead to a two-tiered approach to MMFs that may lead to gaming behavior by investors. If the simpler front-end approach is adopted, this potential gaming behavior would be eliminated.

Additionally, as we discussed above, we would propose an additional solution: exempt both Government MMFs and Municipal MMFs from any final rule the Commission adopts. This would be a pragmatic approach to providing an exemption for retail investors.

Technical Issues

In this section, we identify and address a series of technical issues that are not specific to any of the structural proposals. Topics covered include:

- Amortization
- Basis Point Rounding
- Amendments to Disclosure Requirements
- Amendments to Form N-MFP
- Stress Testing
- Diversification
- Transition Time

1. Amortization

Under the Proposed Rule, MMFs including Government or retail funds that are exempt from FNAV, would no longer be permitted to use the amortized cost method of valuation to facilitate a stable NAV.[37] Those funds would continue to be able to use the penny rounding method of pricing. Currently, amortized cost valuation alleviates the burden of funds having to value each portfolio security each day using market factors. But amortized cost valuation also provides the important benefit of allowing MMFs to efficiently process purchase and redemption orders throughout the day. Intra-day liquidity allows the clearance and settlement system to operate in a smooth and efficient manner and for some investors is vitally important.

MMFs that use penny rounding alone to achieve a stable NAV may not be able to ascertain intra-day market prices for securities held in the fund. As discussed above in “Floating Net Asset Value”, valuing securities intra-day in order to calculate a NAV would be costly and time consuming—and likely not commercially feasible.

MMFs that are exempt from FNAV should be allowed to also use amortized cost valuation provided the MMF each day calculates its mark-to market share price using basis point rounding and publicly discloses it. This would insure that the value at which MMF shares transact approximates market value each day while preserving the operational benefit of amortized cost accounting.

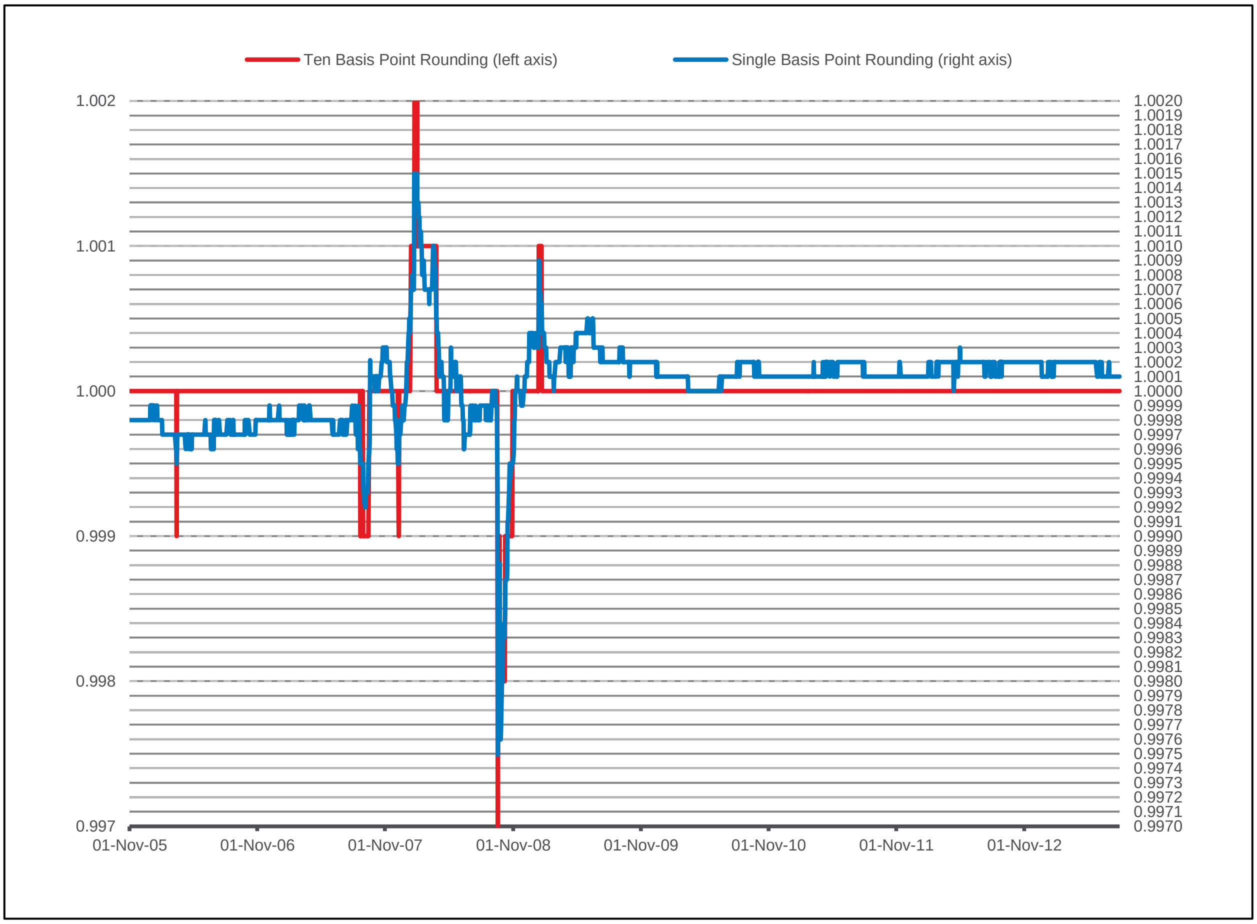
2. Basis Point Rounding

Under the Proposed Rule, MMFs, other than retail MMFs and Government MMFs, would be required to use “basis point rounding” when calculating their NAV. This would require MMFs to price and transact in their shares at a NAV that is calculated to the fourth decimal place for shares with a target NAV of one dollar (or to an equivalent level of precision for shares with a share price at something other than $1.00). We believe that MMFs should not be required to use a more precise measurement than what is required of other open-end mutual funds under the Investment Company Act. MMFs should be allowed to use “ten basis point rounding”.

While basis point rounding does provide greater price transparency than ten basis point rounding and may convey the risk of a floating NAV to investors more clearly by reflecting small fluctuations in value, it does so at a cost. That cost is the increased tax accounting burdens, and realized gains and losses that would result from more frequent changes in a MMF’s NAVs. While the Commission notes that they do not anticipate significant operational difficulties or burden in pricing shares using “basis point rounding” the Commission is only looking at the cost to the MMF and not the cost to the investor. BlackRock calculated the NAV of a large Prime institutional MMF using both basis point rounding and ten basis point rounding for the period November 1, 2005 to July 31, 2013. As illustrated on the following page in Exhibit A, the NAV of this MMF fluctuated 318 times (16% of the business days) using basis point rounding, but only 23 times (1% of the business days) using ten basis point rounding.

[37] *See* SEC 2013 Proposal, *supra* 1, at 48.

Exhibit A: NAV for a Representative Prime Institutional MMF Using Basis Point and Ten Basis Point Rounding



Source: BlackRock

We believe that ten basis point rounding, the traditional requirement for most mutual funds[38], combined with disclosure of a MMF's historical mark-to-market NAVs would provide investors sufficient transparency and convey to them that a MMF NAV will not always be stable. Basis point rounding would do nothing more than increase the number of share transactions that result in a gain or loss, thus increasing the magnitude of the tax and accounting burdens for investors investing in a MMF with a floating NAV.

If MMFs are required to use basis point rounding, we believe investors will be incentivized to invest in ultra-short bond funds with investment parameters similar to money market funds which could still use ten basis point rounding in which to transact shares. The Commission should be cautious about incentivizing investors to use this type of fund, given that they carry the same or greater risk as a MMF but are not subject to the risk-limiting investment and disclosure requirements that apply to MMFs.

[38] *See* Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977), 42 Fed. Reg. 28999 (June 7, 1977). (Mutual funds other than money market funds must calculate the fund's NAV to the nearest 1/10th of 1% (*i.e.*, for funds with shares priced at $1.00, the funds should price their shares to the third decimal place, or $1.000)).

3. Amendments to Disclosure Requirements

An important component of the Commission's Proposed Rule includes a substantial increase in transparency of MMFs' portfolios. BlackRock is a strong advocate for clear disclosure as it benefits investors and markets. We believe that transparency is critical for investor confidence and that an increased understanding of how money market funds have worked in practice should help reinforce investors' understanding of these products. The proposed transparency rules allow, among other things, access for clients to current fund liquidity and NAV data. Therefore, clients will be able to monitor the liquidity levels and mark-to-market NAVs of each money market fund in real time, or with a very minimal lag. Much of this reporting is already being provided voluntarily by BlackRock and other competitor MMFs. We began publishing our funds' mark-to-market NAVs daily in January 2013 (see Exhibit B for an example of a large institutional Prime MMF's mark-to-market NAVs) and we began publishing our funds' daily and weekly liquid assets as of August 14, 2013 (see Exhibit C for an example of a large institutional Prime MMF's weekly liquid assets).

Exhibit B: Mark-to-Market NAV for a Representative Prime Institutional MMF

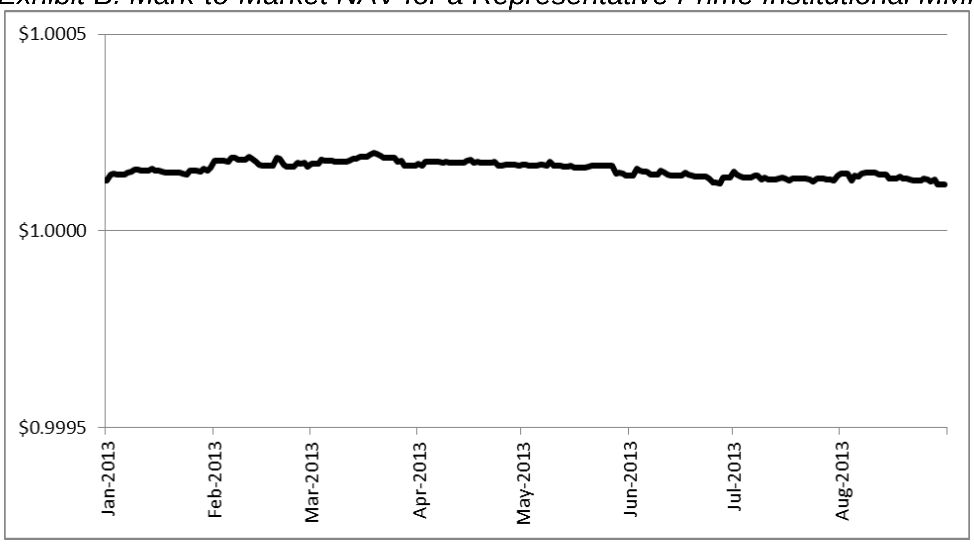
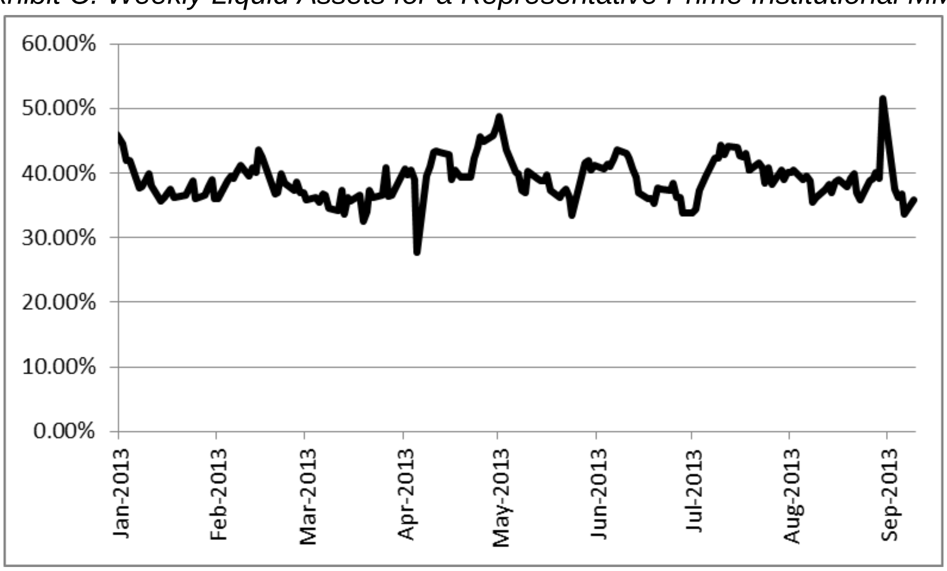


Exhibit C: Weekly Liquid Assets for a Representative Prime Institutional MMF



We encourage investors to review the published mark-to-market NAV data with the understanding that different MMFs' mark-to-market NAVs will naturally differ from each other. We note that investors should keep in mind that changes in the mark-to-market NAV should be expected, that the mark-to-market NAV typically fluctuates in a tight range and that the changes in mark to market are typically caused by changes in interest rates, prevailing economic conditions and investor purchase and redemption activity.

While we encourage transparency for end investors, we believe that some of the proposed information under the Proposed Rules to be provided to investors will not be helpful to them or might suggest a fund is under stress when it is not.

The Commission's proposed definition of financial support includes purchases of fund shares. Affiliates and fund sponsors often use a fund as a cash management vehicle and routinely purchase fund shares. These purchases in no way indicate a fund is under stress. Consequently, we recommend that the financial support that is required to be reported and disclosed should exclude these routine transactions.

The proposal also would require a MMF to publicly disclose the net inflows and outflows in the fund as of the end of the previous day and maintain historical information on these flows. This information could be misinterpreted as suggesting a MMF is under stress if a fund's size, its liquidity levels or the cause of the outflows are not taken into account. Some MMFs are designed to accommodate large flows on a regular basis. We recommend that this information not be required to be reported.

While some MMFs, including BlackRock's MMFs, publicly disclose portfolio information more frequently than monthly, we do not support a mandatory requirement to disclose complete MMF holdings more frequently. We believe more frequent disclosure of a fund's complete holdings will in many cases not meaningfully add to investor protection and the additional cost of providing the complete holdings is not justified.

*4. **Amendments to Form N-MFP Reporting Requirements***

The Commission is proposing to amend Form N-MFP to include certain additional information about MMFs.[39] We generally support these proposed amendments but oppose the requirement to include reporting the purchase date and yield at purchase, the yield as of the reporting date and the purchase price for portfolio positions and securities sold during the period in each Form N-MFP filing. We consider this to be confidential trading information, and we do not believe that this information is helpful for investors to evaluate the risks of MMFs.

If the Commission ultimately adopts a rule requiring the inclusion of this information in Form N-MFP filings, we ask that the Commission give MMFs ten business days after month end to provide MMFs adequate time to gather, review and format the additional information, and retain the current 60-day delay in making Form N-MFP public.

Lastly, we oppose changing the frequency of the filing of Form N-MFP to weekly because it would impose a substantial burden on fund sponsors and, as stated above under "Additional Disclosure Requirements", we do not believe more frequent disclosure will meaningfully add to investor protection.

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[39] *See* SEC 2013 Proposal, *supra* 1, at 46.

5. __Stress Testing__

An important component of the 2010 MMF Reforms was the requirement that MMFs perform periodic stress testing on certain hypothetical events and report the results of those stress tests to the fund's Board. In the 2010 MMF Reforms, the Commission left it to each fund Board to determine if additional stress testing should be performed and if so, what scenarios should be tested. Whether the FNAV proposal or the standby liquidity fees and gates proposal is adopted, we believe all MMFs should continue to be required to perform stress tests as they do today and report the results of those stress tests to the funds' Boards. We also agree with the Commission that additional enhancements to stress testing are appropriate at this time.

It is important for the manager of a MMF and the Board to know the impact that key events would have on a MMF's ability to meet its investment objectives. Under either proposal, we believe that stress testing will continue to play a critical role in a Board's understanding of MMFs. Consequently, stress tests should be performed by a MMF's manager at least weekly to incorporate timely fund and market data.

The Commission should set additional minimum standards for stress tests including requiring a MMF to stress test against the 15% weekly liquid asset threshold. As it does today, BlackRock would also stress test against other weekly liquidity thresholds it deems appropriate to better understand the dynamics of each fund. The Commission should not require MMFs to stress test against daily liquidity. Even during times of stress, securities included in the weekly liquidity measure are easily convertible into daily assets, making weekly liquidity the appropriate measure of a fund's liquidity position.

MMF stress tests could be enhanced if complete fund shareholder information were available. With enhancements to shareholder transparency, MMFs could stress test against specific clients redeeming shares of the fund (i.e., top 5 shareholders in a fund), certain types of shareholders redeeming shares (i.e., hedge funds) as well as other tests that the manager and Board might find useful. Consequently, we recommend that the Commission adopt rules that require the ability for MMFs to obtain information about the underlying shareholders in omnibus accounts that hold shares of a MMF and factor it into stress tests.

We also believe that the stress testing should not be different if one or the other of the Commission's structural proposals is adopted. Investors in FNAV MMFs expect a relatively stable NAV; in a fund that has the ability or is required to implement gates and redemption fees, investors will expect the fund to provide liquidity with minimal disruptions. As a result, neither a fund's investment objective nor investors' expectations will vary enough under the different proposals to warrant different stress test scenarios.

6. Diversification

The Commission proposes several changes to diversification requirements for MMFs. We agree with the proposals related to aggregation of affiliates[40] and the treatment of asset-backed securities ("ABS") sponsors as guarantors.[41]

We are concerned, however, about the proposed elimination of the 25% basket and the impact it would have on Municipal MMFs.[42] Since the financial crisis of 2008, the number of providers of credit and liquidity enhancement has declined due to credit downgrades, U.S. bank consolidation, European banks pulling back from the market, and less availability of bond insurance. Financial reform measures both in the U.S. and globally will continue to suppress the availability of credit and liquidity enhancement. At the same time, MMF reforms will incent more investors to use Municipal MMFs (particularly if they are exempted, as we suggest in this letter, from the structural proposals under the Proposed Rule), leading to greater demand for credit and liquidity enhanced municipal securities.

Assets in Municipal MMFs display a high degree of seasonality. For example, assets increase significantly in the early days of January, June and July. During those periods, the supply of securities eligible to be purchased by MMFs is scarce due to the cyclical demand for municipal securities. The 25% basket is an important tool that MMF managers use to accommodate the seasonal asset variability.[43]
Removal of the 25% basket would be particularly problematic for state-specific Municipal MMFs. State-specific funds have even fewer issuers available to them than national funds, and there are fewer banks regionally that provide credit and liquidity enhancement. Less diversification is available to state-specific funds. A fund's prospectus details the inherent risks of these non-diversified funds.

Inadequate supply of eligible municipal securities may cause MMF managers to seek diversification by purchasing lower-rated, less liquid, and longer duration instruments. The benefit of increased diversification, particularly for Municipal MMFs, may be more than offset by these funds holding lower quality and/or less liquid assets.

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[40] *See Id.* at 424 ("Specifically, we propose to require money market funds to aggregate their exposures to certain entities that are affiliated with each other when applying rule 2a-7's 5% issuer diversification limit.).

[41] *See Id.* at 443 ("We propose, therefore, to amend rule 2a-7 to provide that, subject to an exception, money market funds investing in ABSs, including ABCP, rely on the ABSs sponsors' financial strength or their ability or willingness to provide liquidity, credit, or other support to the ABSs. Subject to the exception, the amendments would require funds to treat the sponsor of an SPE issuing ABS as a guarantor of the ABS subject to rule 2a-7's diversification limitations applicable to guarantors and demand feature providers.").

[42] *See Id.* at 447 ("We also propose to amend rule 2a-7 to tighten the diversification requirements applicable to guarantors and providers of demand features. The amendments would eliminate the so-called "twenty-five percent basket," under which as much as 25% of the value of securities held in a fund's portfolio may be subject to guarantees or demand features from a single institution.").

[43] The 25% basket is used more frequently than a snapshot taken on February 28, 2013 would indicate. *See* SEC 2013 Proposal, *supra* 1, at 450 ("Approximately 109 funds, or 19% of all funds submitting Form N-MFP for February 28, 2013, reported that they made use of the twenty-five percent basket for guarantees and demand features, even when we treat sponsors of ABCP as guarantors (and thus subject to a 10% diversification limitation).").

7. __Transition Time__

As we noted earlier in this letter, it is critical to resolve the tax, accounting and other issues raised in this letter with either structural proposal prior to adoption of a final rule. Most importantly, other government agencies need to resolve certain issues with respect to either structural proposal so that MMF sponsors can assess whether they will offer the new Rule 2a-7 MMFs. To allow sufficient time for MMFs and end-investors to adapt to any new requirements, we recommend that any transition deadlines not be sooner than two years. This two year period will allow time for investor education and implementation of any necessary operational changes.

Conclusion

In conclusion, we are supportive of further MMF reform that seeks to mitigate "run risk" and continues to preserve the benefits of the product for both investors and issuers. To that end, we make the following recommendations to the Commission:

- Choose <u>one</u> of the proposed structural reforms in the Proposed Rule: either FNAV <u>or</u> the liquidity fees and gates;
- Resolve cross-agency issues and provide clear guidance simultaneous to finalizing a new 2a-7 rule;
- Focus only on Prime MMFs and clearly exempt Government and Municipal MMFs from further structural reforms;
- Retail MMFs should be limited to investors with a social security number, and participant- directed retirement plans;
- Mandate increased disclosure to investors;
- Allow for amortization cost accounting for funds that are exempt from FNAV provided the MMF each day calculates its mark-to-market share price using basis point rounding and publicly discloses it; and
- Allow for sufficient time to finalize guidance, address operational issues and educate end investors.

* * * * *

We thank the Commission for its thoughtful and thorough consideration that led to the Proposed Rule and for giving us the opportunity to address many of the critical questions raised by our clients regarding the future regulation of MMFs. We welcome the opportunity to further discuss with you the observations and recommendations contained in this letter.

Sincerely,

Barbara Novick

Barbara G. Novick
Vice Chairman

Richard K. Hoerner, CFA
Managing Director
Head of Global Cash Management

cc:
The Honorable Mary Jo White
Chairman
Securities and Exchange Commission

The Honorable Luis A. Aguilar
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The Honorable Daniel M. Gallagher
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