AMERICAN BENEFITS COUNCIL

September 16, 2013

Submitted electronically at www.sec.gov/rules/proposed.shtml

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

Re: Request for Comments on Money Market Reform, File No. S7-03-13

Dear Ms. Murphy:

The American Benefits Council (the "Council") appreciates this opportunity to comment on the Securities and Exchange Commission's (the "Commission's") proposed reforms to the regulations affecting money market funds. The changes that the Commission has proposed could have adverse effects on Americans' preparedness for retirement, and we write to ensure that the Commission does not move forward without fully considering these effects.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Commission's core proposal is two alternative reforms: (1) prohibit "institutional" money market funds, other than those primarily invested in government securities, from using a stable net asset value ("NAV") or (2) requiring a money market fund to impose a liquidity fee and/or redemption gate, when the fund's liquidity falls below a particular level. Because employers that sponsor defined contribution and defined benefit plans and the participants covered under these plans value money market funds for precisely the attributes the reforms will undermine – a stable value while providing liquidity – the Council does not support these reforms. If the

Commission nonetheless decides to move forward, we strongly recommend the following:

- If the Commission imposes a floating NAV on "institutional" prime money market funds, it should provide that all tax-advantaged defined contribution plans are treated as "retail" investors. As we explain below, these plans are so unlikely to trigger the kind of redemptions that concern the Commission that the cost of recordkeeping at the participant level far outweighs any marginal benefits.

- The Commission should not impose *both* a floating NAV requirement and a liquidity fee (or gate) requirement.

- The Commission's cost-benefit analysis must address the variety of special rules and considerations that apply to retirement plans and the limits, based on those rules, on the ability of retirement plans to switch to other investments to meet their investment needs.

MONEY MARKET FUNDS' IMPORTANT ROLE IN RETIREMENT PLANS

Sponsors of defined contribution and defined benefit plans, such as 401(k) and pension plans, use money market funds in a number of important ways. In particular, sponsors use these funds because they seek to maintain a stable NAV while providing liquidity. Americans saving for their retirement through these plans at work, in turn, value these funds for their stability, low volatility, and diversified, low-cost access to commercial paper, government securities, and other money market instruments. Money market funds fit well into the legal and regulatory structure established by the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").

Defined benefit pension plans use money market funds for their stable pricing and full liquidity. A plan fiduciary, to comply with ERISA, must manage the plan's assets consistent with the purposes and needs of the plan, which typically means some portion of the plan's trust must be available for short-term cash needs. Pension plans have ongoing and critical liquidity needs. Each month they send benefit checks to retirees and hold funds in a liquid form for investment purposes. Holding those assets in more volatile, less liquid investments would introduce additional uncertainty for defined benefit plans, and would make investment planning and plan funding strategy less predictable. In a defined benefit plan, plan sponsors are ultimately responsible for ensuring that sufficient assets are available to pay plan benefits when due under the terms of the plan.

Department of Labor ("DOL") regulations require participant-directed defined contribution plans that want to satisfy section 404(c) of ERISA to make available investments with a range of risk/reward characteristics. Under these regulations, the plan must offer a low risk investment. Money market funds serve this role in many plans—surveys of plan sponsors suggest more than half of plans include them in their investment menus. While most 401(k) savers focus their savings in long-term investments like equities, money market funds play important diversification and capital preservation roles, particularly as a worker nears retirement and prepares to withdraw money from the plan. According to Investment Company Institute data, as of the end of third quarter 2012, Americans held $369 billion in money market funds through 401(k) and similar defined contribution plans and IRAs. Therefore, regulatory action that would hinder the ability of plans to use these funds could have unintended consequences on many Americans' retirement savings.

Both defined contribution and defined benefit plans use money market accounts to ease administration, as well. For example, plans with vesting schedules generally hold forfeitures in a forfeiture account, often invested in a money market fund. Internal Revenue Service guidance requires these forfeiture accounts to be used fully for plan expenses or plan benefits, or allocated to individual accounts of participants. In addition, a money market fund may be the plan's "sweep" investment, holding participant contributions temporarily until they can be invested based on participants' asset allocations.

Money market investments are also often used to provide liquidity in unitized funds. For example, a plan offering investments in employer securities may unitize that investment to ease transactions between those investments and mutual fund investments, where investment transactions settle at different times. The money market component in a unitized fund allows for daily processing of transactions. Holding a portion of a unitized fund in money market investments can also ease volatility in unitized funds due to investment and redemption requests.

While our comments focus on retirement plan issues and thus do not directly address the policy issues and administrative burdens other aspects of the proposed reforms present, we are nonetheless concerned about the total cost of the alternatives the Commission is considering. For example, even though retirement plans are tax-deferred vehicles, service providers will have to adjust their systems to make daily tax basis calculations for other investors, and these costs could well be passed on to all investors, including plans. Accordingly, we urge you to reconsider your current cost estimates in light of the comments you are receiving from financial intermediaries. The discussions our members have had with their service providers suggest that the costs were significantly underestimated in the narrative accompanying the proposed reforms.

"RETAIL" EXEMPTION SHOULD BE AVAILABLE TO ALL TAX-ADVANTAGED DEFINED CONTRIBUTION PLANS

The Commission's floating NAV alternative proposal includes two very important exemptions. First, any money market fund invested primarily in government securities would be exempt. Second, any money market fund that does not permit any shareholder of record to redeem more than $1,000,000 on any one business day would be exempt from the requirement to float its NAV.[1] This is called the "retail" exemption because it is intended to restrict investment to those individual retail shareholders that are unlikely to make large redemptions in response to market stress. The proposal includes a rule that a money market fund may permit a shareholder of record to redeem more than $1,000,000 on a business day if the shareholder of record is an omnibus account holder and the fund has policies and procedures designed to allow the conclusion that no "beneficial owner" of the fund shares will redeem more than $1,000,000 in any day.

We read the proposal to mean that in a defined contribution plan like a 401(k), 403(b), or 457(b) plan, the individual participant with an account would be considered the beneficial owner. Thus, under the proposal, a defined contribution plan could invest in a "retail" prime money market fund so long as the plan restricted redemptions on behalf of each participant to no more than $1,000,000 on any business day. If the plan fiduciary decided to eliminate the money market fund from the plan menu, all of the plan's shares could be redeemed in one day so long as no single participant had more than $1,000,000 held in his or her account in the money market fund.[2]

If the Commission decides to move forward with the floating NAV alternative, we recommend that the Commission *exempt all accounts held under tax-advantaged savings vehicles*. At a minimum this should include 401(k) and similar defined contribution plans, 403(b) plans, and 457(b) plans that allow participants to direct the investment of their account. But such an exemption could also include other defined contribution plans, individual retirement accounts, and tax-qualified defined benefit plans.

Exempting all participants in defined contribution and similar plans is consistent with the purpose of the "retail" exemption. While it is theoretically possible a particular participant could hold more than $1,000,000 in a money market fund and could seek to redeem more than $1,000,000 in a single day, in practice this is very unlikely:

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[1] Technically, the "exemption" for retail funds is the ability to continue to use penny rounding for these funds.

[2] We would note that plan fiduciaries do not remove an investment from a plan menu without significant consideration. ERISA imposes strict duties of care and prudence on fiduciaries in making decisions about a plan menu.

- All tax-advantaged retirement plans are subject to strict contribution limits that prevent them from accumulating excess contributions.[3]

- Participants in these plans generally do not allocate their savings to a single asset class; while a money market fund might represent part of the account, most participants take the importance of diversification of asset classes seriously. In fact, only 4% of 401(k) plan assets are held in money market funds.[4]

- Retirement savers in these plans are among the most stable of all investors in the financial markets. They are long term savers that make investment changes infrequently.[5]

If plans, and their service providers, were required to administer and monitor a $1,000,000 threshold, the plan would incur significant costs, not unlike the massive programming, systems changes, and disclosure required when the Commission implemented redemption fees under Rule 22c-2. And these costs would be to no one's benefit, as these plans pose very little risk of runs during market stress. These costs ultimately are borne by Americans saving for retirement, reducing retirement preparedness.

If the Commission decides not to exempt retirement plans and retains the $1,000,000 redemption threshold or some similar test for a "retail" shareholder, we urge the Commission to make crystal clear in the final regulation that the individual participant in a participant-directed retirement plan is considered the relevant account holder, and that the rule will not restrict plan fiduciaries from eliminating a money market fund from the plan menu if they must do so consistent with their fiduciary obligations. The proposal uses the term "beneficial owner," in reference to shares held by omnibus account holders, but the term is not defined. The preamble discussion seems to confirm our analysis, but this is simply too important of a point on which not to have complete clarity.

THE COMMISSION SHOULD *NOT* ADOPT BOTH ALTERNATIVES

The Commission suggests that it is considering adopting both a floating NAV and a requirement to impose liquidity fees and gates, and combining the proposals. We

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3 For example, a tax-qualified 401(k) plan is limited under sections 402(g) and 415(c) of the Internal Revenue Code to a maximum annual employee contribution of $17,500 and an annual total contribution of $51,000 (in 2013).

4 *See* Jack VanDerhei, Sarah Holden, Luis Alonso, and Steven Bass. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2011," EBRI Issue Brief, no. 380, and ICI Research Perspective 18, no. 9 (December 2012).

5 *See* Vanguard, "How America Saves 2012" at 68-72 (June 2012).

believe either proposal could have particularly difficult effects on defined benefit plans that use these funds to meet cash liquidity needs, but in combination these alternatives would remove both features of money market funds most valued by retirement plan sponsors—liquidity and price stability.

As stated earlier, money market funds are used by defined benefit plans for stable cash management, so that the plan can hold contributions awaiting investment and process monthly benefit checks to the thousands of retirees relying on the plan for their income. As the Commission itself admits, if the Commission were to combine the two alternatives, the fund may no longer be "suitable as a cash management tool."[6]

THE COMMISSION SHOULD CONSIDER THE IMPLICATIONS ON RETIREMENT PLANS

The Commission's cost/benefit analysis does not take into account the special rules and considerations that apply to retirement plans. These must be considered before implementing any of the reforms contemplated by the Commission. We describe some of these considerations below.

Continuing to Use Money Market Funds: Retirement plans governed by ERISA are managed by fiduciaries that owe strict duties to the plans and their participants. If the proposed reforms were implemented, plan fiduciaries, like all investors, would need to reevaluate whether a money market fund continues to be prudent to use or offer to participants in light of the role the fund plays in the overall portfolio of the plan. Some defined benefit plan fiduciaries may exit money market funds because they no longer meet the plan's needs for ready liquidity. Some fiduciaries of participant-directed plans may decide that a money market fund no longer is appropriate to offer on the plan's menu because the fund no longer meets participants' desire for a stable value product. All money market fund investors would need to decide whether to exit the product; what is unique about plan fiduciaries is that ERISA imposes strict duties of care and prudence in making these decisions.[7]

Retirement plans may be restricted in moving to alternative investments in ways that other investors are not. For example, section 403(b) plans — which are used by educational institutions and non-profits — may only invest in annuity contracts or registered mutual funds. While some institutional investors could move their commercial paper investing off-shore, ERISA plans are limited in their ability to invest assets outside the United States because ERISA requires that the indicia of ownership of all plan assets be maintained in the United States.[8]

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[6] 78 Fed. Reg. 36,834, 36,902.

[7] *See* ERISA § 404(a); 29 C.F.R. § 2550.404a-1.

[8] *See* ERISA § 404(b).

Requirement to Diversify: ERISA fiduciaries are required to diversify the assets of a plan so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so.[9] This is relevant for a plan fiduciary who must maintain large amounts of cash for plan purposes. By using a money market mutual fund, the fiduciary is able to diversify the plan's commercial paper investment at low cost. In a bank account, the plan is subject to a single institution's risk, and FDIC insurance is too limited to provide protection against the bank failure.

Deadlines Imposed By Law: Retirement plans operate under a variety of rules that require events to occur by a particular deadline. It is precisely for this reason that money market funds are effective holding investments. Here are a few examples. The Code requires that distributions under plans begin no later than an individual's required beginning date.[10] Failure to pay minimum distributions by the deadline disqualifies a plan and results in an excise tax to the individual.[11] Similarly, the Code imposes limits on contributions that may be made to defined contribution plans, and Treasury regulations generally require that plans return excess contributions by April 15 of the year following the year the excess contribution was made.[12] If the terms of a plan require that a distribution be made by a deadline, the plan administrator must comply with that deadline. Failure to comply could be viewed as a breach of ERISA's requirement that a fiduciary follow the terms of the plan as well as a failure to operate the plan in accordance with its terms, a violation of which jeopardizes the tax-qualified status of the plan.[13] Reforms that significantly impact a plan's ability to redeem its investment or delay that redemption could cause operational problems where a plan must meet a fixed deadline.

We recognize that the liquidity fees and gates alternative proposal is designed so that it would not be imposed under normal market conditions, which limits the risk associated with investing in a money market fund when a deadline may need to be met. On other hand, we do not have enough certainty at this time about *how frequently* these restrictions might apply to be unconcerned.

Use as a Default Investment: It is possible that the floating NAV proposal, if implemented, would make a money market fund ineligible to serve as a qualified default investment alternative ("QDIA"). Section 404(c)(5) of ERISA provides that a participant may be treated as having exercised control over his or her account even if

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9 *See* ERISA § 404(a)(1)(C).

10 *See* Code §§ 401(a)(9), 403(b)(1), and 457(d)(2).

11 *See* Code § 4974.

12 Treas. Reg. § 1.402(g)-1(e)(2).

13 *See* ERISA § 404(a)(1)(D); *see also* Rev. Proc. 2013-12, 2013-4 I.R.B. 316 (treating a failure to operate a plan in accordance with plan terms as a qualification failure).

the participant is defaulted into the investment, if the participant's account is invested in accordance with regulations prescribed by DOL.[14] Under current rules, a money market fund may qualify as a temporary QDIA for up to 120 days.[15] (After that point, the participant must be invested in one of three other types of investments). The advantage of using a money market fund as a temporary QDIA is that a participant, who by definition did not affirmatively elect the investment, is not at risk of significant losses. A fund can be a temporary QDIA only if it is a product that is "designed to preserve principal and provide a reasonable rate of return" and "[s]eeks to maintain, over the term of the investment, the dollar value that is equal to the amount invested."[16]

If money market funds were required to use a floating NAV, it does not appear that the fund would continue to meet this requirement. DOL either would need to amend the regulation or issue guidance that interprets the regulation to mean that a floating NAV money market fund qualifies as a temporary QDIA.[17]

Further, the regulations provide that an investment may not qualify as a QDIA if it imposes fees, like redemption fees, or withdrawal restrictions, in connection with a decision to sell the investment during the 90-day period beginning when the participant is first invested in the investment.[18] Because the liquidity fee, if implemented, could subject a participant to a restriction or fee based on a participant's decision to sell a money market fund, money market funds may be at risk of being ineligible to qualify as QDIAs.[19]

Other Rules Contemplating Money Market Fund Use: Because money market funds are viewed as stable and liquid investments, DOL has often written into its rules and exemptions criteria that contemplate the use of money market funds as holding investments. In some circumstances, retirement assets must be moved because of mandatory rollover requirements or because a plan has been abandoned. Certain safe harbor regulations and prohibited transaction class exemptions effectively require that funds be placed in an investment that seeks to maintain the dollar value that is equal to the amount invested, generally is liquid and does not impose "substantial restrictions" on redemptions.[20] If the proposed recommendation imposing a floating NAV is

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[14] *See* 29 C.F.R. § 2550.404c-5 (setting forth the requirements for an investment to be treated as a QDIA).

[15] *See* 29 C.F.R. § 2550.404c-5(e)(4)(iv).

[16] *See id.*

[17] Plan fiduciaries may still feel uncomfortable using a floating NAV fund as a temporary QDIA because of the possibility that the participant will experience losses prior to deciding to make an affirmative election to another investment or make a withdrawal.

[18] *See* 29 C.F.R. § 2550.404c-5(c)(5)(ii).

[19] The Commission's liquidity fees and gates proposal is preferable, however, to a requirement suggested by the Financial Stability Oversight Commission to impose redemption gates at all times.

[20] *See* 29 C.F.R. § 2550.404a-2; PTE 2004-16, 69 Fed. Reg. 57,964 (Sept. 28, 2004); PTE 2006-06, 73 Fed. Reg. 58,629 (Oct. 7, 2008).

implemented, it appears that money market funds may not continue to meet these safe harbors or exemptions because the fund may no longer be viewed as seeking to maintain a value equal to the amount invested. Further, any proposed recommendation that imposes a restriction on liquidity could be viewed as placing a substantial restriction on a participant's access to the fund assets.

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While we share the goal of ensuring that the regulation of money market funds adequately protects plans and other investors, we are concerned about changes that would remove those features of money market funds most valued by retirement savers—liquidity and stability. These changes should not be implemented without careful consideration of its effect on Americans saving for retirement; for this reason, and the others expressed above, we recommend all retirement plans have access to any "retail" exemption that might be available. We very much appreciate your consideration of our views.

Sincerely,

Lynn D. Dudley

Lynn D. Dudley
Senior Vice President
Retirement and International Benefits Policy