Northern Trust Corporation
50 South La Salle Street
Chicago, Illinois 60675
(312) 630-6000

Northern Trust

September 16, 2013

VIA ELECTRONIC MAIL to: ***rule-comments@sec.gov***

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

RE: MONEY MARKET FUND REFORM; AMENDMENTS TO FORM PF, SECURITIES ACT RELEASE NO. 9408 [File No. S7-03-13], 78 FEDERAL REGISTER 36,834 (June 19, 2013) (The "Proposing Release")

Dear Ms. Murphy:

Northern Trust Corporation ("Northern Trust") is pleased to submit these comments to the Securities and Exchange Commission (the "Commission) on its proposal referenced above (the "Proposed Rule") to modify the regulatory framework applicable to money market mutual funds ("MMMFs") that are regulated under Rule 2a-7 of the Investment Company Act ("2a-7").

Northern Trust is a leading provider of asset servicing, fund administration, asset management, fiduciary, and banking solutions for corporations, institutions, families, and individuals worldwide. As of June 30, 2013, Northern Trust had assets under administration and custody of $5.0 trillion and assets under management of $803 billion.

Northern Trust is a significant sponsor of MMMFs. As of June 30, 2013, Northern Trust is sponsor of thirteen registered 2a-7 MMMFs, with over $77 billion under management. Of these, five registered 2a-7 MMMFs with $41 billion under management are government funds within the definition contained in the Proposal; five MMMFs, with $22 billion under management, would be considered to be prime institutional and tax-exempt funds; and three MMMFs, with $14 billion under management, are prime and tax-exempt funds for retail clients. Within this total, Northern Trust manages four tax-exempt funds with $11.9 billion under management. All of these funds operate on the basis of a stable net asset value ("NAV").[1]

[1] In 2012 Northern Trust registered four floating NAV money market funds, with the initial share price of $1.00, consisting of a Variable NAV Money Market, Variable NAV AMT-Free Municipal Money Market, Variable NAV Government Money Market, and Variable NAV Treasury Money Market. As of this date

The Commission has correctly acknowledged that the combination of principal stability, liquidity, and yield have made MMMFs extremely useful to both retail and institutional investors. Our clients use MMMFs for a variety of purposes, ranging from overnight "sweeps" of available cash for short-term yield, to pools of readily available cash to meet payroll or investment needs, to longer-term strategic allocations of excess cash. It is vitally important that any additional regulatory requirements adequately consider the essential priorities of both retail and institutional investors to have ready access to MMMF investments to meet their various cash needs. Moreover, to be effective we believe additional regulation should be reasonably designed to meet three fundamental objectives:

(1) Lower systemic risk by reducing the risk of a "run" on funds, but without unnecessarily increasing the cost or complexity of operating MMMFs for investors and sponsors;

(2) Preserve investor choice and increase transparency for investors; and

(3) Maintain MMMFs as a key source of liquidity for investors to meet short-term cash investment needs in a low-risk diversified manner, and preserve MMMFs as an important source of short-term financing for high-quality corporate and tax-exempt issuers of securities.

General Comments on the Proposal

We commend the Commission for its thoughtful consideration of the need for further regulation after the 2010 reforms. We agree with the Commission that moving to a floating NAV will likely reduce the "run" risk, but will not eliminate it. In connection with the Proposal, Northern Trust has surveyed many of our retail and institutional clients about various aspects of the Proposal and the potential impact of alternatives in the Proposal on investor behavior. We have also conducted our own analysis of both the Proposal and developments in the MMMF markets since the 2008 financial crisis. Based on comments from clients and our own analysis, we offer the following general observations on the potential impact of the Proposed Rule on investors, MMMF sponsors and managers, and on the financial markets.

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these floating NAV funds have not been launched or marketed to investors. At the time of filing of the registration statement, Northern Trust had not fully evaluated the attractiveness or viability of a floating NAV fund for retail or institutional investors. See, Proposing Release at fn. 297

A. **Retail investors are likely to move cash away from any MMMFs that do not provide very high assurance of full liquidity and preservation of principal.** Among our "retail" clients, over 90% advised us that the main benefits of using registered MMMFs are liquidity and preservation of principal. Over 60% surveyed agreed that the 2008 financial crisis demonstrated the need for higher daily available cash balances, and over 80% now view MMMF investments as more of a risk management tool than as a yield-based investment. If MMMFs were required to convert to a floating NAV, approximately one-third of our clients would continue to use MMMFs at current levels, but two-thirds would move cash out of a floating NAV fund to either stable NAV government funds or to bank deposits.

   Retail clients are also concerned about the imposition of a daily "gate", or limitation, on their ability to obtain funds at any time. Over 70% of clients surveyed indicated that any daily restriction on liquidity would cause them to decrease or stop use of MMMFs, and would lead them to move cash either to stable NAV funds without these restrictions or to bank deposits. Of the two alternatives (floating NAV or stable NAV with liquidity fee and gate), a slight majority would prefer the floating NAV with no liquidity fees or gates. However, retail investors have negative reactions to both alternatives. Moreover, if a combination of both alternatives were adopted, a large majority of both retail and institutional clients would move cash out any funds with these restrictions.

B. **Institutional investors are focused on safety and liquidity.** We have engaged with a small sample of our institutional clients on the proposed rule changes. Those clients place a high value on liquidity and safety, and have expressed concern about changes that would restrict access to their holdings. Many of our institutional clients have indicated that if either a floating NAV, or fees and gating restrictions, were adopted, they would likely move cash to a government or other fund that is not subject to such restrictions.

C. **The current low interest rate environment will present challenges to making either alternative attractive to investors.** As a global custodian, Northern Trust's retail and institutional clients tend to have large cash balances related to their investment activities. These balances are typically part of a "sweep" arrangement in which we have standing instructions to sweep cash on a daily basis into MMMFs. A large number of investors that currently invest in MMMFs will not be willing to invest in any MMMF that either has a floating NAV or that has liquidity fees or daily gates on redemptions. Moreover, as indicated later in our comment letter, a floating

NAV feature will likely not be suitable or operationally practical for daily sweep arrangements.

In part, the current very low interest rates make it impossible to offer clients a sufficiently higher yield for taking the increased risk involved with either alternative. Moreover, it is questionable whether many sponsors will invest in the technology required to make floating NAV MMMFs available for daily sweep arrangements without the ability to earn higher fees. Investor attitude may change over time if there is greater yield differential that encourages them to take on somewhat higher risk. However, we believe that the need for liquidity and preservation of principal will remain key elements that will inhibit use of MMMFs with either alternative.

As a result, we believe that, in the short term, adoption of either alternative will increase volatility in the cash markets. Many investors will move cash to stable value government funds or to bank deposits. We see at least three challenges created by this expected redirection of cash that should be fully considered by the Commission. First, a decrease in cash invested in prime institutional and tax-exempt funds will have an adverse impact on short-term commercial paper financing for high quality corporate and tax-exempt issuers. Second, significant cash movements to stable value government funds will make it more important to provide an exemption for tax-exempt funds in order to provide sufficient alternatives for investors that require full liquidity at stable prices. Third, large cash movements to bank deposits will challenge the capacity of the banking system to absorb large increases in deposits, and in a low interest rate environment a large percentage of additional deposits will be placed with the Federal Reserve. Unless the Basel III leverage ratio is changed to exempt deposits placed with the Federal Reserve, banks will either be incented to redeploy increased deposits into higher risk assets, or will face negative yield caused by the difference between a 3%, or in some cases a 6%, leverage ratio and the .25% interest earned on Federal Reserve funds.

Summary of Specific Comments

Northern Trust offers the following specific comments on the Proposal:

- Of the three alternatives proposed by the Commission, we believe a floating NAV structure for prime institutional MMMFs is the most viable structural change and will conform the structure of these funds to other mutual funds. However, this alternative will <u>only</u> be attractive to investors if the following steps are taken <u>before</u> implementation: (i) financial reporting and accounting guidance confirms that investments in a floating NAV MMMF will qualify as "cash and cash equivalents"; (ii) rules for tax treatment and tax reporting are adopted that are not unduly complex or burdensome for investors or fund service providers; and (iii) guidance is provided on operational issues that will enable floating NAV MMMFs to be made available to investors without excessive cost.

- If the floating NAV alternative is not viable because the issues referenced above are not resolved, we would favor alternative 2: liquidity fees and redemption gates under stressed circumstances. However, the default liquidity fee should be reduced to 1%.

- A combination of floating NAV with liquidity fees and redemption gates is the least satisfactory alternative and is significantly worse than the status quo. If a combination of these alternatives were adopted, we believe the viability of MMMFs as an investment choice for retail and institutional investors will be seriously undermined, with the result that investor cash will move to permitted stable value funds, bank deposits and other alternatives.

- An exception to the floating NAV requirement should be provided for tax-exempt MMMFs. Tax-exempt funds do not present significant systemic risk and did not experience runoffs during the financial crisis. They are a useful short-term investment choice for retail and some institutional investors, and failure to permit municipal funds to retain a stable NAV will unnecessarily limit investor choice and will damage the municipal financing market.

- We support an exception from the floating NAV requirement for retail MMMFs, but the proposed daily limit of $1 million for investor redemptions is insufficient to meet the occasionally higher cash requirements for many retail investors. We recommend an increase to at least $3 million, and preferably to $5 million. We further recommend that retail investors have the ability to withdraw higher amounts with advanced notice. Alternatively, we recommend that the Commission consider other criteria for identifying retail investors, such as by social security number or similar identifying criteria, in order to avoid an arbitrary withdrawal gate that many investors will find unacceptable.

A. Alternative 1: Floating Net Asset Value

This alternative would require institutional prime funds (other than government and retail funds) to adopt a floating net asset value ("NAV"), rounded to the fourth decimal point.

Northern Trust believes a floating NAV for prime institutional funds is operationally feasible and is our preferred alternative, subject to our comments below. However, a floating NAV will introduce significant accounting, tax and operational complexities to MMMFs and require solutions before the rule becomes final and the conformance period begins, in order for a floating NAV MMMF to be acceptable to investors and reasonably affordable for sponsors.

1. **Accounting issues.** Under current accounting guidance, many investors classify MMMF investments as "cash and cash equivalents". We appreciate that the Commission has acknowledged the importance of these accounting and financial reporting issues and is working to resolve them. In order for a floating NAV MMMF to be attractive to investors at least two accounting issues need to be resolved. First, it is necessary to confirm that the floating NAV does not change the conclusion that the MMMF is "convertible to known amounts of cash". Second, it must be confirmed that the possibility of a redemption restriction will not change the conclusion that the MMMF is "readily convertible to cash".

2. **Tax issues.** The floating NAV proposal raises several complex tax issues that must be resolved. As currently proposed, sponsors will be required to build systems to track and report the cost basis for every transaction in the fund. In view of the high volume of transactions in MMMFs this requirement will impose significant new costs. On the other hand, the likely fluctuation in NAV will be extremely limited; substantial record-keeping and reporting will be required for very little, if any, revenue for state and federal tax authorities. In fact, in times of stress, NAVs would likely float lower, resulting in small tax losses for redeeming investors.

   In view of the very high cost of systems enhancements to track gains and losses for very little, if any, revenue benefit, we recommend that the Commission work with the Internal Revenue Service ("IRS") to provide an exemption from the requirement to track and report gains and losses related to floating MMMFs or, alternatively, to aggregate and report gains and losses over longer periods of time (e.g. quarterly). We note that, although the IRS has proposed a limited exemption from the "wash sale" rules for floating MMMFs, this proposal does not go nearly far enough to alleviate the compliance and reporting costs for sponsors and investors.

   Due to the complexity of the tax issues and the need for sponsors to implement significant systems enhancements, we further recommend that the Commission should not issue a final rule for MMMFs until the IRS has confirmed the tax treatment and reporting requirements that will be imposed.

3. **Operational issues.** The floating NAV introduces several operational complexities to MMMFs that need to be resolved. As the Commission has recognized, many investors have provided standing instructions to "sweep" available cash on a daily basis into a MMMF. As a global custodian, many of our retail and institutional clients custody assets with us and provide standing instructions to sweep available cash on a daily basis into MMMFs. Under the current stable NAV and amortized cost paradigm, the operational issues are relatively straightforward and permit a high degree of flexibility as to when funds received during the day are swept into the MMMF and when they are available to the investor. A floating NAV will introduce a higher degree of complexity and risk for sponsors and investors.

   Sponsors will most likely have to establish an earlier "cut-off time" for same-day settlement. We believe it will be difficult for sponsors to establish a cut-off time later than 1:00-2:00 P.M. (and many sponsors will likely set an earlier cut-off time). Once cash is swept into the MMMF prior to the cut-off time it will not be available to the investor until the next business day. Funds received after the cut-off time will likely stay on the sponsor's balance sheet until the next business day.
   If, on the same day but after the cut-off time, the investor requires cash that has been swept into the MMMF to be transferred to a third party to settle a transaction, amounts invested in the MMMF will be unavailable and the investor's only recourse to prevent the transaction from "failing" will be to obtain cash from other sources or to borrow the money from a bank. As a result, investors are likely to keep higher amounts of cash in bank deposits; the circumstances in which an investor may have to borrow money from banks to settle transactions will increase; and there will likely be an increase in disputes between investors and sponsors as to whether MMMF share purchases and sales were completed on time. The timing complexities are increased by the proposed requirements to use market valuations for assets with 60-day maturity or longer and to round the NAV daily to the nearest basis point.

   In the current very low interest rate environment, the cost of the necessary systems and technology enhancements to operate a floating NAV MMMF is likely to significantly outweigh the financial returns to sponsors of such funds. Moreover, investors will see little if any increased yield from the additional risk of a floating NAV fund, compared with a stable government fund or bank deposit. As a result, it will not be surprising if many sponsors simply do not offer a floating NAV MMMF, or offer it with restrictions on investment amounts, or without "sweep" functionality. As interest rates increase, the expected higher yield for a floating NAV MMMF may begin to attract new cash, but the extent to which cash will flow back to floating NAV funds is highly speculative.

4. **The conformance period should be extended beyond 2 years to give sponsors sufficient time to implement major systems upgrades to comply with a final rule.** Northern Trust believes the proposed 2-year implementation period for floating NAV MMMFs is the minimum period that will be necessary to implement technology enhancements to accommodate these new requirements. We recommend a longer period of 3 years for implementation, and the possibility of an extension if tax and accounting issues have not been resolved when a final rule is issued.

5. **The exemption from the floating NAV requirement for government MMMFs should also include MMMFs that invest principally in tax-exempt securities.** The chart below[2] shows the composition of MMMF industry assets from 2008 to present, broken down by tax-exempt, government and non-government securities. The chart demonstrates two things. First, the tax-exempt market is small (approximately 10%) in relation to all MMMFs and does not present significant systemic risk. Second, during the 2008 financial crisis, municipal MMMFs did not experience runoffs, unlike prime institutional funds; in fact, they continued to be a safe haven for investors. The volatility of municipal MMMF portfolio assets also has been very stable. Accordingly, the rationale that has led the Commission to propose a floating NAV for prime institutional MMMFs does not exist for municipal MMMFs. They should be accorded the same treatment as government MMMFs. They should be able to retain a stable value and should not be subjected to liquidity fees and redemption gates.

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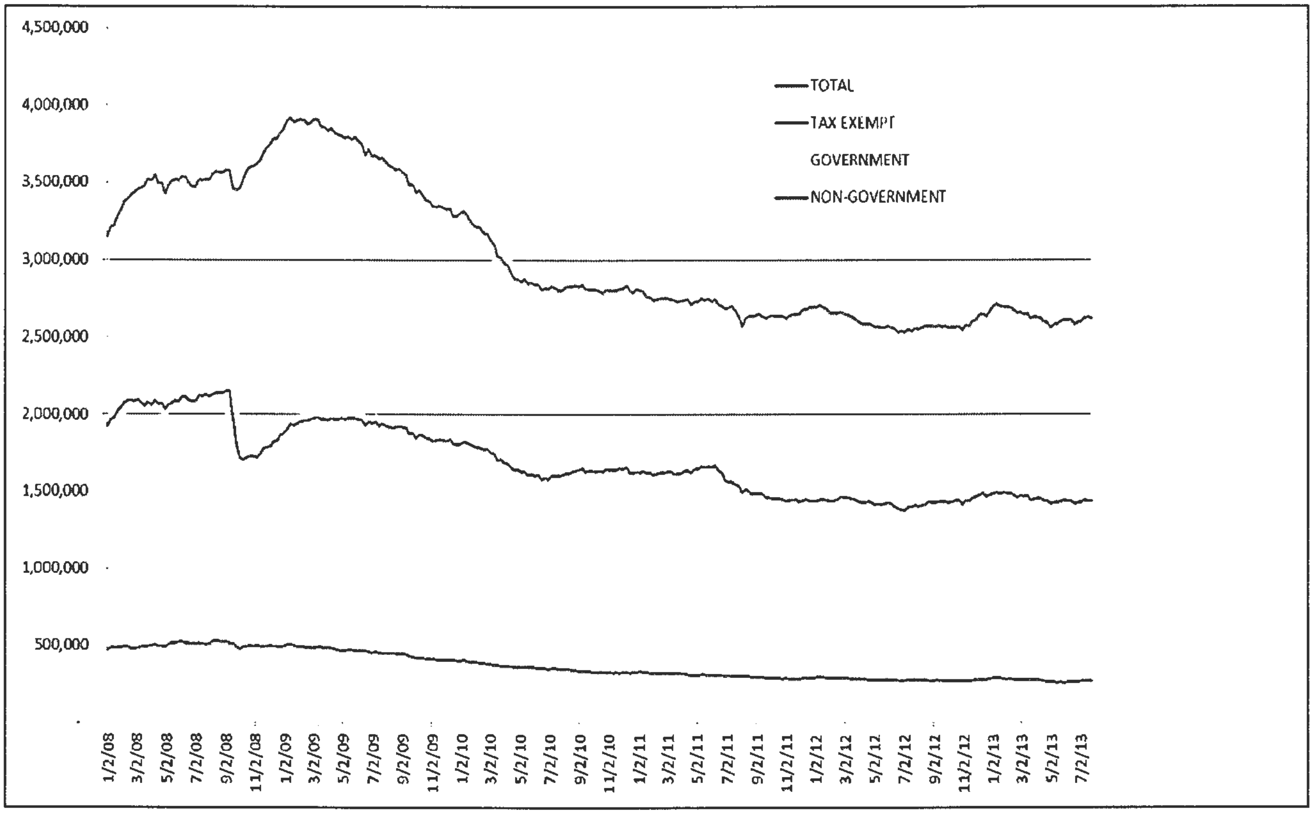
[2] Source: Historical MMMF data obtained from the Investment Company Institute website



6. **The exemption from the floating NAV requirement for retail MMMFs is unnecessarily restrictive.** The daily limit of $1 million for retail investors to redeem assets in the fund is too restrictive and will significantly decrease the attractiveness of those funds for retail investors, and could unnecessarily increase liquidity risks for investors and financial markets. In order to test the impact of a daily "gate", Northern Trust analyzed retail client investments in MMMFs for the month of July. We found that retail accounts with balances of over $1 million made up approximately 70% of total retail investments in our MMMFs. If the daily balance were increased to $3 million, the percentage falls to about 57% and further reduces to about 50% for balances of over $5 million. In terms of number of accounts, if the daily limit were increased from $1 million to $3 million, the number of accounts affected falls by about 70%, and if the limit were increased to $5 million the number of accounts affected falls by about 85%.

We believe it is clear that a daily limit of $1 million on withdrawals will impose unnecessary liquidity risks on retail investors and will increase risks that settlement of securities transactions and other large transactions conducted by retail investors will fail. We suggest that the daily redemption gate of $1 million be increased to at least $3 million, and preferably to $5 million, in order to accommodate larger transactions for retail investors. In addition, we recommend that investors be permitted to withdraw larger amounts for any reason with advanced notice of at least 3 business days. Alternatively, we recommend that the Commission consider other criteria for identifying retail investors, such as by social security number and similar criteria. In this way retail investors could be pre-cleared for a retail fund, the operational issues for both fund sponsors and omnibus accounts would be simplified, and investors would not face the risk of failed transactions caused by an arbitrary withdrawal gate. Finally, liquidity fees and gates should not apply to retail MMMFs.

B. Alternative 2: Standby Liquidity Fees and Gates

This alternative would permit a MMMF to retain a stable share price and continue with penny rounding, but if weekly liquid assets fall below 15% of total assets (1) the MMMF must impose a liquidity fee of 2% on redemptions, unless the fund board determines the fee is not in the best interests of the fund; and (2) the fund board may impose a temporary suspension of redemptions for up to 30 days if it determines gating is in the best interests of the fund.

Northern Trust believes that a liquidity fee and/or a redemption restriction may be effective in preventing a run on the fund in times of stress. We believe the trigger for the liquidity fee and redemption gate if weekly liquidity falls to 15% is reasonable and will demonstrate that these restrictions will not be imposed except in stressed circumstances. However, we believe a default liquidity fee of 2% is excessively high. We recommend that the default liquidity fee be reduced to 1%, but the fund board should be permitted to impose a higher or lower fee if it determines, consistent with the "business judgment rule", that the higher or lower fee is in the best interests of the fund.

If this alternative is adopted, we believe the proposed 1 year period for implementation is insufficient for sponsors to make required systems changes in view of the tax, accounting and operational issues that will have to be addressed. We therefore recommend a longer implementation period of 2 years.

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C. Alternative 3: Combination of alternative 1 and alternative 2

This alternative proposes to combine a floating NAV with the potential for liquidity fees and redemption restrictions.

Northern Trust does not support this alternative and we believe it is significantly worse than the status quo. We believe the combination of these alternatives is unduly punitive on fund investors, will be very costly to implement, and will result in most investors moving their cash investments to bank deposits or other stable non-punitive investment alternatives. Moreover, there has been no determination that this combination of requirements is reasonably necessary to prevent potential runs on MMMFs.

Northern Trust appreciates the opportunity to submit comments on the Proposed Rule to the Commission. Should you have any questions, please contact the undersigned.

Sincerely,

James Roselle

James E. Roselle
EVP, Associate General Counsel
The Northern Trust Company