Occupy the SEC

www.occupythesec.org

September 16, 2013

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

RE: Securities and Exchange Commission Proposed Rule Regarding Money Market Mutual Fund Reform (S7-03-13)

Dear Commissioners:

Occupy the SEC[1] is pleased that the Securities and Exchange Commission (the "Commission") is taking up the challenge of addressing the systemic vulnerabilities created by the present structure of money market funds ("MMF"), and welcomes the opportunity to respond to your proposed regulations (S7-03-13) in this area.

We are also pleased to see that several of the recommendations that we made in our February 2013 letter[2] to the Financial Stability Oversight Council ("FSOC") were referenced in the Commission's Proposed Rule, as we remain convinced that the proposals and comments incorporated in that letter represent the optimal way forward for this crucial process.

With that in mind, we would like to examine the Commission's proposal through the lens of the categories we used in that letter.

I. Universal Measures: Addressing Loopholes from the 2010 Reform

As we noted in our letter to the FSOC, an over-emphasis on various treatments of fund NAVs threatens to obscure equally (if not more) important features of underlying fund portfolios. Left unaddressed, these features would continue to act as sources of vulnerability for all funds, regardless of NAV type. We are heartened by the Commission's focus on tightening the rules in some key areas, though we believe the proposals do not go far enough in others.

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[1] Occupy the SEC (www.occupythesec.org) is a working group within the New York-based Occupy Wall Street ("OWS") protest movement. This letter represents the opinion of the group's members, and does not represent the viewpoints of OWS as a whole.

[2] Comment Letter of Occupy the SEC (February 15, 2013) (available in File No. FSOC-2012-003).

A. Concentration of Risk

The potential for over-concentration of risk exposures in MMF portfolios is particularly acute due to the concentration of the MMF industry itself. Because of this, the Commission's proposal to limit aggregate exposure to issuers across related holding companies to 5% is a welcome change, and aligns with part of our prior proposal. We also strongly support the Commission's proposal of treating sponsors of asset-backed securities (ABS) as providers of credit support, which would render them subject to the standard 10% diversification limit for exposure to any single provider, across all categories of support. Finally, we urge the Commission to follow through with its proposal to eliminate the "25% basket."

While we believe that the 5/10 diversification structure we initially proposed to the FSOC would be optimal, the combination of potential measures put forward by the Commission – if enacted – would go a long way toward addressing the problem of over-concentration at the individual fund and (by extension) industry levels.

B. Misleading Pricing

The Commission's proposal to eliminate amortized pricing for all funds – regardless of NAV type – is long overdue. While the maintenance of basis point (or two-digit) pricing for "stable" NAV funds would lessen the impact of this change in most circumstances, the posting of daily market-based prices on fund company websites would be a strong improvement over current practices.

Unfortunately, the Commission has proposed to avoid taking the steps necessary to make those market prices meaningful. As we noted in our February letter, the exemption of securities with maturities of less than 60 days from market pricing would make mockery of the notion of a fully market-based NAV given the fact that such securities comprise over three-quarters of MMF portfolio holdings in the aggregate.

The Commission appears to address this concern in its proposal by noting that the exemption is based in a 1977 Valuation Release.[3] In its explanation of the terms of the Release, the Commission argues that the exemption it provides is not automatic, but rather only allows fund boards to use amortized pricing "unless the particular circumstances warrant otherwise."

We believe this is a distinction without a difference. The Release in reality leaves the decision of whether to use market or amortized pricing entirely to the "good faith" of the boards, while giving no guidance as to what "particular circumstances" would warrant a shift to market pricing. This is especially meaningless given the ultra-short tenor of the securities held in MMF portfolios, which necessitates a high level of market transactions that virtually no fund board would be able to oversee on a daily basis.

Given the above, we applaud the Commission for proposing to require all funds to release daily market pricing, but also hold to our position that the 1977 Release exemption should not be extended to rule 2a-7 funds.

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[3] 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 FR 28999 (June 7, 1977)].

C. Enhanced Liquidity

The Commission's decision not to move forward with the FSOC's recommendation of increasing daily and weekly liquidity levels to 20% and 40%, respectively, is disappointing. Without such an increase, the potential for redemptions to trigger fire-sales of liquid and later illiquid assets (and, in turn, to hurt shareholders who stay invested) would remain an unwelcome possibility.

D. Discretion and Uncertainty

We objected strongly to the level of discretion afforded to MMF boards in our prior letter, particularly around the secretive provision of support in times of portfolio stress, and remain opposed to it. Our opposition is rooted in two observations. The first is that allowing fund boards to support funds without disclosing that fact to existing and potential shareholders effectively blinds those investors to important information about the fund. The Commission's proposal to mandate disclosure of such events (if enacted) would address these concerns.

While welcome, such measures would leave our second concern unaddressed. Even if disclosed *ex post*, the potential for unannounced support by fund boards in the future would encourage the misapprehension by shareholders and their advisors that no fund company would allow their MMF to "break the buck." This expectation works against market discipline, and creates perverse incentives for shareholders to allocate their scarce time and attention to what they perceive to be riskier investments.

As a result, we recommend that the Commission eliminate the discretion allowed by rule 17a-9.

E. Lack of Disclosure

The Commission's proposal includes disclosure measures that surpass both the FSOC's terms as well as our own earlier recommendations. We strongly urge the Commission to follow through with its proposed measures, including:

- Daily posting of market-based pricing on fund company websites
- Rapid posting of events of board support for fund portfolios on fund company websites, as well as 10 years of historical data on similar events
- Daily posting of daily and weekly liquidity levels in fund portfolios, as well as six months of historical data, on fund company websites
- Monthly posting of portfolio holdings, with more useful detail, on fund company websites

II. Fund Structures: FNAV vs. Liquidity Fees and Gates

The Commission's proposals for various fund structures are addressed below.

A. Floating NAV

Our initial proposal to the FSOC was to foster a more complete market for MMF by allowing fund companies to offer both floating and buffered NAV funds. This recommendation was grounded in a recognition of the impossibility of reconciling the competing objectives of enhanced yield and capital stability within a single investment vehicle. Offering two fund types would allow investors to selfsort into the type of vehicle that best reflected their objectives, while also addressing many of the bad incentives embedded in current "stable" NAV funds.

In that light, the Commission's proposal to move to four-digit pricing for prime institutional and municipal MMFs is only a partial solution. It is a step in the right direction in terms of giving institutional and wealthy individual investors the ability to sort into funds with a range of risk profiles. It also focuses on the area of the MMF marketplace that was the source of the greatest instability in 2008 and 2011.

That said, there are several factors that make this an inadequate approach when taken in isolation. First, there is no way of knowing that prime institutional funds will be the only source of systemic risk in future, since we by definition do not know the nature of the next financial crisis. Second, this approach only allows for risk differentiation in the institutional market. Retail investors should also be provided with a similar range of choices. On a related note, the Commission's definition of a "retail" fund as one that allows investors to withdraw up to $1 million in assets per day is woefully out of line with our understanding of "retail." Finally, we were disappointed to see that the Commission chose not to move forward with the idea of capital buffers, as we believe these to be a necessary condition for any notion of a "stable" NAV that is resilient to market dislocations.

Our response to the Commission's proposal is intended to address these shortcomings, and includes two alternatives:

> 1. If the Commission is intent on moving ahead with a combination of floating prime and "stable" government MMFs, then the rational approach would be to make all prime funds – both institutional and retail – have floating NAVs. This would align the credit and liquidity risk inherent in prime MMF portfolios with the transparency of investment risk promoted by a four-digit NAV that reflects those risks on a daily basis. It would also remove the question of what constitutes a retail vs. an institutional investor.
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> However, in our view, this would only be workable to the extent that allegedly "stable" NAV funds were forced to adopt buffers to support that stability so that they provided true risk differentiation from floating, prime MMFs. Any alternative approach would promote the idea of differentiation without much of its substance.
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> 2. If the Commission is unwilling to consider a capital buffer for stable NAV funds, then all MMFs should be transitioned to a four-digit, market-based NAV on a daily basis. This would address the problems inherent in the current NAV structure while also freeing fund companies from the need to provide the level of ongoing capital support necessary to align the reality of the investment risk inherent in MMF portfolios with the perception of their stability. This approach would have the added virtue of simplifying the regulatory framework for rule 2a-7, which threatens to become overly complex.

B. Liquidity Fees and Gates

We remain categorically opposed to liquidity fees and gates. As we noted in our prior letter, the imposition of such measures would provide powerful incentives for investors to flee at the first sign of potential trouble, worsening the first-mover advantage embedded in the current "stable" NAV structure. If such a run forced a fund manager to sell securities rapidly, the resulting potential losses would be born by those who did not redeem, even as the very same shareholders would also be potentially penalized for protecting their capital. The Commission's proposal also does not distinguish between funds that reach 15% weekly liquidity due to a market dislocation, and those that reach that state through mismanagement. It would appear that fund shareholders would be penalized in both cases. This combination of bad incentives, inequity and likely inadequacy in the face of market dislocations should lead to the removal of liquidity fees and gates from serious consideration by the Commission.

It is also worth noting that the Commission's Proposed Rule justifies this approach by emphasizing the need to foster capital formation, which implies that such formation is no longer the role of the market, but rather the implicit responsibility of savers. However, capital formation is absolutely not the responsibility of savers -- nor are they the ones who should bear all the liquidity risk in times of market stress.

III. Conclusion

Five years ago the Money Market industry suffered a severe crisis caused by a multitude of factors. Inadequate and feckless regulation was indubitably one of these factors. The Commission is to be commended for now taking positive steps to fill this regulatory lacuna with prudential regulations that have the potential to preserve market stability and investor confidence. We urge the Commission to consider our proposals as it completes the rulemaking process.

Sincerely,

Anchard Scott
Josh Snodgrass
Akshat Tewary
et al

Via Internet Submission