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September 17, 2013

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

Re: Comments on Proposed Money Market Fund Rules (File No. S-7-03-13)

Dear Ms. Murphy:

We are writing to offer our comments on the Securities and Exchange Commission's proposed rules relating to money market fund reform. The undersigned have many years of collective experience advising sponsors, advisers and trustees of money market funds. We witnessed first-hand the tumultuous days that followed the failure of Lehman Brothers on September 15, 2008. During that period we advised many of our clients in connection with their efforts to deal with the unprecedented conditions in the financial markets, including the particular challenges faced by money market funds. Our comments represent our personal views only and do not necessarily represent the views of others at this firm or the views of our clients.

As indicated below, we are not taking a position on the fundamental question of whether regulatory change is warranted at this time for money market funds. However, we are offering a number of suggestions that we believe may be helpful to the Commission in the event it determines that change is necessary. Finally, we defer to industry commentators on the many questions posed by the Commission regarding the operational practicality and costs of its various proposed changes.

1. **The lack of clear evidence regarding the reasons for money market fund redemptions during this period or their effect on the financial crisis warrant a cautious approach to new regulation.** The apparent premise for this regulatory initiative is FSOC's conclusion that the current fixed NAV method of operating money funds presents an unacceptable systemic risk to the financial system. This conclusion is based on the unproven assertion that redemptions in prime institutional money market funds following the failure of Lehman were driven primarily by the fear that funds would "break the buck" as opposed to (i) a flight to quality in the face of possible failures of financial institutions and (ii) a need to access liquidity to meet pressing obligations, such as collateral calls.

The November 30, 2012 report prepared by the Commission's Division of Risk, Strategy and Financial Innovation in response to questions posed by Commissioners Aguilar, Paredes and

Gallagher indicated that during the month that followed the Lehman failure, prime money market fund assets fell by $498 billion while government money market fund assets increased by $409 billion. The bulk of this activity was focused in institutional funds. The report stated: "Many potential explanations exist for the money market flows during this period. Since the explanations are not mutually exclusive, it is not possible to attribute shareholders' redemptions and purchases to any single explanation." The report identifies various possible explanations, including a flight to quality and a flight to liquidity, which strike us as highly plausible explanations in the circumstances. The report also notes that the "structural design of money market funds may have accelerated investor redemptions in September 2008," presumably referring to the so-called "first mover effect" discussed in earlier FSOC and Commission proposals. Nowhere is it suggested that this effect was a predominant or even a major cause of the institutional fund flows that occurred during the early days of the crisis. The report portrays retail money market fund flows as largely insignificant during this same period.

We defer to the Commission's judgment on the question of whether changes in the current regulatory structure for money market funds are warranted at this time. However, In light of the limited evidentiary support for the proposition that the fixed-NAV structure permitted by Rule 2a-7 played any meaningful role in the financial crisis, we urge the Commission to proceed cautiously and in a measured way as it considers possible structural changes in a highly successful financial product that has brought great benefits to consumers for almost four decades.

2. **In the event that certain institutional funds are forced to adopt to a floating NAV structure, there is no justifiable basis for imposing additional regulatory burdens on such funds.** If certain funds (i.e., institutional prime money market funds) are forced to adopt floating NAV's, thereby addressing the core of FSOC's concern, there is little basis for imposing excessive regulatory burdens on such funds simply because they choose to label themselves "money market", "cash" or "liquid," as opposed to "ultra-short" or some similar label. Apart from the use of such labels, such funds would be operating in a manner identical to any other type ofmutual fund. In particular, it would make no sense to require such funds to continue to be operated in conformity with the same investment restrictions that apply to fixed-NAV funds. Indeed, allowing such funds greater investment flexibility would result in a yield differential that might induce retail investors to shift investments to floating-NAV funds, thereby further reducing the systemic risk presented by fixed-NAV retail funds. Finally, there is no justification for imposing mandatory liquidity fees and/or redemption gates on floating-NAV funds. Why should mutual funds investing in the most liquid types of assets be forced to live with these requirements, when other types of funds are not?

3. **If floating-NAV money market funds are seen as a potential solution to possible systemic risks, the IRS should be urged to reduce the tax burdens associated with such a structure.** The Commission could help preserve some of the advantages of fixed-NAV funds and make

floating-NAV funds more attractive to investors by offering strong encouragement to the IRS to permit gain/loss reporting on a net annual basis for floating-NAV money market funds. If the purpose of these rule changes is to reduce systemic risk to the financial system, all federal agencies should be contributing what they can, consistent with their respective congressional mandates, to develop effective solutions that will not impose unnecessary burdens on investors.

4. **If the Commission determines to impose liquidity fees or redemption gates, it should be mindful of the rights of existing shareholders under state law.** In imposing requirements for liquidity fees and/or redemption gates, the Commission needs to be mindful that the right of redemption inherent in mutual fund shares is not created by the Investment Company Act of 1940 Act, but rather is an inherent right of shareholders created under state law. Thus, depending on the form of organization, not all money market funds currently in existence necessarily have the corporate power and authority to impose such requirements in response to Commission regulatory action. Some funds may need to seek individual or collective shareholder approval permitting the reorganization of existing shares into new vehicles.

5. **If the Commission determines to impose liquidity fees, it should not apply a rigid 2% limit on the amount of such fees.** In a financial crisis of the type experienced following the Lehman failure, a 2% liquidity fee may not be sufficient to offset transaction costs incurred in "fire sale" prices. For example, one money fund manager reported at the time that the best bid available for Citigroup commercial paper maturing in 10 days was at 90. Other managers reported that bids for any kind of paper were quickly falling to "fire sale" ranges for quantities of any meaningful size. The Commission should abandon its historical presumption that redemption fees in excess of 2% are inherently incompatible with the concept of "redeemability." Maintaining a 2% cap on liquidity fees in the manner proposed by the Commission would make it more likely that money market funds would be forced to suspend redemptions in a financial crisis, resulting in a complete loss of liquidity for shareholders.

6. **The Commission should avoid imposing unrealistic requirements for board action.** The Commission should be realistic in its views of the contributions that can be made by mutual fund boards in times of financial crisis. While boards can be consulted and can monitor developments, they cannot be expected to make on the spot decisions regarding the imposition of redemption fees. There are real practical limits in terms of the time required to assemble board quorums and provide boards the information required for effective decision-making. As a practical matter, determinations with respect to liquidity fees and redemption gates may require considerable delegation to advisers in times of crisis. Thus, at the least, we believe that any rule changes imposing new requirements for board determinations or approvals should be accompanied commentary recognizing that the primary role of the board is oversight and acknowledging both the ability and practical necessity of delegating day-to-day decision-making functions to a fund's officers and investment adviser/administrator pursuant to procedures approved by the board.

7. **The Commission should consider the possibility of allowing liquidity fees to be determined after the fact in light of actual transaction costs.** Rather than forcing all funds to establish liquidity fees at fixed levels in advance of possible redemptions, all in anticipation of some possible future financial crisis, the SEC should consider the possible merits of allowing an alternative regime whereby redemption payments can be delayed for up to seven days (consistent with current Section 22(e) of the Investment Company Act of 1949) while the appropriate amount of a liquidity fee is determined based on actual transaction costs incurred in connection with each day's redemptions. We believe that such an approach would be consistent with existing law and that fund boards should have the flexibility to adopt procedures for implementing such an approach as an alternative to implementing a pre-determined, fixed liquidity fee during periods of financial stress.

8. **Requiring advance notice of redemptions does not provide an effective alternative to liquidity fees.** Requiring advance notice of redemptions is problematic since converting assets to cash in advance of redemptions has potentially dilutive effects on remaining shareholders.

9. **The Commission should consider the possibility of eliminating penny rounding in lieu of eliminating amortized cost.** Eliminating the use of "amortized cost" by fixed-NAV money market funds, as proposed by the Commission, may have the disadvantage of lumping realized losses (representing a permanent impairment of capital) with unrealized gains/losses, which may never be realized if instruments are held to maturity. The better approach might be to permit only "amortized cost" and eliminate "penny rounding" (i.e., by requiring money market funds to calculate their share value to a sufficient number of decimal places). This would force money market funds to address permanent impairments of capital on a current basis, rather than rolling such impairments forward indefinitely. Why should a fund be allowed to sell or buy shares at a $1.00 price that are worth only $0.997 on an amortized cost basis?

We hope that the Commission and its Staff will find these comments helpful in the comment process. We would be glad to discuss any of our comments with members of the Staff at their convenience.

Very truly yours,

John W. Gerstmayr
Bryan Chegwidden