INVESTMENT COMPANY INSTITUTE

COMMENT LETTER OF THE INVESTMENT COMPANY INSTITUTE

TO THE

SECURITIES AND EXCHANGE COMMISSION

MONEY MARKET FUND REFORM;
AMENDMENTS TO FORM PF

(File No. S7-03-13)

September 17, 2013

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September 17, 2013

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

Re: Money Market Fund Reform; Amendments to Form PF (File No. S7-03-13)

Dear Ms. Murphy:

The Investment Company Institute ("ICI")[1] appreciates the opportunity to respond to the Securities and Exchange Commission's request for comment regarding proposed amendments to rules under the Investment Company Act of 1940 and related requirements that govern money market funds.[2] Today, over 61 million retail investors, as well as corporations, municipalities, and other institutional investors, rely on the $2.6 trillion money market fund industry as a low-cost, efficient cash management tool that provides a high degree of liquidity, stability of principal value, and a market-based yield. Money market funds also serve as an important source of direct financing for state and local governments, businesses, and financial institutions, and of indirect financing for households. Without these funds, financing for all of these institutions and individuals would be more expensive and less efficient. As such, ICI and its members remain firmly committed to working with the SEC to strengthen the money market fund industry for the benefit and further protection of investors.

I. Introduction and Executive Summary

Money market funds owe their success, in large part, to the stringent regulatory requirements to which they are subject under the federal securities laws, including most notably Rule 2a-7 under the

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $15.4 trillion and serve more than 90 million shareholders.

[2] *See Money Market Fund Reform; Amendments to Form PF*, SEC Release No. IC-30551 (June 5, 2013), 78 FR 36834 (June 19. 2013) ("Release"), available at http://www.sec.gov/rules/proposed/2013/33-9408.pdf. Page references in this letter are to the version of the Release on the SEC's website.

Investment Company Act. The regulatory regime established by Rule 2a-7 has proven to be effective in protecting investors' interests and maintaining their confidence in money market funds. The SEC deserves tremendous credit for crafting these requirements and administering them in a manner that has allowed money market funds to thrive and to serve so many investors for over 40 years. Indeed, it is the SEC's deep and extensive experience that best positions it to consider and implement any further reforms to money market funds.

In recognition of the importance of money market funds to investors and the economy, ICI and its members have devoted significant time and effort to considering how to make these funds more robust under even the most adverse market conditions—such as those caused by the widespread failures of banks and other financial institutions in 2007 and 2008. Since 2008, the SEC, ICI, and ICI's members have made a great deal of progress toward a shared goal of strengthening the resiliency of money market funds.[3] Taking the initiative to respond quickly and aggressively to the events of fall 2008, ICI formed the Money Market Working Group ("MMWG") to study the money market, money market funds and other participants in the money market, and recent market circumstances. The March 2009 *Report of the Money Market Working Group* ("MMWG Report") addressed these topics and advanced wide-ranging recommendations for the SEC to strengthen money market fund regulation.[4]

In 2010, with ICI's strong support, the SEC approved far-reaching rule amendments that incorporated many of the MMWG Report's recommendations and enhanced an already strict regime of money market fund regulation.[5] These reforms proved their value in 2011 when money market funds—without incident—met large volumes of shareholder redemptions during periods of significant market turmoil, including a credit event involving the historic downgrade of U.S. government debt. Indeed, so far-reaching were these reforms that today's money market fund industry is dramatically different from that of 2008. The SEC staff studied these reforms and their findings generally support our views as to the reforms' efficacy.[6] Yet, calls for further reform continue.

For our part, ICI has consistently supported exploring reasonable options to make money market funds even more resilient while preserving the fundamental characteristics of these funds that are critical to investors. While we continue to believe that the reforms already adopted by the SEC are

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[3] For a detailed overview of these efforts, see *Perspectives on Money Market Mutual Fund Reforms*, written testimony of Paul Schott Stevens, President and CEO, Investment Company Institute, before the U.S. Senate Committee on Banking, Housing and Urban Affairs (June 21, 2012) ("2012 Senate Testimony"), available at http://www.ici.org/pdf/12_senate_pss_mmf_written.pdf, at 11-14.

[4] *See* Investment Company Institute, *Report of the Money Market Working Group* (March 17, 2009), available at http://www.ici.org/pdf/ppr_09_mmwg.pdf.

[5] *See Money Market Fund Reform*, SEC Release No. IC-29132 (February 23, 2010), 75 FR 10060 (March 4, 2010) ("2010 Money Market Fund Reform Adopting Release").

[6] *See* SEC Division of Risk, Strategy and Financial Innovation, *Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher* (November 30, 2012) ("SEC Staff Study"), available at http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf.

sufficient, we understand that regulators do not all share that view. We therefore remain committed to working with the SEC on this important issue, but we submit that this process should be guided by two principles. First, we should preserve to the greatest extent possible those key features of money market funds that have made them so valuable and attractive to investors.[7] Second, we should preserve choice for investors by ensuring a continued robust and competitive global money market fund industry.

With these goals in mind, we are particularly pleased to see that the SEC has decided not to pursue proposals that would require money market funds or their advisers to maintain capital against fund losses (also known as NAV buffers) and/or implement a "minimum balance at risk." These concepts are deeply flawed. The likeliest impact of a NAV buffer requirement would be to impel money market fund sponsors to exit the business, thus depriving investors, issuers, and the economy of the benefits these funds provide. Indeed, the SEC itself acknowledged in the Release that the significant ongoing costs associated with a NAV buffer would directly affect money market fund sponsors or investors and indirectly harm capital formation. The minimum balance at risk also has a number of serious drawbacks. Not only would it constantly restrict some portion of an investor's holdings without regard to the fund's circumstances at the time of redemption, but also it would impose significant operational costs on fund complexes, intermediaries, and service providers. Citing these concerns, the SEC notes that a "[minimum balance at risk] coupled with a NAV buffer would turn money market funds into a more complex instrument whose valuation may become more difficult for investors to understand."[8]

Instead, the SEC is considering two reform alternatives that it could adopt either alone or in combination: (i) require prime and tax-exempt institutional money market funds to "float" their net asset values ("floating NAV proposal"); or (ii) require all non-governmental money market funds to impose liquidity fees of up to 2 percent and to have the option to temporarily suspend redemptions (or "gate" the fund) upon the occurrence of specified events indicating that the fund may be under stress ("liquidity fee/temporary gate proposal").

In the course of our discussions of these proposals with ICI members, and members' discussions with fund shareholders, one thing became abundantly clear: shareholders continue to value strongly the stability of principal and ready liquidity provided by money market funds. When pressed to choose one or the other of the proposals put forth by the SEC, however, some investors placed more of a premium on principal stability, while others more heavily valued ready access to liquidity. To a great extent, these differing investor preferences reflect the circumstances and characteristics of the wide range of investors that our member firms serve. It is quite certain, therefore, that combining the SEC's two proposals

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[7] Indeed, the interest rate environment in which money market funds have operated for the past several years has proven to be an important test of investor demand for money market funds. Currently, yields on money market funds are on average about 100, 150, and 300 basis points below yields on ultra-short bond funds, short-duration bond funds, and longer-term bond funds, respectively. *See* Investment Company Institute; Morningstar; iMoneyNet. Yet, assets in money market funds are roughly $2.6 trillion, still *greater* than the assets held in money market funds prior to the start of the financial crisis in the summer of 2007.

[8] *See* Release, *supra* note 2, at 268.

would not meet the needs or preferences of either of these two camps and would devastate the industry, rendering money market funds entirely unattractive to investors.

The Release also includes a number of less fundamental, yet significant, reforms that would apply under either proposal. These include enhanced disclosure and reporting requirements; more stringent diversification requirements; enhanced stress testing; and improved private liquidity fund reporting.

In summary, our comments are as follows:

Application of Fundamental Structural Reforms to Government and Tax-Exempt Money Market Funds. The Release proposes to exempt government money market funds from further structural reform because, among other things, government money market funds are not susceptible to the risks of mass investor redemptions as other money market funds; their securities have low default risk and are highly liquid in even the most stressful market scenarios; and interest rate risk is generally mitigated because government funds typically hold assets that have short maturities and hold those assets to maturity. We agree with the SEC that no case can be made for applying fundamental changes to government money market funds. We strongly believe that such changes likewise should not apply to tax-exempt money market funds for similar reasons.

A fundamental restructuring of tax-exempt money market funds could compromise the critical source of short-term funding that these funds provide for state and local government entities across the United States. The SEC has produced no evidence that these funds are vulnerable to significant redemptions or otherwise pose systemic risk. Indeed, there is no evidence that investors in tax-exempt money market funds redeem *en masse* during periods of market stress. Moreover, in the unlikely event that tax-exempt money market funds did in fact face widespread redemptions, these funds hold the great majority of their assets in highly liquid securities that can be liquidated to meet redemptions. Additionally, because of these securities' structures, they are likely more immune to credit deterioration. Consequently, tax-exempt funds, like government funds, should be exempt from both the floating NAV proposal and the liquidity fee/temporary gate proposal (Section II).

Liquidity Fee/Temporary Gate Proposal. The SEC's liquidity fee/temporary gate proposal—*i.e.,* allowing money market funds to continue to transact at a stable share price under normal market conditions, but under certain circumstances when a fund may be stressed from a liquidity standpoint (i) requiring the fund to institute a liquidity fee designed to deter further redemptions and (ii) permitting the fund to temporarily suspend redemptions—has the support of many of our members because it promises to slow or stop significant fund outflows. These tools, together with enhanced disclosure, directly address regulators' concerns about redemption pressures on prime money market funds (Section III).

To make these tools even more useful to fund boards, we recommend that the SEC expand the circumstances under which a board may impose a liquidity fee or temporarily suspend redemptions to cover situations when heavy redemptions are already underway or are clearly foreseeable (Section III.A).

Notwithstanding the support for the liquidity fee/temporary gate proposal, it has potential drawbacks. It is unclear how many investors would use a money market fund with liquidity fees and gates given the explicit possibility of restricted liquidity; what impact this measure would have on certain transaction types; and what tax implications a liquidity fee might have for money market funds and their shareholders. There is no question that complex and costly system modifications by fund transfer agents and intermediaries would be necessary to handle liquidity fees and temporary gates (Section III.B). We anticipate that it may take at least three years to allow the industry to complete the operational and other changes necessary to successfully implement liquidity fees and temporary gates (Section III.C).

Floating NAV Proposal. The SEC's floating NAV proposal would require prime and tax-exempt institutional money market funds to let their NAVs float and to transact share purchases and redemptions at the portfolio's daily mark-to-market value. ICI has maintained consistently since 2009 that forcing funds to float their NAVs does not address the problem that most preoccupies many regulators—how to avert heavy redemptions from money market funds. It also is an inefficient way to educate investors that money market funds may lose value—it is extremely costly to fund complexes, to intermediaries, to investors, and to the economy as a whole. Effective disclosure of funds' portfolio holdings and other key characteristics, combined with daily disclosure of funds' mark-to-market share prices accomplish the same goal, without the potential for troubling disruptions to our economy and fundamentally altering the key features that investors value most (Sections IV.A and B).

Forcing money market funds to float their NAVs would impose significant burdens on funds and investors in the tax and accounting treatment of gains and losses. It also could result in the loss of same-day settlement—a service that is extremely important to institutional investors managing their daily cash. Moreover, the product would be unusable as a sweep vehicle. Without these benefits, widespread investor acceptance of a floating NAV money market fund product is unlikely. It is critical, therefore, that the changes necessary to alleviate these burdens be implemented *before* any floating NAV requirement takes effect (Section IV.C).

One clearly foreseeable impact of the floating NAV proposal is a reduction in capital market funding to the private sector. Requiring prime institutional money market funds to float their NAVs risks precipitating an outflow of hundreds of billions of dollars from prime money market funds to other products, including government money market funds. This could result in a major restructuring and reordering of intermediation in the short-term credit markets, and the transition is likely to be highly disruptive. Regulatory changes that push assets from money market funds toward other money market instruments and uninsured bank deposits would be disruptive to the capital markets and fail in the long-run to address the concerns the SEC has raised, such as promoting safer capital markets and reducing risks to the economy at large. It also is not clear that regulatory policies that further concentrate deposits in the largest banks reduce systemic risks (Section IV.D).

The SEC's proposal would require floating NAV money market funds to comply with a pricing standard that is 10 times more onerous than the standard articulated by long-standing SEC accounting guidance for all other floating NAV mutual funds. We question whether investors would buy and sponsors would offer such money market funds (Section IV.E).

If the SEC nevertheless determines, despite our longstanding concerns, to require funds to float their NAVs, we agree that the reach of that action should be reasonably tailored and that it is appropriate to exempt "retail" funds from the floating NAV requirement. Money market funds provide retail investors access to investments not otherwise affordable or accessible—such as commercial paper issued in minimum denominations beyond the reach of the average investor. Maintaining the availability of prime stable NAV money market funds for retail investors, therefore, is particularly important because these funds provide diversification and a market-based rate of return that is not otherwise available through a bank deposit account. (Indeed, these features are often important to certain institutional investors as well.)

We have significant concerns, however, that the SEC's proposal to define retail funds through a daily redemption limit would impair investor liquidity and be more onerous operationally than other methods. Instead, we recommend the use of a U.S. Social Security Administration ("SSA") issued social security number ("SSN") as the fundamental characteristic to identify an investor eligible to invest in a retail money market fund. Under this recommended approach, any account opened by a fund or intermediary that has captured an SSN as a (tax) identification component for the registered owner or beneficial owner of an account would qualify for investment in a stable NAV retail money market fund under the retail exception. This approach would capture a very large percentage of the retail investors who invest in money market funds directly. It also would include accounts whose underlying owners or beneficiaries have an SSN, such as those invested in tax-advantaged savings accounts, retail brokerage, and certain trust accounts that are held in the name of intermediaries on fund transfer agent records. Importantly, using SSNs would be far less costly to implement than other methods of defining retail funds, including the SEC's proposed daily redemption limit (Section IV.F).

We support retaining the exemptive rules that permit money market funds to engage in certain affiliated transactions subject to strict conditions (Rule 17a-9) and authorize money market fund boards of directors to suspend redemptions in narrow circumstances (Rule 22e-3). We explain why we believe Rule 17a-9 transactions are in the best interests of shareholders, whether a fund's NAV is stable or floating, and Rule 22e-3 provides needed flexibility for emergency situations when it would be difficult for the SEC to provide individual exemptive orders as quickly as a fund's board might need to react to protect shareholders' interests (Section IV.G).

Finally, we are concerned that the transition from stable to floating NAV could be destabilizing to the financial markets because it could require money market funds to potentially shed hundreds of billions of dollars of money market instruments as their investors redeem in favor of other products. We anticipate that it may take at least three years for funds and intermediaries to adapt to the new requirements of a floating NAV (Section IV.H).

Potential Combination of Floating NAV and Liquidity Fee/Temporary Gate Proposals. The Release suggests that the combination would provide a broader range of tools to a floating NAV money market fund to manage redemptions in a crisis, would further enhance the ability of money market funds to treat shareholders equitably, could allow better management of funds' portfolios in a crisis to minimize shareholder losses, and would provide fuller transparency of fund valuation and liquidity risk. *As noted above, we strongly oppose the combination of the two proposals.*

An investor simply would not purchase a fund that is saddled with the combination of a floating NAV, the prospect of having to pay a fee to redeem or of being prohibited from redeeming for some time, and the strict portfolio requirements imposed by Rule 2a-7 when other, less onerous, options are readily available. Instead, institutional investors would seek out other cash management investment alternatives that offer principal stability (*e.g*., government money market funds, investment products not registered under the Investment Company Act such as separate accounts or unregistered cash management pools, or bank deposits) or that have neither potential restrictions on redemptions nor the yield-limiting restrictions of Rule 2a-7 (*e.g*., all other mutual funds).

A combination of the floating NAV proposal and the liquidity fee/temporary gate proposal also would undermine the attractiveness of retail money market funds. Under the proposal, a money market fund would be exempt from the floating NAV proposal if it does not permit a shareholder to redeem more than $1 million per day. It is simply overkill to add additional structural reforms to a fund that already meaningfully restricts the daily liquidity available to investors.

From an operational standpoint, the combination of the two proposals would impose excessive costs and burdens on the money market fund industry and money market fund shareholders. Importantly, a combined approach would drive the greatest number of shareholders and fund sponsors away from money market funds (Section V).

Elimination of Amortized Cost Method of Valuation for All Funds. We do not support the SEC's proposal that would require stable NAV money market funds under either the floating NAV or liquidity fee/temporary gate proposal to use the penny rounding method rather than the amortized cost method of valuing securities. The amortized cost method facilitates the current same-day settlement process—a feature available for all types of money market funds, including government funds, that is vitally important to many investors (Section VI).

Enhanced Disclosure and Reporting. ICI consistently has supported efforts to increase the public disclosure of money market fund portfolio information and risks, and enhance the SEC's access to money market fund data. If the SEC requires money market fund NAVs to float, however, the proposed disclosure requirements would be unnecessary and we oppose them. Even the current level of money market fund disclosure and reporting—which is far more detailed and frequent than that for any other floating NAV funds—is unwarranted for money market funds that are required to float their NAVs.

Our support for further disclosure and reporting enhancements, therefore, turns on whether money market funds are permitted to maintain a stable NAV. We thus offer our overall support for enhancing the disclosure requirements for stable NAV money market funds. We do, however, have a number of comments, which are discussed in detail in Sections VII.A-E. We also caution the SEC that it may take at least 18 months for the industry to successfully complete the operational and other changes necessary to successfully implement the new disclosure requirements (Section VII.F).

More Stringent Diversification Requirements.

Issuer diversification. We support the SEC's proposal to require money market funds to aggregate affiliated issuers and count those issuers as one exposure. Limiting money market funds' exposure to affiliated entities appears to be consistent with the purposes of the Rule 2a-7 diversification requirements—to spread the risk of loss among a number of securities (Section VIII.A).

Asset-backed securities. We do not support the SEC's proposal to require money market funds (subject to an exception) to treat the sponsor of a special purpose entity issuing asset-backed securities as a guarantor of the securities subject to Rule 2a-7's diversification limitations applicable to guarantors and demand feature providers. Rule 2a-7 already counts toward a company's diversification limit any asset-backed security for which the company actually provides a guarantee or demand feature. The proposal would change this result by treating a sponsor of an asset-backed security as a guarantor of the entire amount of the security held by the money market fund, even if the sponsor's guarantee or demand feature is limited to a smaller amount or if the sponsor has no legal obligation to support its asset-backed security (Section VIII.B).

Credit Support Diversification (the 25 percent basket). We do not support the SEC's proposal to eliminate the so-called "25 percent basket," which currently allows up to 25 percent of the value of securities held in a money market fund's portfolio to be subject to guarantees or demand features from a single institution. Eliminating the basket would increase rather than decrease risk by increasing funds' reliance on less creditworthy credit support providers and unduly decrease the flexibility currently afforded funds (Section VIII.C).

More stringent investment diversification requirements. Due to unprecedented market conditions and consolidations since the financial crisis, the number of institutions issuing or providing guarantees or liquidity for eligible money market securities has dwindled. We are concerned that further restricting diversification limits may only heighten this problem by potentially forcing money market funds to invest in less creditworthy issuers, which could increase the risk within money market funds' portfolios, rather than decreasing it (Section VIII.D).

Revised Stress Testing. We do not support a dramatic overhaul of the current stress testing requirements. The SEC should consider the limitations of stress testing and of fund directors' capacity to review and interpret stress tests when reforming these provisions (Section X).

Amendments to Form PF Reporting Requirements. We believe that requiring large liquidity fund advisers to file virtually the same information with respect to their private liquidity funds' portfolios holdings on Form PF as money market funds are required to file on Form N-MFP would be more useful to regulators if advisers were required to file the form monthly rather than quarterly. Monthly filings would allow regulators more accurately to compare the information on Form PF with the monthly Form N-MFP filings that money market funds are required to file (Section XI).

II. Application of Fundamental Structural Reforms to Government and Tax-Exempt Money Market Funds

The SEC correctly acknowledges that no case exists for applying fundamental changes to government money market funds. Our research indicates that the characteristics of tax-exempt money market funds—their experiences in 2008 and the redemption behavior of their investors—likewise strongly support the conclusion that applying fundamental changes to them is not warranted.

A. Government Money Market Funds

Government money market funds have significantly different portfolios from other money market funds. Under the proposal, government money market funds are defined as those funds that invest at least 80 percent of their assets in cash, U.S. government obligations, or repurchase agreements collateralized with government securities. Although all money market funds must hold securities with minimal credit risk, credit losses would occur in government securities only if the U.S. government failed to repay its maturing debt in full or allowed a federal agency to default on its outstanding short-term debt—events we assume all regulators would agree are extremely unlikely and, were they to occur, would have market impacts far beyond money market funds.

Both Treasury and government agency markets are deep and liquid, accommodating significant trading volume. Among the primary dealers alone, daily trading volume in 2012 averaged around $225 billion a day for short-term U.S. Treasury securities and $380 billion a day for agency mortgage-backed securities and short-term agency securities.[9] Significant interest rate movements due to impairments in market liquidity, therefore, are highly unlikely. Furthermore, interest rate risk in money market funds is already highly constrained by Rule 2a-7. Given the short duration of money market fund portfolios, any interest rate movements have a modest and temporary effect on the value of the funds' portfolio securities.

Importantly, during periods of financial stress, government money market funds typically experience inflows, rather than outflows.[10] These funds' asset values also tend to appreciate, rather than depreciate, in times of stress. Indeed, the SEC Staff Study found that government funds received "abnormally large daily net inflow during the calendar week [September 15-19, 2008] of the crisis."[11] For all these reasons, we strongly concur with the SEC's conclusion that government money market funds should be exempt from further fundamental reform.

B. Tax-Exempt Money Market Funds

Absent clear evidence that tax-exempt money market funds are susceptible to substantial redemption pressure or pose some manner of systemic risk, the proposed reforms are inappropriate and

[9] Transactions by primary dealers of U.S. Treasury bills, U.S. Treasury securities due in three years or less, discount notes and coupon securities due in three years or less issued by federal agencies and government-sponsored enterprises, and mortgage-backed securities averaged over the year 2012 from Federal Reserve Bank of New York, Weekly Release of Primary Dealer Positions, Transactions, and Financing, Table I, available at http://www.newyorkfed.org/markets/statrel.html.

[10] Government money market funds experienced significant outflows in the weeks and days leading up to August, 2, 2011, reflecting investors' concerns about the failure of the federal government to raise the debt ceiling and the potential chance, however remote, that the federal government would default on its debt. These funds, however, had no difficulty meeting these redemptions.

[11] *See* SEC Staff Study, *supra* note 6, at 12.

unnecessary for these types of funds. Moreover, they potentially would compromise the critical role that these funds play in providing affordable short-term funding for state and local entities across the United States. Tax-exempt money market funds are the largest investors in short-term municipal debt, holding $252.7 billion as of June 30, 2013. This was almost two-thirds of state and local short-term debt (64 percent as of June 2013). Requiring tax-exempt money market funds to restructure themselves to accommodate a floating NAV could be highly disruptive to their investors and the short-term tax-exempt debt markets.

Voicing these concerns, a wide range of state and local government entities are among those who have argued that a floating NAV would destroy the convenience and simplicity of tax-exempt money market funds for investors, and compromise an important source of financing for many state and local governments.[12] Indeed, the United States Conference of Mayors recently unanimously adopted a resolution that expresses opposition to the floating NAV proposal, stating that "[f]orcing [money market funds] to float their value would likely eliminate the market for those products by forcing investors, including state and local governments, to divest their [money market fund] holdings as well as discourage others from using these funds."[13] Members of Congress also have shared their concerns regarding how new regulations on money market funds would impact municipalities' costs of borrowing.[14]

The Release seems to imply that a separate exemption for tax-exempt money market funds is not necessary because the SEC's proposed retail money market fund exemption in connection with the floating NAV proposal (discussed below in Section IV.F) likely would cover most tax-exempt money market funds. To the extent that the investor base in a particular tax-exempt money market fund primarily is retail, many of these individual investors may hold tax-exempt money market funds through intermediaries that are aggregated in omnibus accounts. If the SEC intended that these funds would qualify for the retail exception, it failed to take into account the costs and disruption to shareholders and intermediaries that would be involved with splitting existing funds and maintaining two separate "retail" and "institutional" funds. These costs include the initial expenses of identifying which investors are "retail," reorganizing the fund into two distinct funds, and the ongoing expenses and loss of economies of scale (all borne by shareholders) resulting from running two fund structures.

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[12] For examples of governments, government officials, and organizations that have voiced support for maintaining the stable NAV for tax-exempt money market funds, *see* http://www.preservemoneymarketfunds.org/what-others-are-saying/.

[13] *See* Letter from Scott Smith, Mayor of Mesa, President, The United States Conference of Mayors, to Mary Jo White, Chair, Securities and Exchange Commission (July 18, 2013), available at http://www.sec.gov/comments/s7-03-13/s70313-30.pdf.

[14] For example, during a House Committee on Financial Services hearing on the SEC's FY 2014 budget request, Representative Michael G. Fitzpatrick (R-PA) noted to SEC Chair Mary Jo White the importance of money market funds to municipalities. "[B]efore I came to Congress, I was a local elected official in Bucks County, [PA] . . .and a lot of local officials and state officials rely on money market funds as a source of sort of cash management. It's an important tool to have in the toolbox." *See Oversight of the SEC's Agenda, Operations, and FY 2014 Budget Request*, Hearing before the House Committee on Financial Services (May 16, 2013), available at
http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=333327.

More fundamentally, absent evidence that tax-exempt money market funds pose systemic risks or are subject to precipitous redemptions, there is no basis for the SEC to impose a retail-institutional split on these funds.

Importantly, tax-exempt money market funds do not have the characteristics about which the Release expresses concerns. The Release proposes to exempt government money market funds from further structural reform because, among other things: (i) "in light of the evidence of investor behavior during previous crises, it does not appear that government money market funds are as susceptible to the risks of mass investor redemptions as other money market funds"; (ii) their securities "have even a lower default risk than commercial paper and are highly liquid in even the most stressful market scenario"; (iii) "interest rate risk … is generally mitigated because [government funds] typically hold assets that have short maturities and hold those assets to maturity."[15] These same considerations apply to tax-exempt money market funds and the securities they hold.

1. *Tax-exempt Money Market Fund Investors Do Not Redeem Heavily During Market Events*

History indicates that investors in tax-exempt money market funds do not pose the risks of wide-spread redemptions that the Release discusses. This section reviews evidence from three cases: recent developments surrounding the City of Detroit, Michigan's 2013 bankruptcy, the financial crisis month of September 2008, and the default of Orange County, California in 1994.

a) Detroit's Bankruptcy

A recent and prominent example of how investors in tax-exempt money market funds react during periods of market stress is that of the recent bankruptcy of the City of Detroit. On June 14, 2013, Detroit announced a debt restructuring and a moratorium on principal and interest payments on the city's unsecured debt,[16] leading credit rating agencies to warn of the city's imminent default.[17] On July 18, 2013, Detroit filed for bankruptcy under Chapter 9. With potentially $18 billion in securities at risk, this was the largest municipal bankruptcy filing in history. By contrast, Jefferson County, Alabama, which filed for bankruptcy in 2011, had $4 billion in debt. Questions immediately arose as to how or whether these events might affect other municipalities in Michigan. Borrowing costs

[15] *See* Release, *supra* note 2, at 66.

[16] *See* Bernie Woodall and Steve Neavling, "Detroit Bankruptcy Possible, City Says It Will Stop Paying Some Debts To Bondholders," Reuters (June 16, 2013), available at http://www.huffingtonpost.com/2013/06/14/detroit-bankruptcy-city-debt-paying-bondholders_n_3442367.html.

[17] *See* Fitch Ratings, "Fitch Downgrades Detroit, MI COPs & ULTGO's to 'C'; Water & Sewer Rev Bnds on Rating Watch Negative" (June 14, 2013), available at http://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=793720.

immediately rose for other Michigan municipalities and a few of these municipalities were forced to postpone bond sales.[18]

Evidence indicates that investors in tax-exempt money market funds reacted calmly to Detroit's default. As of May 31, 2013, assets in tax-exempt money market funds totaled $257.2 billion. By July 31, 2013 (the most recent month for which ICI has monthly data), assets in tax-exempt funds had *risen* to $263.7 billion, an increase of $6.5 billion. More detailed data tell the same story. For example, daily changes in assets for national and state-specific tax-exempt money market funds show little visible reaction to events in Detroit (Figure 1). Figure 1 shows that assets in national and state-specific tax-exempt money market funds *increased* in the days immediately following Detroit's announcement on June 14 that it was suspending interest and principal payments on certain of its obligations.[19] Assets in these funds remained virtually unchanged in the days immediately after Detroit filed for bankruptcy on July 18. Indeed, changes in the assets of national and state-specific tax-exempt money market funds around these two dates are small compared to the modest seasonally-driven rise and fall of assets in these funds around month-ends.

Assets in Michigan-specific tax-exempt money market funds also show no cause for concern. Assets in these funds are so small, averaging only about $1.3 to $1.4 billion over this period, that daily changes show up in Figure 1 as almost a flat line. These funds experienced small outflows on July 18 and the three following business days, which totaled $38 million. These flows are very small, however, compared to the size of the money markets and are not particularly large even for Michigan-specific funds. For example, over the four business days April 17 to April 22, 2013, a period when tax-exempt money market funds often see outflows due to final payments on federal income taxes, outflows from Michigan-specific funds totaled $31 million.

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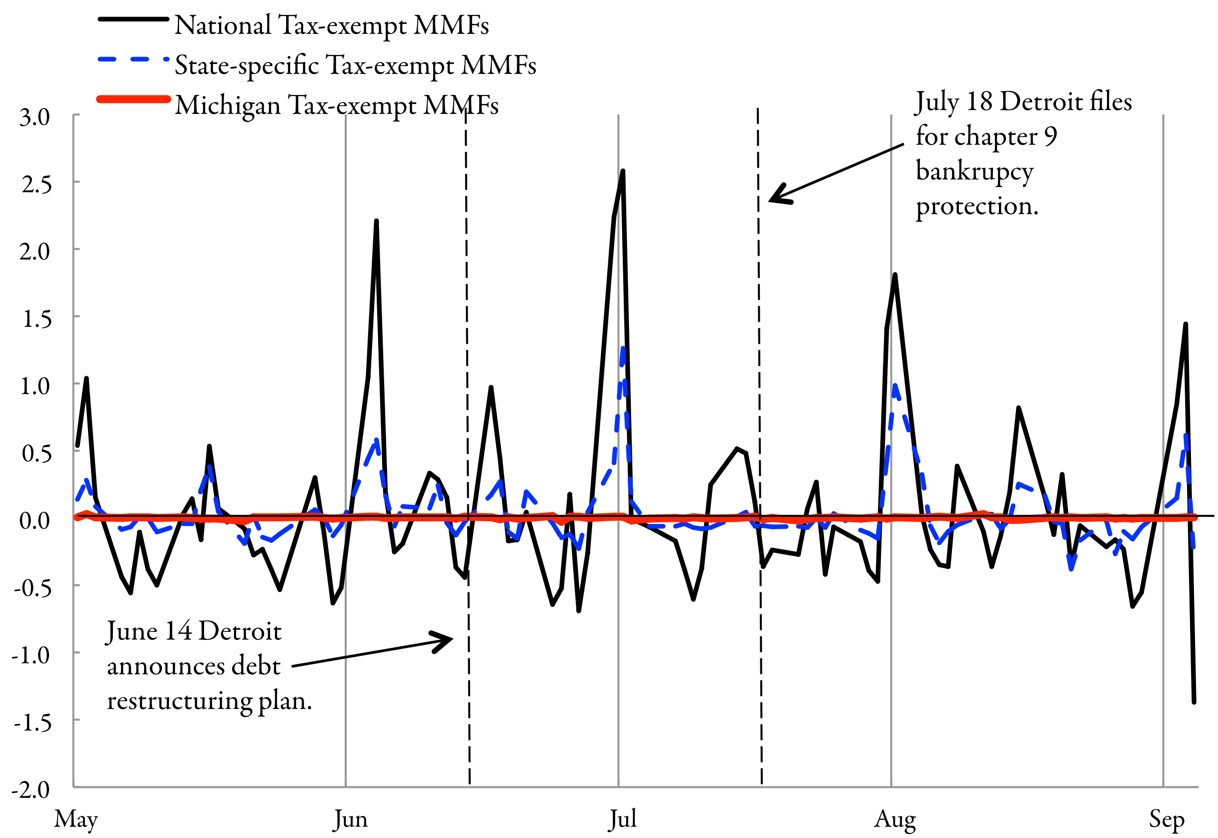
[18] See Mary Williams Walsh, "Woes of Detroit Hurt Borrowing by Its Neighbors," *Dealbook* (August 8, 2013), available at http://dealbook.nytimes.com/2013/08/08/detroit-blocks-other-cities-from-bond-market/?_r=1.

[19] Following the approach in the SEC Staff Study, *supra* note 6, we focus on dollar flows to measure the susceptibility of funds to risks of mass investor redemptions. *See* Release, *supra* note 2, at n. 175 (pointing to SEC Staff Study, *supra* note 6, at 12-13).

FIGURE 1

Changes in Assets of National, State-Specific, and Michigan Tax-exempt Money Market Funds
Billions of Dollars, daily data, May 1, 2013 to September 5, 2013



Source: Investment Company Institute tabulations of iMoneyNet daily data

The calm response of tax-exempt money market fund investors to events in Detroit is characteristic of how retail investors are generally perceived to respond to market stresses. It also may have reflected a feature of the tax-exempt debt market itself. Although municipalities within Michigan but outside of Detroit did decide to delay some bond offerings after Detroit's default, these stresses did not sweep across a large group of municipalities. In addition, recent experience in other states has suggested that state-specific pressures dissipate relatively quickly. For example, in 2012 three cities in California sought court protection, pushing relative borrowing costs for these localities to a six-month high. That yield penalty has since fallen to the lowest since 2008, and in January 2013 California received its first rating upgrade since 2006.[20]

b) 2007-2008 Financial Crisis

The 2007-2008 financial crisis provides little evidence that tax-exempt money market funds are prone to the kinds of large redemptions that might as the Release suggests cause "harm that can result from … rapid heavy redemptions." Tax-exempt dollar flows to money market funds were considerably smaller than those of prime institutional money market funds (Figure 2). Since January 2003, dollar flows (excluding September 2008) of tax-exempt funds have been only one-third as variable as those of prime institutional money market funds.[21] During the crisis month of September 2008, tax-exempt money market funds saw outflows of $38 billion, compared with $360 billion flowing out of prime institutional money market funds.

[20] *See* Brian Chappatta, "Detroit's Bankruptcy Doesn't Faze the Municipal Bond Market," *Bloomberg* (August 8, 2013), available at http://www.businessweek.com/articles/2013-08-08/detroits-bankruptcy-doesnt-faze-the-municipal-bond-market.

[21] From January 2003 to July 2013 (excluding September 2008), the average monthly variability (*i.e.*, "standard deviation") in dollars flows to tax-exempt money market funds was $8 billion compared to $27 billion for prime institutional money market funds.

FIGURE 2

Net New Cash Flow to Tax-exempt and Prime Institutional Money Market Funds
Billions of dollars, monthly data, January 2003 to July 2013

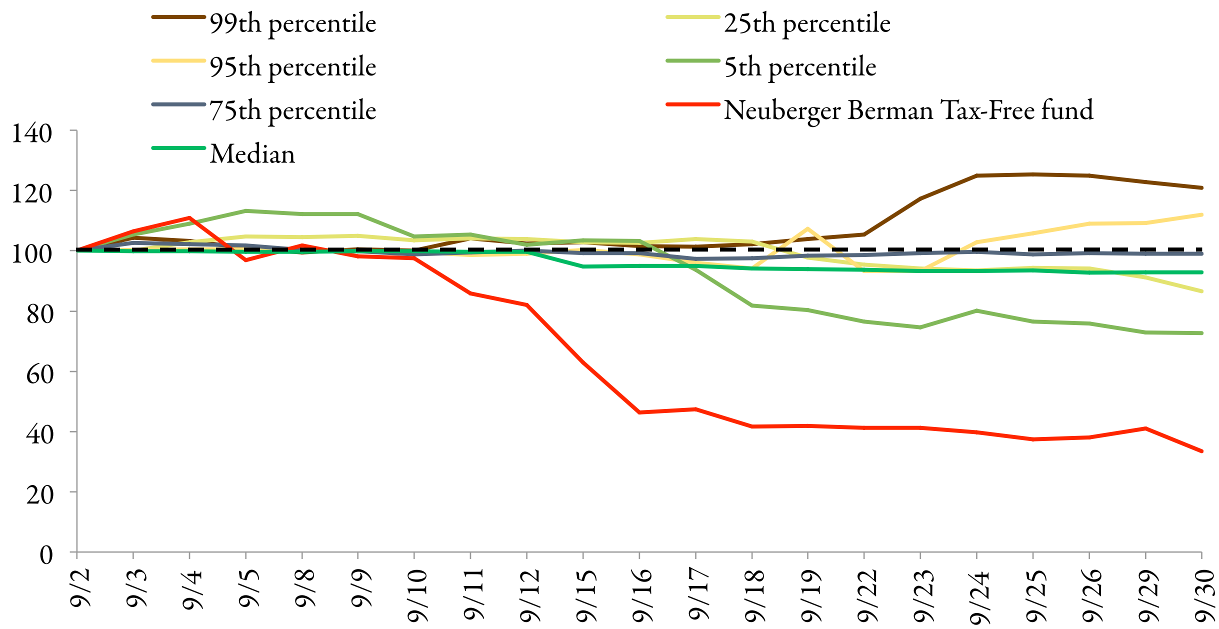
Source: Investment Company Institute

In part, dollar flows from tax-exempt money market funds have been more moderate because, although they hold a large fraction of short-term municipal debt, tax-exempt money market funds are smaller than prime institutional money market funds. In August 2008, tax-exempt money market funds held less than half the assets of prime institutional money market funds ($509 billion versus $1.3 trillion, respectively) and now are even smaller relatively ($264 billion versus $902 billion, respectively). Just by virtue of their smaller size, tax-exempt money market funds must pose less of a concern to regulators. But even at a fund-by-fund level, investors in tax-exempt money market funds generally remained calm during September 2008 (Figure 3). When the Reserve Primary Fund broke the dollar, the Reserve Fund complex also suspended redemptions on 14 of its tax-exempt money market funds on September 17, 2008. A tax-exempt money market fund sponsored by Lehman Brothers—the Neuberger Berman Tax-Free fund—had two thirds of its total net assets redeemed.[22] These events had no ripple effect on other tax-exempt money market funds or the broader municipal market, which remained stable.

[22] Another Lehman fund, the Neuberger Berman NY Municipal Fund, had half of its total net assets redeemed by the end of September.

FIGURE 3

Distribution of Assets of Tax-Exempt Money Market Funds[1,2]
Index = 100 on 9/2/08, daily, September 2008



[1] The sample includes 232 funds. Data exclude Reserve's 14 tax-exempt money market funds, which suspended redemptions on September 17, 2008, funds with missing data during the September period, and funds with less than $50 million in assets.

[2] Neuberger Berman funds were sponsored by Lehman in September 2008.

Source: Investment Company Institute tabulations of iMoneyNet daily data

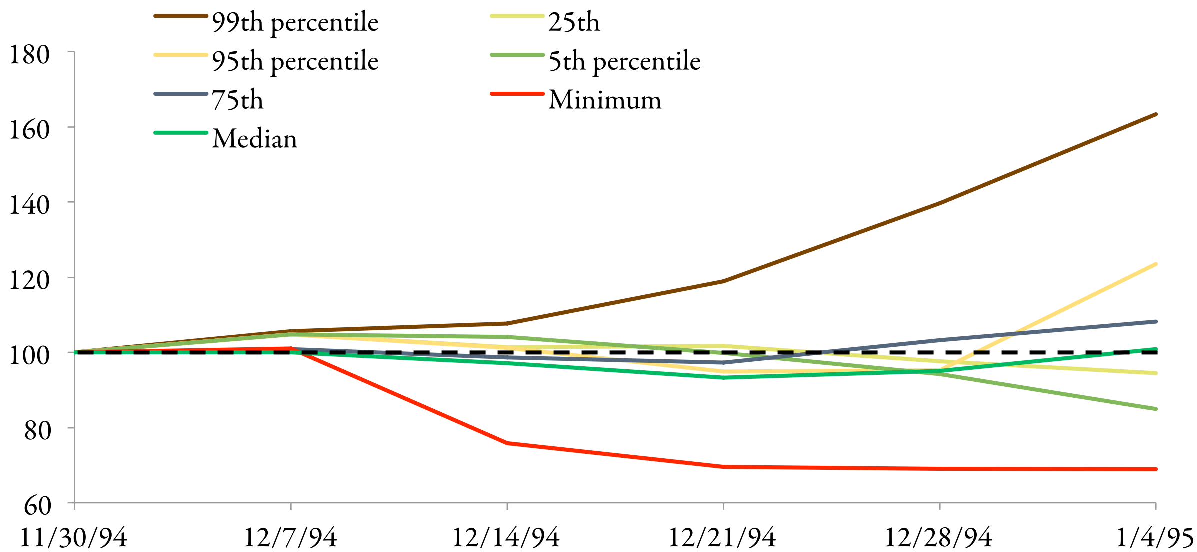
c) Orange County, California

An early instance in which market events could have affected tax-exempt money market fund investor behavior involved the default by Orange County, California on December 9, 1994, and the disclosure the previous week that the county's investment fund had lost $1.5 billion.[23] One tax-exempt money market fund that was heavily invested in securities issued by California municipalities had about 30 percent of its assets redeemed from November 30, 1994 to January 4, 1995 (Figure 4, red line). Other California tax-exempt money market funds also tended to have outflows over this period. But these redemptions did not trigger broad-based, destabilizing outflows from all tax-exempt money market funds. To the contrary, by early January 1995, half of all tax-exempt money market funds had inflows over the period (green line). As a whole, tax-exempt money market funds had *inflows* of about $400 million over this five-week period.

[23] *See* Sallie Hofmeister, "A Default by Orange County," *New York Times* (December 9, 1994), available at http://www.nytimes.com/1994/12/09/business/a-default-by-orange-county.html.

FIGURE 4

Distribution of Assets of Tax-Exempt Money Market Funds[1]
Index = 100 on 11/30/94, weekly, November 30, 1994–January 4, 1995



[1]There are 201 funds in the sample. Data exclude funds with missing data during the given period and funds with less than $50 million in assets.

Source: Investment Company Institute

2. *Liquidity, Credit, and Interest Rate Risk of Tax-exempt Money Market Funds*

The Release notes that government funds "have even a lower default risk than commercial paper and are highly liquid in even the most stressful market scenario" and also that "interest rate risk of government funds … is generally mitigated." These features are also characteristic of tax-exempt money market funds and the securities they hold.

Tax-exempt money market funds have lower credit risk than privately issued paper because municipalities are not generally interconnected. Unlike stresses in the banking system, where deterioration in the credit condition of one bank counterparty can lead to distress at other banks, stresses in one municipality are unlikely to spill over, *per se*, to municipalities in another state because their tax revenue and spending initiatives are independent. This in part explains why stresses in recent municipal defaults—including those in Detroit; Jefferson County, Alabama; and the City of Stockton, California—have not spilled over to other regions of the country. Also, credit quality deterioration in the municipal sector typically occurs over a protracted time frame, rather than declining precipitously, such as has sometimes been seen in the financial sector. Such well anticipated credit events provide ample opportunity for funds to divest themselves of a deteriorating credit, particularly given the highly liquid nature of their securities.

Tax-exempt money market funds hold liquid assets far in excess of the 30 percent required under Rule 2a-7. As of June 2013, tax-exempt funds had weekly liquidity amounting to 79 percent of their total assets. This level of liquidity provides a high degree of protection against shareholder outflows. For example, in the unlikely event that tax-exempt money market funds faced wide-scale redemptions, they could accommodate $203 billion in outflows within one week.[24]

To a great extent, tax-exempt money market funds maintain this high level of liquidity by investing in variable rate demand notes ("VRDNs") issued by state and local governments. For example, as of June 2013 (the latest month for which the SEC's N-MFP data is publicly available), tax-exempt money market funds held 73 percent of their assets in VRDNs. The vast majority of these VRDNs, an estimated 98 percent of the $197 billion that tax-exempt money market funds held in VRDNs in June 2013, have both a 7-day demand feature and 7-day interest rate reset. In combination, these features mean that VRDNs are highly liquid and that interest rate risk is mitigated, precisely the same features that the Release points to as reasons why government funds should be exempt from further structural reform.

The VRDN demand provision allows an investor to demand the return of its cash from the demand feature provider, which is generally a large, well-capitalized bank. Often, but not always, the demand feature provider is also the "remarketing agent" for the securities. The remarketing agent has the duty of trying to resell to another investor any VRDN for which the current investor demands the return of its cash prior to the security's maturity date. Only in cases where the remarketing agent cannot resell the VRDN will it put the securities back to the demand feature provider. From a tax-exempt money market fund's perspective, its ability to "put" a VRDN back to the demand feature provider helps reduce credit risk. Market participants indicate that there were no instances during the 2007-2008 financial crisis in which a remarketing agent was unable to remarket a VRDN.

The interest rate reset feature resets the yield on the VRDN at the security's reset date. On the reset date, the security's yield is adjusted up or down according to an index of the current market yield on short-term municipal debt. For example, if a VRDN has a 7-day interest rate reset, the yield will reset after 7 days, typically to the 7-day SIFMA index. Thus, if yields on short-term municipal securities rise 100 basis points today, the yield on the VRDNs that tax-exempt money market funds hold would adjust upward by approximately that amount after 7 days. In the event of market stress, this upward yield adjustment reduces or eliminates any downward price pressure on the security. Alternatively, if the fund should decide that it wishes to exercise the VRDN's demand feature, for instance to meet redemptions that could be associated with market stress, the upward adjustment in yield will make it easier for the remarketing agent to find a new investor to hold the VRDN. That, in turn, reduces the likelihood that the demand feature provider (whether a bank or other entity) will end up holding the VRDN for more than a very short period.

[24] This is based on the calculation of 77 percent times $263.7 billion—the assets in tax-exempt money market funds in July 2013.

In sum, there is no evidence that investors in tax-exempt money market funds redeem *en masse* during periods of market stress. Moreover, in the unlikely event that tax-exempt money market funds did face widespread redemptions, these funds hold an abundance of their assets in highly liquid securities that can be liquidated to meet redemptions. Additionally, because of these securities' structures, they are likely more immune to credit deterioration. Consequently, tax-exempt funds, like government funds, should be exempt from both the floating NAV proposal and the liquidity fee/temporary gate proposal.

III. Liquidity Fee/Temporary Gate Proposal

As one of two reform alternatives, the SEC proposes to allow money market funds to continue to transact at a stable share price under normal market conditions, but under certain emergency circumstances (i) require money market funds to institute a liquidity fee and (ii) permit money market funds to temporarily suspend redemptions. U.S. government money market funds would be exempt from these provisions; however, these funds could voluntarily opt in.

Under the liquidity fee/temporary gate proposal, if a money market fund's level of "weekly liquid assets" were to fall below 15 percent of its total assets (half the required amount) after the close of business, the money market fund would automatically impose a liquidity fee in connection with redemptions received for processing the next business day. The nonrefundable liquidity fee, which would be equal to 2 percent of redemption proceeds,[25] would be paid to the fund by redeeming shareholders. A 2 percent liquidity fee would not be imposed, however, if the fund's board of directors determines that the fee is not in the best interest of the fund or that a lesser liquidity fee is in the best interest of the fund.

Once a money market fund's weekly liquid assets fell below 15 percent of total assets, its board of directors also would be permitted to impose a temporary gate. A money market fund that suspends redemptions would need to restore the right to redeem within 30 days, although the board of directors could determine to restore it earlier. Money market funds would not be able to suspend redemptions for more than 30 days in any 90-day period.

The SEC explains that the liquidity fee/temporary gate proposal is designed to address the contagion effects of heavy redemptions in money market funds—effects that had a significant impact on investors, funds, and the markets during the financial crisis. Regardless of the incentives to redeem, the Release notes that a liquidity fee would make redeeming investors pay for the costs of liquidity and, if investors continued to redeem from a fund, temporary restrictions on redemptions would directly halt a run.

[25] We understand that some of our members will be providing data as part of their comment letters indicating that a 2 percent liquidity fee is significantly higher than necessary simply to protect remaining shareholders. We suggest that the SEC consider, based on this data, whether the liquidity fee could be lower and yet still act as a deterrent for redemptions.

A. Potential Benefits of Liquidity Fees and Temporary Gates

1. *Liquidity Fees and Temporary Gates Address the SEC's Concerns*

Many of our members support liquidity fees and temporary gates because they promise to slow or stop significant fund outflows. Importantly, liquidity fees and temporary gates are only triggered when a fund is facing unusual circumstances, such as a period of heavy redemptions associated with general stress in the financial markets at large, or with an idiosyncratic credit issue. During normal market conditions, these tools are not used or needed.

The liquidity fee/temporary gate proposal also offers other advantages. Former Commissioner Paredes noted, "the prospect of having to pay a fee to redeem or of being prohibited from redeeming makes the risk of investing in money market funds more transparent to investors."[26] The liquidity fee/temporary gate proposal, therefore, "advances the objective of the floating NAV proposal to sensitize investors to the fact that money market funds are not risk free" without eliminating the stable NAV.[27]

The liquidity fee, particularly one meaningfully higher than the cost of liquidity, would discourage redemptions but still allow the fund to continue to provide liquidity to investors. Insofar as investors choose to redeem, the fee should be large enough to benefit remaining shareholders by mitigating liquidation costs and potentially rebuilding NAVs. Investors truly in need of liquidity would have access to it, but at a cost that serves as a deterrent to redemptions and reflects the premium that market participants place on liquidity during periods of market stress.

At the same time, if the fund's board of directors determines that a fee is not in the best interests of the fund, the board also has the option of temporarily suspending redemptions. Gates would be a temporary expedient designed to allow a fund the breathing room to determine whether and how it could address its portfolio liquidity issues (without having to rapidly sell assets in a fire sale manner) or to start an orderly liquidation process. Significantly, because the gated fund would not be forced to sell assets to meet redemptions, it would not be contributing to potential disruptions in the money markets. At the same time, of course, a money market fund's board would retain its existing authority to employ other measures that best serve the interests of the fund and its investors, including the authority under Investment Company Act Rule 22e-3 to suspend redemptions and liquidate the fund. Alternatively, the board has the option to take no action if it finds that is in the best interest of the fund and its shareholders.

To make these tools even more useful to fund boards, we recommend that the SEC expand the circumstances under which a board may impose a liquidity fee or temporarily suspend redemptions to cover situations when heavy redemptions are underway or are clearly foreseeable. For example, the SEC

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[26] *See* Statement at Open Meeting Regarding a Rule Proposal on Money Market Fund Reform by Commissioner Troy A. Paredes, Securities and Exchange Commission (June 5, 2013), available at http://www.sec.gov/news/speech/2013/spch060513tap.htm.

[27] *Id.*

should permit the decision to impose a liquidity fee or temporary gate following the close of business when the board determines that there is a substantial risk that continued unfettered redemptions would cause the fund's weekly liquid assets to fall below 15 percent by the end of a business day. This change would enable a board to act sooner, and would allow funds to communicate the decision to investors and intermediaries shortly after the close of business that a fee or gate will be implemented the next business day, as opposed to waiting until nightly processing is complete to determine that the weekly liquidity assets have fallen below 15 percent.

2. *Enhanced Disclosure Provides Valuable Transparency to Investors and Regulators*

Importantly, the liquidity fee/temporary gate proposal would be coupled with measures to enhance further the transparency of money market fund portfolios. Such measures would benefit both investors and regulators.

The Release explains that in connection with the liquidity fee/temporary gate proposal, the proposed disclosure requirements are intended to communicate to shareholders the operations and risks of these measures. For example, funds would be required to make prompt disclosure to the SEC, their shareholders, and the public whenever imposing liquidity fees and temporary gates. As part of the measures to increase disclosure to investors and regulators, the SEC also has proposed to require money market funds to disclose daily on their websites their levels of daily and weekly liquid assets and market-based NAVs per share, among other things.

This enhanced transparency (discussed below in Section VII) would encourage an even more conservative approach to the management of prime money market fund portfolios. Investors would have even more information than today about the current market-based NAVs and liquidity of money market funds—including those in which they have invested, as well as all other money market funds. This information could help investors determine more readily whether a sharp decline in a fund's liquid assets is idiosyncratic or not.

B. Potential Drawbacks of Liquidity Fee/Temporary Gate Proposal

1. *Investor Acceptance of Liquidity Fees and Temporary Gates*

Liquidity, like stability of principal value, is a top priority for money market fund investors. Indeed, a hallmark of mutual funds, including money market funds, is that they issue "redeemable securities," meaning that the fund stands ready to buy back its shares at their current NAV.[28] It is not surprising, therefore, that our members report some investors have expressed reluctance about using a cash management product that has the prospect (even if remote) of a fee to redeem or a temporary prohibition on redeeming. A recent survey of 885 organizations by the Association for Financial Professionals found that 56 percent of organizations would be less willing to invest in money market

[28] Section 22(e) of the Investment Company Act generally prohibits funds from suspending the right of redemption and from postponing the payment or satisfaction upon redemption of any redeemable security for more than seven days, except under extraordinary circumstances that are delineated in the statue or determined by SEC rule.

funds if fund companies limit redemptions or charge fees for full redemptions of money market fund holdings.[29] Further, the Release acknowledges that potentially limiting the full, unfettered ability to redeem money market fund shares could result in some shareholders redeeming their money market fund shares and moving their assets to government money market funds or alternative products out of concern that even the potential imposition of a fee or gate could make investments in a money market fund less liquid and therefore less attractive. The effects of this shift on the money market and the economy are difficult to predict, but would likely have an impact on the short-term credit markets as investors move away from prime money market funds. We discuss similar concerns with the floating NAV proposal in Section IV.D.

2. *Impact of Liquidity Fee/Temporary Gate Proposal on Certain Transaction Types*

Sweep vehicles use money market funds to invest on a daily basis the available cash held in customer accounts. This cash is intended primarily to support trading activity conducted in investor accounts during the business day. Under the liquidity fee/temporary gate proposal, intermediaries would not know whether their sweeps would be subject to a liquidity fee or temporary gate until after the daily investment is made. Consequently, requiring certain money market funds to implement liquidity fees and permitting temporary gates may cause sweep vehicles to seek alternative investment products. Similarly, sponsors of 401(k) and other retirement plans may need to reevaluate whether a money market fund with the ability to impose liquidity fees and temporary gates would continue to be an appropriate product that meets their plans' needs for ready liquidity. These decisions may turn on intermediaries' assessments about the likelihood of funds needing to invoke either liquidity fees or temporary gates.

3. *Tax Implications of Liquidity Fees*

Liquidity fees may have certain tax implications for money market funds and their shareholders. According to the Release, the SEC believes that liquidity fees would be treated for tax purposes in the same manner that funds and shareholders currently treat redemption fees under Rule 22c-2 under the Investment Company Act. With respect to shareholders, Rule 22c-2 redemption fees reduce a shareholder's amount realized on the redemption, thus decreasing the shareholder's taxable gain, or increasing the shareholder's taxable loss, on redemption. Under the Internal Revenue Code, redemption fees have no tax consequences to the fund when received.[30] Thus, a reduction in the amount of redemption proceeds paid to a shareholder, due to fees on the redemption, does not result in gain or income to the fund. Funds typically treat Rule 22c-2 redemption fees as paid-in capital to the fund for book purposes.

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[29] *See* Association of Financial Professionals, 2013 AFP Liquidity Survey: Report of Survey Results, (June 2013) ("AFP Survey"); available at http://www.afponline.org/liquidity/.

[30] Pursuant to Section 311(a)(2) of the Internal Revenue Code, corporations (including registered investment companies) do not recognize gain or loss upon a redemption of their shares.

The liquidity fees proposed by the SEC should be treated in the same manner for tax purposes as redemption fees under Rule 22c-2. If a liquidity fee thus has no tax consequences for the fund, the fund can use 100 percent of the fee to repair its NAV that is below $1.00. If redemptions involving liquidity fees cause the fund's shadow price to reach $1.005, however, the fund may need to distribute to the remaining shareholders sufficient value to prevent the fund from breaking the dollar on the upside (by rounding up to $1.01 in pricing its shares). This distribution would be a taxable dividend to the shareholders only to the extent that the money market fund has sufficient earnings and profit to support the distribution. Because the liquidity fees do not generate gains or income to the fund when they are received, they do not create earnings and profits to support a later distribution of those amounts. Unless the fund has earnings and profits from other sources to support the distributions, which is unlikely, some or all of these additional distributions would be treated as a return of capital to the existing shareholders. A return of capital would reduce the recipient shareholders' basis in their shares below $1.00, resulting in unrealized gains. As a result, the fund and intermediaries might become subject to tax-reporting obligations that do not affect stable NAV funds currently.[31]

One solution to this problem would be to treat the fund as having sufficient earnings and profits to support the distribution. The Treasury Department ("Treasury") and the IRS could issue guidance indicating that a stable NAV money market fund that must distribute excess liquidity fees in order to avoid breaking the dollar would be deemed to have sufficient earnings and profits to make the distribution. In this event, the distribution would be treated as an ordinary dividend and would not result in a return of capital to existing shareholders. Although shareholders would have to pay income taxes at ordinary rates on the distribution, it would not affect their cost basis, and no additional tax reporting would be necessary.[32]

ICI has raised this solution with the Treasury and the IRS and has asked them to provide guidance permitting the deemed earnings and profits approach.[33] If the government determines that the

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[31] It is unclear whether a stable NAV fund would be required to begin providing tax information in this event. Under current law, funds that strive to maintain a stable NAV under Rule 2a-7 are not subject to the information reporting requirements. A money market fund that has to make a return of capital distribution under these circumstances technically still should fall within this exemption, but clarification from the Internal Revenue Service ("IRS") is needed. Even if no tax reporting is required, funds and intermediaries likely would want to provide tax information to their customers in some form, if those customers' basis in their shares were affected by a return of capital.

[32] An alternative would be to treat the liquidity fee as a capital gain, under the theory that it is being used to offset capital losses incurred by the fund on its portfolio in order to pay the redeeming shareholders. *See Arrowsmith et al v. Commissioner of Internal Revenue,* 344 U.S. 6 (1952); *see also* Revenue Procedure 2009-10, 2009-1 C.B. 267. If the fees have to be distributed to avoid breaking the $1.00 NAV, the distributions would be capital gain distributions, rather than returns of capital. The primary concern with this approach is that a fund would be required to distribute the liquidity fees as gains, regardless of their effect on the NAV, unless it has offsetting capital losses. Although many funds likely would have current or prior year losses that they could utilize, in other situations losses might have to be generated to offset the gains. This loss management effort could result in unnecessary transaction costs. Therefore, the deemed earnings and profits approach is preferable.

[33] *See* Letter from Karen L. Gibian, Associate Counsel—Tax Law, Investment Company Institute, to Lisa Zarlenga, Tax Legislative Counsel and Michael Novey, Associate Legislative Counsel, U.S. Department of the Treasury, re "SEC Proposals

deemed earnings and profits solution is appropriate, we also asked the Treasury and the IRS specifically to clarify that the liquidity fees (i) do not result in gain or income to the fund when received, and (ii) result in a reduction of gross proceeds to the shareholder. Although ICI believes that this is the proper treatment, the IRS has not issued formal guidance on the treatment of early redemption fees, and some uncertainty remains. Further, ICI has asked the Treasury and the IRS to clarify that payment of the fee by shareholders, (which effectively is a capital loss to the redeeming shareholder) or a return of capital distribution due to excess liquidity fees (if the deemed earnings and profits approach is not adopted), does not create a tax reporting obligation by the fund or intermediaries. Such clarification should be issued before the effective date of any liquidity fee/temporary gate requirement the SEC may adopt.

4. *Accounting Implications*

U.S. generally accepted accounting principles ("GAAP") currently includes investments in money market funds as one of three examples of a "cash equivalent" (along with Treasury bills and commercial paper).[34] Treating money market fund shares as cash equivalents is important to fund investors because, among other things, the investors may have debt covenants that require them to maintain certain levels of cash and cash equivalents. If corporate investments in money market funds are not cash equivalents, they would instead be considered investment securities held for trading purposes under GAAP.

We urge the SEC to issue a staff accounting bulletin or other formal pronouncement that addresses the status of money market funds as cash equivalents under the liquidity fee/temporary gate proposal. For example, the guidance should discuss whether a money market fund that imposes a liquidity fee and/or gate would continue to be considered a cash equivalent investment and whether the amount of the fee or the length of the gate would affect the analysis.

5. *Operational Implications of Liquidity Fees and Temporary Gates*

Although fund transfer agent and intermediary system providers can assess fees on mutual fund redemptions today, applicable systems would require modification to handle a liquidity fee for money market funds. Specifically, the nature of the liquidity fee would entail changes to support a separate fee type, appropriate tax treatment, and investor reporting, including transaction confirmation statements that reference fees charged and applicable tax information for customers.[35]

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for Money Market Fund Reform—Liquidity Fee Tax Issues" (September 12, 2013), available at http://www.ici.org/pdf/27558.pdf.

[34] GAAP defines cash equivalents as short-term, highly liquid investments that are both (i) readily convertible to known amounts of cash, and (ii) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity for this purpose means original maturity to the entity holding the investment.

[35] Under the proposal, a fund's board has the discretion to lower the 2 percent default fee. Such variability adds significant complexity to the implementation of the liquidity fee by funds and intermediaries. Systems would be required to capture and indefinitely retain the variable fee rates and the effective business date(s) of liquidity fees and/or temporary gates for proper

The proposed rule states that "a liquidity fee . . . must be applied to all shares redeemed"; the Release, however, also seems to contemplate that the liquidity fee for a direct shareholder would apply to that shareholder's net redemptions for that day. Currently, systems used to process money market fund transactions do not have the ability to assess a fee by netting one or more purchases against one or more redemptions.[36] This process would be highly complex and require a significant and costly redesign of the processing functionality used by funds and intermediaries today.

Additionally, the Release indicates that netting would occur for the "shareholder of record."[37] Absent further definition, it would be challenging for funds (and intermediaries assessing the fee) to determine how a shareholder of record requirement applies to multiple accounts of a given beneficial owner (*i.e.*, individual account, joint account, retirement account, custodial account, etc.). Shareholders also may have difficulty understanding how multiple accounts affect the application of the liquidity fee. Funds, record keepers, and intermediaries assessing the fees would need to develop complex processing conventions to consistently and accurately assess fees for shareholders of record. Although the netting of redemptions seems intended to be investor-friendly, the reality is that such an approach would be very difficult operationally and confusing to capture, present, and explain to investors, especially if multiple accounts or transactions were impacted. Therefore, we believe the cost of implementing a complex infrastructure for processing liquidity fees on shareholder of record net redemption transactions would far outweigh the potential benefit of netting for the limited number of investors that may be purchasing fund shares during such a period. Instead, we urge that any liquidity fee be applied to each redemption in an affected money market fund. We also suggest that funds specifically disclose that if they charge a liquidity fee, it will not be netted against purchases made on the same day.

Temporary gating also would require fund transfer agent and intermediary system providers to ensure that their systems can suppress redemption activity while supporting all other transaction types. Fund transfer agent system providers have told us that the functionality to restrict redemptions while allowing purchases generally is available. Intermediary systems, however, would need similar capabilities. The ability to implement gating quickly—before the processing of transactions by funds and intermediaries begins for a given business day—would be essential.[38]

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accounting, investor and intermediary notification, confirmation of transactions, and information reporting to the IRS. This information also would be necessary for accurate current and corrective (back-dated) transaction processing, if needed.

[36] For this to be possible, every transaction would need to be reviewed for matching purchases and redemptions, and net redemption transactions would have to be isolated. Attempting to systematically apply the liquidity fee, either in a reduced percentage or to select shares comprising the shareholder's total shares redeemed, would both confuse investors and make it difficult for fund personnel that service investors to effectively explain the application of a liquidity fee under the net redemption requirement. Varying practices for applying the net fee among fund complexes would further confuse intermediaries and investors.

[37] *See* Release, *supra* note 2, at n. 373.

[38] Fund investors and intermediary partners must be notified if the fund is required to implement a liquidity fee and/or gate. Today, notifications are made to investors and intermediaries by web site postings, faxes, emails, and phone calls. None of these manual options can be used by intermediary systems to automatically initiate a liquidity fee and/or a gate on a fund. The industry would need to explore whether a machine-readable notification could be implemented for intermediaries to

System modifications for liquidity fees and gates, especially absent the net redemption requirement, are far less onerous and costly, however, than the extensive programming and other system changes necessary to implement a floating NAV as contemplated by the SEC's proposal. Intermediaries also may be more inclined to make system modifications and not migrate to alternative products if they believe liquidity fees and temporary gates would not drive investors away from money market funds.

C. Transition and Compliance Period

If the SEC were to adopt the liquidity fee/temporary gate proposal, the SEC proposes to give money market funds, their sponsors, and service providers one year to complete the requisite operational changes to their systems to implement these provisions. Industry stakeholders face a variety of transition issues that would have to be addressed, however, prior to the effective date of new rules. Although instituting liquidity fees and temporary gates is less onerous than other options in the proposal, funds and intermediaries would need to implement a variety of system enhancements and changes to processes and procedures to support the communication and processing of liquidity fees and gates.

Funds would need to provide prompt notice to intermediaries and investors regarding any liquidity fee or gate that has been instituted that would affect their money market fund redemption transactions. To do this, industry stakeholders would need to design, test, and implement processes to quickly and efficiently disseminate information about liquidity fees and gates to allow sufficient time for intermediaries to comply with point in time processing requirements. Creating such a near real-time data exchange would be a major undertaking for the industry and would require significant time to achieve industry consensus on the approach and to coordinate amongst the many system vendors and intermediaries that service investors.

Funds and intermediaries also would need to formulate strategies and tactical actions for managing liquidity fee and gate implications for investors. Considerations would include: the appropriateness of money market funds as short-term investments; changes in processes and procedures that would need to be deployed when fees and gates are implemented, including shareholder servicing and investor communications (*e.g.,* modifications to confirmations, statements, etc.); and staff training to manage shareholder inquiries, including impacted or rejected transactions if gates are instituted. These and other issues would require extensive time to design, review, approve, and implement.

Funds would need to decide what disclosures are required for liquidity fees and gates as necessitated by final rules, as well as determine the appropriate communications to inform and educate intermediaries and investors about such changes. This process would entail review and modification of regulatory filings, intermediary materials, and shareholder communications; enhancements to automated shareholder servicing systems (*e.g.,* investor account information accessed via the internet

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automate the initiation and removal of a liquidity fee and/or gate. Notification must come with sufficient time for both funds and intermediaries to alter system rules to institute the fee and/or gate, as applicable, prior to the start of processing for the next business day. Most likely, the process would be a combination of manual and systematic processes that would need to be initiated after the completion of the fund's nightly processing cycle (prior to the opening of the fund's next business day), which will be a very compressed time frame.

and voice response systems); and updates to web site postings. In addition, depending on how the liquidity fee is viewed from a tax perspective, substitute tax forms and shareholder communications on tax impacts would need to address the application of a liquidity fee to redemption transactions.

Systems changes, processes, and procedures would need to be developed between funds and intermediaries for the remittance of liquidity fees. Rule 22c-2 fees are cited in the Release as an example of redemption fees in place today. These fees do not apply to money market funds, however, and when assessed are typically remitted by intermediaries to funds on a monthly basis by check or Fedwire. Since proposed liquidity fees could be material dollar amounts that are intended, in part to rebuild the NAV in a money market fund, these fees would need to be remitted by intermediaries frequently (perhaps as often as daily). There is no industry mechanism in place today to remit these types of liquidity fees in an automated fashion on a daily basis to funds. As a result, funds and intermediaries would need to develop and implement efficient practices for reporting, transmitting, and reconciling the liquidity fees assessed on money market fund redemption transactions.

Our discussions with fund sponsors, intermediaries and vendors that support industry processing indicate that one year is not sufficient for the industry to develop, test, and implement all the necessary changes to various systems (including customer interfaces) and related output (reports, communications, etc.), update procedures, documentation, and disclosures, as well as address customer servicing and related reporting (confirmations and statements) for such changes. Thus, we recommend that the SEC provide the later of at least three years following issuance of final SEC rules or January 1 of the calendar year that begins at least 12 months after final tax guidance is issued to allow the industry to complete the broad client service and operational requirements necessary to successfully implement liquidity fees and temporary gates.

IV. Floating NAV

The SEC's other proposed approach would fundamentally alter prime and tax-exempt institutional money market funds by requiring these funds to have a floating NAV instead of a stable NAV. Specifically, these funds would be required to sell and redeem shares based on the current market-based value of the securities in their underlying portfolios and "basis point round" their share price to the nearest 1/100th of one percent (*e.g.*, the fourth decimal place in the case of a fund with a $1.0000 share price).

The SEC indicates that the floating NAV proposal is designed 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, and to improve the transparency of pricing associated with money market funds.

ICI has maintained consistently since 2009 that proposals to require money market funds to float their NAVs would not achieve such goals.[39] Even assuming that investors are willing to use floating

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[39] *See, e.g.*, Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to the Financial Stability Oversight Council (January 24, 2013), available at http://www.ici.org/pdf/13_fsoc_mmf_recs.pdf; 2012 Senate Testimony,

NAV money market funds, a floating NAV is unlikely to alter meaningfully investors' behavior during a market crisis. On the contrary, there is considerable evidence, as the SEC itself acknowledges, that the outflows from prime money market funds during September 2008 were part and parcel of a flight by investors to the quality and liquidity of the Treasury market. Indeed, there is evidence, as the SEC also acknowledges, that long-term funds (whose NAVs have always floated) experienced significant outflows during the financial crisis.

As discussed in more detail below, the floating NAV proposal would require funds and intermediaries to make very significant and costly operational changes to accommodate floating NAV money market funds. Regulators might argue that such costs are justified by the policy concerns at stake. The argument misses the point, however; the operational changes required are so extensive, difficult, and costly that sponsors and intermediaries are unlikely to make the substantial investment required, unless they believe investors would accept a floating NAV product in meaningful numbers. These disincentives to offer floating NAV funds would be compounded by additional regulatory requirements. Like all long-term funds, prime and tax-exempt institutional money market funds would have to float their NAVs but, unlike long-term funds, these funds would still be required to adhere to Rule 2a-7 *and* a proposed pricing standard that is 10 times more stringent than the pricing standard for other floating NAV products. The lukewarm policy goals set out in the proposal do not appear to justify these costs.

If investors reject this new product, they also are likely to move to alternative products that are not regulated under the Investment Company Act. For example, assets might flow to bank deposit accounts. This could raise a new systemic issue: dollars that flow from institutional money market funds to uninsured demand deposit accounts may simply flee if there are concerns about a bank's viability, potentially exacerbating stresses within the banking system.[40] This effect may be mitigated to a certain extent by the SEC's proposal to allow government money market funds to maintain a stable NAV. It is very unlikely, however, that currently there is sufficient supply of short-term Treasury and agency securities and collateral for repurchase agreements to absorb the sizable inflows if investors reject prime floating NAV money market funds in search of more stable products. As a result, many investors likely would be compelled to move to less regulated products or uninsured bank deposits.

A. Floating NAVs are Unlikely to Significantly Reduce Redemption Activity

The SEC argues that a floating NAV will help mitigate the risks of large redemptions during a financial crisis because it will disincentivize investors from attempting to redeem their shares at $1.00

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supra note 3; Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (January 10, 2011), available at http://www.ici.org/pdf/11_sec_pwg_com.pdf and http://www.ici.org/pdf/11_sec_pwg_deck.pdf; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 8, 2009); MMWG Report, *supra* note 4.

[40] The FDIC provided unlimited insurance on noninterest-bearing checking accounts until December 2012. With the expiration of that program, balances in demand deposits above $250,000 are once again uninsured.

even if the fund has suffered a loss.[41] For a number of reasons, we doubt that a floating NAV would have much effect in this regard.

First, in normal circumstances, a "floating" NAV is unlikely to alter investor behavior because it will move little. Recent mark-to-market valuations support this conclusion. From January 2011 to July 2012, 96 percent of prime money market funds recorded an average absolute monthly change in their mark-to-market value of 1/100th of a cent (1 basis point, or $0.0001) or less.[42] Even during the summer of 2011, when the short-term markets were buffeted by the Eurozone sovereign debt crisis, the U.S. debt ceiling impasse, and the downgrade of the U.S. government's long-term debt, the mark-to-market share prices of most prime money market funds remained in a very narrow range around $1.00.[43] This lack of price volatility simply reflects that for money market funds, during normal market conditions, amortized cost is an extremely efficient proxy for mark-to-market pricing.

Second, during periods of financial stress, investors typically shift toward the safest, most liquid market, which is usually the U.S. Treasury market. For example, there is considerable evidence that all types of investors, in a wide array of financial products, shifted dramatically into short-term Treasury securities during the financial crisis. Yields on Treasury bills fell and demand for longer-dated commercial paper collapsed on September 15, 2008, indicating that a general flight to the quality of government securities was underway *before* there were significant outflows from prime money market funds. The SEC Staff Study acknowledges that a flight to the quality and liquidity of government securities was a factor motivating redemptions from prime money market funds during September 2008.[44] The tendency of investors to move to the Treasury market during financial crises, to a great extent, stems from a desire to avoid uncertainty. This is understandable. As events move quickly, market prices may or may not reflect fundamentals, in part because liquidity may dry up in particular sectors of the fixed income market as investors move to Treasuries. Requiring money market funds to float their NAVs is highly unlikely to change this behavior.

B. Floating NAVs Are Unnecessary To Improve Transparency

The SEC asserts that the floating NAV proposal is designed to increase the transparency of money market fund risk. Specifically, it states that the floating NAV would make gains and losses a more regular and observable occurrence in money market funds, thus altering investor expectations by making clear that money market funds are not risk-free and that the fund's share price will fluctuate based on the value of the fund's assets. The SEC further asserts that investors in floating NAV money

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[41] *See* Release, *supra* note 2, at 50-51.

[42] *See* S. Collins, E. Gallagher, J. Heinrichs, and C. Plantier, "Money Market Mutual Funds, Risk, and Financial Stability in the Wake of the 2010 Reforms," *ICI Research Perspective* (January 2013), available at http://www.ici.org/pdf/per19-01.pdf.

[43] *See* SEC Staff Study, *supra* note 6, at 33–34.

[44] *See Id*. at 7-9. The 2010 reforms addressed concerns regarding both liquidity and transparency for all money market funds.

market funds should become "more accustomed to, and tolerant of, fluctuations in money market funds' NAVs and thus may be less likely to redeem shares in times of stress."[45]

For these assertions to be true, investors would need to see and experience *material* fluctuations in the value of funds' NAVs on a daily basis. As noted above, however, a floating NAV money market fund is unlikely to experience material NAV fluctuations during normal market conditions. The SEC itself acknowledges that fluctuations in floating NAV funds are likely to be insignificant.[46] The SEC Staff Study also found that funds' shadow NAVs did not deviate significantly from their stable NAVs between 1994 and 2012.[47] In fact, money market fund shares fluctuate so little that the SEC has proposed an artificially sensitive pricing scheme that is 10 times more precise than the standard applicable to all other mutual funds, simply to force money market funds' reported NAVs to show movement.

In any case, requiring funds to float the NAV is unnecessary to achieve the SEC's goal of transparency. Instead, robust monthly disclosure of funds' portfolio holdings and other characteristics, combined with the *daily* disclosure of funds' mark-to-market share prices, would accomplish the same goal without eliminating the stable share price that provides so much benefit to investors.

C. Floating NAVs Could Eliminate Key Benefits to Investors

For investors, floating NAV mutual funds do not currently offer the host of tax, accounting, recordkeeping, and operational benefits that a stable NAV money market fund provides.

1. *Tax Implications*

The SEC acknowledges that a stable NAV simplifies tax compliance for money market fund shareholders. The stable NAV relieves shareholders, funds, and intermediaries from having to track capital gains and losses and determine for every redemption which share was redeemed, the tax basis (generally, the acquisition cost) of that share, and whether the holding period of that share was long term or short term.[48] Because a money market fund's shares are typically bought and sold at the same

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[45] *See* Release, *supra* note 2, at 53-54.

[46] *Id.* at 121.

[47] *See* SEC Staff Study, *supra* note 6, at 27- 28 and Figure 16. These findings were based on information from twice-yearly Form N-SAR filings.

[48] When an individual shareholder redeems shares from a mutual fund, the tax laws require the fund to send the shareholder and the IRS an IRS Form 1099-B. The fund must report on this form the shareholder's gross proceeds from the sale and, for shares acquired after January 1, 2012, the shareholder's cost basis in the shares redeemed, to permit the shareholder (and the IRS) to calculate the shareholder's capital gain or loss. For shares acquired in 2012 and thereafter, the fund also must report to the shareholder whether such capital gain or loss is long term or short term. Forms 1099-B must be sent by February 15 of the year following the year in which the sale transaction took place. These rules also apply to shareholders that are partnerships or S corporations. Certain other shareholders, including corporations, financial institutions, registered investment companies, retirement plans, and other tax-exempt entities, are "exempt recipients" to which information reporting is not required. Corporations and other exempt recipients would still be responsible, however, for tracking their

price, shareholders do not realize capital gain or loss upon a redemption; thus, all of the fund's returns are ordinary income to its shareholders. The stable NAV also eliminates the need to consider the timing of sales and purchases of fund shares (*i.e.,* "wash sale" tax rule considerations).[49] To be sure, investors already face these burdens in connection with investments in mutual funds with floating NAVs. But most investors make fewer share purchases and redemptions from such mutual funds because they are used for long-term investing, not cash management. Moreover, many purchases (or exchanges) in floating NAV mutual funds are made within tax-advantaged accounts (*e.g.,* 401(k) plans) where such issues simply do not arise.

In an effort to provide some relief from these tax burdens, the SEC has indicated that the Treasury and the IRS are considering alternatives for modifying forms and guidance (i) to include net information reporting by the funds of realized gains and losses for sales of all mutual fund shares; and (ii) to allow summary income tax reporting by shareholders. The SEC correctly notes, however, that if the proposal is adopted and institutional, non-government money market funds are required to have a floating NAV, then many shareholders will be "exempt recipients" to which information reporting is not required.

For those investors that are exempt recipients who must file a tax return, such as corporations and financial institutions, net information reporting, as suggested by the SEC, provides no benefit, as these entities do not receive Forms 1099-B from the funds in which they invest.[50] These investors thus

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cost basis and reporting any gains or losses. Money market funds that maintain a stable NAV under Rule 2a-7 currently are exempt from these information reporting rules.

[49] The Internal Revenue Code imposes rules intended to prevent taxpayers from recognizing capital losses on securities if the taxpayer has not truly liquidated its position in that security. The "wash sale" rule thus prevents taxpayers from recognizing losses on the sale of securities if, within 30 days before or after such sale, the taxpayer purchased substantially identical shares. In the money market fund context, the wash sale rule poses particular problems in connection with a floating NAV. Many money market fund investors automatically reinvest their dividends. Money market funds typically declare dividends daily and pay them monthly, so a redemption from the fund would almost always be within 30 days of a dividend reinvestment. The wash sale rule thus could prevent a shareholder that redeems shares from the fund from recognizing all or a portion of a capital loss, until the shareholder completely liquidates its position. For some investors, such as those institutions that use a money market fund for their sweep accounts, those losses could be suspended indefinitely. Any disallowed loss on a redemption would be added to the basis of the newly purchased shares. Under the cost basis reporting rules, funds and brokers would be required to track these wash sales for any shareholders that are not exempt recipients and adjust their cost basis accordingly. Corporations, which do not receive cost basis information from the funds, would have to track these wash sales and basis adjustments themselves.

[50] In our discussions with regulators, it has been suggested that perhaps funds should be required to begin reporting tax information to corporations and other exempt recipients to facilitate tax reporting on floating NAV money market funds. We believe that this would be overly burdensome, and any benefits would not outweigh the substantial costs. Traditionally, taxpayers such as corporations and financial institutions have been exempt from tax reporting because they typically have a fiscal year other than a calendar year; tax information reporting, which is calculated on a calendar year basis, thus has no meaning for those taxpayers. Other exempt recipients, such as charitable organizations and retirement plans, generally are not subject to tax at all. The only way to provide useful tax information to exempt recipients would be to provide it on a monthly basis, to ensure that each recipient received information corresponding to its year-end. Current tax reporting and cost basis systems operate on a calendar-year basis; requiring monthly reporting would be a significant and costly undertaking, particularly for information that would only be relevant to each shareholder 1/12 of the time. Further, it is not clear that

would be required to build systems to track and report their own basis information and calculate any gains or losses on their money market fund transactions. This is no different than what is required currently for other types of funds; however, the large volume of transactions in a money market fund would pose substantially increased burdens. The ability to provide summary information on tax returns, rather than transaction-by-transaction details, mitigates the reporting burdens somewhat, but these investors still must keep track of their adjusted cost basis and any gains and losses, however small, on every transaction and subsequently aggregate the gain/loss impact prior to reporting. The potential for gains and losses, and the need to track and tax report for such amounts, could deter many institutional investors from choosing to continue investing in money market funds with floating NAVs.

For those investors to which funds and intermediaries are required to provide applicable IRS information reporting (tax forms), netting information on IRS Form 1099-B would simplify reporting. Nevertheless, funds and intermediaries would bear significant new costs because they currently are not required to provide Form 1099-B to money market fund investors. To do so, fund complexes and intermediaries would have to enable money market fund redemption tax reporting on core recordkeeping systems and add money market funds to the systems necessary to capture, report, and transfer cost basis. This would involve additional time, effort, and costs, which likely would be borne by investors. The additional work would be required to report to only a small subset of the investor base, as many investors in institutional funds are exempt recipients.[51] The ability to provide summary information on their tax returns would provide some relief to investors in floating NAV money market funds, as they would not be required to report transaction-by-transaction detail. But, it is not clear how many investors would remain to absorb the fixed costs of the transition, given questions about whether investors will continue to use money market funds as a cash management tool if there is a potential for gains and losses.

With respect to wash sales, the Treasury and the IRS recently released proposed administrative guidance under which redemptions of floating NAV money market fund shares that generate losses below a *de minimis* threshold would not be subject to the wash sale rules.[52] The proposed Revenue Procedure defines a *de minimis* loss as a loss realized upon a redemption of money market fund shares that is not more than 0.5 percent (50 basis points) of the taxpayer's basis in those shares. If the loss realized is more than 0.5 percent of the taxpayer's basis in the shares, then the loss is disallowed pursuant to the wash sale rules. The Treasury and the IRS note in the proposed Revenue Procedure that tracking

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these investors would continue to utilize a floating NAV money market fund, even if this tax information was provided to them.

[51] Many individual investors hold shares in institutional funds. Other non-exempt recipients in an institutional fund would include, among others, partnerships (such as hedge funds) and S corporations. Funds and intermediaries would be required to report gross proceeds and cost basis information to these investors on Form 1099-B.

[52] *See* IRS Notice 2013-48. The Treasury and the IRS have asked for comments on the proposed Revenue Procedure by no later than October 28, 2013. ICI submitted comments on September 12, 2013. *See* Letter from Karen L. Gibian, Associate Counsel—Tax Law, Investment Company Institute, to Lisa Zarlenga, Tax Legislative Counsel and Michael Novey, Associate Legislative Counsel, U.S. Department of the Treasury, re. "Notice 2013-48—Proposed *De Minimis* Exception to the Wash Sale Rule" (September 12, 2013), available at http://www.ici.org/pdf/27558a.pdf.

wash sales of money market fund shares, given the expected volume of transactions, would present floating NAV money market fund shareholders with significant practical challenges. Given that redemptions of money market fund shares do not give rise to the concerns that the wash sale rule is meant to address, the Treasury and the IRS state that it is in the interest of sound tax administration to provide relief from that rule under certain circumstances.

Although we appreciate these efforts to provide limited relief from the wash sale rule, *a de minimis exception does not mitigate the tax compliance burdens that would result from the SEC's proposed changes*. In fact, the Release acknowledges that even with this type of relief from the wash sale rule, money market funds still would incur significant operational costs to establish systems with the capability of identifying wash sale transactions, assessing whether they meet the *de minimis* criterion, and adjusting shareholder basis as needed when they do not. As noted above, if the floating NAV proposal applies only to institutional money market funds, funds and intermediaries likely would not be required to provide tax information to most investors. But exempt recipients who invest in institutional money market funds would be required to calculate and track their own wash sales. The investors and funds would incur significant operational costs to establish systems to identify and calculate wash sales. Again, this additional burden alone could be a deterrent to investors who might otherwise consider a floating NAV money market fund.

As discussed in ICI's comment letter on the proposed Revenue Procedure, a more effective solution for addressing the wash sale issue would be to exempt money market funds from the rule entirely. As the Treasury and the IRS themselves acknowledge, money market funds are not the type of investment at which the wash sale rule is aimed.[53] The rule is intended to prevent a taxpayer from generating current losses in a security that the taxpayer continues to own and expects to rise in value. Investors do not expect any capital appreciation in a money market fund, so it is unlikely that money market fund shareholders would abuse the rule. Further, any dividends paid and reinvested likely would be small, meaning that any losses disallowed due to the wash sale rule also would be small.[54] The nature of the product and the small amount of potential losses are sufficient justification for an exception from the wash sale rule. We thus strongly urge the SEC, the Treasury, and the IRS to consider pursuing this solution if the floating NAV proposal is adopted. These statutory changes and any implementing rules and/or guidance would have to be in place *before* the compliance date for floating NAV funds.

2. *Accounting Implications*

The SEC acknowledges that there may be accounting implications related to floating NAV money market funds. As previously stated, treating money market fund shares as cash equivalents is important to fund investors because, among other things, the investors may have debt covenants that

[53] The proposed Revenue Procedure states: "Redemptions of shares of [money market funds], which have relatively stable values even when share prices float, do not give rise to the concern that [Internal Revenue Code] § 1091 is meant to address." *See* Notice 2013-48, Proposed Revenue Procedure, Section 2, paragraph (4).

[54] A *de minimis* rule may prevent many investors from having disallowed losses on money market fund redemptions. Any amount over that threshold, however, would be subject to the wash sale rule.

require them to maintain certain levels of cash and cash equivalents. If corporate investments in money market funds are not cash equivalents, they would instead be considered investment securities held for trading purposes under GAAP. Investment securities held for trading purposes are marked-to-market on the balance sheet, and gains and losses (both realized and unrealized) flow through to earnings. Although gains and losses on investments in money market funds likely would be immaterial to the corporation's earnings, they still would need to be tracked for financial reporting purposes. The burden associated with tracking gains and losses would act as a further disincentive to corporate and institutional investors in money market funds and may cause these investors to migrate to other products.

Recognizing the importance of classifying money market fund investments as cash equivalents, the SEC stated in the Release its belief that money market funds would continue to qualify as cash equivalents under GAAP, notwithstanding the advent of a floating NAV. As a basis for this belief, the Release states that "fluctuations in the amount of cash received upon redemption would likely be insignificant and would be consistent with the concept of a 'known' amount of cash." We believe such guidance is appropriate given that money market funds' investments would continue to be subject to the risk-limiting provisions included in Rule 2a-7. We therefore urge the SEC to issue a staff accounting bulletin or other formal pronouncement to this effect. We also believe the Financial Accounting Standards Board and the Governmental Accounting Standards Board should address this issue to ensure consistent treatment across private companies and governmental entities.

Finally, it is important to note that formal SEC guidance recognizing floating NAV money market funds as cash equivalents under GAAP would not relieve corporate investors from tracking and reporting gains and losses for financial reporting purposes which, as indicated above, would in itself act as a strong disincentive to using money market funds as cash management vehicles.

There also may be financial reporting and disclosure considerations for a money market fund required to transition to a floating NAV. For example, it is unclear whether the floating NAV proposal would require the fund to provide a response to Item 77J of Form N-SAR regarding material changes in the method of valuation during the reporting period or whether it would require a response to Item 77L relating to changes in accounting principles and practices and a related letter from the fund's independent accountant approving the change in accounting principle. There also is a question as to how the floating NAV proposal would affect per share information reported in the financial highlights table (*i.e.*, would per share information need to be presented based on four decimal places?) and whether any change in value of the fund's investment securities attributable to the change in valuation methodology should be separately presented in the statement of operations or in the financial highlights table. We urge the SEC to consider and address these issues well before the compliance date for any floating NAV funds.

3. *Operational Processing and Cost Implications*

For many investors, a variety of business applications involving automated and specialized systems has made the $1.00 per share pricing vitally important to the usefulness of money market funds. Accommodating a floating NAV, therefore, would require significant industry and investor resources.

Money market fund advisers are already under significant cost pressures from prolonged low interest rates and regulatory uncertainty. Indeed, to avoid negative yields for investors, fund companies have waived significant fees and expenses since 2009. Investors have received virtually no yield on their investments during this time. Thus, the current environment discourages investors, intermediaries, and fund sponsors from expending significant resources to implement a floating NAV cash management product when there is very little return or incentive to do so, especially since alternative products (with lower implementation and ongoing costs) are available. Below, we discuss some of the primary systems, services, and stakeholders that would be substantially affected by a floating NAV requirement.

Same-day Settlement. Same-day settlement (T+0 processing) is important to many investors.[55] Many money market funds utilize ancillary and proprietary systems that support the same-day settlement transaction processing that includes the remittance of redemption proceeds through the Fedwire system throughout the day at various cutoff times (often hourly). The stable NAV allows sponsors to calculate each fund's NAV at the appropriate cutoff times using amortized cost, absent an event during the day that would be expected to move the NAV below \$0.995 or above \$1.005.

Elimination of the ability to use amortized cost to maintain a stable NAV for money market funds likely would force intermediaries and fund sponsors to consider how or whether they could continue to provide same-day settlement. Floating NAV money market funds may not be able to ascertain intraday market prices for fund securities (pricing vendors currently provide prices for money market securities only once a day after 4:00 p.m. Eastern). Indeed, we have concerns that pricing vendors may not be able to provide intraday data, or that the data they would provide would not be subject to comprehensive analysis and updating throughout the day.[56]

Therefore, to continue to offer same-day settlement for investors several times a day, funds not only would need to obtain reliable intraday data for securities from pricing vendors periodically during the day, but also would need to make significant systems modifications and procedural changes to support multiple, intraday NAV calculations. Once calculated, the variable NAV rate would need to be communicated to fund transfer agents and intermediaries (*e.g.*, portals) for transactions pended for processing intraday and transaction confirmations would need to be generated for investors (which are currently not required). This would require significant and costly changes to various systems, processes, and procedures that currently handle transaction requests utilizing a stable NAV. If intraday pricing and processing cannot be accommodated, the valuation process generally would occur only at the end of the day. Investors would have to decide whether end-of-day liquidity was sufficient for their needs; for many investors it would be inadequate.

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[55] Approximately two-thirds of money market fund assets are in institutional share classes that primarily use same-day settlement for their money market fund transactions. Some retail funds also offer same-day settlement, although the service is used to a significantly lesser degree.

[56] Given that many of the securities in which money market funds invest are not actively traded, funds rely on pricing vendors to provide market-based prices for purposes of calculating shadow NAVs. These prices are typically developed using "mark-to-model" or "matrix pricing" estimates. It is unclear whether pricing vendors would be able to provide multiple intraday price files for these securities.

Sweep programs. The stable NAV enables the processing of cash balances through cash sweep programs, in which all customer cash balances are "swept" into investments in shares of money market funds that are owned by the customers but transacted through fund accounts registered to a broker-dealer or a bank. Sweep programs cannot accommodate floating NAVs. These programs are predicated on the return of principal and would therefore be rendered inoperable by the possibility that money swept into the fund may be negatively impacted by a floating NAV product.

Shareholder cash management systems. It is not clear that specialized cash management systems could operate with a floating NAV or that shareholders would be willing to expend the resources necessary to modify existing systems to accommodate such a product.[57] Today's cash management systems are designed to utilize the constant share value afforded by a stable NAV fund. Examples of specialized shareholder systems that use stable NAV money market funds as cash equivalents for short-term liquidity include trust accounting systems at bank trust departments, corporate payroll processing, corporate and institutional operating cash balances, federal, state and local government cash balances, municipal bond trustee cash management systems, consumer receivable securitization cash processing, escrow processing, custody and investment manager cash balances, employee pension benefit plan processing, broker-dealer and futures dealer customer cash balances, and cash management-type accounts at banks and broker-dealers.[58]

Intermediaries. The floating NAV proposal would greatly increase the recordkeeping and reporting burdens on intermediaries that maintain omnibus accounts on behalf of their money market fund clients. Typically, intermediaries and others in the distribution chain do not maintain the capacity to process money market fund transactions using a floating NAV.[59] Intermediaries also are responsible for providing annual tax reports to their clients. As noted previously, a floating NAV would require intermediaries to track and report gains and losses, provide cost basis reporting, transfer basis information, and monitor for potential wash sales for all of their clients' money market fund transactions. Accordingly, intermediaries, such as broker-dealers, would need to modify their brokerage platforms, cash management systems, sub-transfer agent and recordkeeping systems, cost basis systems,

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[57] *See* U.S. Chamber of Commerce Center for Capital Markets Competitiveness, *Operational Implications of a Floating NAV across Money Market Fund Industry Key Stakeholders*, written by Treasury Strategies (Summer 2013) ("TS U.S. Chamber Report"), available at http://www.centerforcapitalmarkets.com/1/floating-nav-report_final3-0docx/. "The operational complexity, systems alternations, and business process changes needed to support a floating NAV threaten continued use of [money market funds] for most investors, including corporations and municipalities." *Id.* at 3.

[58] For a detailed description of each of these specialized systems that use stable NAV money market funds to hold temporary liquidity balances, *see* Letter from John D. Hawke, Jr., Arnold & Porter LLP, on behalf of Federated Investors, Inc., to The Honorable Mary L. Schapiro, Chairman, Securities and Exchange Commission (November 2, 2012), available at http://www.sec.gov/comments/4-619/4619-274.pdf.

[59] Under Rule 2a-7, as amended in 2010, money market funds (or their transfer agents) must have the capacity to redeem and sell fund shares at prices based on the funds' current NAV per share. This requirement did not extend to intermediaries. The Release acknowledges this gap, noting that funds, transfer agents, intermediaries, and others in the distribution chain may not currently have the capacity to process transactions at floating NAVs constantly, as would be required by the SEC's proposal.

customer statements and reporting, and other existing controls and procedures to accommodate money market funds with floating NAVs.

Confirmation of Shareholder Transactions. The Release acknowledges that if the floating NAV proposal were adopted, Rule 10b-10 under the Securities Exchange Act of 1934, the confirmation rule, may require broker-dealers to send confirmations to clients for every purchase or redemption of floating NAV money market fund shares. The rule currently provides an exception for transactions in money market funds that attempt to maintain a stable NAV, provided that no sales load is deducted upon the purchase or redemption of shares in the fund. For stable NAV money market funds, the rule permits a broker-dealer to provide transaction information to shareholders on a monthly basis in lieu of providing an individual, immediate confirmation for each purchase or redemption.

The potential cost of providing investors with immediate confirmations as required under the proposal is significant and an expense that is ultimately borne by investors. Given that the price fluctuations in floating NAV money market funds are likely to be insignificant, the need for investors to receive immediate confirmations does not appear to outweigh the costs to broker-dealers to provide confirmations on a transaction-by-transaction basis. Thus, we urge the SEC to permit broker-dealers to provide confirmations for floating NAV money market fund transactions on a monthly basis.

D. Floating the NAV Would Likely Reduce Capital Market Funding to the Private Sector

Assets in prime money market funds totaled $1,431 billion as of July 2013, of which $902 billion (63 percent) was in institutional share classes. Requiring prime institutional money market funds to float their NAVs risks precipitating an outflow of hundreds of billions of dollars from prime money market funds to other products. Indeed, a recent survey of 885 organizations by the Association for Financial Professionals found that 65 percent of organizations surveyed would be less willing to invest in floating NAV money market funds.[60] This could result in a major restructuring and reordering of intermediation in the short-term credit markets, and the transition is likely to be highly disruptive.

The effects of this shift on the money and capital markets and the economy at large are difficult to foresee precisely, as they would depend importantly to which products and in what proportions institutional investors redirect their assets.

Market participants indicate that many institutional investors—those who wish to continue investing in a money market fund product with a stable NAV—likely would shift to government money market funds. This will skew short-term funding away from private markets to the public sector. Depending on how much of the $902 billion in prime institutional assets investors redirect toward these funds, the effects could be quite significant. Flows into the Treasury and agency government market would significantly increase the demand for short-dated securities in these markets, which are already in short supply. Inflows into government money market funds likely would push the yields on these

[60] *See* AFP Survey, *supra* note 29.

securities to zero, or even to negative numbers in the secondary markets. Such yields might persist even when short-term interest rates begin to rise.

To the extent that assets flowed from prime money market funds to government money market funds, prime funds would be forced to sell or roll off their holdings. As of June 2013, prime institutional money market funds (or prime funds with institutional share classes) held $659.3 billion of private sector money market instruments such as commercial paper, bank CDs, Eurodollar deposits, medium term notes, and other securities (*see* Figure 5). Even if a portion of the outflows from prime institutional funds are invested in other products that can invest in short-dated money market instruments, the transition could be disruptive to these markets.

FIGURE 5

Money Market Instruments
Billions of dollars, June 30, 2013

	Money market fund holdings		
	All funds	Prime funds	Prime institutional funds
Security Type	**2,585.5**	**1,421.4**	**885.8**
Commercial paper	**393.8**	**382.9**	**244.0**
Asset backed commercial paper	98.3	97.2	64.2
Financial company commercial paper	208.3	206.3	130.8
Other	87.3	79.4	49.0
Certificates of deposits ("large time deposits")	**468.4**	**464.2**	**285.4**
Treasury and agency debt	**812.7**	**207.1**	**124.1**
Treasury debt	458.8	105.8	63.5
Agency debt	353.9	101.3	60.6
Repurchase agreements	**451.6**	**172.1**	**102.4**
Treasury repo	153.6	14.1	8.3
Agency repo	227.2	88.6	49.0
Other repo	70.8	69.5	45.1
Other notes and instruments	**459.0**	**195.1**	**130.0**
Variable rate demand notes	244.5	48.2	29.2
Other notes and instruments	141.7	139.4	96.0
Other	72.8	7.5	4.7

Note: Components may not add to the total because of rounding.

Source: Investment Company Institute tabulations of SEC Form N-MFP data

Some institutional investors may migrate from prime money market funds to non-money market fund products that can still offer a stable NAV. Many intermediaries already have the ability through banks to select among various sweep arrangements that seek to offer a stable unit value, such as repurchase agreement sweeps, commercial paper sweeps, and, importantly, sweeps into offshore (non-money market fund) accounts.[61] These products are not subject to the detailed regulatory requirements applicable to money market funds. In addition, new stable NAV money market fund-like products may be developed in offshore markets (*e.g.,* Bermuda and the Cayman Islands) that are largely beyond the jurisdictional reach of U.S. regulators. Regulatory changes that push assets from money market funds toward other money market instruments would disrupt the capital markets and fail in the long-run to address the concerns the SEC has raised, such as promoting safer capital markets and reducing risks to the economy at large.

Bank deposits are another alternative that institutional investors may consider. Generally speaking, corporate cash managers and other institutional investors do not view an undiversified holding in an uninsured (or underinsured) bank account as having the same risk profile as an investment in a diversified short-term money market fund subject to the risk-limiting conditions of Rule 2a-7. Despite this concern, there is some evidence that institutional investors are shifting toward bank deposit accounts. Figure 6 shows the proportion of nonfinancial corporations' short-term assets held in money market funds and bank checking accounts. The percentage invested in money market funds fell from 37 percent in 2008 to 21 percent in March 2013, while the share invested in bank checking accounts rose from 25 percent to 36 percent. This trend is apparently leading to a concentration in deposits at the very largest banks.[62] The reason for this trend is unclear, but could reflect market participants' views that the largest banks have an implicit guarantee from the federal government. Whatever the cause, the SEC has offered no reason to believe that a furtherance of this trend would reduce systemic risk. Notably, if a particular bank with a large amount of uninsured deposits were at risk, these deposits could flee, exacerbating strains at the bank, in the banking system, and in the economy at large.

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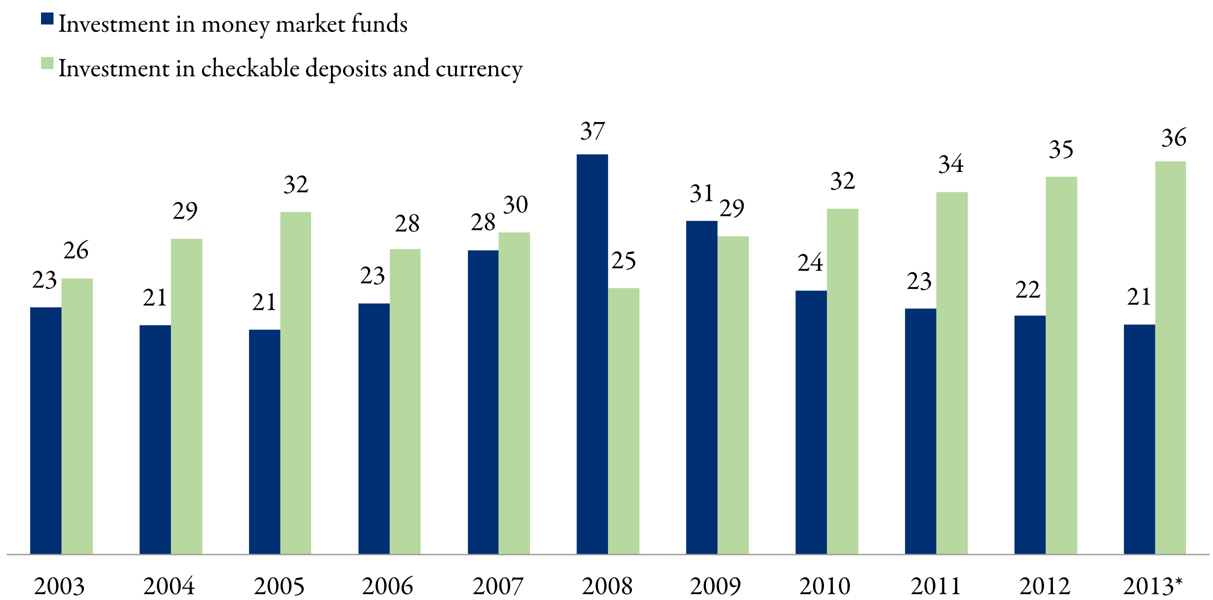
[61] For a general discussion of overnight sweep arrangements, *see* MMWG Report, *supra* note 4, at 43–44.

[62] *See* J.P. Morgan, *Short Term Market Outlook and Strategy* (June 3, 2013), available at https://markets.jpmorgan.com/research/EmailPubServlet?action=open&hashcode=i830bq1a&doc=GPS-1136176-0.pdf, at Exhibit 8 (showing that over 50 percent of uninsured deposits are with the four largest banks).

FIGURE 6

Percent of U.S. Nonfinancial Businesses' Short-Term Assets[1] in Checkable Deposits
*Percent, 2003–2013**



*Data as of March 31, 2013.

[1]U.S. nonfinancial businesses' short-term assets consist of foreign deposits, checkable deposits and currency, time and savings deposits, money market fund shares, security repurchase agreements, and commercial paper.

Sources: Investment Company Institute and Federal Reserve Board

E. Money Market Fund Pricing

1. *Share Price Rounding*

Under the SEC's floating NAV proposal, all money market funds, other than government and retail money market funds, would be required to price and transact in their shares at an NAV that is calculated to the fourth decimal place for shares with a target NAV of $1.00 (*e.g.*, $1.0000). These funds would be permitted to use amortized cost to the same extent as other mutual funds, *i.e.*, for securities maturing in 60 days or less.

The Release argues that this level of precision would increase the observed sensitivity of a fund's share price to changes in the market values of the fund's portfolio securities, and should better inform shareholders of the floating nature of the fund's value. In addition, the SEC believes that "basis point" rounding would help stabilize funds in times of market stress by deterring redemptions from investors that would otherwise seek to take advantage of less precise pricing to redeem at a higher value than a more precise valuation.

Accounting Series Release 219 ("ASR 219"), which predates the adoption of Rule 2a-7, provides that the appropriate standard of materiality when calculating a mutual fund's NAV is 1/10th of 1 percent. Thus, for mutual funds that typically offer their shares at an initial price of $10 (*i.e.*, funds that are not money market funds), this equates to $0.01; accordingly, an NAV per share of between $9.995 and $10.005 would round to $10.00.

Rule 2a-7, as adopted in 1983, expands the standard articulated under ASR 219 and permits a money market fund to use "penny rounding" on a $1.00 NAV; as a result, a money market fund NAV of between $0.995 and $1.005 would round to $1.00. This penny-rounding convention, and the use of amortized cost to value all of its securities, is currently available to a money market fund provided that it complies with the risk-limiting conditions of the rule.

We believe virtually all mutual funds round their calculated NAV, regardless of share price, to the nearest penny for purposes of processing trades in fund shares.[63] *By contrast, the SEC's proposal would require money market funds to comply with a pricing standard that is 10 times more precise than the standard articulated in ASR 219.* Indeed, money market fund shares fluctuate so little that the SEC has proposed an artificially sensitive pricing scheme to force "movement" in the NAVs of the funds. The only result of such disparate treatment would be to drive investors and intermediaries to other products that are not burdened by this pricing standard. Thus, for example, under ASR 219, an ultra-short bond fund manager could initially price the fund's shares at $10 and structure its portfolio (*e.g.*, by creating a very liquid portfolio with a majority of its securities maturing in 60 days or less) so that its NAV fluctuates less than the NAV of a floating money market fund. We doubt investors would buy a money market fund that potentially floats more than an ultra-short bond fund, particularly if, as discussed above, outstanding tax, accounting, and operational complexities associated with a floating NAV product destroy the convenience and simplicity of money market funds for investors and intermediaries.

Four decimal place precision could, in effect, be accommodated within the current system of penny rounding if money market funds adopted a target NAV of $100.00. ICI members have indicated that investors would be reluctant, however, to utilize a cash management product priced at $100.00. Thus, most money market fund shareholder recordkeeping systems and ancillary systems—used by funds, intermediaries (*e.g.*, banks, broker-dealers, bank trust companies, retirement plan record keepers), and municipal and corporate entities—would require significant modification to comply with basis

[63] Rule 2a-4 under the Investment Company Act provides support for this practice. In particular, Rule 2a-4(b) provides that daily accrual of fund expenses, dividends receivable, and interest income need not be reflected in the NAV so long as they do not cumulatively amount to as much as 1 cent per outstanding share.

point pricing (*i.e.* \$1.0000). These systems, many of which are designed for different (non-money market fund) investment products, typically process and record-keep transactions using two decimal points in today's environment.[64] Storing and using the proposed expanded basis point pricing for money market funds as proposed would require extensive, fundamental changes to core record keeping system components used to calculate transactions for *all* mutual funds. Ancillary investor-facing inquiry and trading systems also would require modification to provide expanded price support. Transaction calculation accuracy and consistency would rely on application of expanded "fractional cent" rounding logic between funds and their intermediary partners (as compared to other mutual fund products), to avoid costly and recurring reconciliation issues that do not exist in the current mutual fund NAV processing environment. Data files used to deliver NAV prices and daily confirmation information also would require review, modification, and testing. Shareholder confirmations and statements would need corresponding layout and descriptive changes.

The operational implications, complexity and costs associated with implementing basis point pricing significantly adds to the costs of implementing a floating NAV money market fund product. The burdens of this new requirement, in addition to other changes noted above, would further drive funds, intermediaries and investors away from offering or investing in such a product. If the SEC requires money market funds to float their NAVs, money market funds should be permitted to price and transact their shares consistent with all other floating NAV mutual funds.

2. *Amortized Cost Valuation*

ASR 219 permits mutual funds, including money market funds, to use amortized cost to value securities, provided the securities have maturities of 60 days or less. Although the text of the Release states that floating NAV money market funds would be permitted to use amortized cost similar to other mutual funds under ASR 219, the language in footnote 136 in the Release suggests, perhaps inadvertently, that the SEC may be articulating a new or heightened interpretation of ASR 219. Specifically, the footnote states that ASR 219 "effectively limits the use of amortized cost valuation to circumstances where it is the *same as* valuation based on market factors" (emphasis added). It is unclear whether this means that amortized cost must at all times be identical to a market-based price, or whether it is just another way of saying funds must use market-based pricing and not amortized cost. We urge the SEC to clarify that ASR 219 and its interpretations remain unchanged.

Given the short-term, high quality nature of money market fund instruments, we believe amortized cost is substantially identical to market-based pricing under normal market conditions for securities with maturities of 60 days or less.

[64] Currently, many systems are capable of extended pricing during certain corporate action events such as fund mergers, NAV splits, or reversals, to ensure accuracy and ease reconciliation issues. These back-end processes, however, do not extend to shareholder transaction processing, money settlement, shareholder statements, and confirmations.

F. The Retail Exemption

We support the SEC's recognition that its proposals should be appropriately targeted. In the event that the SEC determines to require, despite our longstanding concerns, certain money market funds to float their NAVs, we agree that "retail" funds should be exempt from the floating NAV requirement. Money market funds provide retail investors access to investments not otherwise affordable or accessible—such as commercial paper issued in minimum denominations beyond the reach of the average investor. Maintaining the availability of prime stable NAV money market funds for retail investors, therefore, is particularly important because these funds provide diversification and a market-based rate of return that is not otherwise available through a bank deposit account. (As discussed, these features are often important to certain institutional investors as well.)

The SEC explains that it is proposing a retail exemption because retail investors historically have behaved differently from institutional investors in a crisis, being much less likely to make large redemptions quickly in response to market stress. As proposed, a retail fund would be defined as a money market fund that does not permit any shareholder of record to redeem more than $1 million per business day. To accommodate retail investors that purchase money market fund shares through omnibus accounts, the proposal would permit omnibus accounts to exceed the $1 million redemption limit, provided the fund has policies and procedures reasonably designed to allow the conclusion that the intermediary implemented the limit on underlying accounts. The SEC does not mandate how funds must satisfy the requirement to have policies and procedures to allow that conclusion. Rather, the fund would be expected to "manage these relations in whatever way that best suits their circumstances."[65] The Release suggests, by way of example, that the fund may enter into agreements with intermediaries requiring them to impose the limit, obtain certifications from intermediaries regarding their imposition of the limit, or obtain transparency into transactions in omnibus accounts. Funds that adhere to the retail fund definition would be permitted to continue to maintain a stable price. Funds with separate share classes for different types of investors (as well as funds that mix different types of investors together) that wish to offer a stable price would need to reorganize, offering separate money market funds to investors who are willing to accept the $1 million per day redemption limit and those who are not.

The Release acknowledges that it could be difficult to distinguish objectively between retail and institutional investors. Currently, funds generally offer "retail share classes" or "institutional share classes," or both, but there are no consistent criteria for defining such share classes and no industry definition of either a retail investor or a retail money market fund. Indeed, although some fund sponsors do offer money market funds primarily to clearly identifiable retail or institutional investors, many funds include a substantial combination of both types of investors that are not so easily categorized. Because there are important areas of overlap between retail and institutional investors, drawing a bright line between types of investors is quite challenging and could lead to inconsistencies across the industry. For example, although retail investors typically invest in money market funds through retail share classes, they also invest in institutional share classes, through 401(k) plans or broker or bank sweep accounts,

[65] *See* Release, *supra* note 2, at 90.

where assets of retail investors are held in omnibus accounts but where control of the investments nevertheless ultimately remains with an underlying retail investor.

Despite these definitional challenges, the SEC suggests that a daily redemption limit would be "relatively simple to implement, since it would only require a retail money market fund to establish a one-time, across-the-board redemption policy."[66] The SEC also maintains that the daily redemption limitation approach should allow a fund to manage redemptions effectively in a crisis because it would limit the total amount of redemptions a fund can experience in a single day. In selecting the proposed $1 million redemption limit, the SEC explains that it sought to find a threshold that is low enough that institutions would self-select out of retail funds, but high enough that it would not impose unnecessary burdens on retail investors.

As discussed further below, we have concerns that the SEC's proposed approach to defining a retail fund would be operationally more onerous than other methods and would negatively impact investors by restricting their daily liquidity in money market fund investments.[67] We describe these impediments for the SEC's consideration. We therefore recommend an alternative method of distinguishing between retail and institutional money market funds.

1. *Role of Intermediaries*

Today, many shareholders do not purchase, sell, and hold their money market fund shares directly with the fund. Instead, these shareholders hold money market fund shares through intermediaries that provide recordkeeping and other services to their clients and transact money market fund shares on their behalf. Examples of intermediaries that offer money market funds to their customers are broker-dealers, bank trust departments, insurance companies, retirement plans, 529 plans, and money market fund portals.

- Both broker-dealers and banks use money market funds as a sweep investment vehicle for client end-of-day cash balances. In addition, broker-dealers (as part of typical brokerage services) and banks (while providing trust and custodial services) service investors that hold money market fund positions that may include check-writing and debit card services. They also may serve investors that hold money market funds in retirement, 529 plans, and other tax-advantaged savings accounts. In most cases, these intermediaries hold both sweep and customer investments in omnibus accounts.

- Defined contribution plans (and other types of tax-advantaged retirement savings accounts) use money market funds as a low risk investment option for plan participants. The assets in these plans also are typically held on the books of the fund in omnibus accounts.

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[66] *See* Release, *supra* note 2, at 80.

[67] ICI's membership includes complexes that, unlike others, have a large direct shareholder component. For practical reasons, the views of these members on the implementation of the $1 million daily redemption limit may differ from those of other complexes as the redemption limit likely would be far easier for those fund families with direct shareholders to implement.

- Insurance companies may use money market funds as part of variable insurance product contracts, which reside in omnibus accounts on funds' books.

- Larger institutional investors use portals to purchase and redeem money market fund shares efficiently from different fund sponsors. Portals systems and software are integrated with treasury management and other investor systems to ensure compliance with corporate investment policies.

Intermediaries typically process customer transactions through the National Securities Clearing Corporation ("NSCC") for their omnibus or intermediary controlled accounts. They also process large volumes of aggregate money market fund trade orders (*e.g.*, for sweep same-day settlement money market fund transactions) directly with the fund. An omnibus account includes the shares of multiple investors—sometimes numbering in the thousands—that are customers of the intermediary. Omnibus accounts are held on the books of a fund in the name of the financial intermediary, acting on behalf of its customers. When an intermediary submits its transactions for an omnibus account, whether through the NSCC or direct with the fund transfer agent, it usually consolidates the transactions of all customers that are purchasing or redeeming shares of the same fund that day into one or a few "summary" transactions for processing by the fund.

As a result of investors' extensive use of financial intermediaries to effect mutual fund transactions, a mutual fund recordkeeper may have limited information about the underlying shareholders in omnibus accounts. Although the fund's lack of information does not affect the shareholder's ownership rights, it does impair the fund's ability to know the identity and detailed transaction activity of each underlying shareholder. Without a direct relationship with these underlying shareholders, the fund does not have access to beneficial owner account-level information.[68] Thus, *intermediaries* would be responsible for enforcing a fund's retail exemption with respect to their customers' money market fund shares.

2. *Redemption Limits Impair Investor Liquidity and Will Pose Operational Challenges*

Although redemption limits may appear to be easy to understand and implement, the reality is very different. Redemption limits not only impair investor liquidity, but are operationally complex and expensive to implement.

Retail investors utilize money market funds for a variety of purposes, many related to short -term cash management needs. Such needs can vary but may include the following:

[68] Any underlying information provided by intermediaries post transaction processing may be limited (such as snap shot information that is partially disclosed, or that contains incomplete information about underlying shareholders), and is not incorporated in the fund's primary transfer agent recordkeeping system.

- Cash sweep products offered through intermediaries use money market funds to invest the daily un-invested cash balances of retail investors.[69] Typically, after all other transactions for the day have been posted, the total remaining collected balances (or all available cash) in customer accounts are invested in (swept into) money market funds.

- Check writing and debit card transactions are processed against money market fund investment account balances on a daily basis.

- One-time redemption requests to cover large payments, such as the purchase of a home or real estate.

- Short-term or temporary investment of security transaction proceeds that are needed to settle other securities transactions that are on a different settlement cycle. This is a common occurrence when an investor or financial advisor is rebalancing or reallocating assets to meet revised investment objectives over time.

Any definition of retail money market fund that limits an investor's ability to access the investor's available shares in a money market fund account can create acute liquidity issues. The fund or intermediary is placed in the unenviable position of standing between the retail investor and the immediate or near-term cash need, and then communicating to the investor that the redemption request cannot be honored. Even with disclosure, certain investors might forget such restrictions exist and fail to plan ahead, which could be quite disruptive to the investor.

From an operational perspective, the proposal would require the daily redemption limit to be applied to each "shareholder of record." Fund recordkeepers and intermediaries would be required to utilize "reasonably available identifying information on hand" to aggregate transaction activity where multiple accounts or money market fund investments in the same fund are held by a shareholder of record when applying the redemption limit, including those with joint ownership.[70] The operational burden of defining, identifying, and tracking "shareholder of record" accounts within a fund by itself is a significant operational burden; however, it becomes even more burdensome and difficult to apply for daily transaction processing purposes and would certainly create investor confusion regarding the impact on their redemption requests, as well as significant operational complexities for intermediaries.[71]

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[69] Uninvested cash balances for retail investors serviced by intermediaries can widely vary from day-to-day as other investment securities are liquidated or purchased or margined positions are changed in their accounts.

[70] *See* Release, *supra* note 2, at 92-93 and n. 229.

[71] The SEC assumes that funds and intermediaries would adopt the same criteria to determine "shareholder of record"; however, determination of account registration and type is done individually at the opening of every account. Each fund complex or intermediary has hundreds of varying account registration types tailored for its business structure. Since many fund families and intermediaries utilize third-party recordkeeping systems, these system providers would incur significant costs to program and implement the added functionality to address the variability and complexity that would exist for retail funds.

As proposed, the redemption limit for retail investors would require costly programming for funds and intermediaries to apply the "shareholder of record" definition, limit daily redemption transactions to $1 million, and create exception processing, procedures, and related controls to ensure compliance with the new requirements. For *every retail redemption transaction received*, the following steps would need to occur:

1. Identify the investor's accounts to which the definition applies, using whatever criteria the fund uses to define "shareholder of record."

2. Verify that each redemption transaction (as well as the aggregation of multiple redemption requests) does not exceed the daily redemption limit for all the accounts of a "shareholder of record."

3. Implement exception processing and procedures to reject, limit, or pend transaction requests in excess of the limit. These procedures will likely include costly and very time-sensitive manual intervention to communicate with investors that exceed the redemption restriction.

4. Create controls, reports, and procedures to reconcile exceptions and ensure compliance with the new requirements.

Although the processing changes would be automated, funds and intermediaries would need to execute the complex process flow for millions of retail investors that transact each day through various interfaces for different accounts for each retail money market fund. Programming, systems processing, and procedures would have to accommodate changes for same day and next day settlement cycles.[72] Related exception processing also would require significant manual intervention, and creates investor servicing issues. Contrary to the SEC's belief that its proposed daily redemption limit method of defining retail funds is intended to be "relatively simple to implement,"[73] it would impact systems and redemption processing for retail money market funds in a way that is highly burdensome and unwieldy.

Any "shareholder of record" that exceeds the redemption limit[74] because of multiple transactions (orders) received on the same business day,[75] creates additional challenges for funds and intermediaries. Even though the proposal requires prospectus language to outline the treatment of redemption requests that would exceed the daily threshold, funds and intermediaries are most likely immediately to contact any investor that exceeds the redemption limit to determine if an alternative course of action is needed. Determining which redemption orders constitute an "excessive redemption

[72] Funds and intermediaries utilize multiple systems (primary and ancillary to core recordkeeping systems) for transaction processing, which occurs through batch cycles that are run nightly. In many cases, transactions that are rejected are not known until the next business day.

[73] *See* Release, *supra* note 2, at 80.

[74] The Release refers to this as an "excessive redemption request." *See id* at 87.

[75] Although the Release addresses the operational implications of an excessive redemption request in one order, it does not address an excessive redemption request caused by multiple orders.

request," processing orders up to the redemption limit, managing any related exception processing and completing any investor communications all must occur in a very short timeframe. For these reasons and others detailed above, we believe an alternative retail definition would better serve investors than the daily redemption limit proposal. The alternative should be one that investors could easily understand and would not impair their access to liquidity, as well as lessen the operational complexity, shareholder servicing burdens, and related costs for funds, intermediaries, and service providers to implement and operate on a daily basis.

3. *Use of Social Security Numbers Provides a Better Method of Defining a Retail Fund*

ICI has considered a variety of ways to define "retail investors." As discussed above, we believe the SEC's proposed daily redemption limit is too complicated and costly for funds and intermediaries to implement. As an alternative, we recommend using an SSN to identify retail investors eligible to invest in retail funds. Under this proposed alternative, *any account opened by a fund or intermediary that has captured an SSN as a (tax) identification component for the registered owner or beneficial owner of an account would qualify for investment in a stable NAV retail money market fund.* This approach would capture a very large percentage of retail fund investors, including those invested in tax-advantaged savings accounts (as discussed below), retail brokerage, and certain trust accounts[76] that are held in the name of the intermediary on the fund's transfer agent records.

Using SSNs in the definition of a retail fund would be less costly to implement than other alternatives that have been explored, including the proposed daily redemption limit. An investor opening a mutual fund account is required to provide identification information, including an SSN or other tax identification number.[77] The SSN is a well-established attribute, which is issued to a natural person who qualifies under the SSA requirements. Thus, an SSN can clearly distinguish retail from institutional investors, which are typically corporations or other entities that do not have SSNs. Since SSNs are currently obtained as part of the account opening process and are populated in transfer agent and intermediary recordkeeping systems, enhancements to systems, processes, and procedures would be minimal for the industry. Additionally, controls to monitor compliance and oversight functions would be much easier to implement, maintain, and adhere to for retail funds.

For intermediaries using omnibus account registrations where the underlying customers or beneficial owners are individuals (*e.g.*, retail brokerage accounts, certain trust accounts and defined contribution plan accounts), an SSN is a core component of their customer account opening and

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[76] For a description of certain trust accounts associated with SSNs, *see* Letter from Scott C. Goebel, Senior Vice President and General Counsel, FMR Co, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 16, 2013), at n. 55.

[77] Anti-money laundering rules, including customer identification rules, require a financial institution to identify and verify the identity of the customer opening the account. This includes a requirement to obtain a taxpayer identification number. *See, e.g.,* Joint Final Rule: Customer Identification Programs for Mutual Funds, SEC Release No. IC-26031 (April 29, 2003). In general, Section 326 of the USA PATRIOT Act directs the Secretary of the Treasury (through FinCEN) to prescribe regulations setting forth minimum standards regarding the identity of the customer that shall apply in connection with the opening of an account with a financial institution. *See* USA PATRIOT Act § 326, *codified at* 31 U.S.C. § 5318(l).

compliance processes as well as being part of beneficial owner account data. Consequently, intermediaries would have the ability to determine retail investors by using the SSN attribute as their key criteria for defining which investors qualify for investment in stable NAV retail money market funds under the retail exemption. Funds would need to determine how best to monitor each intermediary for compliance with the SSN requirement but this would be easier and less costly to manage from a compliance and oversight perspective than other alternatives considered for defining a retail investor.[78]

Unlike other proposed methods of distinguishing retail and institutional funds, individual investors are familiar with using an SSN as a tax identification number. Using SSNs also significantly simplifies the implementation and client servicing requirements for investors during and after the transition to new rules.

Use of SSNs to define a retail fund would include accounts invested in money market funds through tax-advantaged savings accounts. This would meet the SEC's stated goals of allowing less reactive investors to continue using a stable NAV while at the same time minimizing operations costs and burdens on funds and intermediaries.

Since the account owner or beneficial owner for tax-advantaged savings accounts is an individual, an SSN is part of the account data that fund sponsors, intermediaries, and industry service providers collect for each account. Allowing these accounts to remain invested in a stable NAV money market fund would ensure that millions of retail investors who are saving for retirement, their children's education, or for medical expenses later in life can retain the full benefits of an important cash management and risk diversification investment product for their current and future savings needs.

The following are examples of tax-advantaged savings accounts.

Retirement Plans: As of March 31, 2013, $368 billion was invested in money market funds in individual retirement accounts ("IRAs") ($217 billion) or through defined contribution plans ($151 billion). Defined contribution plans use money market funds to offer plan participants a low risk investment option. Similarly, IRA investors also may use money market funds to invest a portion of their retirement savings, or, after retirement, to make purchases or pay bills directly through a money market fund.

IRA investments and defined contribution plan assets may flow to money market funds through omnibus accounts whose "shareholder of record" is an institution, such as a broker or a 401(k) plan recordkeeper. These assets, however, typically are controlled either by, or on behalf, of an underlying individual investor using an SSN rather than an institutional investor.

[78] Today mutual funds use a variety of oversight techniques for their intermediaries. Contracts, certifications, questionnaires, attestations, and site visits are among the many tools funds employ to ensure intermediaries are complying with regulatory and business obligations. Monitoring of intermediary enforcement of an SSN requirement would be included in the fund's comprehensive oversight program.

In addition, mutual fund investors saving for retirement, such as through a defined contribution plan or an IRA, are among the most stable of all investors in the financial markets. For example, as Figure 7 shows, assets in prime retail money market funds[79] are much more stable than those in prime institutional money market funds. Notably, following the federal government's decision to let Lehman Brothers fail, prime institutional money market funds experienced large outflows totaling $301 billion in the third quarter of 2008, whereas prime retail funds saw outflows of only $28 billion. In stark contrast, prime money market funds saw *inflows* of $17 billion from IRAs and another $9 billion from defined contribution plans. Over the period 2007 to 2013:Q1, prime money market funds experienced flows from defined contribution plans and IRAs that were considerably less variable in dollar terms than flows from other types of assets to prime institutional money market funds (or share classes).

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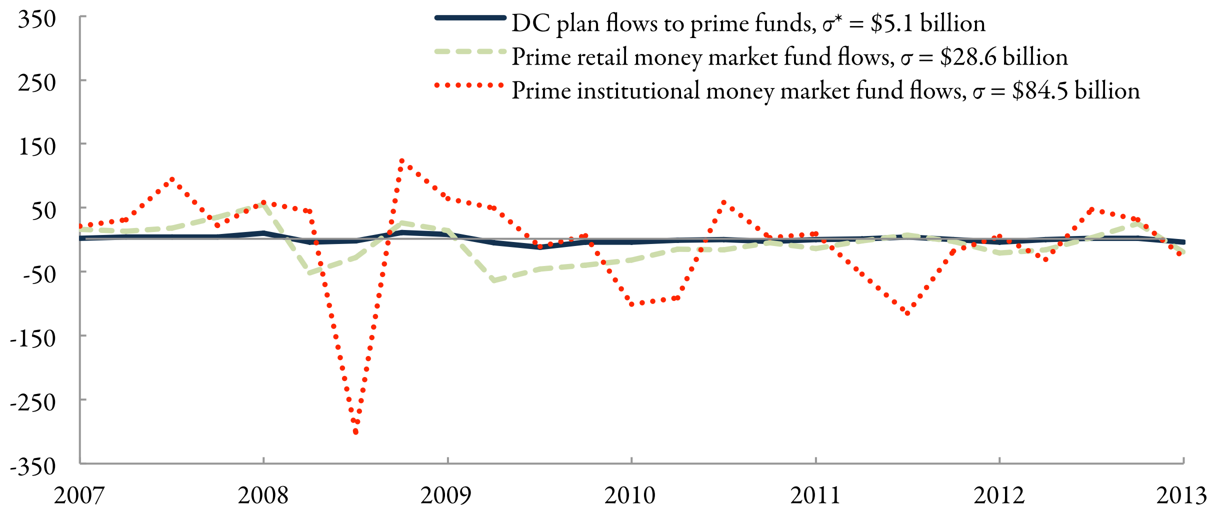
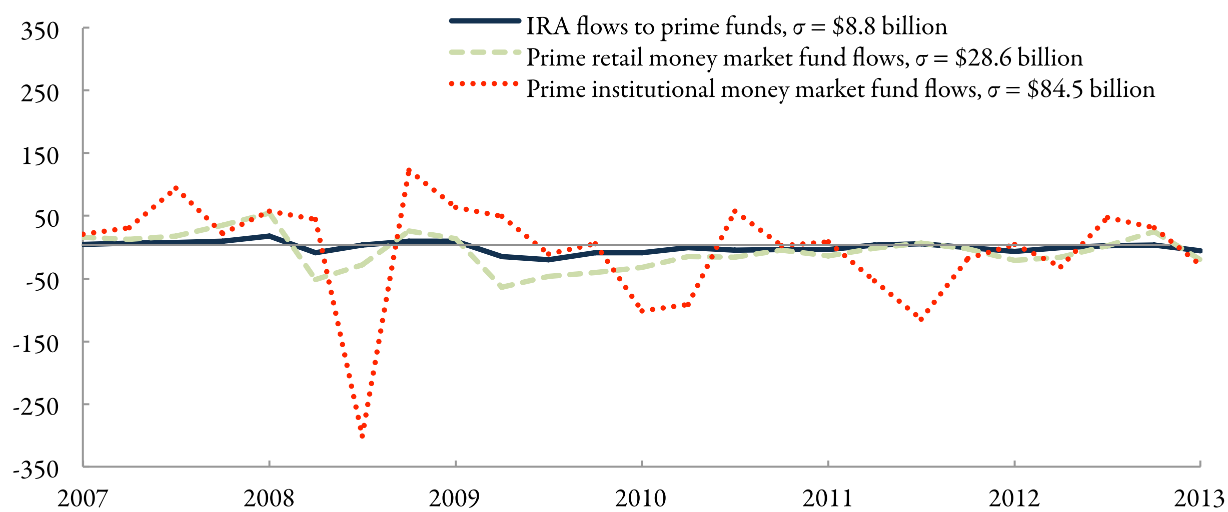
[79] ICI classifies "retail funds" by using language in fund prospectuses and including assets in stand-alone funds as well as assets in all share classes of multi-share class funds that are not sold primarily to institutional investors or institutional accounts. We caution that under this definition some significant portion of the assets classified as "institutional" include accounts that are purchased by or through an institution such as an employer, trustee or fiduciary on behalf of clients, employees, or owners. These "institutional" funds and classes include assets of retail investors who are the ultimate beneficiaries, such as employees in 401(k) plans whose assets may be invested in money market funds through institutional share classes.

FIGURE 7

Defined Contribution ("DC") Plan and IRA Flows to Prime Money Market Funds Are Very Stable

Billions of dollars, quarterly, 2007:Q1–2013:Q1



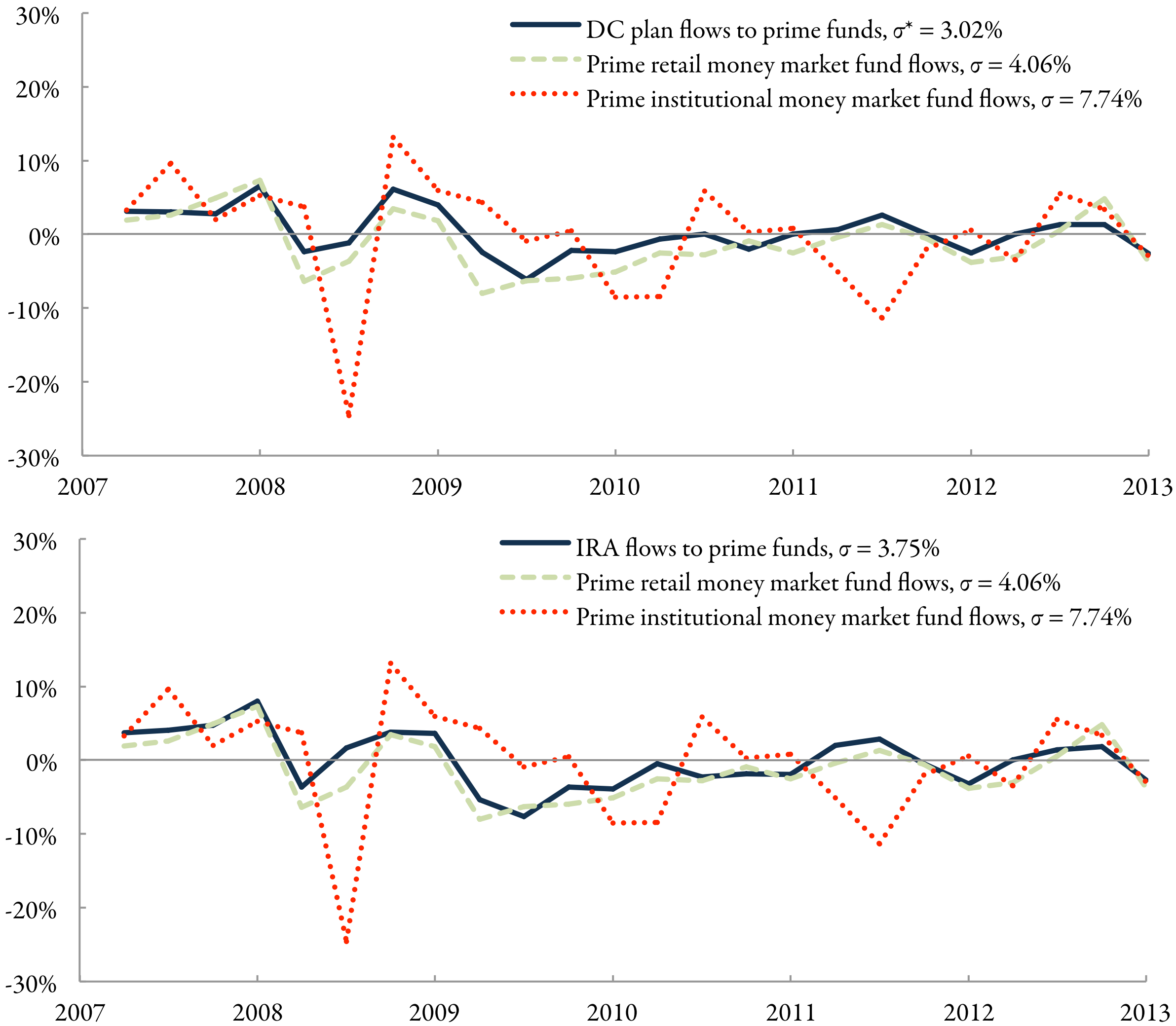


*Note: "σ" represents the standard deviation.
Source: Investment Company Institute

The stability of flows to prime money market funds from IRAs and defined contribution plans also is apparent in percentage changes. Figure 8 shows flows to prime money market funds from IRAs and defined contribution plans, scaled by the prime money market fund assets (as of the previous quarter end) attributable to IRAs or defined contribution plans, respectively. In percentage terms, flows to prime money market funds from defined contribution plans and IRAs are considerably more stable than flows from other types of assets to prime institutional money market funds and mirror the stability of the percentage flows to prime retail money market funds.

FIGURE 8

Defined Contribution ("DC") Plan and IRA Flows to Prime Money Market Funds Are Very Stable
Flows as a percentage of previous period assets, quarterly, 2007:Q2–2013:Q1



*Note: "σ" represents the standard deviation.
Source: Investment Company Institute

Education Savings Plans: Education savings plans, including "529 plans," also are tax-advantaged savings plans designed to encourage saving for the qualified education expenses of a beneficiary who must be designated and identified using an SSN when the account is opened. For example, 529 plans are sponsored by states, state agencies, and educational institutions subject to strict requirements imposed by Section 529 of the Internal Revenue Code on the establishment and use of such accounts. In particular, with limited exceptions, an account holder only can withdraw money that is invested in a 529 plan for qualified higher education expenses without incurring taxes and penalties. In addition, participants in college savings plans have limited investment options, which are determined by the state or other plan sponsor, and they are not permitted to switch freely among available investment options. Indeed, under current law, an account holder is only permitted to change his or her investment option one time per year. As a result, redeeming or exchanging from such an account outside the strict parameters of the Section 529 would subject the account holder to significant tax penalties. Most importantly, however, the assets invested in money market funds through these plans are *de minimis*, perhaps totaling only a few billion dollars.[80] Thus, no plausible argument can be made that the investments of these and other educational savings plans in money market funds pose any possible "generalized" risks to the financial markets.

Medical Savings Accounts: Medical savings accounts, including Health Savings Accounts and Medical Savings Accounts, are tax-advantaged savings plans designed for individuals whose medical insurance coverage is through a high deductible health plan. The IRS imposes strict limits on the use of these accounts. As with retirement and education savings plans, a health savings account holder must provide an SSN to open an account and only may withdraw money that is invested in these plans for qualified medical expenses without incurring taxes and penalties. Although these plans only make up a small percentage of all tax-advantaged savings plans, they mirror the same tax limitations that strongly discourage account holders from placing withdrawals (redemptions) outside the strict parameters imposed by IRS regulations.

Past regulatory efforts to distinguish between retail and institutional investors have been unsuccessful due, in part, to a lack of consistency in how fund sponsors have structured their funds and categorized retail versus institutional funds. By using an investor's SSN, the distinction between retail and institutional becomes a straightforward exercise using existing data that is obtained when opening an account for every investor. Using SSNs in the definition of a retail fund then becomes a simple application of information already provided by investors and already held by funds and intermediaries. In comparing the simplicity of using SSNs to the highly complex and costly modifications of other alternatives, the SSN clearly stands out as the most efficient and effective method for defining a retail investor. We therefore urge the SEC to use the SSN standard, in lieu of daily redemption restrictions, for the purpose of the retail exemption for stable NAV pricing.

G. Exemptions Under the Investment Company Act

Under the floating NAV proposal, the SEC would retain two exemptive rules that are designed to protect shareholder interests: Rule 17a-9, which allows money market fund affiliates to purchase portfolio securities from a fund for a variety of purposes, including to help the fund maintain a stable

[80] Data on assets in 529 plans are available on a state-by-state basis from College Savings Plan Network. Details about the allocation of these assets to types of underlying investments is generally not available. On the basis of data available from third-party mutual fund data providers, it is possible to identify only $1.1 billion invested in money market funds through share classes specifically designed for 529 plans.

NAV, and Rule 22e-3, which allows a fund board to suspend redemptions and begin an orderly liquidation if the fund has broken or is about to break the dollar.

The SEC adopted Rule 17a-9 in 1996 (and then expanded it in the 2010 amendments) to codify a series of no-action letters in which the SEC staff agreed not to recommend enforcement action if affiliated persons of a money market fund purchased portfolio securities from the fund to prevent the fund from realizing losses on the securities that may otherwise have caused it to break the dollar. The SEC adopted the rule because in its experience these type of transactions appeared to be "fair, reasonable, in the best interests of fund shareholders, and consistent with the requirement that money market funds dispose of a defaulted security in an orderly manner as soon as practicable."[81] Sponsors engage in affiliated support transactions for a variety of reasons, often having little to do with any risk that the fund might break the dollar. For instance, a fund sponsor may buy downgraded securities from a fund's portfolio to maintain the fund's AAA credit rating. To provide fund sponsors with flexibility to protect shareholder interests, the SEC proposes to continue to allow fund sponsors to support money market fund operations, provided such support is thoroughly and consistently disclosed. We believe these types of transactions are in the best interests of shareholders whether a fund's NAV is stable or floating, and therefore support retaining the rule.

Rule 22e-3 facilitates the orderly disposal of assets in a troubled fund in a manner that protects the interests of all shareholders—making it possible to avoid a fire sale of portfolio securities or a first-mover advantage for early redeemers. As discussed above, the experience of products with a floating NAV indicates that variable NAVs do not preclude the possibility of substantial shareholder outflows. Indeed, the SEC acknowledges that outflows from a money market fund might occur even if the fund has a floating NAV. The exemptive rule provides needed flexibility for emergency situations; it is difficult for the SEC to provide individual exemptive orders as quickly as a fund's board would be required to react. We therefore support the SEC's proposal to retain Rule 22e-3.

H. Transition and Compliance Period

The SEC proposes to delay compliance with the floating NAV proposal for a period of 2 years from the effective date of its proposed rulemaking. Under the proposal, money market funds subject to the floating NAV proposal could continue to price their shares as they do today for up to 2 years following adoption. On or before the compliance date, all stable value money market funds not exempted from the floating NAV proposal would convert to a floating NAV.

Without addressing specific investor concerns and allowing for sufficient preparation in advance of implementation, it is very likely that the transition from stable to floating NAV itself could be destabilizing to the financial markets. It could require money market funds to shed hundreds of billions of dollars of commercial paper, bank certificate of deposits, Eurodollar deposits, repurchase agreements,

[81] *See Revisions to Rules Regulating Money Market Funds*, SEC Release No. IC-21837 (March 21, 1996), 61 FR 13956 (March 28, 1996) at 13974; 2010 Money Market Fund Reform Adopting Release, *supra* note 5, at 10088. The rule imposes strict conditions designed to assure that any such transactions do not provide the opportunity for abusive conduct by fund affiliates.

and other assets, as their investors redeem in favor of other products, including government money market funds. Even assuming the calmest of financial market conditions, this would be an unsettling and difficult process.

Redesigning fund structures to a floating NAV would be a dramatic change requiring many steps to ensure a smooth transition for fund, intermediaries, and investors. As discussed above, the industry would need to make significant modifications to a variety of systems to transact and accommodate same-day settlement for floating NAV money market funds, properly maintain shareholder, accounting, and tax records, including the implementation of complex tax reporting that will be necessary for floating NAV money market funds.

Institutional investors would be significantly impacted and would need to make changes to their accounting, tax and cash management systems to accommodate a floating NAV. In addition, many investors would need to analyze their cash management strategies to determine how much, if any, of their short term cash can be held in a floating NAV investment. This could involve changes in their investment policies that require approval by various management committees and potentially boards of directors, as well as changes to loan covenants and financing terms. Once all the preliminary work is finished and investment strategies are revised and approved, daily cash management functions would need to be modified to handle any investments in a floating NAV product and other cash management options.

Applying the retail exemption for stable NAV money market funds also is a complex and labor intensive undertaking. Funds that currently have single or multi class structures would need to determine if they want to continue to offer a retail money market fund product and, if so, complete the necessary work to convert their existing retail funds or create, register, and establish new retail funds as defined in the final rules. Funds would need to analyze current shareholders to determine which shareholders would qualify to invest in a retail money market fund. Shareholders that qualified would need to be informed of the pending changes in the fund structures and advised of any steps they may need to take to ensure a smooth transition. Intermediaries serving investors in retail funds also would have to perform similar activities, but only after fund sponsors restructured their funds.

Funds would need to devise a strategy for those shareholders that do not qualify for the retail exemption but also do not meet funds' current qualifications for floating NAV institutional share classes (typically determined by minimum investment amount). Funds may choose to change the existing qualifications of an institutional share class to accommodate these investors or may offer other investment alternatives. Likewise, intermediaries would also need to address this same category of investor. Regardless, a monumental effort would be necessary to inform existing shareholders of changes, and then manage the transition for intermediaries and investors, including answering inquiries and completing the necessary follow up to ensure a smooth transition for investors.

To support a smooth transition for investors and intermediaries, customer service staff would require significant training to utilize modified systems, processes, and procedures, and to accurately inform shareholders about the changes, including options available to investors that are impacted by the changes. Funds would need to determine the appropriate method to ensure intermediaries complied with the requirements of a retail exemption for omnibus accounts and to develop processes and procedures to include those compliance requirements in new or existing oversight programs. Intermediaries would face many of the same strategic and client servicing challenges as funds. Determining which short term investment options to maintain, where gaps in options would result due to final rules, and what alternatives can be used to fill those gaps would entail significant time and resources for intermediaries.[82] Intermediaries would need a substantial amount of time to design and implement a transition strategy for their customers prior to the effective date of final rules.

Mitigating impact to shareholders must be a primary goal for the industry and regulators when considering such significant changes to the money market fund industry. With all that needs to be considered and accomplished by funds, intermediaries, and investors, the industry needs a significant transition period with a compliance date of the later of at least three years following issuance of final SEC rules; or January 1 of the calendar year that begins at least 12 months after final tax guidance is issued. This transition period allows sufficient time to implement significant legal and operational changes, including fund restructures, support the work needed to service investors impacted by the final rules, and minimize any disruptions or dislocations to the industry that might occur if a transition to a floating NAV had to occur in a very compressed timeframe.

V. Potential Combination of Floating NAV and Liquidity Fee/Temporary Gate Proposals

The SEC also is considering whether to combine the floating NAV and the liquidity fee/temporary gate proposals into a single reform package. If the proposals are adopted in combination with each other, prime and tax-exempt institutional money market funds would be required to transact at a floating NAV and, in addition, all non-government money market funds would be required to impose liquidity fees (unless waived by the board) and permitted to impose temporary gates in certain circumstances. The Release suggests that the combination would provide a broader range of tools to a floating NAV money market fund to manage redemptions in a crisis, would further enhance the ability of money market funds to treat shareholders equitably, could allow better management of funds' portfolios in a crisis to minimize shareholder losses, and would provide fuller transparency of fund valuation and liquidity risk.

We disagree and strongly oppose the combination of these two proposals. In Dr. Seuss's *Sleep Book,* the great American writer, poet, and cartoonist, Theodor Seuss Geisel told of the Zizzer-Zoof Seeds:

> At the fork of a road,
> In the Vale of Va-Vode,
> Five foot-weary salesmen have laid down their load.
> All day they've raced round in the heat, at top speeds,
> Unsuccessfully trying to sell Zizzer-Zoof Seeds

[82] For example, as discussed above, broker-dealers would need to determine the impact on same-day settlement and cash sweep options for their customers.

Which nobody wants because nobody needs.[83]

The combination of the two SEC proposals will produce a kind of Zizzer-Zoof fund, lacking both the share price stability and the assured redeemability of today's money market fund—the result, a fund which nobody will want because nobody will need. Instead, institutional investors would seek out other cash management investment alternatives that offer principal stability (*e.g.*, government money market funds, investment products not registered under the Investment Company Act such as separate accounts or unregistered cash management pools, or bank deposits) or that have neither potential restrictions on redemptions nor the yield-limiting restrictions of Rule 2a-7 (*e.g.*, all other mutual funds). Although these options are not ideal cash management vehicles, for many investors they are far more attractive than a floating NAV fund that also may not always provide ready liquidity. The principal impact of such a combination, therefore, would be to dramatically shrink—perhaps to extinction—the assets of prime and tax-exempt institutional money market funds.

A combination of the floating NAV proposal and the liquidity fee/temporary gate proposal also would undermine the attractiveness of retail money market funds. Under the proposal, a money market fund would be exempt from the floating NAV proposal if it does not permit a shareholder to redeem more than $1 million per day. It is simply overkill to add additional structural reforms to a fund that already meaningfully restricts the daily liquidity available to investors.

From an operational standpoint, the combination of the two proposals would be extremely burdensome and cost prohibitive for the industry. Funds, transfer agents, intermediaries, institutional investors, and others would incur significant operational costs that include establishing or modifying a wide range of systems and procedures to process transactions at floating NAVs (not to mention the necessary changes to accommodate increased recordkeeping, accounting, and tax reporting burdens). Then, in addition, they would incur costs in establishing or modifying systems to administer a liquidity fee and temporary gate.

It is informative to consider the SEC's own estimated costs of its proposals. Using the Release's estimated one-time and ongoing costs[84] to implement the floating NAV and liquidity fee/temporary gate proposals, we estimate the following costs would be incurred:

- Funds and their transfer agent service providers would incur *one-time costs* ranging from approximately $400 to $712 million, and *annual ongoing costs* of approximately $40 to $137 million to implement both proposals. These estimates *do not include* one-time and ongoing costs for intermediaries, institutional investors, or others affected by the proposed changes.

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[83] Dr. Seuss's *Sleep Book* (1962).

[84] *See* Release, *supra* note 2, at 107, 126, 129, 203, and 227. In discussions with our members regarding the one-time and ongoing annual costs estimated in the Release, they have indicated that those cost estimates are low when compared to their own estimates.

- The industry (including funds, transfer agents, intermediaries, institutional investors, and service providers) would incur 2 to 2 ½ times the estimated costs for funds, with total *one-time costs* ranging from approximately $800 million to $1.75 billion, and *annual ongoing costs* of approximately $80 to $350 million.

These daunting implementation and ongoing costs, as well as the burdens of such a wide-scale restructuring of money market fund products as they exist today, would make it difficult for many intermediaries and institutional investors to justify implementing the combination of alternatives.

The Release also indicates that the SEC could consider allowing sponsors to decide which alternative best suits their investors' needs. As explained in the Release, money market funds (other than those that are exempt) would choose either to apply a floating NAV or liquidity fees/temporary gates to their funds. As noted above, there are drawbacks to both proposals—the floating NAV proposal eliminates the benefits of the stable price for investors and the liquidity fee/temporary gate proposal potentially limits investors' full, unfettered ability to redeem money market fund shares. Providing such a choice would allow each money market fund provider to choose the alternative that is most preferable to its shareholders. We therefore support such an either-or approach, while adamantly opposing a both-and approach. Given the tremendous one-time and ongoing costs associated with the two alternatives, however, we doubt intermediaries would be willing to accommodate both proposals for their customers.

VI. Elimination of the Amortized Cost Method of Valuation for All Funds

Today, virtually all money market funds use both the amortized cost method of valuation[85] and penny rounding pricing[86] together to maintain a stable value.[87] Under both the floating NAV and the liquidity fee/temporary gate proposals, stable NAV money market funds would no longer be permitted to use the amortized cost method of valuation (other than for securities with remaining maturities of 60 days or less), but could continue to use the penny rounding method of pricing.

The Release argues that although either method alone effectively facilitates a stable NAV, the principal benefit to a money market fund of being able to use the amortized cost valuation method in addition to penny rounding is that it alleviates the burden to the money market fund of having to value

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[85] Under the amortized cost method, portfolio securities generally are valued at cost plus any amortization of premium or accumulation of discount. The basic premises underlying money market funds' use of the amortized cost method of valuation are: (1) high-quality, short-term debt securities held until maturity will return to their amortized cost value, regardless of any temporary disparity between the amortized cost value and market value; and (2) while held by a money market fund, the market value of such securities ordinarily will not deviate significantly from their amortized cost value. Thus, Rule 2a-7 permits money market funds to value portfolio securities at their amortized cost *so long as* the deviation between the amortized cost and current market value remains minimal and results in the computation of a share price that represents fairly the current NAV per share of the fund.

[86] Share price is determined under the penny-rounding method by valuing securities either at market value, fair value, or amortized cost, and rounding the per share NAV to the nearest cent on a share price of $1.00.

[87] Industry standard is for a money market fund to use the amortized cost method and also round share price to the nearest cent using penny rounding.

each portfolio security each day using market factors. The Release then explains that because the SEC is proposing that all money market funds be required to disclose on a daily basis their share price with portfolios valued using market factors and basis point rounding, funds would have to value their portfolio assets using market factors instead of amortized cost each day. The SEC concludes by suggesting that this increased transparency renders penny rounding alone an equal method of achieving price stability in money market funds. We disagree.

As noted above in Section IV.C.3, the ability to use amortized cost to provide a stable NAV for money market funds facilitates the current same-day settlement process—a feature that is vitally important to many investors. Amortized cost allows sponsors to calculate each fund's NAV at various cutoff times, absent an event during the day that would be expected to move the NAV below \$0.995 or above \$1.005. In contrast, under penny rounding alone, money market funds that now offer same-day settlement several times a day, and wished to continue doing so, would need to obtain intraday price quotes from vendors. These funds also would need to make significant systems modifications and procedural changes to support a multiple, intraday NAV calculation process for their stable NAV funds. Both the availability of data from pricing vendors and costs associated with striking an NAV multiple times a day may force funds to dramatically change the current liquidity available to investors through same-day settlement.

We therefore urge the SEC to retain money market funds' ability to utilize the amortized cost method of valuation for stable NAV money market funds exempted from the floating NAV proposal and for all money market funds under the liquidity fee/temporary gate proposal.

VII. Enhanced Disclosure and Reporting

ICI consistently has supported efforts to increase the public disclosure of money market fund portfolio information and risks, and enhance the SEC's access to money market fund data. In 2009, the MMWG Report recommended that money market funds reassess their risk disclosures, and provide more transparency into the holdings of money market fund portfolios.[88] In 2010, with ICI's strong support, the SEC dramatically increased both the amount and frequency of disclosures required by money market funds, making them one of the most transparent financial products in the United States. The SEC is now proposing additional transparency of money market fund operations and risks.

The industry continues to support efforts to increase money market fund transparency so that investors have an opportunity to better evaluate the risks of investing in a particular fund and the SEC can obtain important information needed to administer its regulatory program. Indeed, many funds voluntarily are providing more disclosure than is currently required.

Our support for further disclosure and reporting enhancements, however, is largely contingent on money market funds' being permitted to maintain a stable NAV. For example, as noted above, we believe the liquidity fee/temporary gate proposal should be coupled with measures to further enhance

[88] *See* MMWG Report, *supra* note 4, at 91-93.

the transparency of money market funds. This enhanced transparency not only would communicate important information to shareholders about the operations and risks of fees and gates, but also would encourage an even more conservative approach to the management of stable NAV money market fund portfolios. We therefore offer our overall support for enhancing the disclosure requirements for stable NAV money market funds. We have a number of comments, however, which are discussed in detail below.

As previously discussed, the SEC's goals behind the floating NAV proposal could be achieved just as effectively, but with far less cost and disruption, through the daily disclosure of funds' mark-to-market share prices. Conversely, increased transparency of money market fund operations is simply not necessary for a floating NAV money market fund. Accordingly, if the SEC requires money market fund NAVs to float, we question whether the application of the proposed disclosure requirements to floating NAV funds is worth the additional cost. Even the current level of money market fund disclosure and reporting—which is far more detailed and frequent than that for any other floating NAV funds—is unwarranted for money market funds that are required to float their NAVs.

A. Financial Support Provided to Money Market Funds

We support the SEC's proposal that would require money market funds to disclose current and historical instances of sponsor support for stable NAV funds. The Release notes that these disclosure requirements would clarify, to current and prospective investors as well as to the SEC, the frequency, nature, and amount of financial support provided by money market fund sponsors. Specifically, money market funds would be required to disclose current instances of sponsor support on their websites and to the SEC on new Form N-CR. Proposed amendments to Form N-1A would require money market funds to provide historical instances in which the fund has received financial support from a sponsor or fund affiliate during the last 10 years. Under the proposal, the term "financial support" would include, but not be limited to (i) any capital contribution, (ii) purchase of a security from the fund in reliance on Rule 17a-9, (iii) purchase of any defaulted or devalued security at par, (iv) purchase of fund shares, (v) execution of a letter of credit or letter of indemnity, (vi) capital support agreement (whether or not the fund ultimately received support), (vii) performance guarantee, or (viii) any other similar action to increase the value of the fund's portfolio or otherwise support the fund during times of stress.

We are concerned that the definition of "financial support" for purposes of the required disclosures is overly broad and would include the reporting of routine fund matters. For example, the reference to "purchase of fund shares" under (iv) would seem to include reporting of routine purchases of money market fund shares by affiliates—information that is not indicative of stress or the need for support and is unlikely to assist investors in appreciating the risks of investing in a particular money market fund. We believe these routine purchases could be frequent and would result in recurring disclosures that amount to "false positives" in that there may be no stress on the fund. Another routine matter that could result in unwarranted disclosure is fee waivers and reimbursements.[89] The catch-all

[89] Fee waivers have been fairly common among money market funds, even during more normal interest rate environments. For example, in 2006, before the onset of the financial crisis, 60 percent of money market fund share classes were waiving expenses. By the end of 2012, reflecting the extremely low interest rate environment, 97 percent of money market fund share

language under (viii) would appear to include situations in which a fund's operating expenses or management fees are waived—information that is more appropriately disclosed elsewhere.[90] We therefore recommend that the SEC revise the definition of "financial support" to clarify that these types of situations should not be deemed "financial support." For example, adding "nonroutine" before "purchase of fund shares" and the clause "to support the fund during periods of stress (*e.g.*, when the fund's NAV deviates by more than ¼ of 1 percent)" after "purchase of fund shares" would make it clear that routine affiliate purchases normally should not be deemed "financial support." Likewise, revising the language of (viii) to read "any other similar action intended to increase the value of the fund's portfolio during times of stress" would clarify that routine matters, such as fee waivers, are not the type of situations the SEC intended to consider as "financial support."

The SEC also seeks comment on whether instead of, or in addition to, requiring funds to disclose historical information about financial support received from a sponsor or fund affiliate in a fund's statement of additional information, the SEC should require fund sponsors to publicly disclose their financial statements. ICI opposes such disclosure. Many fund investors may not be qualified to interpret a sponsor's financial statements or discern anything from the sponsor's balance sheet that could meaningfully inform their decision-making. It also could lead investors to assume that the sponsor would support the fund—why else would that information be relevant? The proposed method for disclosing historical instances of financial support is a more appropriate and direct way to convey this information to current and prospective investors.

B. Daily Disclosure of Daily Liquid Assets, Weekly Liquid Assets, and Net Inflows and Outflows

We support the SEC's proposal to require stable NAV money market funds to disclose prominently on their websites the percentage of the fund's total assets that are invested in daily and weekly liquid assets, as of the end of the previous day and a schedule, chart, graph, or other depiction showing historical information about the fund's investments in daily liquid assets and weekly liquid assets, for a rolling six-month period, updated daily.

We agree with the SEC that this information is likely to promote transparency regarding how money market funds are managed, and thus may permit investors to make more efficient and informed investment decisions. Enhanced disclosure of liquidity levels would likely impose external market discipline on portfolio managers by encouraging careful management of daily and weekly assets.

The proposal also would require a money market fund to disclose the fund's net inflows and outflows, as of the end of the previous day (and maintain historical information about these flows for 6 months). The Release suggests that disclosure of information about net shareholder flow would provide

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classes were waiving at least some expenses. *See* Investment Company Institute, "Trends in the Expenses and Fees of Mutual Funds," *Perspective,* April 2013, vol. 19, no. 3, available at http://www.ici.org/pdf/per19-03.pdf.

[90] We note that proposed amendments to Form N-MFP Item B.8 would require that funds provide information relating to expense and fee waivers.

"helpful contextual information regarding the significance of the reported liquidity information, as a fund would require greater liquidity to respond to greater shareholder flow volatility, and vice versa."[91] We are concerned that such information could be misinterpreted as suggesting a fund is under stress when it is not, or worse, lead to front running of a fund's portfolio trades. For example, net outflows may be interpreted in isolation without also considering the level of daily and weekly liquid assets or the cause of those outflows (large redemption by an investor of which the fund has advance notice).[92] Also, the volatility of flows can vary widely across funds, and, in fact, some funds are designed to accommodate large flows. Furthermore, we are concerned that large outflows (in excess of the fund's liquidity levels) or large inflows would suggest that the fund must sell or purchase securities in the market and could facilitate front running of the fund's portfolio trades to the detriment of the fund and its shareholders. We therefore do not support requiring money market funds to disclose daily net inflows and outflows.

C. Daily Website Disclosure of Mark-to-Market Share Prices

As noted above, rather than requiring money market funds to float their NAVs, we believe that daily disclosure of a money market fund's mark-to-market share price is the best way to increase funds' transparency and permit investors to better understand money market funds' risks. Indeed, a number of money market fund sponsors earlier this year began voluntarily disclosing their funds' daily NAVs using available market quotations. Consistent with these industry trends, the SEC's proposal would require each money market fund to disclose prominently each day on its website the fund's current NAV per share, rounded to the fourth decimal place in the case of a fund with a $1.0000 share price, as of the end of the previous day. A fund also would be required to maintain a schedule, chart, graph, or other depiction on its website showing historical information about its daily current NAV per share for the previous 6 months, and would have to update this historical information daily. We support the proposal requiring stable NAV funds to disclose their NAV per share to the fourth decimal place and we believe that 6 months is the appropriate time period for historical information.

Today, money market funds are required "periodically" to compare the amortized cost NAV of the fund's portfolio with the mark-to-market NAV of the portfolio and then disclose this shadow price monthly on Form N-MFP. Thus, funds that currently do not disclose their daily mark-to-market share price also may not be calculating (nor have any need to calculate) a daily shadow price for their funds. Any new requirement to show historical information about a fund's daily current NAV per share, therefore, should be prospective only and begin after the effective date of the new disclosure.

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[91] *See* Release, *supra* note 2, at 329.

[92] ICI frequently gets press inquiries immediately following quarterly tax payment dates, indicating that this flow information is often misunderstood.

D. Disclosure of Portfolio Holdings

1. *Harmonization of Rule 2a-7 and Form N-MFP Portfolio Holdings Disclosure Requirements*

The SEC is proposing amendments to Rule 2a-7 that would harmonize the specific portfolio holdings information that Rule 2a-7 currently requires funds to disclose on the fund's website with the corresponding portfolio holdings information proposed to be reported on Form N-MFP pursuant to proposed amendments to that form. In particular, the SEC is proposing to modify the prescribed categories of securities (*e.g.*, Treasury Debt, Government Agency Debt, Variable Rate Demand Note) and harmonize the categories across Form N-MFP and the required website disclosures. We support efforts to modify and harmonize the prescribed categories.

We are pleased that the SEC is not proposing to expand the monthly website disclosure to include all information filed on Form N-MFP. Form N-MFP requires funds to provide a tremendous amount of detailed portfolio information that is useful to the SEC, academics, and industry groups. Much of that information would have little utility for the average investor. The fund's website disclosure should continue to include only the most salient information about a fund's portfolio.

2. *Additional Website Disclosure on Portfolio Holdings*

The SEC is considering whether to require more frequent disclosure of money market funds' portfolio holdings on a fund's website, including the market value of individual portfolio securities. The Release suggests that increasing the frequency of such disclosure might provide greater transparency to investors and the SEC, particularly during times of stress. At the same time, the Release acknowledges that more frequent disclosure of portfolio holdings might lead to "front running" of the portfolio, where other investors could trade ahead of money market fund purchasers, or "free riding," where other investors mirror the investment strategies of the money market fund.

Generally speaking, mutual funds are very sensitive to frequent public disclosure of portfolio holdings information due to concerns about front running of a fund's trades to the detriment of fund shareholders. Front running is generally a far less significant concern for money market funds than for other types of funds because of the very short-term, high-quality nature of money market fund holdings. Citing these factors, we supported the SEC's 2010 amendments that required monthly disclosure of money market funds' portfolio holdings.[93] We are concerned, however, that further increasing the frequency of this disclosure could heighten front running and free riding concerns for money market funds. We also do not believe that more frequent portfolio holdings disclosure would add meaningfully to investor protection. We therefore do not support more frequent public disclosure of money market funds' portfolio holdings.

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[93] *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 8, 2009), available at http://www.ici.org/pdf/23769.pdf, at 27.

E. Amendments to Form N-MFP Reporting Requirements

The SEC is proposing to amend Form N-MFP to request certain additional information and make other improvements to the form based on the SEC's experience with filings submitted during the past 2 ½ years.

1. *Additional Portfolio Security Information*

We generally support the proposed amendments; however, we have serious concerns about reporting the information in items C.17 and C.25. Item C.17 would require that money market funds disclose additional information about each portfolio security, including the purchase date, the yield at purchase, the yield as of the Form N-MFP reporting date (for floating and variable rate securities, if applicable), and the purchase price. Item C.25 would require the same information for each security sold during the reporting period. Funds would be required to report this information separately for each lot purchased or sold.

According to the Release, this additional information would facilitate, among other things, "price discovery." The price discovery process is the process of determining the price of an asset in the marketplace through the interactions of buyers and sellers. In a dynamic market, this process takes place continuously in real time. In contrast, items C.17and C.25 would require funds to report a tremendous amount of historical information (information that can be up to 35 days old).[94] We recognize that transparency of this information ultimately could facilitate price discovery; however, it is more likely to facilitate the free riding of money market funds' trading strategies than to provide true price discovery. Indeed, our members have expressed concern that the reporting of this type of confidential trading information could compromise the management of their portfolios. The Release also suggests that the information in item C.17 would enable the SEC and others to evaluate pricing consistency across funds (and identify potential outliers). Item C.18, which requires funds to report portfolio security market values both including and excluding the value of any sponsor support, can accomplish the same goal.

We therefore recommend that the detailed transaction information listed above be removed from items C.17 and C.25. If the SEC does not modify these items as recommended, we urge the SEC to consider giving funds an additional 5 business days to file Form N-MFP (for a total of 10 business days) in order to provide sufficient time for funds to gather, review, and format the new data as required. Furthermore, if the SEC does not modify these items as recommended, we recommend that it retain the current 60-day delay in making the Form N-MFP information public because the immediate release of the information in items C.17 and C.25 could be harmful to funds and their shareholders.

[94] For a security with a 12 month maturity that was purchased 9 months ago, the information reported at Item C.17 would be at least 275 days old. It is unclear why the same information would be required to be filed each successive month after the security is purchased until it ultimately matures or is sold.

2. *Public Availability of Information*

Currently, each money market fund must file information on Form N-MFP electronically within 5 business days after the end of each month and that information is made publicly available 60 days after the end of the month for which it is filed. The SEC proposes to make Form N-MFP publicly available immediately upon filing. Given our members' experience with Form N-MFP over the past 2 ½ years, we believe shortening the time between when the form is filed and its public availability is appropriate (subject to our concerns expressed above). We continue to believe, however, that given the tremendous amount of information on Form N-MFP, (especially as proposed to be revised) a slight delay in making the form contents publicly available to accommodate amendments and other unforeseen circumstances is warranted. We therefore urge the SEC to consider at least a 5 business day delay after filing before making the form available to the public. Given the proposed daily website disclosure (*e.g*., market-based share price rounded to the fourth decimal, daily liquid assets, and weekly liquid assets) and monthly website disclosure (*e.g*., WAM, WAL, and portfolio securities) we believe a 5 business day delay after filing is appropriate and will not impede the immediate availability of the most significant information.

3. *Frequency of Filing*

To increase the transparency of money market funds and the utility of information disclosed, the SEC requests comment on increasing the frequency of filing Form N-MFP from monthly to weekly. We strongly oppose changing the frequency of this filing. Members report that it takes significant time and effort to accurately compile and review the information necessary to complete the form. Funds typically apply a heightened control and review process to the data to be filed that involves personnel from compliance and/or legal, as they would do with any other SEC filing. Thus, even if a fund uses an outside vendor to gather the data necessary to complete the form, funds still need sufficient time to evaluate and validate this data. Weekly filing would impose a substantial burden on fund sponsors that does not appear justified (*i.e*., 52 filings per year vs. 12 filings per year).

F. Compliance Period

The SEC is proposing a nine month compliance period for money market funds, their sponsors, and vendors to implement any applicable disclosure requirements and conduct any applicable requisite operational changes to their systems to implement these provisions. Our discussions with fund sponsors and others indicate that nine months may not be sufficient for the industry to implement and test amendments to the disclosure requirements. We therefore recommend that the SEC provide a minimum of 18 months to allow the industry to successfully comply with the new disclosure requirements.

VIII. Revised Diversification Requirements

Rule 2a-7 requires a money market fund's portfolio to be diversified, as to both the issuers of the securities it acquires and the guarantors of those securities. Under the proposal, the SEC would tighten certain diversification requirements.

A. Issuer Diversification

Money market funds generally must limit their investments in the securities of any one issuer of a first tier security to no more than 5 percent of fund assets. Rule 2a-7 does not, however, require a money market fund to aggregate its exposure to entities that are affiliated with each other when measuring its exposure for purposes of these requirements. The Release suggests that, as a result, a money market fund could be in compliance with Rule 2a-7 while assuming a concentrated amount of risk to a single economic entity. Citing concerns that an issuer's financial distress quickly can spread to affiliates, the proposal would require a fund to aggregate affiliated issuers and count those issuers as one exposure. Entities would be considered affiliated if one controlled the other or was controlled by it or if the entities were under common control. "Control" for this purpose would mean ownership of more than 50 percent of an entity's voting securities.

We support the amendment. Limiting money market funds' exposure to affiliated entities appears to be consistent with the purposes of the diversification requirements—to spread the risk of loss among a number of securities. Moreover, ICI members report that for risk management purposes they typically already aggregate affiliated issuers and count those issuers as one exposure. Thus, we do not believe that the proposed amendment would have a significant impact on the operations of most money market funds. Our members also report that the proposed definition of "control" generally would not limit money market funds' investment flexibility or be difficult to apply. On the other hand, a definition of control that would include more attenuated relationships (*e.g.*, all entities that must be consolidated on a balance sheet) or lower ownership levels could limit a fund's investment opportunities to issuers whose risks are not necessarily correlated to their parents.

The Release requests comment on whether Rule 2a-7 should incorporate the definition of a "majority-owned subsidiary" from Section 2(a)(24) of the Investment Company Act,[95] rather than introducing a new definition of "control." We think using the Section 2(a)(24) definition would be a better approach, given the frequent use of the term "control" in federal securities laws and regulations (including the Investment Company Act) with definitions that differ from the definition proposed for Rule 2a-7. Majority-owned subsidiary more accurately expresses the relationship that should result in aggregation of issuers.

B. Asset-Backed Securities

Currently, Rule 2a-7 does not require diversification of exposures to sponsors of asset-backed securities ("ABS") because ABS are supported by qualifying assets held by special purpose entities ("SPEs") rather than by the sponsors' assets. Under the proposal, a money market fund would be required to treat the sponsor of the SPE issuing ABS as a guarantor of the ABS subject to Rule 2a-7's

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[95] *See* Section 2(a)(24) of the Investment Company Act ("'Majority-owned subsidiary' of a person means a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a majority-owned subsidiary of such person.")

diversification limitations applicable to guarantors and demand feature providers. As a result, a fund could not invest in an ABS if, immediately after the investment, it would have invested more than 10 percent of its total assets in the sponsor's ABS and in securities issued by or actually subject to demand features or guarantees from the sponsor. The proposal provides an exception to the requirement, however, if the fund's board (or its delegate) determines that the fund is not relying on the sponsor's financial strength or its ability or willingness to provide liquidity, credit, or other support to determine the ABS's quality or liquidity.

We do not support this proposal. Rule 2a-7 already counts toward a company's diversification limit any ABS for which the company actually provides a guarantee or demand feature. If a company only guarantees or provides a demand feature for a portion of the qualifying assets, however, only that portion of the ABS is counted towards the diversification limit. For example, if a company agrees to purchase defaulted qualifying assets up to 10 percent of the pool underlying an ABS, Rule 2a-7 counts 10 percent of the amount of the ABS held by a money market fund towards the company's diversification limit for demand features and guarantees.

The proposal would change this result by treating a company that sponsors an ABS as a guarantor of the *entire* amount of the ABS held by a fund, even if the company's guarantee or demand feature is limited to a smaller amount. More alarmingly, the proposal would treat a sponsor as a guarantor of the entire amount of the ABS even when the sponsor has *no* legal obligation to support its ABS, or even when the sponsor expressly disclaims any obligation to support its ABS. This seems to endorse the practice of relying on an "implicit" guarantee—an assumption that a sponsor will voluntarily assume losses on its financial products—when assessing the credit risk of an ABS.

The proposal appears to reflect a misunderstanding that money market funds "make investment decisions based, at least in part, on the presumption that the sponsor will take steps to prevent the ABCP [asset-backed commercial paper] from defaulting, including committing capital."[96] Our members do not make minimal credit risk determinations for ABCP based on any such "presumption." Legally enforceable obligations to support ABCP are the critical factors in the assessment of ABCP, which is why credit analysts devote time to "reviewing existing legal documentation defining the contractual obligations of the counterparties providing liquidity and credit support facilities to a conduit, and assessing the creditworthiness of those counterparties."[97] Such review and analysis would be unnecessary if analysts simply "presumed that the sponsor will take steps to prevent the ABCP from defaulting."

The proposal would not require a money market fund to treat a sponsor as a guarantor if "the money market fund's board of directors has determined that the fund is not relying on the sponsor's

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[96] *See* Release, *supra* note 2, at 441-442.

[97] *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute Letter, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (October 4, 2011), available at http://www.sec.gov/comments/s7-08-10/s70810-212.pdf, at 8 (commenting on SEC's Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment (File No. S7-08-10)).

financial strength or its ability or willingness to provide liquidity, credit or other support to determine the quality or liquidity of the asset-backed security, and maintains a record of this determination."[98] For an ABS that is fully supported by a guarantee or demand feature provided by a third party, such as certain tender option bonds,[99] it should be easy to make such a finding. We do not think that it would be a productive use of the adviser's and directors' time and attention, however, to make such an obvious determination. Their time would be better spent assessing the credit strength of those third-party entities that are obligated to support the ABS, as currently required in accessing the minimal credit risk of an ABS, than confirming that the sponsor does not have any such obligation.

A more difficult arrangement to assess would be if a sponsor has some involvement in the ABS that falls short of a guarantee or demand feature. Historically, Rule 2a-7 has not applied diversification limits to servicers, liquidity providers, payment agents, registrars, or other companies involved in the administration of ABS (or other securities). Under the proposal, money market funds could continue to exclude such companies from Rule 2a-7's diversification requirements—unless the company was the sponsor of the ABS. In that circumstance, unless the money market fund's board can reach the difficult conclusion that the sponsor's financial strength is unrelated to its ability to perform administrative services, the fund must treat the sponsor as a guarantor of the ABS. The Release provides no justification for this exceptional treatment of sponsors as compared to other service providers. The proposal could result in the reduction of the supply of securities to money market funds without any increase in investor protection. We therefore do not support treating the sponsor of an SPE issuing ABS as a guarantor of the ABS.

C. Credit Support Diversification (the 25 Percent Basket)

Money market funds generally must limit their exposure to any one provider of credit support for portfolio securities to 10 percent of total assets; however, 25 percent of a fund's portfolio may be subject to guarantees or demand features from a single institution ("25 percent basket"). Under the proposal, the 25 percent basket would be eliminated and the fund would be required to test exposure to credit supports in the entire portfolio. Citing events during the financial crisis as well as the more recent financial troubles of a European bank that provided demand features and guarantees for many municipal securities held by money market funds, the SEC explains that the proposal is designed to limit the extent to which a money market fund becomes exposed to a single guarantee or demand feature provider.

We urge the SEC to retain the 25 percent basket. Our members are concerned that eliminating the basket would increase rather than decrease risk by increasing funds' reliance on less creditworthy credit support providers and decrease the flexibility currently afforded funds. Since the financial crisis, the universe of institutions issuing or providing guarantees or liquidity for eligible money market securities has become extremely limited. Further restricting these diversification limits may only

[98] *See* Release, *supra* note 2, at 443, n.857.

[99] For sponsors of tender option bonds that provide the demand feature for the security, Rule 2a-7 already counts the tender option bonds towards the sponsor's diversification limit because the sponsor has a legally enforceable obligation to support the tender option bond.

heighten this problem by potentially forcing money market funds to invest in less creditworthy credit support providers to meet new diversity requirements.

D. More Stringent Investment Diversification Requirements

The SEC requests comment on whether it should further restrict the diversification limits of Rule 2a-7 relating to issuers and/or guarantors. Money market funds generally must limit their investments in the securities of any one issuer (other than government securities) to no more than 5 percent of fund assets and limit their investments in securities subject to a demand feature or a guarantee to no more than 10 percent of fund assets from any one provider.

As noted above, due to unprecedented market conditions and consolidations since the financial crisis, the number of institutions issuing or providing guarantees or liquidity for eligible money market securities has dwindled. Potentially forcing money market funds to invest in less creditworthy issuers to meet new diversification requirements could materially reduce the amount of funding that money market funds provide to larger (and potentially safer) issuers. This could have the effect of actually increasing the risk within money market funds' portfolios, rather than decreasing it.

IX. Revised Stress Testing Requirements

The SEC proposes to expand the stress tests conducted by money market funds and reported to their boards. Both alternative versions of Rule 2a-7 would require: (i) testing the impact of stresses on a fund's holdings of weekly liquid assets; (ii) an indefinite number of stress tests; (iii) testing of combinations of stresses; (iv) assumptions as to the potential correlation of stresses and how the portfolio might change in response to stress factors; and (v) more information to help the fund's board interpret stress testing results.

Stress testing was introduced in the 2010 amendments to Rule 2a-7, and most fund boards now have three full years of experience reviewing stress-testing results. ICI members believe that this reform has worked well and the SEC struck the right balance in the tests mandated by the current rule. Although we agree with proposed changes that could clarify and help further standardize the testing required by Rule 2a-7, we do not believe that the dramatic overhaul of stress testing proposed in the Release is warranted. The SEC needs to take into account the limitations of stress testing and of fund directors' capacity to review and interpret stress tests when reforming these provisions. These limitations could lead to diminishing returns as the number and complexity of stress tests are increased.[100]

[100] These comments also would apply to the stress testing for floating NAVs in the event that the SEC adopts the floating NAV proposal. We would recommend that the SEC limit the added complexity to Rule 2a-7 that would result from adoption of the floating NAV proposal by treating funds uniformly for purposes of stress testing.

A. A Fund Cannot Test its Ability to Maintain Weekly Liquid Assets as a Result of Changing Market Conditions

There is no practical means of testing when a hypothetical event "would cause the money market fund to have invested less than fifteen percent of its total assets in weekly liquid assets."[101] Only redemptions would directly cause a reduction in a fund's weekly liquid assets (assuming the fund does not sell other portfolio securities to cover redemptions or to restore its weekly liquid assets). Funds do not have any basis for determining the amount of redemptions that might indirectly result from significant changes in interest rates, spreads or a downgrade of or default on portfolio securities. Without this information, a fund cannot devise a test that would indicate how far interest rates must rise or ratings must fall before the fund's weekly assets fall below 15 percent of its total assets.

In the Release, the SEC claims to "understand that when a fund tests its ability to maintain a stable price (the metric that stress tests currently require), a fund also tests its ability to avoid crossing liquidity thresholds, such as the 15 percent weekly liquid asset test that we are proposing today."[102] The Release does not indicate the basis for this understanding, but we suspect it reflects confusion between the assumptions underlying a stress test and the test results. Rule 2a-7 already requires funds to test the potential impact of redemptions on their shadow prices, so current stress tests make *assumptions* about the level of redemptions that a fund may encounter, both in isolation and in conjunction with other stress events. A fund may or may not make further assumptions about what assets would be sold to cover the assumed redemptions, which would imply an *assumed* level of weekly liquid assets following the redemptions. The stress test then measures the potential impact of these assumptions on the fund's shadow price. Such assumptions are always *inputs* for the stress test, never an *output* of the test results.

In other words, a test that combines a one percent increase in general interest rates with the redemption of 20 percent of a fund's shares assumes the *coincidence* of the two events, rather than testing the extent to which the increase in interest rates might *cause* an increase in redemptions. We are not aware of any current stress tests that purport to measure such causal relationships. While some stress tests may include assumptions about liquidity, it is not the case that current stress tests "also tests [a fund's] ability to avoid crossing liquidity thresholds."[103]

Therefore, it may not be possible for money market funds to comply with a requirement, under either the floating NAV or liquidity fee/temporary gate proposals, to test their ability to maintain 15 percent of their total assets in weekly liquid assets. We recommend instead that the SEC continue to allow stable NAV money market funds to test only their ability to maintain a stable NAV. We further recommend that, should the SEC adopt the liquidity fee/temporary gate proposal, stable NAV money market funds calculate the percentage of redemptions that, if paid out of weekly liquid assets without selling any other portfolio securities, would reduce the fund's weekly liquid assets to 15 percent of its

[101] *See* Proposed Rule 2a-7(g)(7)(i) & (ii)(A).

[102] *See* Release, *supra* note 2, at 472.

[103] *Id*.

total assets, and include this level of redemption in its stress tests. For example, using these assumptions, a fund currently maintaining weekly liquid assets of 40 percent could sustain redemptions of approximately 29 percent and still maintain weekly liquid assets of 15 percent.

This calculation would quantify for the fund's directors the risk that redemptions might require a fund to impose a liquidity fee or suspend redemptions, assuming worst case market conditions in which the fund could not dispose of non-weekly liquid assets. Combining this level of redemptions with other events would indicate the extent to which such a reduction in weekly liquid assets might diminish a fund's ability to handle other stresses while maintaining a stable NAV. This information might help directors prepare for the rare circumstances in which they may be asked to determine whether a liquidity fee, suspension of redemptions, or continuation of redemptions is in the best interest of the fund's shareholders.

B. Assumptions Required for Mandatory Stress Tests Need Clarification Not Complication

The Release proposes to retain the four stress tests currently required by Rule 2a-7, although it would rephrase the fourth test regarding the "widening or narrowing of spreads." We recommend further clarifications of the third stress test (regarding downgrades or defaults of portfolio securities) in addition to the fourth. We also recommend using "worst case" assumptions for each of these tests. These stress tests should serve to inform a fund's directors as to the fund's risks. As discussed below, however, going beyond these clarifications renders the proposed stress testing framework unusable.

Thus, we continue to believe that Rule 2a-7 should require tests for only four hypothetical events.

1. A parallel increase in the Treasury yield curve (which corresponds to Proposed Rule 2a-7(g)(7)(i)(A));

2. A parallel increase in the spread of non-Treasury securities over the Treasury yield curve (which seems to be the intent of Proposed Rule 2a-7(g)(7)(i)(D));

3. Redemptions (which corresponds to Proposed Rule 2a-7(g)(7)(i)(B), and should include the calculation of redemptions that would reduce weekly liquid assets to 15 percent previously discussed); and

4. A downgrade or default of a significant issuer and/or provider of demand features and guarantees, (which would clarify that the test required by Proposed Rule 2a-7(g)(7)(i)(C) should quantify the fund's most significant credit risks).

Each test would correspond to a specific risk regulated by Rule 2a-7. The first test would reflect the risk represented by the fund's weighted average portfolio maturity ("WAM"), the second test would reflect the fund's weighted average portfolio life ("WAL"), the third test would reflect the fund's overall liquidity risk, and the fourth test would reflect the fund's credit risks after diversification. The first two tests would assume a complete correlation among the fund's portfolio securities (for example, in the case of the second test, that spreads on all non-Treasury securities held in the fund's portfolio would increase by the same amount, regardless of issuer or maturity), which would be the "worst case" for a change in interest rates.

A truly "worst case" approach to the fourth test, in which all portfolio securities are downgraded below second tier or default, would almost always result in the fund breaking a dollar. Apart from being completely unrealistic, a test that always produces the same result would not aid the directors in determining whether the fund is taking on more or less credit risk. As discussed in more detail below, there is no reliable means of determining how the downgrading or default of one portfolio security might affect the rest of the portfolio. We therefore recommend that the fourth test focus on the most significant individual credit risks to the fund (measured by the size of the holding, the likelihood of default, or both). The fourth test also would make assumptions consistent with the diversification requirements of Rule 2a-7 (for example, an issuer's downgrade or default would not affect a security fully guaranteed by an unaffiliated third party).

The SEC's proposal calls for much more detailed and sophisticated assumptions in connection with some of these tests. For example, the proposed reforms would require the redemption test to include assumptions as to how the fund would sell portfolio securities to meet redemptions[104] and would also require the fund to assume that a default or downgrade by one issuer will adversely affect other issuers in the same industry or geographic location.[105] There are several problems with trying to incorporate such assumptions into a stress test.

- Simple assumptions regarding portfolio changes may not yield a result. For example, using an assumption that securities are sold to maintain a constant WAM, the fund would never reduce its weekly liquid assets below 15 percent of its total assets, because it would proportionately sell non-weekly liquid assets to maintain a constant WAM.

- Complex assumptions can lead to irresolvable interactions. For example, a fund might assume it would sell the least amount of securities needed to maintain compliance with the maturity requirements of Rule 2a-7, but this assumption would not work if the sales necessary to maintain compliance with the 60-day limit on WAM caused the portfolio to exceed the 120-day limit on WAL, and vice versa. While there would be a large number of intermediate changes to the portfolio that would comply with both limitations, there would not be a rule for selecting which change to apply. If assumptions intended to maintain diversification and avoid deterioration in credit quality are added, the interactions become exceedingly complex and could prove insoluble.

- Any assumptions would be inconsistent with the active management of the portfolio. Any event that leads shareholders to redeem their shares will also affect the investment decisions of the fund's portfolio manager. A stress test cannot realistically model how a portfolio manager might anticipate a hypothetical event.

[104] Proposed Rule 2a 7(g)(7)(i)(B).

[105] Proposed Rule 2a 7(g)(7)(i)(F).

The problems with attempting to correlate the impact of a downgrade or default of a security on other portfolio securities are more fundamental. First, a fund cannot "tak[e] into consideration the extent to which the fund's portfolio securities are correlated such that adverse events affecting a given security are likely to also affect one or more other securities,"[106] without knowing what "adverse events" to consider. A stress test can assume a downgrade or default without making any assumptions about what caused it. There could be any number of possible reasons for the downgrade or default, none of which (given the minimum credit risk determination) should be expected to occur. Without some basis for assuming a specific adverse event that led to the hypothetical downgrade or default, a fund cannot have any basis for assessing what other portfolio securities might be correlated to the event.

Second, even if the test assumes a specific adverse event, money market funds are unlikely to have the data necessary to determine any potential correlations. Financial statements and other financial information are general in nature. The information provides a picture of a company's overall financial strength and, in some cases, the strength of its principal business segments. It rarely provides information regarding its exposure to particular companies or specific market sectors. Thus, a money market fund frequently cannot tell before the fact what the effect of a default by one issuer will be on other companies and financial institutions. It would be even more difficult to tell what effects a generic adverse event might have on a group of portfolio securities.

These problems are inherent in any stress testing process and might be mitigated through sophisticated techniques and highly detailed models. Such refinements, however, should not produce meaningfully different results. The limitations of Rule 2a-7 do not permit wide disparities in the risks taken by money market funds. For example, the results of a stress test that assumes a fund's WAM is extended from 45 to 55 days will not be materially different from the results of a test at that assumes a static 45-day WAM. (The difference would be less than 3 basis points for each 100 basis point increase in interest rates.) Generally, the results of a test using simple, worst-case assumptions will be close to the results of a test using complex assumptions and modeling. Fund directors and shareholders are therefore unlikely to benefit from the time and cost that would be incurred in developing and conducting highly sophisticated stress tests.

C. Allow Fund Directors to Determine which Combinations of Stresses to Test

The proposal would require funds to conduct stress tests using "[c]ombinations of these and any other events the adviser deems relevant …."[107] We support the combination of stress events in testing. Many funds currently report test results for combined stresses to their directors; some funds include tests for scenarios that combine all four stress events. Within reasonable limits, testing combined stresses is a practice the SEC should encourage.

It is not clear that the current proposal would be subject to reasonable limits, however. "Combinations of these events" could be interpreted to require combinations of every event tested

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[106] Proposed Rule 2a-7(g)(7)(i)(F).

[107] Proposed Rule 2a-7(g)(7)(i)(F).

individually. Because the number of test results grows geometrically[108] with each permutation of stress events, this would produce a massive number of outcomes without adding meaningfully to directors' understanding of fund risks. We do not believe that directors or shareholders will benefit from testing rote combinations of stress events. It is important that fund directors have the ability to determine what combinations they would find most informative and incorporate only those combinations into the stress testing procedures.

Two aspects of the current rule make it more difficult for directors to include combined stresses in a fund's testing procedures. First, the rule requires the fund to report "the magnitude of each hypothetical event that would cause [its shadow price to deviate by more than half a cent from a dollar]." This requires a fund to perform and report stress tests of each event in isolation. Second, the staff has interpreted the rule to require the directors to review the results of all stress test conducted under the fund's procedures.[109] The consequence of these requirements is that including combination tests in a fund's stress testing procedures necessarily increases the number of results directors must review, regardless of whether the results are significant. Changing these requirements, so a board would not be required to review isolated test results or test results that were not significantly different from a base set of combination tests, would make it easier for boards to include combination tests in the fund's procedures.

D. Stress Testing Requirements Should Not be Vague or Open-Ended

The Release proposes to add two new categories of tests. First, a fund would have to test "other movements in interest rates that may affect the fund's portfolio securities, such as parallel and non-parallel shifts in the yield curve."[110] Second, as part of the new combination and correlation requirements, the fund would have to test "any other events the adviser deems relevant."[111] The open-end nature of these new requirements would make it practically impossible for a fund to determine how many and what kinds of tests it must conduct to comply with Rule 2a -7.

For example, the proposed rule does not indicate how many movements in interest rates a fund must test. The rule currently requires funds to test parallel movements in interest rates (in the form of a change in general interest rates), so this aspect of the new requirement would be redundant. While there

[108] To illustrate, testing ten different interest rate increases produces ten stress-testing results. Testing these interest rate increases in combination with ten increases in interest spreads produces one hundred results. Combining these with ten redemption percentages produces one thousand results, and combining another ten downgrades or defaults would produce ten thousand results. Combinations of two events can be reduced to a simple grid and significant results can be highlighted for the directors. Adding other events requires multiple grids, most of which (as noted above) will contain largely the same results. Thus, large-scale combinations of events could produce hundreds of grids reporting thousands of nearly identical results, which would not help the directors' understanding of the fund's current risks.

[109] Staff Responses to Questions about Money Market Fund Reform, Question III.A.4 (rev. August 7, 2012), available at http://www.sec.gov/divisions/investment/guidance/mmfreform-imqa.htm.

[110] Proposed Rule 2a-7(g)(7)(i)(E).

[111] Proposed Rule 2a-7(g)(7)(i)(F).

is only one way to move interest rates in parallel, there are an infinite number of non-parallel interest rate movements. The proposal does not indicate how many non-parallel movements funds must test, or even what kind of movements (*e.g*., steepening, flattening, convex, concave, inverted, etc.). The number of other events that someone might, at some time, "deem relevant" to a fund is also unlimited.

Although it might not be immediately apparent, a parallel change of a given magnitude (*e.g.,* 25 basis points) produces greater stress on the shadow price than a non-parallel change of the same magnitude (*e.g.,* in which one segment of the yield curve changes 25 basis points and the other segments change by a smaller amount or not at all). A parallel movement affects the yield on every portfolio security to the same degree, while a non-parallel movement affects yields on securities of certain maturities more than other maturities. As a result, for a change of a given magnitude, the result of a parallel change in rates will exceed the results of a non-parallel change. We think it is easier for directors to focus on "worst case" scenarios (in this case, a parallel change in interest rates), with the understanding that actual market fluctuations will probably be less uniform and significant, than to provide them with tests for a series of "less worse" scenarios.

Another problem with testing whatever an adviser deems relevant is that it would intrude into communications between the adviser and the fund's directors. The proposal presupposes that a stress test is the best means of alerting a fund's board to developing risks. This is not always the case; in some cases, a list of exposures or narrative report may be a more effective means of explaining risks to a fund's directors. We also hope that the SEC would not fault an adviser that provides directors with an analysis of actual, rather than hypothetical, events. We support open communication between fund advisers and directors regarding important risks, and believe that advisers should provide any information (including additional stress tests) reasonably requested by a fund's directors. We do not believe that this communication, however, must always include a stress test.

Another aspect of communication with the board is the proposal that the adviser's assessment of stress testing results include "such information as may reasonably be necessary for the board of directors to evaluate the stress testing."[112] We support the common practice of providing directors with information that helps to place stress-testing results in context. For example, it may be helpful to remind directors of the Federal Reserve's announced intention to continue its current interest rate policy when discussing the results relating to potential increases in interest rates. So long as the proposed requirement is limited to such contextual information, we would not object to the proposed change.

E. Stress Testing and Portfolio Management

Our comments have focused on the use of stress tests by fund directors because that is the context of stress testing in Rule 2a-7: the fund's board is required to adopt stress-testing procedures and review stress-testing results. The level of proposed testing, however, together with statements made in the Release, suggest that the SEC may believe that highly sophisticated stress testing should be required

[112] Proposed Rule 2a-7(g)(7)(ii)(B).

for the management of money market funds. If so, this would represent a novel and unwarranted intrusion into the management process.

Sophisticated risk quantification and management systems are expensive and labor intensive. The data used by the system must be updated continuously, and must include information about the market as well as the portfolio. Data commonly used in equity risk management systems, such as daily trade information and defined indexes, are not available in the money market. This lack of data and the severe risk constraints imposed by Rule 2a-7 make stress testing less useful for the management of money market funds than it may be for other types of mutual funds. Money market funds should be the last funds for which the SEC considers mandating that sponsors make significant investments in stress testing software.

X. Amendments to Form PF Reporting Requirements

The SEC is proposing to amend Form PF, the form that certain SEC-registered investment advisers use to report information regarding private funds they manage, including "liquidity funds" that can resemble money market funds. Specifically, the SEC proposes to require large liquidity fund advisers—registered advisers with $1 billion or more in combined money market fund and liquidity fund assets—to file virtually the same information with respect to their liquidity funds' portfolio holdings on Form PF as money market funds would be required to file on Form N-MFP. The SEC adopted Form PF to assist the Financial Stability Oversight Council ("FSOC") in determining whether and how to deploy its regulatory tools and to collect data for use in the SEC's own regulatory program.

We support this amendment, and share concerns with the SEC and others that if further reforms to money market funds cause investors to seek alternative products, including unregistered liquidity funds, transparency and other protections could be reduced, and could potentially increase systemic risk. We therefore agree that the additional information the SEC proposes to require advisers to report on Form PF would likely enhance the SEC's ability to evaluate and develop regulatory policies that would protect investors and maintain fair, orderly, and efficient markets.

We believe the information would be more useful to the FSOC and the SEC, however, if advisers were required to file the information relating to liquidity funds monthly rather than quarterly. Monthly filings would allow regulators more accurately to compare the information on Form PF with the monthly Form N-MFP filings.

XI. Conclusion

ICI and its members appreciate the opportunity to comment on the SEC's proposed money market fund reforms. We remain firmly committed to working with the SEC to further strengthen money market funds' resilience to severe market stress.

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If you have any questions regarding our comments, please feel free to contact me at (202) 326-5901 or Karrie McMillan, General Counsel, at (202) 326-5815.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
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Investment Company Institute

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
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Norm Champ
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