

FINANCIAL INFORMATION FORUM

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September 17, 2013

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

Re: File Number S7-03-13; Money Market Fund Reform; Amendments to Form PF

Dear Ms. Murphy,

The Financial Information Forum (FIF)¹ would like to take this opportunity to comment on proposed Money Market Fund Reform; Amendments to Form PF (the "Proposal"). The FIF Back Office Committee includes broker dealers and service bureaus responsible for back office processing. We have evaluated the Proposal from this perspective primarily focused on the implementation issues associated with sweep account processing.

Preserving the Use of Money Market Funds as Sweep Vehicles

Broker dealers offer retail investors money market funds (MMFs) as cash management vehicles as part of sweep accounts where free credit balances are maintained. Services associated with these sweep accounts include trade settlement as well as check-writing, ATM services including debit cards for purchases, etc. It is the unique attributes of MMFs (i.e., stable NAV with no limitations on redemptions) that allow broker dealers to offer these services. Without preserving the certainty and lack of redemption restrictions either with a well-defined retail exemption or disapproval of the rule, money market funds will no longer be acceptable sweep vehicles. Both Alternative 1 and Alternative 2 pose significant operational challenges that would be difficult and costly² to resolve as discussed in more detail below.

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

² Based on the available information, one back office processing service provider estimates the implementation cost of Alternative 1 at \$1,725,000, the cost of Alternative 2 at \$1,697,000 and the costs of implementing both Alternative 1 and 2 at \$2,703,000. Cost estimates include development, information technology, support, etc.

Alternative 1 Issues

In assessing the impact of the Alternative 1 – Floating NAV Proposal, the FIF Back Office Committee has identified the following operational issues that would prevent MMFs from operating as sweep vehicles:

- Impact on Trade Settlement – Investors might not understand their net need for money market funds as a result of both buying and selling activity. Investors are not accustomed to limiting their transactions based on disbursement limitations. Additionally, with Alternative 1 it is possible for there to be insufficient funds to settle transactions. We are also concerned with the impact a redemption limit will have on margin accounts. Currently, clients journal money market fund positions to cover obligations in margin accounts in order to reduce or eliminate the need for a house or Fed call. Imposing a redemption limit would restrict the ability of a MMF to fulfill this function.
- Availability of Funds for Check Writing – Determining the amount of available funds would be very difficult if MMFs were subject to the Floating NAV Proposal of Alternative 1. FIF members are uncertain how calculations could be performed to support check-writing services to ensure that investors do not over draw on their account.
- Debit Card Processing – Currently to support debit card transactions, files are sent to VISA/MasterCard with available balance information. It is unclear how such a process would work when the available funds would be subject to a floating NAV. Additionally, charges in accounts pend in an account for some time. New processes would have to be established to ensure that the debit charges remained the same even as the value of funds in accounts changes.
- Same day settlement – Some sweep accounts offer same-day settlement. We do not think this would be possible under the Floating NAV proposal. If Alternative 1 is approved and it becomes necessary to determine NAV multiple times during the day there will be operational changes required by third party pricing providers as well as broker dealers that will need to reconfigure upstream and downstream workflows.
- Impact on shortened settlement cycle proposals – It is our understanding that DTCC is considering moving to a shortened settlement cycle.³ We believe that access to money market sweep accounts is critical to achieving this goal.

Alternative 2 Issues

Similar issues as discussed above exist with imposing liquidity fees and gates in times of distress. Given the uncertainty of when liquidity fees and gates would be applied, it is possible for customers to be unable to settle trades previously purchased. Additionally, investors could over-trade their account by settling an amount greater than their balance due to a liquidity fee not known at the time of order entry. Another possibility is that they would write a check that would not clear due to the inability to withdraw funds. Charging a liquidity fee and imposing gates effectively removes money market funds as a sweep vehicle since these accounts are designed to be a liquidity product and firms will no longer be

³ See October 2012 [Cost benefit analysis of shortening the settlement cycle](#), prepared by the Boston Consulting Group and Commissioned by DTCC

able to guarantee liquidity. In the event of the fees and gates being imposed, broker dealers would have to consider a number of actions including:

- Determine alternate means of trade settlement for previously purchased securities
- Working with investors in affected MMFs to potentially move them into new MMFs that are not subject to fees and gates
- Re-evaluating obligations under suitability requirements to ensure that affected MMFs were still appropriate investments and taking appropriate action (e.g., restricting new investment in affected MMFs and only allowing redemptions)
- Determining the feasibility and compliance impact of limiting transactions solely to redemptions

It is the conclusion of the FIF Back Office Committee that the uncertainty of the redemption amount in both Alternative 1 and Alternative 2 as well as the potential unavailability of funds in Alternative 2 would make MMFs unsuitable sweep vehicles. In order to preserve the use of MMFs as a sweep vehicle, either a retail exemption or disapproval of the rule is required. In the following sections, we explore how an exemption might be structured that would reduce operational impact.

Operationalizing Retail Exemptions for Money Market Funds

Alternative 1

We believe the retail exemption described in Alternative 1 should be part of any money market reform proposal and that only those funds exempted from the Proposal could qualify as sweep vehicles. The criteria for exemption should factor in the operational complexities associated with monitoring for and applying the exemption. Depending on the complexity of the exemption, selecting the right fund for a retail client may pose operational issues. Additionally, prior to any new money market regulation, all accounts and money market holdings by a client may need to be analyzed to ensure appropriate asset allocation.

The FIF Back Office Committee has evaluated the suggested and alternate proposals and would like to make the following additional comments.

Suggested Proposal – Limitation on Disbursement

We have evaluated the suggested proposal of basing the retail exemption on a limitation on disbursement and believe there are several issues with that approach including:

- Customer Tracking - The tracking of customers would be operationally very significant. It is unclear how related accounts will be treated. Consider, for example, a single individual who has one account where they are the sole beneficial owner as well as a joint account.
- Planned fund conversion exemption - A brokerage may plan to change fund offerings from one fund group to a different fund group. In the course of the conversion to the new fund, there would normally be accounts that exceed the \$1 million transaction limit. It is important to recognize that these conversions are not initiated by the shareholder. If this approach is

selected, there should be an exemption for planned fund conversions with some advance notice.

- Retail Automated Customer Account Transfer/Account closures exemption: A retail customer may request transfer of an account to another brokerage through ACATS or close and transfer an account by other means. Money Markets balances are liquidated automatically so the funds can be transferred to the receiving brokerage and could be in excess of the \$1 million limit. Additionally, a retail customer may transfer funds from a money market to an equity or bond fund. If this approach is selected, there should be an exemption for accounts that are closing or being transferred.
- Trade clearance omnibus account exemption: The rule as proposed places the \$1 million limit on accounts owned by the brokerage. Some brokerages offer same day liquidity to retail accounts for purposes of check writing, ACH, Fed wire transfer after the fund has settled between 9 to noon. They allow clearing client money market liquidation activities through a house omnibus clearance account held overnight which is then liquidated the next day in bulk. House omnibus trade clearance accounts should be exempted from the limit as long as the brokerage can maintain that transactions that were cleared through it, along with the transactions processed before settlement that day did not exceed the \$1M limit per customer.

It is important to note that the majority of brokerage accounts with sweep transactions and manual redemption requests are settled the same day, between 9 and noon usually. The requirement to force the \$1 million limit gives the transaction processor too short a time to analyze all transactions and relationships between accounts. We encourage the Commission to consider processes that could be based on overnight processes. By doing the analysis overnight on same day liquidations, it will allow sufficient time to fully analyze the account. To discourage the account owner from attempts to game the system and encourage them to choose a government MMF if they regularly make transactions that exceed the limit, the Commission could explore including penalties for over-withdrawal.

The Proposal also seeks comments regarding the dollar threshold of \$1 million dollars. It is the experience of our group that high net worth customers do exceed \$1 million dollar disbursement thresholds. We would recommend a higher threshold in order to accommodate high net worth customer activity. Additionally, if the disbursement amount is expected to change periodically, this should be made clear in the final proposal so that firms regard the amount as a parameter rather than a fixed value.

Advance Notification Option

The Proposal asks for comment regarding the inclusion of a provision to allow redemptions greater than the limit provided they give advance notification. FIF members believe that offering such a provision would be useful and help to preserve the value of money market accounts. Retail customers, including very high net worth clients, use these accounts to help fund major purchases including stock purchases, real estate purchases, etc. Additionally, an advance notice provision might address our concerns with planned fund conversions addressed above.

Alternate Criteria for Retail Exemption: Account Balance Limitation

The Proposal also seeks comment on an alternate approach for determining eligibility for the retail exemption based on the maximum balance allowed per owner of \$1M or \$5M. FIF agrees with the comments made in Footnote 233 of the Proposal which states – “there may be significant differences in costs depending on how such an exemption was structured, and that it could be significantly less costly to test whether an investor investing through an omnibus account has exceeded a maximum account balance periodically rather than on a trade-by-trade basis. “FIF recommends calculating account balances based on activity at the end of the day in order to leverage existing back office processes.

FIF believes that this approach would be easier to implement than the \$1 Million disbursement limit if the maximum account was calculated based on overnight processing. We would recommend this approach using an account balance of at least \$5 million as the exemptive criteria over the suggested disbursement approach as well as the other alternate criteria discussed in the Proposal (e.g., shareholder concentration and shareholder characteristics).

It should be noted that this approach is not without its challenges especially as it relates to aggregating account balance information across accounts. FIF recommends considering a safe harbor for broker dealers, similar to the SEC Large Trader Reporting Rule 13h-1(f). The safe harbor established a reasonableness standard that requires consideration of account name, tax identification number, or other identifying information available on the books and records of such broker-dealer. By harmonizing with this standard, broker dealers will be able to leverage existing “house holding” relationships.

Alternative 2 Exemptions

While there is no retail exemption proposed for Alternative 2, FIF strongly recommends the inclusion of a retail exemption based on the Alternative 1 discussion above. The filing does ask about the possibility of an exemption for small redemption requests. If a retail exemption along the lines outlined above is not adopted, FIF agrees that small amounts under \$10,000 should be exempt from any liquidity fee or gate provision.

Similar to the FIF response to advance notification under Alternative 1, FIF believes investors should be exempt from any liquidity fees or gates if they provide sufficient advance notice. Concerns regarding gaming could be addressed by limiting the number of such requests in any given period.

Implementation Challenges for Non-Exempt Funds (Non-Sweep Vehicles)

We recognize that if the Proposal is adopted there will be non-exempt funds subject to the rule. We would like to offer the following comments.

Alternative 1 Issues

We believe Floating NAV funds would be offered as an alternative investment as a self-managed, non-sweep vehicle. Operational issues would in large part be the responsibility of money market processing and other third party pricing providers. We expect there will be an impact on third party shareholder platforms. One concern we have is impact of basis rounding of prices on share balances (i.e., any requirement to provide share balances out to four decimal places).

Internal brokerage systems are programed to assume a \$1 NAV. The reclassification process would require significant system remediation. Additionally, drawing the distinction between exempt and non-exempt funds would require development effort of both in-house and vendor systems including establishing procedures to process both types of MMFs.

Alternative 2 Issues

If exemptions were granted that would allow sweep vehicles to continue to use MMFs as they do today, we believe that for non-exempt funds, Alternative 2 would be easier to implement. If retail accounts could afford themselves of the retail exemption, large institutions may still be interested in mutual funds with gates and liquidity fees as an alternate investment vehicle. The Proposal asked for comment on potential refinements to the Alternative 2 Proposal. FIF has the following comments:

- Discretionary liquidity fees would be slightly more involved to program for but still would be more beneficial if they resulted in lower fees for investors.
- Partial gates based on the percentage of outstanding shares will be difficult to implement. Operationally having to make that assessment will be challenging.

Accommodating Cost Basis/Tax Reporting Requirements

We have reviewed the Proposal's comments on cost basis as well as the "IRS Notice 2013-48 - Application of Wash Sale Rules to Money Market Fund Shares" and are concerned about the operational impact to support cost basis requirements under Alternative 1. Even with the de minimis exception, firms would still have to calculate the profit and loss and then calculate the exception amount to see if the transaction is in fact exempt from the wash sale rule. This would be tremendous operational overhead. Even with Alternative 2, there would be additional cost basis programming required since fees are generally considered an adjustment to cost basis.

It is important to note that currently money market transactions are not incorporated into cost basis systems. If the Proposal is approved, firms would treat MMFs like a new product with its own set of rules. This would require security master changes as well as appropriate modifications to a firm's cost basis reporting regime around these products. Not only would this have development implications but also firms would have to determine the additional capacity requirements on cost basis systems to incorporate these additional transactions. For example, for a firm with ten million reportable accounts account today that has one million accounts with prime MMF balances, we would estimate that the impact of the change will be at least a 10% overall increase in tax reporting activity.

Additionally, it is unclear whether aggregating Form 1099-Bs will be permitted under the Proposal. FIF recommends allowing broker dealers the option to aggregate 1099-Bs for MMF tax reporting. Allowing aggregation will require development on the part of firms but may also mitigate a significant increase in 1099-B reporting volume that will result with the inclusion of MMFs as part of the 1099-B reporting regime. It is worth noting that without aggregation an account that has only two redemptions a week would require over 100 new 1099-Bs per year. Given that these changes will impact multiple accounts across the industry, without the ability to aggregate 1099-Bs there are likely to be significant challenges to both broker dealer and IRS systems that will require additional capacity and processes to accommodate the reporting volume.

Impact on Retail Investors Relying on MMF Sweep Accounts

While our focus is primarily on back office processing we do believe that without an exemption, the Proposals are likely to force investors into an FDIC product because of gate or floating NAV; we expect to see a higher demand for the FDIC products and thus, even lower yields. Even if we could surmount the operational challenges described, we do not believe investors will find the changes to money market funds especially in sweep accounts to be acceptable given the impact these changes will have on their trading activity and the trade settlement process.

Implementation Time

We believe many operational issues will arise during the implementation of the Proposal and would request active engagement between the SEC and the industry to promptly resolve issues. Without full details on the specific Proposal adopted (e.g., Alternative 1, Alternative 2, criteria for retail exemption), it is difficult to determine if two years is sufficient. For example, if it becomes necessary to determine NAV multiple times within a day, a complete reengineering of money market processing would be required. Alternately, if a retail exemption based on an account balance limitation of at least \$5 million as determined by end of day balances were adopted, two years may be sufficient. We do believe that if Alternative 2 is adopted at least two years will be necessary as significant customer interaction and education in addition to operations and technology changes will be required. FIF would appreciate the opportunity to offer additional comments on implementation timing once additional details are available.

Conclusion

Given the integral role of money market funds in the trade settlement process, FIF believes that the approved money market reform rule should preserve the use of MMFs as sweep vehicles. Specifically, FIF recommends that the Commission:

- Establish a retail exemption based on an account balance of \$5 million or more that applies to whatever alternative or combination of alternatives is adopted. If a retail exemption based on a redemption limit is approved then omnibus accounts, account transfers, high net worth activity, and planned conversions will need to be accommodated.
- Leverage current overnight back office processing cycles by basing retail exemption criteria off of end of day activity

- Consider a safe harbor for broker dealers adhering to reasonableness standards for account aggregation
- Permit aggregation of 1099-B reporting of MMF activity
- Offer the industry an opportunity to offer informed comments on implementation timing once additional details are available.

Without implementing these recommendations, particularly the retail exemption we do not believe money market funds will be suitable as sweep vehicles. We look forward to working with the Commission if this Proposal is adopted to ensure a successful and efficient implementation.

Regards,



Manisha Kimmel
Executive Director
Financial Information Forum

cc: The Honorable Mary Jo White, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel J. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner