COMMONWEALTH of VIRGINIA

Department of the Treasury

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Ms. Elizabeth M. Murphy, Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Comment on the Proposed Rulemaking on Money Market Fund Reform File No. S7-03-13

Dear Ms. Murphy,

As Treasurer of the Commonwealth of Virginia, I appreciate the opportunity on behalf of the Virginia Treasury to comment on the SEC Reform Proposals for Money Market Funds (MMFs). My comments are in three sections as follows: the impact on MMFs, the impact on "2a-7 like" Local Government Investment Pools (LGIPs), and the impact on state and local government financing.

Impact of the Proposals on MMFs

The SEC proposes two reforms which may be adopted singly or together or in some combination. The first proposal is to require MMFs to adopt a floating Net Asset Value (NAV) based on daily pricing of MMF security holdings. The second proposal is to allow MMFs the discretion to impose a redemption fee if the fund falls below a liquidity threshold and to restrict withdrawals ("gating") under the same circumstances. The stated goal of the proposals is to *"address money market funds' susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds."*

Virginia Treasury respectfully submits that the first proposal, to impose daily pricing and a floating NAV, would not reduce MMFs' susceptibility to heavy redemptions and potential contagion but, paradoxically, would encourage redemptions and contagion during times of financial stress. The first point we would like to make concerns the assumption that daily pricing of assets accurately transmits the risks of a fund's portfolio holdings. Most MMF securities, as noted elsewhere in the proposal document, are priced using a matrix approach, with MMF custodians using pricing services. These services price holdings according to the type, quality

rating and maturity of the securities rather than an actual transaction price or actual dealer bid for a specified security on the pricing date. Thus, pricing is an approximation. Because MMF holdings are so short in maturity and so high in credit quality, in almost all instances and market environments, matrix pricing is reasonably close to the fair value of these low risk securities. However, when markets are most susceptible to "heavy redemptions" aka "runs," as occurred after the Lehman failure, pricing is likely to be a misleading measure of risk for such short, high quality assets as those held in MMFs.

Runs are a sudden, mass demand for immediate liquidity. Under such conditions, securities which do not mature on the day of demand must be sold to realize cash to pay withdrawals or fund redemptions. The more demand for cash, the lower the bid price of securities by market makers seeking to protect their own capital against falling prices. As prices fall it leads to a vicious cycle of still heavier selling and more defensive bids. Under this scenario, which is precisely what the SEC seeks to avoid, sharply falling prices communicate panic in the financial system and can actually encourage investor redemptions.

Perhaps this proposal is based on an assumption that if investors have knowledge of pricing it will discourage heavy redemptions as they seek to avoid the capital losses incurred by share withdrawals during such periods. Experience in other markets, notably the steep fall of the U.S. equity markets in 2008-09 and the European MMFs in 2008, where investors panicked despite daily pricing, suggests to us that daily pricing will not stop investors from demanding withdrawals during a financial system crisis.

We submit that MMF investors who sought redemptions during the 2008 crisis did so in great part due to the lack of transparency of particular credit exposures of MMFs at that time. Because MMFs were not posting daily asset holdings, investors had no way of knowing which funds may have been holding Lehman paper or may have had large exposures to other large financial institutions. Learning that The Reserve Fund's holdings of Lehman paper had caused it to break the buck, investors had no way of knowing if other MMFs held similar positions. Without such information investors chose to assume the worst and subjected MMFs to heavy redemptions.

The second proposal, "gating" could stop a run or excessive demand to redeem shares because it simply removes access to the MMF. This would only be useful in stopping a run once it is underway as it is very unlikely a fund's management would "gate" unless liquidity is at risk, that is, it is evident that a pattern of heavy redemptions in one fund or across the industry is occurring. However, the knowledge that a fund may limit access at some point as liquidity conditions deteriorate also only heightens the risk of a run as it gives an incentive for fund investors to get out before a fund is gated. It is impossible to say what percentage decline in a fund's liquidity position is enough to prompt investor concern that it is best to redeem shares. Clearly, though, at some point, as the fund's liquidity measures fall, investors will try to get out before the gate is closed, thereby creating a potentially destructive wave of redemption pressure. Adding fees will not help the situation. Knowing fees may be charged or are being charged only serves to let investors estimate the risks of staying in a fund as the fee becomes a breakeven

calculation between principal losses due to fees or fund losses due to asset pricing or default on fund holdings. Fees may not stop redemptions if an investor is truly concerned about a fund.

Virginia Treasury suggests consideration of an alternative approach. We believe that the best indication of a MMF's risk is not pricing but the specifics of the assets held by the fund. SEC 2a-7 changes in 2010 were a step in this direction but we believe the risks of MMFs would be made more transparent if the disclosure is made daily by each MMF on the fund website. Doing so would assure that fund managers know their portfolios are subject to near real-time scrutiny and give them an incentive to keep asset quality at a very high level. Perhaps more importantly, daily disclosure by credit, yield and maturity allows investors to review the fund's risk in detail and to decide for themselves if given positions meet their standards of acceptable risk. For example, if a fund holds positions in one or more credits that are generally perceived to have increasing risk or represent relatively large concentrations by credit or industry that may be of concern, the investor can judge whether the risks merit continued investment in the fund. This is not to suggest the investor is an expert in portfolio risk but it does provide valuable information to the investor about the types and extent of risk of given funds. Investors can't be expected to fully assess every risk but every investment carries some risk and investors have to bear the responsibility for taking that risk.

As noted, we suggest a floating NAV will not prevent a run and may make one worse should it occur. If pricing is to be considered at all, we suggest weekly shadow pricing by a pricing service which is then immediately posted to the MMF website. This shadow valuation will provide investors with a sense of the inherent stability associated with short maturity, very high credit quality of MMF assets. In conjunction with the daily posting of fund holdings this would increase the transparency of fund risks without requiring fund holders record daily gains and losses.

Impact of proposals on "2a-7 like" Local Government Investment Pools (LGIPs)

As noted in the SEC Proposal, LGIPs managed as "2a-7 like" funds are not under the supervision of the SEC. The pertinence of the MMF proposals to LGIPs is the result of GASB directing "2a-7 like" pools to fully follow the rules that govern 2a-7 funds. We would stress that certain aspects of the proposed changes create particular difficulties for LGIP managers and their participants.

The first difficulty is that many governmental entities are not permitted by law to invest in funds that have fluctuating market values. Requiring LGIPs to daily value holdings will mean that their participants, without a change in their laws, will be unable to use LGIPs or money market funds as a short-term liquidity vehicle. This will create cash flow management issues for them and may force them into less liquid and lower yielding bank deposits or demand deposits.

For state LGIPs the floating NAV proposal burdens both the LGIP managers and fund participants with increased administrative costs and complexity of implementation. Few LGIP managers and participants have the accounting software necessary to handle daily valued

investments. Acquiring such software would be expensive and, combined with daily accounting requirements, would make LGIPs less attractive as a cash management vehicle.

It is doubtful that LGIP participants would be permitted to invest in a fund that could be subject to "gating." These investors are in LGIPs because of the immediate and full liquidity advantages they offer; without full liquidity they will either not invest or invest in much smaller amounts with the difference once again likely to go to lower yielding instruments or possibly demand deposits.

For these reasons the proposals, as presented and if adopted either singly or in part, create significant issues for the administrators and participants of LGIPs. We recognize that the SEC does not oversee LGIPs and that the issues for LGIPs are the result of GASB rules mandating that LGIPs operating as "2a-7 like" must follow 2a-7 standards. However, we would like to ask the SEC that in adopting any of the proposed reforms it closely consider the problems both of these proposals present to LGIPs and especially their participants. We note that very few LGIPs suffered financial loss as a result of assets held in their portfolios during the crisis. Also, very few LGIPs were subject to the redemption pressure that concerns the SEC. While the SEC does not oversee "2a-7 like" funds, the SEC would do a valuable service to LGIPs if, in proposing changes to MMFs, the SEC notes that LGIPs are not typical MMFs.

Impact of Proposals on State and Local Government Financing

Municipal MMFs represent both an important low-cost, short-term financing option for municipalities and a cash management tool to manage liquidity.

If investors are driven away from municipal MMFs as a result of requiring funds to have floating NAVs, the ability of these funds to purchase municipal securities would diminish and municipalities would be faced with fewer options to obtain cost-effective financing for public projects.

In this event, state and municipal governments (and ultimately taxpayers) will therefore be forced to pay more to borrow, limiting resources otherwise available to pay for important infrastructure improvements as well as social programs and public safety projects.

The profile of Municipal MMF's is more like that of government MMFs. These funds did not experience heavy redemptions during the financial crisis. We ask that the SEC consider excluding them, along with government funds, from the proposed reforms.

Conclusion

In conclusion, we appreciate the SEC's efforts to further strengthen MMFs and protect MMF investors. We do, however, question whether either daily pricing or the adoption of gating and or fee requirements represents the best way to meet this goal. We believe experience shows that when it is the financial system itself that is in crisis daily pricing is a misleading measure of

risk. Pricing may actually serve to encourage heavy redemptions as the crisis deepens. We likewise suggest "gating" and fees may also encourage investor flight, particularly among sophisticated, better informed investors as they seek to redeem before the "gating" as fees are imposed.

We suggest instead a proposal to increase daily transparency to increase investor awareness of MMF risks. To the extent MMFs may be required to value security holdings, we suggest weekly and publicly available shadow pricing without the necessity of recording accounting gains and losses.

We also note the administrative and cost burdens the current proposals would place on LGIPs and their participants if the proposals are adopted. We note that LGIPS are subject to 2a-7 rules only as a result of GASB mandating that LGIPs wishing to offer themselves to investors as "2a-7 like" must follow these rules. Most LGIPs did not experience heavy redemptions during the financial crisis.

Finally, we suggest that MMFs specializing in holding state and local government debt be exempted from the proposals. The stability and other characteristics of these funds are more similar to "government" funds than "prime" funds. Requiring these funds to adopt the proposals may reduce their investor base and reduce the short-term financing options available to state and local governments while increasing their financing costs.

Warm regards,

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