NEW YORK
CITY BAR

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September 26, 2013

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 (Rel. Nos. 33-9408; IA-3616; IC-30551 (File No. S7-03-13)

Dear Ms. Murphy:

The Committee on Investment Management Regulation of the New York City Bar (the "Committee") is composed of lawyers with diverse perspectives on investment management issues, including members of law firms and counsel to financial services firms, investment company complexes and investment advisers. A list of our members is attached as Annex A.

This letter responds to the request for comment of the Securities and Exchange Commission (the "Commission" or the "SEC"), *Money Market Fund Reform; Amendments to Form PF,* SEC Release No. 33-9408, IA-3616, IC-30551 (June 5, 2013) (the "Proposing Release"), which proposes two alternatives for amending rules that govern money market mutual funds (or "money market funds") under the Investment Company Act of 1940 (the "1940 Act").[1] The proposed two alternatives are "designed to address money market funds' susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such

1 15 U.S.C. 80a *et seq.*

redemptions, and increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds."[2] The first alternative proposal ("Alternative One") would require institutional, non-government money market funds to sell and redeem shares based on the current market-based value of the securities in their underlying portfolios, i.e., transact at a "floating" net asset value per share ("NAV"). The second alternative proposal ("Alternative Two") would require money market funds to impose a liquidity fee (unless the fund's board of directors/trustees (the "board") of a money market fund determines that imposition of a liquidity fee is not in the best interests of the fund) if a fund's liquidity levels fall below a specified threshold and would permit a money market fund to suspend redemptions temporarily, i.e., to "gate" the fund, under the same circumstances. Under the proposal, the Commission could adopt either alternative by itself or a combination of the two alternatives.

The Proposing Release contains additional amendments that are "designed to make money market funds more resilient by increasing the diversification of their portfolios, enhancing their stress testing, and increasing transparency by requiring money market funds to provide additional information to the SEC and to investors."[3] To further these goals, the Proposing Release would require money market funds to revise the disclosures in their prospectuses and, if used, summary prospectuses, and to add disclosures in advertisements for money market funds prepared under Rule 482 under the Securities Act of 1933 (the "1933 Act").

A. The Commission Should Extend the Comment Period on the Proposed Rules

Given the length of the Proposing Release and the number of issues identified in the Proposing Release as to which the Commission has requested comments, we urge that the Commission consider extending the comment period to permit additional time for interested parties to consider the proposals, respond to the Commission's questions posed in the Proposing Release[4] and suggest revisions and/or alternatives that might meet the Commission's stated goals while reducing the burdens that the proposals would impose on money market funds and their boards (burdens that would ultimately be borne by money market fund shareholders). While this letter focuses on certain legal issues raised by the Commission's proposals, we are aware that there are a number of other issues that we expect will be the subject of comment by others. Identifying and adequately addressing these issues continues to be a challenge for many who will be affected by the proposed amendments to the rules. Additional time to evaluate and make suggestions to the Commission would insure that the burdens and possible impracticalities of complying with the proposed rule revisions are better understood before the adoption of final rules.

B. Role of Boards under Alternative Two

The Committee notes the key role assigned to money market fund boards in respect of the imposition of fees and gates in Alternative Two. This alternative contemplates that money market fund boards would be called upon to make difficult, time-pressured decisions in crisis situations where the relevant facts may be complex and rapidly changing. The challenges boards would face under certain situations should Alternative Two be adopted are evident and this has

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2 Proposing Release at p. 1.

3 Proposing Release at pp. 1-2.

4 We estimate that the Proposing Release poses over 1,000 questions.

been acknowledged by the Commission. For example, in her opening remarks at the meeting at which the proposals were approved for public comment, SEC Chair White noted that, in the Commission's view, fund boards would have to meet a "high burden" before approving a reduction in the proposed mandatory redemption fee.

The Committee does not comment on the appropriateness from a public policy point of view of imposing such burdens on fund boards or of the proposed fees or gates themselves. However, the Committee recommends that, to the extent the Commission determines to implement some version of Alternative Two, the final rules or the adopting release address the following two practical points relating to the exercise by money market fund boards of the new duties that would be imposed upon them and the related disclosure requirements.

1. **The Proposed Requirement That Money Market Funds Promptly Publicly Disclose the Reasons for Board Actions in Respect of Fees and Gates Should Be Eliminated or Substantially Revised.**

While the Committee supports prompt public disclosure of the fact that redemption fees or gates have been imposed or modified, it questions the appropriateness, and the usefulness to investors, of requiring money market funds to file Form N-CR to provide public disclosure, within four business days[5] of a breach of the 15% liquidity threshold, of "a short discussion of the board of directors' analysis supporting its decision" to impose or not impose a liquidity fee or to suspend redemptions.

The Committee notes that board decisions in crisis situations, like board decisions in any other situation, will reflect the result of the directors' collective consideration of the relevant facts and circumstances and that different directors may assign different weights to different factors. It would seem obvious that a board decision to, for example, reduce the amount of the automatic 2% redemption fee to a lesser percentage as permitted by Alternative Two would involve significant judgment by the directors at a time of extreme market stress, and the Committee questions what more could be appropriately said in response to the proposed disclosure requirement than that the directors considered the facts and circumstances that they deemed relevant and concluded, in the exercise of their reasonable business judgment, to take the actions described in the report. Since fund investors reasonably expect that any board decision reflects such a process by the board, and since there is no particular reason to expect that directors acting in crisis situations will not be appropriately considering the relevant factors, the Committee questions the benefit of requiring this unusual special disclosure of the board's analysis.

If the Commission determines to require special disclosure of the board's rationale for its decisions in respect of fees or gates, the Committee is concerned that the Commission's proposed requirement that the board's "analysis supporting its decision" be publicly disclosed four business days after the action is taken would result in responsive disclosure being sub-optimal as it would necessarily be drafted under enormous time pressure, without time for thoughtful review and approval by the relevant persons, including the board. This would all be

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[5] The Instructions to Items E.4 and F.4 of proposed Form N-CR require that a fund amend its initial Form N-CR, which must be initially filed within one business day of the fund's breach of the 15% weekly liquid assets threshold, "by the fourth business day after the initial date on which the [f]und has invested less than fifteen percent of its Total Assets in weekly liquid assets."

done at a time of crisis when relevant personnel are addressing multiple pressing matters at the same time. The disclosure would subsequently be reviewed with the benefit of hindsight and could be used against the board and the fund in the sort of opportunistic litigation that follows any financial crisis. The Committee questions the benefit to fund investors of the type of disclosure that would result from this proposed requirement and is concerned about its potential consequences to money market funds and their investors, as they will ultimately bear the expense of any opportunistic litigation that may result.

With respect to the value of the disclosure to investors, the Committee notes the Commission has proposed to amend Rule 2a-7 for purposes of Alternative Two to require a money market fund "to post prominently on its website," within one business day of a breach of the 15% liquidity requirement, the same information that the fund would be required to disclose on Form N-CR within the same time period and does not propose to require website posting of the board's analysis supporting their decisions regarding fees and gates. *See* proposed Rule 2a-7(h)(10)(v).

The Commission also notes in the Proposing Release that "[a] fund currently must update its registration statement to reflect any material changes by means of a post-effective amendment or a prospectus supplement (or 'sticker') pursuant to rule 497 under the Securities Act [of 1933]," and that the Commission expects that, to meet this requirement, "promptly after a money market fund imposes a redemption fee or gate, it would inform prospective investors of any fees or gates currently in place by means of a prospectus supplement."[6] Such supplements would be posted on the fund's website, which is where investors may be most likely to go to seek information about their fund, rather than on an SEC form. Indeed, the Commission notes its "understand[ing] that investors have, in past years, become accustomed to obtaining money market fund information on funds' websites."[7]

In the Committee's view, the type of prospectus supplement required in the event of the imposition of redemption fees or gates pursuant to Alternative Two would not ordinarily be required to include "a short discussion of the board of directors' analysis supporting its decision [regarding fees or gates]" because such information would not typically be considered material information to investors. The critical information would be that the fees or gates had been imposed and when they were modified or removed. Proposed Rule 2a-7(h)(10)(v) and the existing disclosure requirements that would mandate a prospectus supplement ensure that investors will be provided with the information that is material for them regarding a board's decisions regarding fees and gates.

For the reasons set forth above, the Committee recommends that the Commission eliminate the requirement for public disclosure of the board's analysis in respect of decisions regarding redemption fees and gates.

To the extent the Commission decides to include a requirement that the reasons for a board's actions in this area be publicly disclosed, the Committee recommends that the disclosure be provided in the report to shareholders covering the relevant period and that it consist of a list of material factors considered by the board in making its determination. Inclusion of the disclosure in the next report to shareholders would permit adequate time for the drafting of the

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6 Proposing Release at pp. 219-220.

7 Proposing Release at p. 219.

disclosure by counsel, for discussion thereof and for review and comment by management and the fund's board. Such an approach to the timing of disclosure would be consistent with the approach of the Commission with respect to disclosure regarding the basis for fund boards' approval of investment advisory contracts, which permits time for accurate and adequate disclosure to be prepared for public dissemination to shareholders.[8]

The Committee also recommends that any required disclosure be of "the material factors considered by the board of directors" (similar to the disclosure requirements in respect of board approvals of investment advisory contracts), rather than the "discussion of the board of directors' analysis supporting its decision" in proposed Form N-CR. The Committee is concerned that the proposed language suggests a uniformity of analysis by fund directors that is not necessarily consistent with how a money market fund board may operate in a particular situation, particularly in the middle of a financial crisis, which almost certainly would involve telephone meetings.

2. The Commission Should Provide Additional Guidance to Money Market Fund Boards Concerning the Exercise of Their Discretion with Respect to Fees and Gates.

The Committee applauds the Commission's inclusion in the Proposing Release of examples of factors that a money market fund's board may wish to consider in determining whether to impose a liquidity fee, and whether such a fee should be less than 2%, once the fund's weekly liquid assets have fallen below 15% of its total assets and urges that, to the extent a version of Alternative Two is adopted by the Commission, an expanded version of such list be included in the adopting release. The Committee also urges that the Commission include a non-exclusive list of factors that a money market fund board may wish to consider when determining whether or not to suspend redemptions.

In addition to the factors listed in the Proposing Release regarding the imposition and amounts of redemption fees, the Committee suggests that the adopting release include consideration by the directors of the recommendation and analysis of the money market fund's adviser or sponsor, recognizing that such persons can be expected to have expert knowledge that many of the board members will not have. The Committee suggests that the adopting release also caution the board to consider any conflicts that the fund's adviser or sponsor may be subject to in making its recommendation.

The Committee further suggests that the money market fund's adviser's projections of the fund's liquidity based on the maturity of its portfolio securities and repurchase agreements, market conditions and anticipated redemptions, and a report from the fund's principal underwriter concerning recent and proposed shareholder communications, would also be appropriate factors for inclusion in such a list.

The Committee believes that the potential factors for consideration by a money market fund board contemplating a suspension of redemptions would be similar or identical to those relevant to evaluation of redemption fees and urges the Commission to indicate this, or to

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8 See Rule 30e-1 under the 1940 Act and Item 27(c)(d)(6) of Form N-1-A requiring disclosure in annual and semi-annual reports to fund shareholders, if the fund's board has approved an investment advisory contract during the fund's most recent fiscal half year, of a discussion "in reasonable detail [of] the material factors and the conclusions with respect thereto that formed the basis for the board's approval."

enumerate other factors it believes to be potentially relevant in the adopting release in the event "gates" remain a part of the final rule amendments.

Finally, in order that the Commission's listing of factors not have the unintended consequence of exposing a money market fund board that believes some factors in the list are not relevant to the particular situation at hand to litigation risk, the Committee urges that the adopting release make it clear that money market fund boards should consider those factors they reasonably believe to be relevant to an evaluation of the situation at hand (*i.e.*, in providing examples of factors that a fund board may wish to consider, the Commission does not intend to suggest that all such factors, or any particular such factor, must be considered in any particular situation).

C. The Commission Should Provide Specific Exemptive Relief to Allow a Fund Having Separate "Retail" and "Institutional" Share Classes to Reorganize the Classes as Series.

In the Proposing Release, the Commission recognizes that some money market funds offer different share classes to "retail" and "institutional" investors and would be required to take organizational action to restructure to comply with the floating NAV requirement and retail exemption from that requirement. According to the Commission, "[a] fund relying on the retail exemption would need to be structured to accept only retail investors as determined by the daily redemption limit, *and thus any money market fund that has both retail and institutional shareholders would need to be reorganized into separate retail and institutional money market funds.*"[9]

In the Proposing Release, the Commission postulates the one-time costs associated with such a reorganization.[10] The Commission's analysis of the actions required by a fund to reorganize does not address the "corporate" organizational and structural changes that would be required for a fund facing such a reorganization and the need to conform not only to applicable state laws, but also the requirements of the 1940 Act.

We believe that money market funds having multiple classes of shares, with separate classes offered to "retail" and "institutional" investors, would be required to take substantially more burdensome actions than the Commission anticipates in the Proposing Release to reorganize into separate money market funds (or separate series). One of those burdens results from the position currently taken by the Staff of the Division of Investment Management of the Commission (the "Staff") that may hinder such reorganizations, as discussed below.

Rule 18f-3 under the 1940 Act provides exemptive relief to permit a mutual fund to issue more than one class of shares of voting stock without violating the provisions of Section 18(f)(1) or 18(i) of the 1940 Act that prohibit an open-end fund from issuing "senior securities." Those classes must differ in the manner in which they distribute their securities or provide services to shareholders, but represent interests in the same portfolio of investments (although the different

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9 Proposing Release at pp.105-106 (emphasis added). Those reorganization requirements and considerations would not be relevant for an open-end investment company organized as a "series company" having a separate "retail" money market fund series and a separate "institutional" money market fund series pursuant to Section 18(f)(2) and Rule 18f-2 under the 1940 Act.

10 Proposing Release at p. 106.

classes may have their own expenses and must have exclusive voting rights on matters submitted to shareholders that relate solely to the arrangements of that class). Classes of shares are not separately incorporated or organized as juridical entities. Since none of a fund's portfolio securities are allocated specifically to a class, there is no way to directly "reorganize" a class into a separate investment company unless the board is able to re-designate a class as a separate series of the fund and allocate a portion of the fund's portfolio securities into that series.

Some fund complexes have recognized that limitation of the multiple class structure and have drafted provisions in the fund's organizational documents (the articles of incorporation or declaration of trust) to allow the fund's board to convert a share class into a separate series (which is treated under the 1940 Act as a separate investment company).

The Proposing Release does not deal with how a money market fund (or series of a fund) that has separate classes of shares offered to "retail" and "institutional" investors could reorganize those classes into separate retail and institutional funds. Such a reorganization would presumably require allocation and assignment of a ratable portion of the fund's portfolio securities to separate "buckets" representing the interests of the respective classes. However, on September 2, 2010, the Staff announced its view[11] that separation of a class into a series[12] is not possible with respect to share classes of registered investment companies under the 1940 Act. In pertinent part, the Staff's position in the summary states:

> **Rule 18f-3 under the Investment Company Act — Removal of a Class**
>
> . . . Nothing in rule 18f-3 permits a Fund with multiple classes of shares to separate a class from the other classes and merge that class into another Fund.
>
> The staff is aware of a provision in the organizational documents of certain Funds that purports to authorize each Fund's board of directors or trustees to designate any class of the Fund as a separate series (the "Provision"). The Provision is intended to facilitate the merger of the series created from the designated class into another Fund. The staff takes the view that the Provision conflicts with sections 18(f)(1) and 18(i) of the Investment Company Act. The staff believes that a Fund's designation of any or all classes as separate series pursuant to the Provision creates differences in the rights and obligations of the classes not permitted by rule 18f-3, thus making the rule unavailable to the Fund.

That statement on the Division's web page accompanying the referenced summary states that "[t]he summaries are not rules, regulations or statements of the Commission, and the Commission has neither approved nor disapproved these summaries." The Committee suggests that the Commission provide exemptive relief in the final rule to allow a fund board to designate a class of shares as a separate series of an investment company to enable the fund to comply with the provisions of Alternative One.

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11 See Investment Management Staff Issues of Interest, avail. at http://www.sec.gov/divisions/investment/issues-of-interest.shtml#rule18f-3.

12 The Staff stated that the action was taken for the purposes of facilitating a merger of the resulting series; however, the underlying basis of the Staff's assertion would presumably be applied even if the resultant series were not merged into another fund.

D. The Commission Should Provide Clear Guidance or Exemptive Relief So That a "Retail Money Market Fund" Will Satisfy the Requirements of Sections 2(a)(32) And 5(a)(1) of the 1940 Act as an "Open-End Investment Company" That Issues "Redeemable Securities."

In Alternative One, the Commission proposes that money market funds have a "floating NAV," subject to certain exceptions. The Commission states that "retail money market funds" would be exempted from the floating NAV, partly in recognition that retail investors are less likely than institutional investors to redeem large amounts from money market funds in times of market stress. The Proposing Release defines a "retail money market fund" as a "money market fund that restricts a shareholder of record from redeeming more than $1,000,000 in any one business day."[13] The Proposing Release states that "[t]he proposed retail exemption would provide exemptive relief from the [Investment Company] Act and its rules to permit a retail money market fund to restrict daily redemptions as provided for in the proposed rule," citing proposed Rule 2a-7(c)(3)(iii) in Alternative One.[14]

That cited subsection of the proposed rule would provide such retail money market funds with exemptive relief from the requirements of Section 18(f)(1) of the 1940 Act (which prohibits open-end funds from issuing senior securities other than through borrowing from banks) and Section 22(e) of the 1940 Act (which in pertinent part prohibits open-end funds from suspending the right of redemption except in circumstances specified in that section). Such exemptive relief would permit a retail money market fund to limit redemptions in excess of $1 million of redeemable securities on any one business day. The Proposing Release does not address the question whether a retail money market fund that places such a monetary limitation on the redemption of its shares would nonetheless be an "open-end company" that issues "redeemable securities."[15]

Under Section 5(a)(1) of the 1940 Act, an "open-end company" means a "management company which is offering for sale or has outstanding any redeemable security of which it is the issuer." A "redeemable security" is defined in Section 2(a)(32) of the 1940 Act as "any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof."[16]

Whether or not a security is "redeemable" under the 1940 Act has been examined principally in connection with requests for no-action relief by issuers seeking exclusion from the definition of "investment company" under Section 3(c)(5) of the 1940 Act so that they need not register as an investment company under the 1940 Act. In particular, Section 3(c)(5) of the 1940 Act excludes from the definition of "investment company" a "person who is not engaged in the

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13 Proposing Release at p. 80.

14 Proposing Release at p. 80 n. 211.

15 The Proposing Release also discusses whether Rule 22e-3 should be revised to conform to the proposed revisions to Rule 2a-7. Rule 22e-3 currently enables money market funds to suspend redemptions and postpone the payment of redemption proceeds to facilitate an orderly liquidation of the fund. That discussion does not bear on the issues raised in this section.

16 15 U.S.C. §80a-2(a)(32).

business of issuing redeemable securities" and primarily engages in certain businesses specified in that section. The language of Section 3(c)(5) with respect to issuance of redeemable securities was added by Congress in 1970 to extend the provisions of the 1940 Act to companies that had attempted to capitalize on the popularity of open-end investment companies by issuing redeemable securities without registering as investment companies.[17] Rule 3a-7 under the 1940 Act provides an exclusion from the definition of "investment company" for certain issuers that do not issue "redeemable securities." In the adopting release for Rule 3a-7 in 1992,[18] the Commission indicated that legal counsel concerned whether a security would be deemed to be a "redeemable" security under Rule 3a-7 should examine the no-action letters issued by the Staff of the Commission under Section 3(c)(5) of the 1940 Act for guidance.

The no-action letters issued by the Staff under Section 3(c)(5) and Rule 3a-7 do not provide clear-cut guidance as to all of the types of restrictions on redemption that would cause a security to be deemed not to be redeemable. In a letter denying a request for no-action relief under Rule 3a-7 in 1993,[19] the Staff stated that the determination whether a financing program issues redeemable securities will depend on "whether there are substantial enough restrictions on an investor's ability to withdraw portfolio securities," and, in that regard, the Division of Investment Management considers, among other factors: (1) whether an investor's withdrawal right is conditional or absolute, (2) whether the amount of portfolio securities that an investor can withdraw at any one time is limited or unlimited, (3) how often an investor can withdraw portfolio securities from the program, (4) whether there is a holding period requirement, and (5) how the withdrawal right is presented to investors. It is not entirely clear where a restriction against redeeming more than $1 million in share value per day would fall under that type of analysis.

In other cases in which no-action relief was requested from the Staff of the Commission seeking its concurrence that the issuer requesting relief was not issuing redeemable securities and therefore was excepted from the definition of investment company under Section 3(c)(5), the Staff has denied relief where the security was redeemable after a period of time (for example, relief was denied where the security was redeemable after a period of six months,[20] or after a

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17 *Senate Committee Report No. 91-184* (1969), page 37; *House Committee Report No. 91-1382* (1970), Page 17.

18 SEC Release No. IC-19105, Nov. 19, 1992 at n. 24. "Numerous no-action positions have addressed the definition of redeemable security in the context of section 3(c)(5). See, e.g., California Dentists' Guild Real Estate Mortgage Fund II (pub. avail. Jan. 4, 1990) (a security that may be presented to the issuer by the holder is not a redeemable security if substantial restrictions are placed on the right of redemption). Counsel concerned about whether a security would be a redeemable security under rule 3a-7 may examine these no-action positions for guidance."

19 Brown & Wood, pub. avail. Feb. 24, 1994. The Staff stated that the request did not present sufficient information about the withdrawal rights in that instance to enable it to concur that the withdrawal arrangements would not cause Rule 3a-7 to be unavailable.

20 Robert D. Brody, pub. avail. Nov. 22, 1979.

period of one quarter[21]). Theoretically, as Alternative One is drafted, a request to redeem more than $1 million in value from a retail money market fund might never be permitted by a fund.[22]

Thus, in some circumstances in which an issuer seeking to be excepted from the definition of investment company has imposed restrictions on the redemption of its securities, the Staff has concurred that the securities are not "redeemable securities" for purposes of Section 2(a)(32) of the 1940 Act, and in other cases the Staff has stated that despite the restrictions an issuer has placed on the redemption of its securities, the securities may be deemed to be redeemable. One commentator has suggested that this approach prevents issuers seeking the protection of the exception provided under Section 3(c)(5) from offering substantial redemption rights on their securities subject to only insubstantial limitations, and that Section 2(a)(32) should be interpreted differently for funds (*i.e.*, open-end investment companies) that represent that they offer redeemable securities than for companies excepted or exempt under the 1940 Act if they offer nonredeemable securities.[23] The authors do not, however, suggest the basis for such distinctive treatment.

In another no-action letter,[24] the Staff of the Commission stated that a fund may charge a redemption fee to cover certain administrative expenses associated with processing redemptions, but if that fee exceeded 2%, the fund's share may not be considered to be redeemable and the fund might not be able to hold itself out as a mutual fund.[25] Although the Staff no-action positions were withdrawn by the Commission when it adopted Rule 22c-2 (because such no-action relief was tied to finding that the redemption fee reflected the costs associated with processing redemptions), allowing fund boards to have discretion in determining whether to impose redemption fees, the Commission adopted the Staff's position that a fee in excess of 2% would be an "undue restriction on the redeemability of shares required by the [1940] Act."[26] Significantly, in adopting Rule 22c-2, the Commission noted the need to use its authority to exempt funds from the provisions of Section 2(a)(32) of the 1940 Act if their boards imposed a redemption fee:

> We also are using our exemptive authority under section 6(c) of the Act in adopting rule 22c-2. By adopting the rule, we are providing an exemption from the Act's requirement that investors redeeming shares of a mutual fund must receive their pro rata net asset

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21 Huntoon Paige & Co., Inc., pub. avail. Nov. 28, 1974.

22 The Proposing Release at p. 85 does ask whether the Commission should include a provision allowing redemptions in excess of $1 million if the shareholder provided advance notice, and it also notes at p. 87 that a money market fund could comply with the daily redemption limit by treating such redemption order as "not in 'good order' and reject the order in its entirety" or treat the order as a request to redeem $1 million. All of those approaches nonetheless would still result in significant limitations or restrictions on a shareholder's ability to redeem more than $1 million in a single day.

23 1 TAMAR FRANKEL AND ANN TAYLOR SCHWING, THE REGULATION OF MONEY MANAGERS: MUTUAL FUNDS AND ADVISERS, §5.08[C][2] (2d ed. 2009 Supp.).

24 John P. Reilly & Associates, pub. avail. Jul. 12, 1979.

25 *See also* Neuberger & Berman Genesis Fund, Inc., pub. avail. Sep. 27, 1988.

26 *Mutual Fund Redemption Fees*, SEC Release No. IC-26782 (Mar. 11, 2005) ("Redemption Fee Rule Release") at p. 12.

value of their shares (section 2(a)(32) of the Act [15 USC 80a-2(a)(32)) and from the Act's prohibition against the issuance of a senior security.[27]

In other contexts, the Commission itself appears to take the position that some "restrictions" may be imposed on open-end investment company shares without causing those funds to issue shares that are not redeemable. For example, the Proposing Release points out that under Item 11(c) of Form N-1A ("Redemption of Fund Shares"), a fund must disclose pursuant to Item 11(c)(1) "any restrictions on redemptions," a requirement that has been in Form N-1A since its adoption in 1983 (without, however, any explanation in the proposing or adopting releases as to what types of "restrictions" were to be described).[28] However, there is no discussion as to the effect of particular types of "restrictions" on redemptions on a fund's compliance with Section 2(a)(32) or Section 5(a)(1) of the 1940 Act.

If, in the Commission's view (which may be discerned from reviewing prior interpretations of Section 3(c)(5) of the 1940 Act and Rule 22c-2 by the Staff and the Commission), the significance of a limitation or restriction on redemption determines whether a security is "redeemable," then arguably, because that determination necessitates a subjective judgment, clear guidance or exemptive relief is desirable with respect to the effect on the determination of "redeemability" of an open-end retail money market fund's shares that would result from the imposition of a daily limitation on redemptions of more than $1 million by a shareholder of the fund.

While the Proposing Release describes the exemptive relief that would be provided under Sections 22(e) and 18(f)(1) of the 1940 Act under Alternative One, and Proposed Rule 2a-7(c)(3)(iii)(A) under Alternative One specifically sets forth such exemptive relief, there is no specific statement that exemptive relief is also provided under Section 2(a)(32) to allow a retail money market fund to impose a restriction on daily redemptions of more than $1 million of shares by a record shareholder. We believe that such explicit exemptive relief is appropriate and desirable if Alternative One is adopted.

Similar issues are raised in connection with Alternative Two, which would allow money market funds to continue to transact at a stable net asset value but (1) would require such funds to institute a liquidity fee in certain circumstances and (2) would permit funds to impose a suspension of redemptions ("gate") in certain circumstances.[29] Under Alternative Two, if a money market fund's liquid assets fall below 15% of total assets, the board of the fund would have the ability to impose a temporary suspension of redemptions for a limited period of time (not more than 30 calendar days in any 90-day period) if the board determines that doing so is in the fund's best interests.

Alternative Two does not contain any explicit statement that if a money market fund's board takes action to impose a temporary suspension of redemptions of the fund's shares, the fund is exempted from the provisions of Sections 2(a)(32) and 18(f)(1) of the 1940 Act. Additionally, Section 22(e) of the 1940 Act provides a statutory basis for suspensions of redemptions of shares of a fund under the specific conditions stated in subsections (1)-(3) of that

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[27] Mutual Fund Redemption Fee Release at Note 30.

[28] *See, e.g.*, discussion of Item 8 to proposed Form N-1A, SEC Release No. IC-12927, December 21, 1982.

[29] Proposing Release at pp. 153 *et seq.*

section. Section 22(e) requires the Commission to determine by rule or regulation the conditions under which trading is deemed to be restricted or an emergency exists, as set forth in sub-sections 22(e)(1) and (2). The fact that a money market fund has less than fifteen percent of its total assets in weekly liquid assets does not squarely fit within the concepts of a market emergency or trading restriction under sub-sections 22(e)(1) and (2). However, under Section 22(e)(3) redemptions may be suspended for "such other periods" as the Commission may permit by order for the protection of security holders of the investment company. Arguably, Alternative Two might be deemed to represent a regulatory basis for defining the conditions constituting "such other periods" under which redemptions may be suspended by a money market fund for the protection of security holders. However, the Commission is essentially forgoing the issuance of an order making such finding and is instead delegating to the fund's board the authority to determine that conditions exist such that suspension is in the best interest of the fund (the Proposed Rule uses the term "fund" rather than "security holders of the company"). For the purposes of tying the delegation of authority to the board to suspend redemptions as in the best interest of the fund, it would be desirable to explicitly state that such action represents the Commission's determination of "such other period" under Section 22(e)(3).

Additionally, since the ability of a fund's board to suspend redemptions for up to 30 days in a 90-day period could arguably be deemed to be a restriction on share redemptions affecting the status of the fund's shares as "redeemable securities" for the purposes of Section 2(a)(32), as discussed above, it would be desirable to include exemptive language in the Proposed Rule with respect to Section 2(a)(32).

E. The Commission Should Confirm That a Fund is a "Retail Money Market Fund" If It Has Stated Policies Restricting Redemptions to Not More Than $1 Million Per Day and Adopts Procedures Reasonably Designed to Comply with the Requirement.

While the Proposing Release does not discuss the possible consequences, under Alternative One for Proposed Rule 2a-7, of a "retail" money market fund's failure to comply with the requirement of Section 2a-7(c)(3)(i) if a shareholder of record inadvertently is allowed to redeem more than $1 million of redeemable securities on a single business day, the Committee believes that it is reasonable to conclude that a fund will be in compliance with the requirements if it has stated policies restricting redemptions to not more than $1 million per day and adopts procedures reasonably designed to comply with the requirement.

Alternative One of Proposed Rule 2a-7 does not expressly define the term "retail money market fund,"[30] although in paragraph (c) of Alternative One, which sets forth the requirements

30 On page 72 of the Proposing Release, the Commission states that "... we would define a retail fund as a money market fund that does not permit a shareholder to redeem more than $1 million in a single business day." Presumably the use of the term "retail money market funds" in the caption of Proposed Rule 2a-7(c)(3) is intended to serve as a definitional reference. Arguably it would be clearer to make the term "retail money market fund" part of the definitional requirements in sub-paragraph (c)(3)(i). Although paragraph (b) of Proposed Rule 2a-7 prohibits a fund from holding itself out to investors as a "money market fund" or the equivalent of a money market fund unless the fund complies with the Rule, the proscription does not make reference to a fund that holds itself out as a "retail money market fund." If the use of the term "retail money market fund" in the caption of sub-paragraph (c)(3) of the Proposed Rule means that the Commission will hold a fund that publicly characterizes itself as a "retail money market fund" accountable to comply with subsection (c)(3)(i) of Proposed Rule 2a-7 and that failure to so comply will constitute a violation of the a fund's requirement to comply with the provisions of Section 35(d) of the 1940 Act dealing with "deceptive or misleading names," then we believe it would be desirable to have greater clarity as to the meaning and purpose of the use of the term "retail money market fund" in the Proposed Rule.

for the computation of a money market fund's share price for purpose of distribution, redemption and repurchase, sub-paragraph (c)(3) is captioned "Exemption for retail money market funds." Sub-paragraph (c)(3)(i) states that, notwithstanding section 2(a)(41) of the 1940 Act, a money market fund may compute the current price per share of its redeemable securities by using the penny-rounding method, if "the fund does not permit any shareholder of record to redeem more than $1,000,000 of redeemable securities on any one business day."

That sub-paragraph makes a cross-reference to the provisions of sub-paragraph (c)(3)(iii) that exempt such funds from the requirements of Sections 18(f)(1) and 22(e) of the 1940 Act to the extent necessary to allow that restriction on redemptions. An exception is made for redemptions by omnibus account holders under sub-paragraph (c)(3)(ii). In other words, as the Proposed Rule is drafted, the fund's ability to use penny-rounding is expressly conditioned on its not *permitting* such a redemption at any time by a shareholder other than an omnibus account holder. What happens if it does? The Proposed Rule does not say. However, while the Commission acknowledges that "[a]pplying the daily redemption limitation to omnibus accounts may pose difficulties,"[31] the Committee submits that applying the redemption limitation may similarly pose difficulties for retail funds and their transfer and shareholder servicing agents with respect to direct accounts, because of the different manner of account registration formats under which a single beneficial owner may hold shares and because of the possibility of inadvertent human or computer error.

Because that condition, not permitting a redemption in excess of $1 million per day, is used to make the exception to the "floating NAV" share price calculation requirement of section (c)(1) available to retail funds, the language of sub-paragraph (c)(3)(i), as stated, could be read narrowly to mean that if a money market fund *permits*, even inadvertently, a shareholder of record to redeem more than $1,000,000 of redeemable securities on any one business day, it *may not* compute its NAV using the penny-rounding method. If that narrow reading were followed, a fund that discovers (directly or as a result of a report from its transfer agent) that such a redemption has occurred, even if due to error, would arguably either have to seek immediate exemptive relief from the Commission to allow it to continue to use the penny-rounding method (assuming that the Commission would be willing to grant such relief) or immediately convert its operations to use a floating NAV, entailing implementation of systems changes and disclosures to shareholders and investors, among other requirements. It is not inconceivable that an inadvertent processing of such an excess redemption request could occur, due to a computer or human error on the part of a fund's transfer agent. We believe that the Commission did not intend such a draconian result from an inadvertent error, which could harm the fund's shareholders as well as the fund's sponsor and distributor. We believe that such a narrow reading of that provision would not help effect the Commission's purposes in creating a "retail" money market fund exemption from the floating NAV requirement.

The Committee believes that it is a reasonable construction of sub-paragraph (c)(3)(i) that a "retail money market fund" may use penny-rounding if (1) the fund's registration statement and prospectus (including any summary prospectus that is used by the fund) states that the fund does not permit a shareholder of record to redeem more than $1,000,000 of shares on any one business day, and (2) the fund adopts and in good faith implements (which can mean causing its transfer or other shareholder servicing agent to implement) procedures reasonably designed to limit redemptions of the fund's redeemable securities held in the name of any one shareholder of

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31 Proposing Release at p.81.

record of the fund to not more than $1,000,000 on any one business day. We would expect such procedures to include a requirement by the fund that its transfer or shareholder servicing agent implement procedures to identify multiple accounts owned of record by the same shareholder, procedures to monitor shareholder account activity in related accounts, and periodic reports to the fund on such implementation.[32] We also believe it is reasonable to interpret that provision to mean that if a fund (or its transfer agent or shareholder servicing agent) inadvertently allows a redemption that does not conform to such limitation, notwithstanding the adoption and implementation in good faith of such procedures, the fund shall not be automatically disqualified from the ability to use the penny-rounding method in computing the current price per share of its redeemable securities for purposes of distribution, redemption and repurchase, provided that it takes reasonable steps to identify the reason for the error and to implement, or cause its transfer or shareholder servicing agent to implement, any procedures or controls that may be appropriate to seek to prevent recurrences of such error. The Committee believes that approach reflects the reasoning for the exception granted for omnibus account holders in sub-paragraph (c)(3)(ii).

Additionally, Alternative One of Proposed Rule 2a-7(g) includes, under "Required Procedures," a requirement in sub-section (1) that the fund's board adopt written procedures for supervising the fund's operations and portfolio management responsibilities, including written procedures "reasonably designed, taking into account current market conditions . . . for a money market fund that relies on the exemption provided by paragraph (c)(2) or (c)(3) of this section, to assure to the extent practicable" that the price per share computed using the penny-rounding method will not deviate from the stable price established by the fund's board. However, there is no requirement that a so-called "retail money market fund" adopt procedures reasonably designed to enable the fund to comply with the requirements of paragraph (c)(3)(i) with respect to the limitation on redemptions in excess of $1,000,000 by a shareholder of record on any one business day. Of course, Rule 38a-1 under the 1940 Act does require investment companies to adopt and implement written policies and procedures reasonably designed to prevent the fund from violating federal securities laws.

The Committee believes that the Commission should make clear in the adopting release for any final rule that a retail fund's disclosure in its prospectus that it limits redemptions by shareholders of record to $1,000,000 per business day, and its adoption and good-faith implementation of policies and procedures reasonably designed to restrict redemptions of shares owned of record by any one shareholder of record on a business day to not more than $1,000,000, would mean that a fund would not be automatically prevented from continuing to use penny rounding if the fund (or its transfer agent) inadvertently permitted a redemption in excess of that amount by a shareholder of record on a business day. An express inclusion in the adopting release for any final rule of a requirement to adopt and implement such policies and procedures would help dispel an interpretation of the Rule that a fund whose transfer agent inadvertently allowed a redemption of more than $1 million on a single business day by a shareholder of record (other than an omnibus account) would have to seek exemptive relief from the Commission to continue to use penny-rounding, or, in the alternative, to immediately utilize a floating NAV calculation methodology to price its shares for distribution, redemption, and repurchase.

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32 Because we cannot anticipate all of the facets of such procedures that funds and their transfer agents might adopt and implement to assist in compliance with this requirement, we do not think it is necessary or desirable to try to include specific requirements for such procedures in the final rules, but rather to let funds and their boards adopt such procedures as they believe are appropriate for their business operations.

F. The Commission Should Reconsider Required Disclosures under the Proposed Amendments to Rule 482.

Rule 482 under the 1933 Act, which governs advertisements by registered investment companies, including money market funds, requires that such advertisements include a number of statements advising investors of the risks of investing in a fund. Rule 482(b)(4), in particular, applies to advertisements for money market funds and requires that money market funds that hold themselves out as maintaining a stable net asset value must include the following statement (in addition to other statements that advertisements for all funds must include):

> An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.

The Commission has proposed new risk disclosures for money market fund advertisements under Rule 482, with different versions under Alternatives One and Two of the proposal for amending Rule 2a-7. These would replace the statement set forth above.

1. Cumulative Effect and Possible Redundancies of the Proposed Legends

The Committee believes that the Proposing Release reflects the Commission's long-standing efforts to assure that investment company advertisements will provide important disclosures to investors about the operations and risks of investing in money market funds, and that the Commission's prior efforts, reflected in the adoption of, and subsequent amendments to, Rule 482, have greatly benefitted not only investors, but also investment companies, by promoting the integrity of the marketplace, assuring a "level playing field" for investment companies in advertising, and, most importantly, helping assure that investors are better able to compare different investment company alternatives. For several decades, the Commission has also pioneered the adoption of changes to disclosure documents and advertising requirements to eliminate the use of "boiler plate" risk disclosures, to assure the clarity and comprehensibility of those documents for investors. Notably, in adopting very significant amendments to Rule 482 in 1988, to mandate standard requirements for performance calculations in fund advertisements, the Commission adopted requirements for risk disclosures but chose not to adopt a specific format or language for that disclosure, noting the comments it had received about the risks of requiring "boiler plate" disclosures.[33]

In the spirit of the Commission's efforts to promote clarity and comprehensibility in advertisements, the Committee believes that mandated legends should be used sparingly.[34] First, we are concerned that a lengthy or repetitive legend or group of standardized legends can serve

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[33] *See* Release No. IC-16245 (Feb. 2, 1988), *Advertising by Investment Companies* ("The Commission has decided not to adopt a specific format for this disclosure" placing the onus on "whoever sponsors the ad, be it the fund, the underwriter, or the dealer . . . for assuring that the ad is not false or misleading," reflecting the Commission's concern, expressed in the Proposing Release for those amendments, about the use of "boiler plate" language about risks. Release No. IC-15315 [Sep. 17, 1986]).

[34] We note that the various legends discussed below are proposed to be required not just for advertisements or sales material, but also for the prospectus and summary prospectus. While some of our comments below are specific to Rule 482, our suggestions regarding the legends should be understood more broadly as applicable to any venue in which they might be required.

to obscure rather than highlight the importance of the underlying message(s). Second, and particularly in inherently brief formats like advertisements, there is a risk that mandated legends may crowd out material informational content. The unintended outcome in each case is that advertisements can be made less useful to both consumers, who refer to advertisements as a preliminary source of information, and to funds, which use advertisements to communicate to potential investors.

The Proposing Release provides:

- For all money market funds, legends comprised of three different bullet point sentences that, each in a somewhat different way, warn of a risk of loss of principal, which would be added, when used in Rule 482 advertising, on top of existing legends under that rule, which also includes a separate required statement of risk of loss.
- For funds that may be subject to liquidity fees or redemption gates, legends comprised of two very similarly worded bullet point sentences, one for fees and one for gates.

We strongly encourage the Commission to consider closely how these various proposed legends and disclosures will operate in practice and, especially, the cumulative effect and possible redundancies of multiple new required disclosures. We also encourage the Commission to consider the disparity of treatment – and the resulting potential for investor confusion – in a disclosure regime that would layer on one required new legend after another for money market funds while doing nothing of the sort for a variety of undoubtedly more risky asset classes among both investment companies and other categories of issuers.

2. Proposed Legend Addressing "Sponsor Support"

In all versions of the proposals to amend Rule 2a-7, the Commission has proposed adding a new required statement for money market fund advertisements under Rule 482 as follows:

> The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.[35]

The Commission's rationale for including that new disclosure is to "change the investment expectations and, therefore, the behavior of money market fund investors."[36] Stating that the risk-limiting conditions of Rule 2a-7 and past experiences of money market fund investors have created expectations of a stable, cash-equivalent investment, the release goes on to state that "one reason for such expectation may have been the role of sponsor support in maintaining a stable net asset value for money market funds," citing the discussion in Section II.B.3 of the Proposing Release about occurrences of such sponsor support in past financial crises.[37] But in that earlier discussion, the Proposing Release notes that "instances of sponsor support are not required to be disclosed outside of financial statements, and thus were not particularly transparent to investors." Thus the Commission has fashioned a risk disclosure to

35 Proposing Release at pp. 577-578, 579-580.

36 Proposing Release at p. 140.

37 Proposing Release at p. 140.

warn investors about a practice, sponsor support, that by the Commission's own admission, investors were not aware of and that was not per se a factor in investor decisions to invest in money market funds during the 2007-2008 crisis.

The issue of concern cited by the Commission as the basis for this proposed new requirement is that the practice of sponsor support for money market funds (along with other factors) may have lent stability to money market fund share prices, and that created unwarranted expectations on the part of investors that they could not lose money by investing in money market funds. Thus it appears that what the Commission is actually concerned about is unwarranted investor expectations about the stability of money market fund share prices, not particular factors unknown to investors that may have led to such stability in particular instances in the past.

Singling out one particular factor, sponsor support, that may have led to share price stability as the basis for a primary risk disclosure in a fund advertisement raises it to a level of importance and prominence that may be unwarranted in view of (1) the Commission's acknowledgement of investor ignorance of the practice and (2) the fact that it is not the primary risk factor the Commission appears to be concerned about – which is investors' false sense of money market fund share price stability. If the Commission believes it is important to warn investors that they could lose money in money market funds, selecting one possible factor, the lack of assurance of sponsor support, may overstate the effect of that factor and omit other material possible factors, for example, the risk that unanticipated market illiquidity may affect the prices of securities the fund holds. While sponsor support of money market funds may have been a phenomenon of the 2007-2008 market crisis, it may not be a factor in future financial crises and may place undue emphasis on the effect of that practice with respect to the stability or instability of a fund's share price in future financial crises.

The references to "financial support" by the "fund's sponsor" also are unlikely in our view to have clear meaning to ordinary investors. Rather, if used as proposed (i.e., within a single brief sentence), the phrases risk trying to impart too much information too quickly and thus present the possibility that the resulting disclosure simply will not be understood. We thus encourage the Commission to consider whether this element of the proposed legends could be dropped altogether, perhaps in favor of requiring that funds discuss the limitations of sponsor support in another format that will allow for greater context and flexibility of explanation.

3. Other Proposed Legends

The phrase "stable value" as used in the first bullet point sentence in the legend proposed for floating NAV funds also offers the potential for confusion since the same phrase has been widely used for decades in connection with another class of investment products. In particular, "stable value" already has an established meaning well understood by financial advisers and planners as referring to a retirement product that will use a combination of government bonds, guaranteed return insurance wrappers and potentially other synthetic instruments to deliver a minimum rate of return. We suggest that the Commission rephrase this legend.

Under Alternative 2, money market funds, other than government money market funds that choose to rely on the exemption for such funds from proposed requirements as to liquidity fees or gates, would be required to include two additional statements in their advertisements:

- The Fund may impose a fee upon sale of your shares when the Fund is under considerable stress.

- The Fund may temporarily suspend your ability to sell shares of the Fund when the Fund is under considerable stress.

While we agree that the ability of a fund's board to impose liquidity fees or redemption gates under limited circumstances is important to disclose to investors, we have several concerns with these proposed disclosures. The first concern is whether the phrase "when the Fund is under considerable stress" will provide meaningful disclosure to investors about the circumstances under which such fees or gates could be imposed. We submit that the phrase "considerable stress" does not have a commonly understood meaning and that investors reading an advertisement might not understand what types of events could constitute "considerable stress." Such an amorphous term would not provide investors with a sufficient basis to understand the potential magnitude or likelihood of the manifestation of the risk that such fees or gates would be imposed and may even suggest to some investors that a fund might do so arbitrarily. To the extent that investors imply that "considerable stress" would likely only result from exogenous factors, such as extreme market events, ignoring the possibility that failure to meet weekly liquid asset requirements could conceivably result from internal portfolio management decisions in an otherwise functioning market, the use of "considerable stress" could mislead come investors as to the circumstances under which fees could be imposed or redemptions suspended.

Under proposed Rule 2a-7(c)(2), the imposition of liquidity fees or gates could occur under circumstances and subject to conditions that do not ideally lend themselves to the type of "shorthand" reference that is desirable for disclosure in a risk "legend" in an advertisement. It would be difficult to draft a brief description of the circumstances described in proposed Rule 2a-7 under Alternative 2 under which liquidity fees or redemption gates might be imposed, which include the existence of certain "weekly liquid asset" (itself a complicated concept to reduce to shorthand disclosure in a legend) holding thresholds, possible board decisions, and time limitations for the imposition and existence of such fees or gates.

That difficulty raises the question whether, when weighed against the possibility that they may confuse investors, the two proposed disclosure requirements above are important or material enough to be required in an advertisement under Rule 482. In weighing those factors, there is the additional factor that investors cannot purchase money market fund shares directly through an advertisement, which under most circumstances cannot include an application for the purchase of securities[38] and which merely acts as an inducement for the investor to seek additional information about the advertised fund, including the prospectus. Since, under the Proposing Release, the disclosures about the circumstances under which liquidity fees and redemption gates could be imposed would be described more completely in the fund's prospectus, investors would have ready access to that information, more completely described in the prospectus (as a result of the Commission's proposed amendments to Items 4 and 16 of Form N-1A).

At the very least, if the Commission is not inclined to omit those two disclosures from the proposed Rule 482 amendments, as an alternative we suggest that, instead of having the disclosures refer to "considerable stress," the Commission could consider including a reference

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[38] Rule 482(c) prohibits advertisements under the Rule from containing or being accompanied by an application to purchase shares, except in certain cases involving unit investment trusts.

to a reduction in the liquidity of the fund's portfolio holdings as the basis of the imposition of such restrictions. In that case, we believe that the two proposed disclosures could be restated and combined into one disclosure that states the information more clearly without sacrificing its impact (and clarifying that the imposition of a fee or a gate would be alternatives):

> The Fund may impose a fee on your redemption of shares or may temporarily suspend your ability to redeem your Fund shares if the liquidity of the Fund's portfolio holdings becomes substantially reduced because of market conditions or other factors.

We believe that approach provides clearer information to investors about the type of circumstances in which those fees or restrictions on redemptions would be applied than the Alternative 2 proposed disclosures.

We also believe that the open-ended reference to the imposition of "a fee" should be changed, if this legend is used, to refer instead to "a fee of up to 2%" or similar language that establishes the maximum fee.

G. Disclosure of Liquidity Fee

The Committee agrees with the Commission's preliminary view that, assuming there ultimately will be a liquidity fee option for some funds, such a fee would not be appropriate to include in a prospectus risk/return summary's fee table and expense example. That presentation of fees and expenses is intended to show a typical investor the range of anticipated costs that will be borne by the investor directly or indirectly as a shareholder. It is not an ideal presentation for the kind of highly contingent cost that would be represented by a liquidity fee. Using that table for this kind of disclosure risks overemphasis and would serve to present the liquidity fee almost as a given. It also is the case that the fee table and expense example, or data points inside either of them, can be picked up by various information services and at times reproduced without explanation, which would further aggravate this issue. The same purpose could be achieved without the same concern if a registrant instead could include a brief reference to the liquidity fee in a footnote to the fee table, supplemented by more detailed disclosure elsewhere.

H. The Commission Should Reconsider the Costs of Certain New Disclosures.

A practical impact of a number of the proposed new data disclosure requirements will be that firms affirmatively adapt their management practices to avoid having to make some types of disclosures. These types of disclosure-driven impacts on how investment advisory firms conduct their business are inevitable, as the Commission notes in several instances in the Proposing Release. By way of example, the Proposing Release states:

> ...this enhanced disclosure [of daily and weekly liquidity figures] may impose external market discipline on portfolio managers, in that it may encourage fund managers to carefully manage their daily and weekly liquid assets, which may decrease portfolio risk and promote stability in the short-term financing markets.[39]

[39] Proposing Release at p. 327 at n. 634 and accompanying text, citing the ICI's comment letter to the Financial Stability Oversight Council that prime money market funds should be required to make frequent public disclosure of weekly liquid asset levels to "enhance transparency and encourage a highly conservative approach to portfolio management."

While those benefits may indeed be present, such a change in portfolio management practices also carries costs, which should be explored in the course of the Commission's rulemaking.

As the excerpted text acknowledges, portfolio managers responding to the new disclosure requirement no longer would be managing their funds solely to achieve a commercially desirable balance of liquidity versus performance. Nor even, we would suggest, would portfolio managers be seeking a commercially desirable balance bounded by a stated regulatory minimum requirement. Instead, the driving factor could become perceptions (guesses, really) of what the firm expects the market and regulators will find favorable as a matter of disclosure, with the potential for various distortions. A notable impact of managing a fund to higher liquidity benchmark than the "normal" commercially desirable balance or any stated regulatory minimum – assuming that is a result of an overemphasis on disclosure – could be that the risk-return trade-off implicit in the fund is shifted so that the risk of negative real returns outweighs the risk of loss in the eyes of prospective investors. That would, we submit, be to the detriment of fund shareholders, their managers, and the markets in which funds invest – all potentially without the detailed cost-benefit analysis that would accompany setting a "hard" stated regulatory minimum liquidity requirement in lieu of using disclosure to encourage an amorphous, but higher requirement.

More subtle distortions also are possible. For instance, "normal" portfolio management practices might have daily and/or weekly liquidity positions moving up or down more than will be the case if continuous disclosure is required, assuming firms believe they are expected to stay only within particular bands or only along smooth or predicable vectors. Moreover, such a shift to smoother or band-limited moves in liquidity levels – if that develops – may not cleanly correlate to risk. The cost in terms of distorted portfolio management outcomes thus may be borne by funds and their shareholders without a correspondingly reduced risk level.

As another example in a different area of the proposed rules, the various proposed disclosures regarding sponsor support may affect a sponsor's decision-making in times of need by a fund in various ways. Willingness to provide support in the first instance may be adversely affected, as could decisions about which support measures to consider and the scope of support – all outcomes that ultimately may increase the risks borne by money market fund shareholders and, perhaps, the wider market.

In sum, the Committee urges the Commission to weigh carefully the costs and benefits of the various disclosure proposals, as disclosure may involve substantial costs. Outcomes associated with required disclosures can be both far-reaching and unpredictable, so that a disclosure mandate should not be used without care. That is especially so when, as at various points in the Proposing Release, the intent to change conduct is explicit and the disclosure mandate therefore fairly may be viewed as a substitute for establishing or modifying conduct standards.

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The Committee appreciates the opportunity to comment on the proposed rules. If we can be of any further assistance in this regard, please do not hesitate to contact Kathryn L. Quirk at (215) 822-8320 or klquirk@comcast.net.

Very truly yours,

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