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Via email to: rule-comments@sec.gov

September 30, 2013

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

Re: File No. S7-03-13
Release Nos. 33-9408, IA-3616, IC-30551
Money Market Fund Reform; Amendments to Form PF

Dear Ms. Murphy:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee" or "we") of the Business Law Section (the "Section") of the American Bar Association (the "ABA"), in response to the request for comments by the U.S. Securities and Exchange Commission (the "Commission") in its June 5, 2013 proposing release referenced above (the "Proposing Release").[1] The Commission proposed amendments to rule 2a-7 under the Investment Company Act of 1940 (the "1940 Act") and related rules and forms that would impact how money market funds operate. The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

The principal areas that we address in this letter include:

- Floating Net Asset Value Proposal – Alternative 1
  - Specific Comments on the Floating NAV Proposal
  - Proposed Retail Fund Exemption and Omnibus Account Issues
  - Accounting Implications and Money Market Fund Shares as Cash Equivalents
  - Effects on Other Money Market Fund Exemptions – Request for Comment Concerning SEC Rule 17a-9
- Standby Liquidity Fees and Gates Proposal – Alternative 2
  - Structure of the Liquidity Fee

1 This letter uses, without definition, the same defined terms that are used in the Proposing Release.

- Structure of Temporary Gates
- Role of Members of a Board of Directors
- Board Composition Requirement
- Application of Board Findings Requirement
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- Issues for Variable Annuity Contracts
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  - Proposed Disclosures for "Institutional" Money Market Funds under Alternative 1
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  - Alternative 2: Required Money Market Fund Disclosures
  - Format of Proposed New Disclosures in Advertisements
- Modification of Investment Objectives and Policies
  - Amendment to Organizational Documents
  - Modification of Investment Objectives and Investment Policies
  - Issuer Diversification Limits and the "Twenty-Five Percent Basket"
- A Floating NAV - Transparency and Market-Based Pricing

Floating Net Asset Value – Alternative 1

The Commission seeks comment in the Proposing Release on a number of questions relating to its floating NAV proposal and the purposes of the proposal – to address the incentive of money market fund shareholders to redeem shares in times of fund and market stress based on the fund's valuation and pricing methods, and to improve the transparency of pricing associated with prime money market funds. We take no position as to whether the Commission should require money market funds to convert to a floating NAV.

Specific Comments on the Floating NAV Proposal. We offer the following responses to certain specific questions posed by the Commission in its Proposing Release. (At the end of this letter, we also offer some general thoughts about the Commission's position that a floating NAV will promote greater transparency that will, in turn, ameliorate systemic risk posed by money market funds.)

Do commenters agree that floating a money market fund's NAV would lessen the incentive to redeem shares in times of fund and market stress that can result from use of amortized cost valuation and penny rounding pricing by money market funds today?

In the Proposing Release, the Commission states that stable NAV money market funds may be susceptible to runs because there may be a "first mover advantage" in redeeming before others due to the minimal trading in the funds' portfolio securities. Absent the availability of relative redemption data with respect to the experience of a U.S. - based "money market" type fund having a floating NAV during times of extraordinary market stress, the response to this somewhat hypothetical question should be based on extrapolations of data from closely comparable funds – *i.e.,* ultra-short bond funds. On that basis, we believe that the extent to which a money market fund's floating NAV would reduce incentives to redeem may be marginal and, in any event, highly contingent on the type of "stress" experienced by a particular money market fund or the debt market in general.

It is reasonable to infer that comparable incentives to redeem were present for persons owning shares of ultra-short bond funds in 2008, and these funds themselves experienced significant redemptions. Because money market funds with a floating NAV functionally would be ultra-short bond funds, it is difficult to conclude that any meaningful reduction in incentives to redeem will be achieved through a floating NAV in. We understand that investors in both money market funds and ultra-short bond funds have as their primary objective the preservation of capital. If either type of fund is experiencing losses of any sort (an issuer default, sale of assets to pay redeeming shareholders during a period of rising interest rates, an issuer's loss of an investment grade credit rating, etc.), shareholders in either type of fund will have an incentive to redeem.

What would be the effect of the other incentives to redeem that would remain under a floating NAV with basis point pricing requirement?

The liquidity needs of stable NAV money market funds and ultra-short bond funds appear to be closely comparable. In either instance, a fund must have cash to pay redeeming shareholders and, at some point, may need to sell assets under distress conditions. With respect to incentives created by what the Proposing Release characterizes as "imperfect transparency," it does not seem at all clear, as we explain below, that a floating NAV based on pricing models incorporating assumptions about value rather than based on market prices will accomplish much, if anything, to ameliorate conditions of "imperfect transparency."

The Proposing Release devotes two short paragraphs to what is described as "incentives created by money market funds investors' desire to avoid loss."[2] It seems safe to say that ultra-short bond fund investors also have strong incentives to avoid loss. After all, they, like money market fund shareholders, have chosen to forego a potentially higher return in order to protect

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[2] Proposing Release *supra*, text accompanying notes 62 to 64.

their principal. If these investors were prepared to tolerate any appreciable risk of loss of principal, they may want to allocate this portion of their portfolio to longer term bond funds or to equity funds.

With regard to the risks associated with "effects on other money market funds, investors, and the short-term financing markets" discussed in the Proposing Release,[3] the Commission notes that "the potential for liquidity-induced contagion may have negative effects on investors and the markets for short-term financing of corporations, banks, and governments."[4] Again, we suggest that these concerns are not confined to stable NAV money market funds but rather apply with nearly equal weight to ultra-short bond funds.

Investors at this end of the risk/reward continuum by definition are extremely risk averse (at least with respect to this portion of their portfolio) and are much more concerned with the liquidity of their investments. Isolating stable NAV money market funds from other funds holding money market instruments and other types of short-term debt securities invites a great deal of speculative analysis of what "may" or "can" happen. The extent to which systemic risks posed by ultra-short bond funds are scrutinized in the Proposing Release, however, falls short of the scrutiny brought to bear on stable NAV money market funds. Of course, if the adoption of floating NAVs leads to a substantial contraction of assets held in institutional money market funds then, perforce the systemic risk posed by these funds can be expected to contract as well -- at least after the initial redemptions by shareholders of institutional prime money market funds before the floating NAV requirement takes effect.

Would floating a money market fund's NAV provide sufficient transparency to cause investors to estimate more accurately the investment risks of money market funds?

As discussed in more detail at the end of this letter, there may be limitations inherent in the estimation methodology of "matrix pricing" and yield curve modeling that could detract from transparency of money market fund portfolios and inject a lack of comparability across similarly situated money market funds, thereby hampering the ability of investors to make informed investment decisions.

Additionally, the proposed rule that would require these money market funds to publish information about their pricing and the basis for it assumes that all so-called "institutional" investors have equal resources and capabilities to analyze such information. It is more likely, however, that larger institutions have greater analytical resources than other institutional investors, such as small pension plans and companies. Thus, the proposal would preserve the risk for these smaller institutional investors of a "first mover" advantage on the part of those larger investors, enhanced by the availability of pricing data that the proposal would require.

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[3] *Id.* at text accompanying notes 65 to 91.

[4] *Id.* at text accompanying note 69.

Are there other places to disclose the shadow price that would make the disclosure more effective in enhancing transparency?

The websites of investment advisers that sponsor money market funds offer an appropriate venue for investors to find and use a fund's shadow price.

Would floating NAV money market funds treat non-redeeming shareholders, and particularly slower-to-redeem shareholders, more equitably in times of stress?

It is not clear whether a floating NAV will advance the equitable treatment of investors contemplated by the Commission's question. It seems more likely that investors who are slow to redeem from a money market fund that is losing principal value will fare less well than those who redeemed earlier.

To the extent that some investors choose not to invest in money market funds due to the prospect of even a modest loss through a floating NAV, would the funds' resiliency to heightened redemptions be improved?

In our view, the answer seems to be "no." Investors who are prepared to accept a "modest loss" of principal are much more likely to require compensation (*i.e.,* yield) for accepting this risk, and are therefore likely to invest, say, in a short-term or intermediate-term bond fund. So, by self-selection, those who invest in money market funds, whether with stable NAVs or floating NAVs, should not be assumed to be patient investors willing to ride out a downward move in the principal value of their investment.

Would money market fund sponsors voluntarily make cash contributions or use other available means to support their money market funds and thereby prevent their NAVs from actually floating? Would larger fund sponsors or those sponsors with more access to capital have a competitive advantage over other fund sponsors?

This question would seem to call for some degree of speculation regardless of which side of the broader debate one happens to be on. With this significant caveat, we would suggest (that is, speculate) that sponsors of money market funds are as likely to make capital contributions in a floating NAV environment as they have been in a stable NAV environment. The question for the sponsor of any money market fund will remain whether the capital contribution is manageable and likely to sustain a stable (or unchanging) NAV and thus mitigate its financial contribution and reputational risk. We believe there is a reasonable basis for postulating that sponsors having greater financial resources will be better able to contribute capital to the money market funds they sponsor than will sponsors with fewer resources. This inequality in financial resources potentially creates a competitive advantage for larger sponsors, and therefore may give rise to a substantial barrier to entry for some smaller sponsors. The answer may depend, in part, on whether the sponsor believes that the diminution of a fund's NAV is temporary as the result of market factors, or that the loss to the money market fund would be permanent, resulting, for example, from the default of a portfolio security.

Additionally, the answer will depend on the importance to institutional investors of maintaining a stable NAV and the marketplace tolerance for even minor deviations from a stable NAV. Without surveying the institutional investor market, we cannot be certain.

Proposed Retail Fund Exemption and Omnibus Account Issues. If the Commission intends to adopt the floating NAV requirement for institutional prime money market funds, and to provide a retail fund exclusion, as proposed, we urge the Commission to address the points discussed below. We suggest that the Commission adopt a standard for distinguishing retail money market funds from institutional money market funds that is not based exclusively on a redemption limit or on relationships with intermediaries using omnibus accounts.

First, the Commission does not reconcile the proposed redemption limit for retail funds with the requirement that all open-end funds, including retail prime money market funds, issue only redeemable securities as defined in section 2(a)(32) of the 1940 Act. Absent an exemption from that requirement, it is not clear that retail money market funds would have sufficient legal authority to limit redemptions. If the Commission intends to adopt the proposal, it should expressly address the requirements of section 2(a)(32) of the 1940 Act.

Second, the Commission correctly identifies the common use of omnibus accounts by intermediaries as a crucial impediment to imposing a workable redemption limit. We agree that finding a workable solution for omnibus accounts is a necessary precondition to allowing money market funds to impose any redemption limits on their investors. We believe, however, that the Commission's current proposal does not establish a sufficient legal basis to enable boards of directors of money market funds to conclude that the money market funds with investors who have purchased shares through omnibus accounts can rely on rule 2a-7 and maintain a stable NAV through the "penny rounding" arithmetic convention.

Specifically, the Commission proposes to allow a money market fund with omnibus account shareholders to be classified as a "retail" fund if:

> ...the money market fund has policies and procedures reasonably designed to allow the conclusion that the omnibus account holder does not permit any beneficial owner of the money market fund's shares, directly or indirectly, (or the omnibus account holder for its own account) to redeem more than $1,000,000 of redeemable securities on any one business day.

In the Proposing Release, the Commission states that the use of the "directly or indirectly" wording is designed to address the need for a money market fund's policies to be enforced by intermediaries at each step in the chain of ownership. Otherwise, the money market fund must apply its redemption limit at the aggregate omnibus account holder level (or rely on a cooperating intermediary in the chain to apply the fund's redemption limits to any uncooperative intermediaries further down the chain).

The proposal imposes subjective factors such as "reasonably designed" procedures permitting a "conclusion" about the omnibus account intermediary's own procedures. While those terms may provide boards of directors with needed flexibility in connection with the establishment of their funds' compliance policies pursuant to rule 38a-1 under the 1940 Act, those terms are confusing when applied to an exemptive rule.

The proposal does not identify who is authorized to draw a conclusion regarding the amount of a redemption limit. Is it the money market fund's board of directors, the fund's investment adviser, or a person who owns shares through an omnibus account? Absent further guidance from the Commission, the phrase "reasonably designed" is so open-ended as to be meaningless. At a minimum, the Commission should indicate from whose perspective the procedures must be "reasonably designed" and provide some non-exclusive factors or examples illustrating what the Commission means by the term "reasonably designed" in this context. We are concerned that the Commission's enforcement staff may challenge the reasonableness of a fund's procedures after the fact, especially if the Commission does not provide guidance as to which procedures would be reasonable under a particular set of circumstances. Nor is it clear what sort of policy or procedure would allow the chief compliance officer of a money market fund to survey activities within a third-party's omnibus account to verify ongoing compliance with the fund's policies and procedures.

In our view, the "retail" exemption would not be "relatively simple to implement" because it is not clear how money market funds could establish reasonable procedures to address omnibus accounts without negotiating and entering into multiple, different agreements with the sponsors of an omnibus account and those investors who chose to invest through them. Even assuming a third-party sponsor of omnibus accounts would be willing to develop and implement the systems necessary to apply a money market fund's redemption limit, it is not clear how the fund could rely on those systems or be sure of their implementation during a crisis absent an enforceable agreement with the omnibus account holder. Realistically, a money market fund may have limited bargaining power in connection with such negotiations; different money market funds will have different levels of bargaining power. Finally, the Commission does not explain what the consequences would be for a money market fund in the event of a breach of the redemption limit, whether or not the breach resulted from a failure within an omnibus account. Specifically, the Commission should clarify that, in the event of a breach (whether through direct holdings or through omnibus accounts), the money market fund would be able to continue to rely on the "retail" exemption under rule 2a-7 and continue to maintain a stable NAV.[5]

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[5] We believe that it is reasonable to read sub-paragraph (3)(3)(i) to mean that a "retail money market fund" may use penny-rounding if (1) the fund's registration statement states that the fund's policies do not permit a shareholder of record to redeem more than $1 million of shares on any one business day, and (2) the fund "adopts and in good faith implements procedures reasonably designed to limit redemptions of the fund's redeemable securities held in the name of any one shareholder of record to not more than $1 million on any one business day." 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 exceeds the $1 million daily limit in violation of its procedures, the fund may continue to use the penny-rounding method to compute the daily NAV, provided that the fund (itself or acting through an appropriate agent) takes reasonable steps to identify the

If the Commission determines to differentiate institutional funds from retail funds, we suggest that the Commission adopt a standard for distinguishing retail money market funds from institutional money market funds that does not rest exclusively on a redemption limit or relationships with omnibus account holders and provide more certainty that good faith reliance by someone on the ability of an omnibus account to limit redemptions will not jeopardize a money market fund's ability to rely on rule 2a-7.

Accounting Implications and Money Market Fund Shares as Cash Equivalents. We urge the Commission to confirm the staff's view that shares of a money market fund with a floating NAV would be considered to be a "cash item" for purposes of section 3(a)(1)(C) of the 1940 Act, subject to certain conditions as contained in existing SEC staff no-action letters.

As currently articulated in FASB ASC Paragraph 305-10-20, shares of a money market fund are "cash equivalents" under U.S. GAAP. The Committee agrees with the Commission that fluctuations in the amount of cash received upon redemption (as a result of a floating NAV) likely would be insignificant and would be consistent with the concept of a "known" amount of cash. Shares of a money market fund with a floating NAV would continue to have the essential qualities of a "cash equivalent" - a high degree of liquidity and relative safety of principal. Those money market funds would continue to be designed to preserve the principal value of their assets by complying with the strict risk-limiting conditions relating to portfolio maturity, quality, and diversification of rule 2a-7. In addition, as a practical matter, money market fund shares would continue to serve the function of a cash management tool for investors that are commercial or industrial companies.

Similarly, the Commission's staff has provided assurances that it would not recommend enforcement action if an issuer treats shares of a money market fund as "cash items" and not as investment securities for purposes of determining whether the issuer is an investment company as defined in section 3(a)(1)(C) of the 1940 Act and rule 3a-1 thereunder, subject to certain conditions.[6] The staff's no-action position rests, at least in part, on the fact that money market funds seek to maintain a $1.00 stable NAV.

Without clarification by the Commission, the staff's no-action position may not provide sufficient legal certainty for the entire range of investors in money market funds; the Commission or the courts ultimately may take a different view. We urge the Commission to confirm its staff's view that a money market fund with a floating NAV would be considered to be a "cash item," subject to the qualifications in the staff's no-action letter.

Effect on Other Money Market Fund Exemptions - Request for Comment Concerning SEC Rule 17a-9. We agree with the Commission's proposal to retain rule 17a-9 under the 1940 Act because support from an affiliated person of a money market fund would

reason for the error and to implement appropriate corrective measures. We believe that approach reflects the reasoning for the exception granted for omnibus account holders in sub-paragraph (3)(3)(ii).

[6] *Willkie Farr & Gallagher* (publicly available October 23, 2000).

remain important to funds that have floating NAVs. As background, the Commission in the Proposing Release asks whether it should retain rule 17a-9 under the 1940 Act in light of its floating NAV proposal. That rule allows affiliated persons of a money market fund to purchase portfolio securities from the fund under specified circumstances.

The Commission states that it designed rule 17a-9 to allow an affiliated person of a money market fund to provide liquidity to the fund and prevent it from "breaking the buck." The Commission also expanded rule 17a-9 in 2010 so that it more broadly permits an affiliated person to purchase portfolio securities from a money market fund for any reason, as long as any profit the affiliated person subsequently realizes on the security is turned over to the fund. The Commission pointed out that in the "staff's experience . . . under such circumstances [as required in rule 17a-9], these transactions appear to be fair and reasonable and in the best interests of fund shareholders."

The Commission states that it proposes to retain the rule for all money market funds because they all may face potential liquidity, credit, and reputational issues in times of extreme market stress, with resultant pressures on money market funds to honor redemption requests. In addition, a floating NAV money market fund may have reasons unrelated to extreme market stress to arrange a transaction with an affiliated person. For example, a rated money market fund may wish to dispose of a downgraded holding to retain its rating.

We believe that the possibility of economic support from an affiliated person would remain important to money market funds that have a floating NAV because we agree with the Commission's assumptions about liquidity concerns remaining significant to money market funds (and other funds holding the same investments). Thus, we do not believe that the Commission should limit the availability of the rule.

In addition, retaining the rule would not undercut the Commission's goal of providing transparency of money market fund risks, particularly in light of the Commission's companion proposals calling for disclosure of historical instances of economic support from sponsors of money market funds. Moreover, allowing economic support for floating NAV money market funds would not negatively affect the way that the money market funds are structured or marketed; to our knowledge, rule 17a-9 has not thus far done so.

We believe that additional limitations or prohibitions, such as those proposed in the request for comment, are unnecessary and would only impose additional implementation costs for both the Commission's staff and money market funds. To our knowledge, there is no evidence that rule 17a-9 has been abused or manipulated and leaving it in place will allow sponsors of money market funds much needed flexibility as they navigate the new money market fund regulatory scheme. Eliminating rule 17a-9 could increase credit and counterparty risks for shareholders insofar as a sponsor of a money market fund could not provide economic support to the fund. New limits only would impose additional implementation costs for the Commission's staff, who would need to stand ready to address no-action requests, and money market funds, which would need to draft those requests.

Standby Liquidity Fees and Gates – Alternative 2

Under Alternative 2, all money market funds would be permitted to maintain a stable NAV, but would be given new tools to manage the redemption demands of fund shareholders during times of market stress. More specifically, a money market fund (except for a government fund) would be required to impose a "liquidity fee" on redeeming shareholders in certain circumstances and would be permitted to impose a "gate" (*i.e.*, temporarily suspend redemptions) in similar circumstances. We take no position as to whether the Commission should adopt this alternative. If the Commission chooses to adopt Alternative 2, we offer the following suggestions:

Structure of the Liquidity Fee. We urge the Commission to permit money market funds' boards of directors to exercise discretion not to apply a liquidity fee to redemptions of fund shares purchased while a liquidity fee is in place.

As proposed, a liquidity fee, once imposed on a money market fund, must apply to "all shares redeemed," including (we presume) shares purchased while the liquidity fee is in place ("new shares"). The practical consequence of such a fee would be to stop virtually all purchases of fund shares during its pendency, denying the money market fund an important source of liquidity at the time when it most needs it. A rational investor would be very unlikely to invest in a money market fund that has a liquidity fee in place. With the relative level of current money market fund yields, it would take years to accumulate sufficient dividends to offset the immediate losses that investors would realize should they need immediate access to their cash. To the extent that an investor purchases new shares shortly after a fund has imposed a liquidity fee, there would be a high degree of risk that the investor would be unaware of the liquidity fee notwithstanding the fund's good faith effort timely to make all required disclosures.

The inability to exempt new shares from the liquidity fee may place unnecessary pressure on a money market fund's board of directors to exercise its authority to immediately lift a liquidity fee that has been automatically imposed or to suspend redemptions. First, as discussed above, it may exacerbate the fund's liquidity problems. A money market fund, already under significant liquidity pressure having crossed the 15 percent liquidity threshold, would then face the prospect of having to adjust its portfolio to improve internal liquidity, which will be inherently limited by the size and make-up of the portfolio, or seek support from its sponsor, which may not be available. Second, the resulting need to "turn off" sweep and other omnibus accounts may irreparably damage important business relationships on which the fund and its sponsor may be relying.

An exemption for new shares may make it more likely that current shareholders continue to invest additional assets with the money market fund, knowing that they would not be subject to the liquidity fee upon redemption. Any new cash coming into the fund would contribute to its stabilization and, given the transparency of fund liquidity levels the Commission proposes, may help to allay the concerns of investors who might otherwise consider redeeming their shares. To the extent new shares are subsequently redeemed, those redemptions (whether by new investors or existing investors) would not be likely to contribute to a money market fund's liquidity problems. Redemptions of new shares would essentially be a "wash" to the fund. If the Commission adopts a combination of floating NAVs and liquidity fees so that a liquidity fee requirement would apply to a money market fund with an NAV that is below $1.00, the imposition of a liquidity fee on the redemption of new shares may eliminate arbitrage opportunities that would attract new stabilizing investments in the fund.

Structure of Temporary Gates. We urge the Commission to permit boards of directors to impose partial gates.

The Commission proposes to delegate authority to a board of directors to decide whether or not to impose a gate -- a responsibility of great magnitude in that the board's decision may subject large numbers of retail and institutional investors to potential financial hardships and may affect the survival of the money market fund and its sponsor. We agree that boards of directors of money market funds are capable of bearing this responsibility. We do not understand why, however, having proposed to vest the board of directors with such significant responsibilities, the Commission would consider the same board to be incapable of imposing a partial gate when such a gate is determined to be in the best interest of the fund.

A partial gate would act as a more gradual brake on redemptions. A partial gate also could provide some liquidity to investors while allowing time for the fund to satisfy the remaining portion of redemption requests under improved market conditions or with internally generated liquidity. The availability of a partial gate also will make it easier for a board to determine that a gate is in the best interest of the fund because it will impose a lesser hardship on investors. Although the Commission expressed concern that a partial gate may be subject to various drawbacks compared to a full gate in terms of operational costs and added complexity, we believe that board members are capable of determining whether the costs and complexity outweigh the potential benefits to a particular money market fund. We note that the proposed rule text is unclear as to whether a gate, once imposed on a money market fund, must apply to all shares redeemed and ask the Commission to clarify whether the fund's board has discretion to exempt new shares from a gate.

Role of Members of a Board of Directors. The Commission's proposals would amend rule 2a-7 to require a money market fund automatically to impose a 2 percent liquidity fee when the fund's weekly liquid assets fall below 15 percent of fund assets (50 percent of the required 30 percent) unless the fund's board of directors (including a majority of those members who are not interested persons of the fund ("independent directors")) modifies the amount of the fee or waives the fee in its entirety. The proposal also would amend rule 2a-7 to authorize a money market fund's board of directors (again, with the approval of a majority of independent directors) to temporarily suspend redemptions (impose "gates") in fund shares.

The Commission would assign the money market fund's board of directors substantial new responsibilities over "life and death" decisions in the event of a run on the fund. Each time that the board of directors takes action with respect to a liquidity fee or gate, it must determine that its actions are "in the best interest of the fund." We understand that, as a matter of state law, in these cases the board's conduct would have the benefit of the "business judgment rule," assuming the board meets the necessary conditions. We ask the Commission to confirm in the adopting release that it shares our understanding.

Board Approval Requirement. We urge that the Commission permit board action based on approval of a majority of independent directors who are available to vote.

Alternative 2 would authorize the money market fund's board of directors to reduce or lift a liquidity fee and/or impose a gate only if the board, including a majority of independent directors, determines that the action(s) to be taken are in the best interest of the fund. Because a money market fund's liquid assets can be depleted very quickly and thus automatically trigger a liquidity fee, which itself may trigger the need for a gate, the fund's board of directors may need to make these determinations very quickly, possibly on the same day during which the fund's liquidity shortfall occurs.

We are concerned that in some cases a majority of independent directors may not be available on very short notice, in which case the liquidity fee (if the Commission adopts Alternative 2 as proposed), having been automatically and perhaps unnecessarily imposed, would remain in place with potential adverse consequences to the fund and its investors. We believe that it is highly likely, for example, that in many cases the sponsor or some other affiliated person of a money market fund that is experiencing a liquidity shortfall will seek to provide additional liquidity to the fund by purchasing from the fund some of its less liquid portfolio securities (pursuant to rule 17a-9). If such a transaction cannot be arranged before the close of business on the day during which the fund's liquidity shortfall occurs then, as proposed, a liquidity fee would be imposed the next day notwithstanding any imminent resolution of the matter simply because the fund's board of directors could not be properly convened on such short notice. Thus, to facilitate the board's ability timely to take appropriate action to protect the fund, we suggest that the final rule require the approval of a majority of those independent directors actually voting rather than of the total number of independent directors.

Guidance on Board Findings Requirement. We suggest that the Commission give boards of directors additional guidance regarding the nature and scope of the findings they can make under the proposed rule amendments.

We ask the Commission to confirm in the rule that a money market fund's board of directors, in the exercise of its judgment, could determine that it is in the best interest of the fund to pledge that it will waive any automatically imposed liquidity fee and will not impose any temporary gate. We believe that the Proposing Release suggests that the Commission expects a money market fund's board of directors to use its judgment to respond to events that have precipitated heavy redemptions in the fund so that the fund's required weekly liquid assets are seriously depleted. While the Commission apparently anticipates that the default decision for a board of directors would be for a fund to impose a liquidity fee and then, if necessary, a gate, the Commission acknowledges that the rule does not compel such a sequence of events and that the board of directors could respond to heavy redemptions by immediately imposing gates on the money market fund.

Alternative 2 has stimulated a great deal of discussion among members of the Committee, members of money market funds' boards of directors, and other participants in the mutual fund industry. Many are very concerned that the uncertainty created by the potential imposition of fees or gates could have a destabilizing effect on a money market fund. Some are concerned that with fund liquidity levels made transparent under the proposed rules, as fund investors see the fund's liquidity level begin to drop below some threshold acceptable to investors (likely to be considerably higher than 15 percent), they will begin to redeem their shares to avoid the possibility of paying a fee or being "locked up." If liquidity further declines as a result of such redemptions, further redemptions could begin to snowball, leading to a preemptive run on the fund.

A money market fund's board of directors that believes that the potential imposition of a liquidity fee or gate will result in the scenario described above might reasonably conclude that it would be in the best interest of the fund never to impose a liquidity fee or gate. Of course, an internal discussion among the members of the board of directors leading to such a determination would do nothing to address the uncertainty of fund investors faced with a potential loss of fund liquidity at some date in the future. Therefore, a board might seek to commit itself by disclosing in the money market fund's prospectus that it had determined that it is in the best interest of the money market fund not to impose liquidity fees or gates and to pledge that, under authority provided to it by the Commission, it will not permit either to be imposed.

This approach only would work if investors believed that the board of directors had legally committed itself to such a course of action. Counsel to a board of directors would then be faced with the questions of whether the board by making such statements had, in the case of liquidity fees, already made the best interest finding required by the rule, and whether the Commission would conclude that the board's finding was adequately supported despite the absence of any contemporaneous redemption activity. The Commission's conclusions in this regard are important, both because of potential liabilities associated with violating a Commission rule, and because the approach would be effective only if investors believe that the board's disclosed course of conduct is legally grounded (*i.e.*, the board will not be compelled in some future circumstances to revoke its commitment). Indeed, once any one board of directors is forced to revoke its commitment, the ability of any money market fund's board to seek to protect the fund from the dynamics of a preemptive run by following a similar approach would be impaired.

We urge the Commission to confirm that a money market fund's board of directors, in the exercise of its judgment under the proposed rule, could determine that it is in the best interest of the fund to pledge that in the future it will waive any liquidity fee that may be automatically imposed and will not impose any temporary gate. We also urge the Commission to address the question of whether a board, having made such a forward-looking determination, would need to make a separate determination at the time it actually waives a liquidity fee that had been automatically imposed. Such a separate determination would not in our view be the best use of the board's time and may raise practical issues, discussed above, regarding convening a board meeting. In sum, we believe that the Commission should give boards ample discretion to act in the best interests of the money market funds they oversee, and guided by a set of principles that the Commission has clearly articulated.

Requirement that the Board Ask for, and that the Adviser Must Provide, Information Relevant to the Board's Deliberations. We suggest that the Commission provide guidance in the adopting release to the effect that a money market fund's board of directors should request and evaluate, and the fund's investment adviser should provide, information sufficient to allow the board to evaluate the need for a liquidity fee.

Section 15(c) of the 1940 Act requires the board to "request and evaluate," and the adviser to furnish "such information as may reasonably be necessary" for the board to evaluate an advisory contract. The Commission has adopted rules that require fund boards to disclose how and the extent to which they consider various factors in their annual review of advisory contracts, and to report to shareholders on their consideration of such factors. We believe that the Commission could provide guidance that takes a similar approach with respect to a money market fund board's consideration of whether to accept the default 2 percent liquidity fee, to impose a lower fee, or impose no fee at all.

To accomplish this objective, we suggest that the Commission provide guidance in the adopting release to the effect that investment advisers and other service providers should provide the board of directors of a money market fund with information that is necessary for the board's informed decision making. This information could consist of, by way of example, periodic summaries of a fund's liquidity, delivered weekly, daily, or on a frequency determined by a pre-determined trigger event. Of course, the board of directors would be free to ask the adviser to provide additional information that it deems reasonably necessary for its review, just as the board does in the context of its evaluation of investment advisory contracts under section 15(c). The board may formulate its own request for information, or it may base the request on recommendations of an expert or consultant retained for that purpose.

Preparation of the Board for Its Additional Responsibilities. We urge the Commission to provide an adequate compliance period to permit boards of directors of money market funds to prepare to take on their new and ever-expanding responsibilities.

The additional burdens that the Commission would impose on boards of directors would require boards to work with the sponsors and/or advisers to their money market funds, along with the necessary compliance and legal personnel, to develop processes and procedures for analyzing fund portfolios (*e.g.*, with respect to maturity ladders and related stress tests). Such processes and procedures could be designed to provide boards with valuable information about a money market fund's portfolio to better help board members make a determination through the reasonable exercise of their business judgment about the terms upon which to impose and/or lift a liquidity fee or gate, if any. Boards will need adequate time to make such preparations.

We would anticipate that a properly counseled board of directors would consider various options to assist it with carrying out its additional responsibilities under the Commission's proposal. A board also might receive summary reports, perhaps including simplified dashboards, regarding investment portfolios, which could be reviewed by a committee of the board comprised of some, rather than all, independent directors. Having information about the structure of the money market fund's investment portfolio regularly available during normal times could help prepare a board to react more thoughtfully, on very short notice, during an emergency.

Issues for Variable Annuity Contracts

We urge that the Commission revise rule 2a-7 to clarify that, if the Commission adopts Alternative 2, liquidity fees and gates will be applied by the money market funds underlying insurance company separate accounts and that the separate accounts themselves are exempt from that requirement.

Variable insurance contracts typically include investment alternatives that permit contract owners to allocate premium payments to insurance company separate accounts. These separate accounts (or subaccounts of the separate accounts) may invest the proceeds in a money market fund. Section 27 of the 1940 Act and rule 22c-1 thereunder require, in effect, that contract holders must have the right to require the insurance company to surrender, or partially surrender, amounts held in these subaccounts each day. In the case of a partial surrender, the variable insurance contracts typically provide a method of allocating the withdrawal among subaccounts.

Unlike direct interests in the underlying mutual funds, an investment in a variable annuity contract is a contractual arrangement. The insurance company cannot unilaterally change the terms of the contract. As a consequence, state law may not allow an insurance company to impose a redemption fee or suspend redemptions from a separate account. This issue arose most recently in the early-2000s when insurance companies attempted to protect their contract owners from the adverse effects of abusive market timing by imposing redemption fees. Some contract owners resisted these efforts, asserting that they had a contractual right of free exchange among subaccounts without restriction.

The proposed rule and the Proposing Release (at note 403) appear to require (or at least presume) that the insurance company separate account would be able to impose the liquidity fee or the gate. The power to impose a liquidity fee or gate, however, creates issues for insurance companies because such fees and gates may not be enforceable under state law. Moreover, requiring separate accounts to impose a liquidity fee or gate also is problematic from a corporate governance perspective, because most separate accounts are organized as unit investment trusts and do not have a board of directors to perform the functions anticipated by the Commission (*i.e.*, determine whether and when to modify the redemption fee and impose a gate).

If the Commission adopts Alternative 2, we suggest that it impose the liquidity fee and gate requirements only on the underlying money market funds, and exempt the separate accounts to the extent necessary to accommodate the imposition of a liquidity fee or gate by the underlying money market fund. In the case of insurance company separate accounts, this accommodation appears to be necessary because a liquidity fee or gate could prevent the separate account from meeting its contractual redemption obligations to contract owners.

We thus suggest redrafting the rule text as follows:

(c)(2)(iii) (B). A registered separate account funding variable insurance contracts and the sponsoring insurance company of such account are exempt from the requirements of section 27(i)(2) (A) to the extent necessary to permit the separate account to invest in a money market fund that may apply a liquidity fee or temporarily suspend redemptions pursuant to paragraph (c)(2) of this section.

Many variable insurance contracts written after the mid-2000s contain provisions that anticipate the imposition of redemption fees and the possibility that redemptions of underlying funds may be suspended. The change in the rule text we suggest should address the problems with respect to those contracts. In the case of contracts written earlier, it would be important that the Commission include a discussion in the adopting release, as the Commission did in the release adopting rule 22c-2 under the 1940 Act, expressing the view that because liquidity fees and gates will be imposed by the underlying money market fund and not by the insurance company through its separate account, enforcing the liquidity fee or gate with respect to investors in variable insurance contracts should not cause insurance companies to breach their contracts.

Proposed Amendments Relating to Money Market Fund Advertising

Background. The Commission proposes to adopt mandatory new risk disclosures for money market fund advertisements and prospectuses. Under either Alternative 1 or Alternative 2 the proposed new disclosures, when added to the disclosures required under existing SEC rules, will substantially increase the number of mandatory disclosures in money market fund advertisements. Under the proposals, money market fund advertisements would include far more SEC-mandated specific disclosures than must appear in advertisements for junk-bond funds, or funds investing in small-capitalization stocks or emerging market debt and equity securities.[7] The Committee is concerned that the proposed new disclosures may (1) overstate the investment risks of money market funds relative to other classes of investment companies, (2) overwhelm readers with standardized mandated "legends" and discourage investors from reading what they may view as regulatory "boilerplate," or (3) take up so much of the space available in an advertisement (particularly in the case of social media) that the disclosures will discourage investors from viewing other important information in the communication.

We believe that the Commission should consider carefully whether the proposed new additional disclosures are duplicative of existing disclosure requirements. The Commission also should consider whether such additional disclosures will enhance average investors' understanding of the essential characteristics of money market funds or overburden investors with information that is not necessarily important to making an investment decision, especially

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[7] The new disclosures would also be included in the summary section of a money market fund's prospectus, under Item 4 of Form N-1A, and elsewhere in the fund's statement of additional information under Item 16.

when that information otherwise would be available and better described in the fund's prospectus. In short, the Committee questions whether advertisements are the appropriate vehicles in which to educate investors about certain facets of money market fund structure and operation.

Rule 482 under the Securities Act of 1933 currently requires that advertisements for funds holding themselves out as money market funds maintaining a stable NAV 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.

There are essentially three elements in the currently required disclosure: (1) money market funds are not insured or guaranteed by the FDIC or other government agency, (2) money market funds seek to maintain a stable NAV of $1.00 per share, and (3) nonetheless it is possible to lose money investing in a money market fund. The Commission has proposed to retain the first and third of those elements, to revise the second, and to add a number of new required disclosure elements for money market fund advertisements.

Proposed Disclosures Common to All Money Market Fund Advertisements. The Commission proposed amendments to rule 482 that would require all money market funds to include the following disclosures in their advertisements:

- You could lose money by investing in the fund.
- An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.
- 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.[8]

In proposing to add the third "bulleted" statement above to required disclosure, the Commission stated its view that the risk-limiting conditions of rule 2a-7 and past experiences of money market fund investors may have created expectations that money market funds are a stable, cash-equivalent investment. The Commission also said that "one reason for such expectation *may have been* the role of sponsor support in maintaining a stable net asset value for

8 Proposing Release, pp. 577-578, 579-580.

money market funds" (emphasis added),[9] although the Commission also notes that "instances of sponsor support are not required to be disclosed outside of financial statements, and thus were not particularly transparent to investors."

The Proposing Release does not offer any data from studies or focus groups to substantiate the possibility that, in considering whether to invest in money market funds, investors have relied upon the likelihood that money market fund sponsors will support the fund's NAV. Thus, the Commission has fashioned a risk disclosure to warn investors about a practice that, by the Commission's own admission, investors were not aware of and that was not *per se* identified as a factor in investor decisions to invest in money market funds during the 2007-2008 financial crisis.

We are concerned that singling out sponsor support in this manner raises it to a relative level of importance and prominence that may be unwarranted and may overstate the effect sponsor support can have on share price stability to the exclusion of other possibly material factors (for example, the risk that unanticipated market illiquidity may affect the prices of securities a money market fund holds). While sponsor support of money market funds may have been a phenomenon of the 2007-2008 financial crisis, it may not be a factor in future financial crises. Additionally, because the Commission proposes to retain the requirement to disclose that an investor could lose money by investing in a money market fund, specific references to "sponsor support" seems unwarranted.

In addition to the general concern above, the Committee notes that advertisements generally afford little space or opportunity for a money market fund or its distributor to explain the purpose or meaning of required disclosures. Thus, investors may be left with questions about the proposed new disclosure, including: (1) the identity of a fund's "sponsor" (a term not typically used in mutual fund disclosure documents or advertisements); (2) what is meant by a sponsor lending financial support to a fund; and (3) what the effect the sponsor's financial support might have on a fund or its share price. For those reasons, we believe that this proposed disclosure item is neither appropriate nor capable of sufficiently succinct explanation or clarification to require that it be included in an advertisement.

Proposed Disclosures for "Institutional" Money Market Funds under Alternative 1. In addition to the disclosure regarding fund sponsors discussed above, the Commission has proposed that money market funds that are not "government" or "retail" money market funds (*i.e.*, "institutional" money market funds) include the following two disclosures in their advertisements:

- You should not invest in the fund if you require your investment to maintain a stable value.

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9 *Id.*, p. 140.

- The value of shares of the fund will increase and decrease as a result of changes in the value of securities in which the fund invests. The value of the securities in which the fund invests may in turn be affected by many factors, including interest rate changes and defaults or changes in the credit quality of a security's issuer.

We believe that, when considered alongside currently required disclosure that an investor could lose money investing in the fund, these additional disclosures are redundant. The two additional disclosures would add substantially more text to an advertisement. The Committee is concerned that, when added to all of the other disclosures mandated by rule 482, this disclosure could dwarf the basic informational contents of an advertisement and overwhelm an investor reading such an advertisement, in much the same way as "boilerplate" disclosures in automobile financing advertisements tend to be ignored because of their impenetrable length.[10]

We suggest that a clearer approach to the Commission's identified concerns is to require floating NAV money market funds to include in their advertisements a statement that their principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Effect of Additional New Disclosures in Presentation of Information in Advertisements for Money Market Funds. To demonstrate the potential disproportion between "marketing" information and the required disclosures that would be added by the Proposing Release to already mandated disclosures under rule 482, a hypothetical "yield" advertisement for an institutional money market fund, conforming to the Commission's proposed disclosure requirements, is set forth below:

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[10] We also note that rule 482 contemplates the inclusion of mandatory disclosures in radio and television advertisements for funds, with equal emphasis to that used in the major portion of the advertisement. The required disclosures, as augmented by those in the Proposing Release, could themselves become the "major portion of the advertisement." Reading them in a radio advertisement or showing them on-screen in a television advertisement could consume most of the typical radio or television advertisement.

> Institutional investors looking for money market fund opportunities should consider ABC Money Market Fund.
>
> The Fund's Current Yield for the 7-days ended 8/30/13 was 0.0001%.
>
> For more information about the Fund, please call ABC Fund Distributors at 1-800-xxx- xxxx for a free Prospectus or Summary Prospectus, which you should read carefully before investing. Before investing in the Fund, investors should carefully consider the Fund's investment objectives, risks, charges and expenses and other information about the Fund which are explained in the Prospectus and the Fund's Summary Prospectus.
>
> - You could lose money by investing in the Fund.
> - You should not invest in the Fund if you require your investment to maintain a stable value.
> - The value of shares of the Fund will increase and decrease as a result of changes in the value of the securities in which the Fund invests. The value of the securities in which the Fund invests may in turn be affected by many factors, including interest rate changes and defaults or changes in the credit quality of a security's issuer.
> - 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.
>
> The past performance shown does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted above. For current month-end performance information, you may call 1-800-xxx-xxxx.
>
> The Fund's shares are distributed by ABC Fund Distributors.

Because institutional funds are likely to be marketed to relatively sophisticated investors that have at least a general understanding of the workings of financial markets, the required statement in the third "bullet" of the proposed disclosure about the factors that could affect a fund's investments seems to be unnecessary. The Proposing Release does not offer any explanation of why the Commission believes these additional disclosures are needed in communications addressed to institutional investors and what the disclosures are meant to accomplish that could not be done by a simple, single disclosure to the effect that a money market fund's share price may fluctuate and an investor could lose money by investing in the fund.

Proposed New Disclosures for "Retail" and "Government" Money Market Funds under Alternative 1. Alternative 1 would amend rule 482 to require "retail" and "government" money market funds to include some of the disclosures that would be required for institutional money market funds as well as a revised version of the stable NAV disclosure element currently required by rule 482(b)(4), but which would be amended to state:

- The fund seeks to preserve the value of your investment at $1.00 per share, but cannot guarantee such stability.

We note that, in fewer words than the proposed disclosures, the currently-required disclosure clearly states: "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 reference to "stability" in the proposed disclosure does not appear to enhance the meaning of the disclosure about the risk of losing money.

Alternative 2: Required Money Market Fund Disclosures. Under Alternative 2, similarly there would be two versions of the rule 482(b)(4) disclosures for money market fund advertisements. As proposed, all money market funds would be required to include the following disclosures:

- You could lose money by investing in the fund.
- The fund seeks to preserve the value of your investment at $1.00 per share, but cannot guarantee such stability.
- An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.
- 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.

We reiterate our comments above on the possible efficiency that would be afforded by reverting to the current version of the disclosure that already combines the substance of the first two bulleted items, as well as our comment questioning the need for the last disclosure with respect to sponsor financial support.

Under Alternative 2, money market funds (other than government money market funds that choose to rely on the proposed exemption for such funds from liquidity fees or gate requirements) 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.

We agree that the ability of a money market fund's board to impose liquidity fees or redemption gates under limited circumstances is important to disclose to investors. However, we question 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. We suggest that, at a minimum, the Commission explain the use of the phrase in an instruction and/or the adopting release.

We are concerned that the proposed disclosure would not provide investors with a sufficient basis to understand the potential magnitude of the fees or the likelihood that fees or gates could be imposed. For example, investors may infer that considerable stress would only likely result from exogenous factors, such as extreme market events, ignoring the possibility that a money market fund's failure to meet its weekly liquid asset requirements could conceivably result from internal portfolio management decisions in an otherwise functioning market. In such case, the use of the phrase "considerable stress" could mislead some investors as to the circumstances under which fees could be imposed or redemptions suspended. The proposed disclosure may even suggest to some investors that a money market fund might impose fees or gates arbitrarily.

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 suitable for disclosure in a legend in an advertisement. The Committee believes it would be difficult to draft a brief description of the circumstances described in Alternative 2 under which liquidity fees or redemption gates might be imposed.

We therefore suggest that the Commission consider including reference to a reduction in the liquidity of a money market fund's portfolio holdings as the basis of the imposition of liquidity fees and gates. 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 liquidity fee or a redemption 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 liquidity fees or restrictions on redemptions would be applied than the Alternative 2 disclosures proposed by the Commission in the Proposing Release.

Format of Proposed New Disclosures in Advertisements. The Commission has proposed amendments to rule 482 that state that an advertisement must present the required disclosures as prescribed in Item 4(b) of Form N-1A. The proposed amendments to Item 4 of Form N-1A state that a money market fund's Risk/Return Summary must "include the following *bulleted* statement." Additionally, the Proposing Release introduces the list of proposed disclosures in Alternative 1 and Alternative 2 with the statement that each money market fund must "include the following *bulleted* disclosure statement on their advertisements and sales materials"[11] (emphasis added).

We question whether the consistent use of the word "bulleted" indicates that the Commission is mandating a particular format for presenting the proposed disclosure. If that is the case, we urge the Commission to reconsider that mandate. Prescribing a particular graphical format for particular disclosures is neither necessary nor desirable, particularly with respect to advertisements, when the use of social media for advertising may make the utilization of a bulleted format difficult, if not confusing. Additionally, calling special attention, through the use of graphic devices such as "bullets," to certain disclosures rather than others may give them undue emphasis or weight, suggesting that other disclosures are less material or important. We do not believe that the Commission should restrict the ability of money market funds and their distributors to use different graphical presentations to present important required information, either in the prospectus or in an advertisement, as long as the Commission's other stated requirements as to type size and relative prominence are met.

Modification of Investment Objectives and Policies

We urge the Commission to consider the potential need for money market funds to modify their investment objectives, investment policies or organizational documents to conform to the new features of money market funds required by the Proposing Release.

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11 *See, e.g.*, Proposing Release, p. 138-139, noting further that the Commission also proposes"...to require a substantially similar bulleted disclosure statement in the summary section of the statutory prospectus (and, accordingly, in any summary prospectus, if used). In introducing this proposed disclosure under the versions of the proposed amendments to rule 482(b)(4) under Alternative 1 for "government" and "retail" money market funds, the Commission augments that commentary by stating it proposes to require such funds"... to include the following *bulleted* disclosure statement in the summary section of its statutory prospectus (and accordingly, in any summary prospectus, if used), and on any advertisement or sales material that it disseminates (including on the fund website) (emphasis added)." (Proposing Release, pp. 139-140.) Similar language is used in introducing the proposed new rule 482(b)(4) disclosure requirements in Alternative 2 (Proposing Release, pp. 210, 211.)

Amendments to Organizational Documents. Money market funds are organized under the laws of the various states and subject to the laws of those states with regard to when and under what circumstances amendments to governing documents may require the approval of fund shareholders. While the laws of several states in which money market funds are organized may permit amendment of organizational documents under certain circumstance without shareholder approval, not all do and individual organizational documents may not so permit. Money market fund organizational documents (*e.g.*, charters and trust instruments) may include provisions that require modification to accommodate new features in the Proposing Release. In considering the costs associated with the proposals and the proposed transition period, the Commission should consider the potential cost for such shareholder meetings and the amount of time involved in securing any necessary shareholder approvals.

Modification of Investment Objectives and Investment Policies. Money market funds may have to modify their investment objectives and investment policies to conform to the Commission's final rules. While some funds may accomplish the required modifications without shareholder approval, others may require shareholder approval under the 1940 Act. The Commission should consider providing money market funds with an exemption permitting the modification of investment objectives and investment policies that money market funds believe are necessary or appropriate without requiring shareholder approval.

Issuer Diversification Limits and the "Twenty-Five Percent Basket." Rule 2a-7 currently requires money market funds to be diversified, both as to issuers of the securities acquired and to the providers of guarantees and demand features related to those securities. Generally rule 2a-7 limits exposure to an issuer to 5 percent of a fund's total assets and to guarantors and demand feature providers to 10 percent of a fund's total assets. In addition, rule 2a-7 provides a "Twenty-Five Percent Basket" under which up to 25 percent of a fund's total assets can be subject to guarantees and demand features from a single institution.

The Commission proposes to: (a) require the treatment of certain entities that are affiliated with each other as a single issuer for purposes of the rule 2a-7 issuer diversification requirements; (b) require the treatment of sponsors of asset-backed securities as guarantors subject to rule 2a-7 diversification provisions under certain circumstances; and (c) remove the Twenty–Five Percent Basket. Specifically, the proposal would aggregate the exposure that a money market fund has to securities of a parent company and its controlled affiliates for purposes of the 5 percent issuer diversification requirement by applying a majority ownership test (more than 50 percent ownership of the voting securities of an affiliate) to determine control and thus aggregation for the 5 percent diversification requirement.

Recognizing the differing policy concerns underlying rule 2a-7 and the other provisions of the 1940 Act regarding the definition of "control," we believe that the use of a majority ownership test is more appropriate than the use of "control" as defined in section 2(a)(9) of the 1940 Act. However, while recognizing that there may be some commonality of risk between such affiliated entities, they are separate legal entities and, unless there is a legal requirement to guarantee or otherwise provide support to the other affiliate, that separateness should continue to be recognized in rule 2a-7. To that end, the Committee urges the Commission to consider subjecting such combined group to the 10 percent limit applicable to guarantors rather than the 5 percent limit applicable to individual issuers. The securities of each issuer would continue to be subject to the 5 percent issuer limit. This approach would achieve the Commission's goal of limiting a type of risk which may be more akin to that of a guarantor than that of one issuer.

There also may be interpretative issues arising under the proposed majority ownership test, especially where securities and corporate structures are complex. For example, how should certain convertible securities and other securities be treated for purposes of defining control? How should majority-owned subsidiaries of majority-owned subsidiaries be treated? We ask the Commission to provide guidance in the rule or in the adopting release regarding the appropriate analysis that should be employed for making such determinations. Moreover, we urge the Commission to clarify that money market funds and their advisers should not have regulatory exposure for such determinations when made in good faith and on a reasonable basis.

A Floating NAV - Transparency and Market-Based Pricing.

This portion of our letter provides general views and considerations relating to the Commission's proposal for a floating NAV for certain funds.[12]

We note that in eliminating the use of amortized cost pricing, the Commission is not proposing a methodology of valuation of a money market fund's holdings after purchase that reflects actual prices paid in the secondary market for the short-term debt securities held in a money market fund's portfolio. The Commission recognizes the lack of an active secondary

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12 The Commission in its floating NAV proposal, quite properly, seeks to address not only systemic risk but also fairness to investors. The Proposing Release attempts to do so by considering dilution that might be absorbed by investors remaining in a stable NAV money market fund as other, more "informed" investors rush to redeem. It is not at all clear, however, that this theoretical potential for harm will lead to actual harm absent the relatively rare circumstance when a stable NAV money market fund breaks the buck. The prospect for actual dilution does, however, lie in the floating NAV proposal. Any number of extraneous events can drive "market-based" factors -- a change by the Federal Reserve Board of its federal funds rate (even by 25 basis points or less), disclosure by the Federal Reserve Board that it *might* change the rate, the Federal Reserve Board's plans to "taper" its Treasury or mortgage-backed bond buying program more gradually (or less gradually), rumblings in Europe over actions to be taken (or not) by the EU central bank, further fiscal or budget impasses between the legislative and executive branches of the Federal government, prognostications about unemployment or inflation figures, and the like. Even events that are not economic in origin, such as changes in the geopolitical situation in a foreign country, can find their way into "market-based" valuations.

All of these externalities, however brief in duration, can and presumably will cause fluctuation in the daily valuation of an institutional prime money market fund's portfolio under the floating NAV proposal, even though all or virtually all of these money market funds will continue to hold all of their portfolio investments to their actual maturity. Current shareholders of these funds will suffer the dilution under these circumstances when new shareholders purchase their shares at a fraction below a $1.00 per share price and reap the benefit of the fund's "hold to maturity" investment approach. Perhaps, at least in theory, there are opportunities for arbitrage, or unfairness to existing shareholders or to investors, in a stable NAV money market fund, but the floating NAV proposal creates its own opportunities for this potential unfairness.

market for most categories of money market securities as a fundamental characteristic of the money markets in the Proposing Release. It could not be otherwise, for there can be no secondary market prices when there is no, or virtually no, secondary market. Accordingly, most of the investment company industry values those instruments for stress testing largely through "mark-to-model" or "matrix pricing" estimates.[13]

Reflecting the absence of actual secondary market trading, the Commission is careful to refrain from referring to its floating NAV proposal as requiring "market" prices. Instead, the Commission consistently characterizes the valuation underlying a money market fund's floating NAV as "market-based."[14] That terminology blurs the basic distinction drawn in the 1940 Act between an asset that must be given its market value when a quotation is readily available, and an asset that must be given a "fair value" through a determination by (or, consistent with Commission and staff guidance, on behalf of) the board of directors of a registered investment company because market quotations are not readily available. Accordingly, we respectfully submit that the "market-based" approach advanced by the Commission thus is fair value pricing, not market pricing.

The Commission devotes modest attention in the Proposing Release to what "market-based" valuation actually entails. Without elaboration, the Commission refers to "mark-to-model" and "matrix pricing," and cites one source that refers to two techniques: yield curve pricing and discounted cash flow pricing. But these are not techniques that necessarily identify prices at which illiquid money market instruments would trade in a resale market. As the Commission itself recognizes, these techniques arrive at "estimates" of value,[15] not market value itself. It is not clear that these market-based techniques will improve transparency over what is now provided through the amortized cost method of pricing because the exact methodology for pricing each security held by a money market fund would not be disclosed. In addition, those valuation techniques can entail judgments, which could vary from fund group to fund group. The resulting lack of comparability across money market funds will further derogate from the Commission's stated goal of transparency.

The Commission should reconsider whether the estimation process underlying "mark-to-model" or "matrix pricing" will bring greater precision or uniformity to the valuation of money market instruments than does the amortized cost method of accounting--or less. The strength of the amortized cost method of accounting, in contrast to "market-based" valuation, is its objectivity and uniformity across all money market funds in the industry. In an important sense, the amortized cost method of accounting can be understood to be, in fact, a "market" price because it reflects the cost actually paid by the money market fund to the issuer in a primary

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13 Proposing Release, at text accompanying note 27.

14 §2(a)(41)(b).

15 Proposing Release at text accompanying note 27.

market transaction, a price that is adjusted not by estimates but by precise accretion of discounts or accrual of premiums. Further, amortized cost can be seen as a market price, given that virtually all debt securities held in a money market fund's portfolio are usually held to their actual maturity, and, upon maturity, the payment made by the issuer is the amortized cost, a precise amount, not an estimate.[16]

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We appreciate the opportunity to comment on the Proposing Release and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

/s/ Catherine T. Dixon
Chair of the Federal Regulation of Securities Committee

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16 The data indicate that over 99% of total money market fund assets are held until their actual maturity.