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Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Submitted electronically through http://www.sec.gov

Re: Comments on Proposed Money Market Fund Reform; Amendments to Form PF (Release No. 33-9408, IA-3616, IC-30551, File No. S7-03-13) – Staff Analysis of Data and Academic Literature Related to Money Market Fund Reform

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on the four reports it released on March 24, 2014 (the "Reports")[2] related to its proposed rule "Money Market Fund Reform; Amendments to Form PF" (the "Proposed Rules").[3] This letter supplements our September 16, 2013 submission in response to the Proposed Rules (the "September 2013 Letter").[4]

We are well positioned to provide feedback and commentary on the Reports because of our experience and expertise in the money market mutual fund ("MMF") industry,[5] as well as

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[1] Fidelity is one of the world's largest providers of financial services, with assets under administration of over $4.7 trillion, including managed assets of over $2 trillion. Fidelity provides investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 5,000 financial intermediary firms.

[2] Analysis of Liquidity Cost During Crisis Periods (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-321.pdf (the "Liquidity Cost Study"); Analysis of Government Money Market Fund Exposure to Non-Government Securities (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-322.pdf (the "Government MMF Study"); Analysis of Municipal Money Market Funds Exposure to Parents of Guarantors (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-323.pdf (the "Muni MMF Guarantor Study"); Analysis of Demand and Supply of Safe Assets in the Economy (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-324.pdf (the "Safe Asset Supply Study").

[3] Money Market Fund Reform; Amendments to Form PF, 78 Fed. Reg. 36834 (June 19, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-06-19/pdf/2013-13687.pdf.

[4] Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 16, 2013), *available at* http://www.sec.gov/comments/s7-03-13/s70313-149.pdf. All capitalized terms used in this letter, unless otherwise defined in this letter, shall have the meaning assigned to such terms in the Proposed Rules.

[5] Fidelity is the largest MMF provider in the world, with more than $413 billion in MMF assets under management as of March 31, 2014. Funds we manage represent more than 16 percent of MMF assets in the United States and more than 9 percent of MMF assets worldwide. Asset percentages are as of February 28, 2014 from Crane Data and Investment Company Institute, respectively.

our active engagement in MMF reform efforts over the past several years. Our position, as stated in our comment letters,[6] is that the SEC should analyze the costs and benefits of any additional MMF reform. The SEC should narrowly tailor targeted reform to address the SEC's concern about the risk of runs that exists only in the institutional prime segment of the MMF industry. Additionally, the SEC should define retail MMFs based on natural persons and should treat both retail prime and municipal MMFs the same as Treasury and government MMFs – meaning that the SEC should exclude these types of MMFs from structural changes, including the floating NAV and fees and gates proposals, because none of these MMFs experienced significant outflows during times of market stress.

We recognize and value the analytical and empirical approach that the Division of Economic and Risk Analysis ("DERA") took in preparing the Reports. As discussed in greater detail in the remainder of this letter, we highlight some additional information and analysis that is intended to assist the Commission as it considers final rules on MMF reform.

We encourage the SEC to consider the following:

1. **The data support an exemption from structural reform for government MMFs.** The SEC appropriately exempted both Treasury and government MMFs from proposed fundamental structural changes because these MMFs are not susceptible to the risks of mass redemptions during periods of market stress. Both the Safe Asset Supply Study and the Government MMF Study provide further data to support this conclusion.[7]

2. **The SEC should limit any government MMF exemption from structural changes to those government MMFs that hold exclusively government securities.** This approach aligns with investors' expectations that government MMFs are composed of only government securities. The Government MMF Study shows that only a few government MMFs make investments in non-government securities.

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[6] Letter from BlackRock, Inc., Fidelity Investments, Invesco Ltd., Legg Mason & Co, LLC, Western Asset Management Company, Northern Trust Corporation, T. Rowe Price Associates, Inc., Vanguard and Wells Fargo Funds Management, LLC, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Oct. 31, 2013), *available at* http://www.sec.gov/comments/s7-03-13/s70313-263.pdf; Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Sept. 16, 2013), *available at* http://www.sec.gov/comments/s7-03-13/s70313-149.pdf; Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Feb. 3, 2012), *available at* http://www.sec.gov/comments/4-619/4619-116.pdf.

[7] In addition to exempting Treasury and government MMFs, a Final Rule should exempt municipal and retail prime MMFs from structural changes as well. The best way for the SEC to meet its reform objectives is to limit structural reform to institutional prime MMFs.

3. **If the SEC proceeds with the liquidity fee and redemption gates alternative for institutional prime MMFs, the SEC should set the redemption fee rate at one percent.** Both the Liquidity Cost Study and our analysis comparing DERA's work to the market conditions Fidelity observed during the 2008 financial crisis support this recommendation.

4. **The SEC should not eliminate the "25 percent basket" and, instead, should reduce the 25 percent basket to a 15 percent basket for MMFs.** DERA's analysis in the Muni MMF Guarantor Study supports this position and demonstrates that there would be real costs to MMFs if the SEC either eliminates the 25 percent basket or reduces it by too much.[8]

I. The Data Support an Exemption From Structural Reform for Government MMFs

Fidelity applauds the SEC's efforts to identify the appropriate set of MMFs that should be subject to any further structural reform. Accordingly, we support the SEC's exemptions for Treasury and government MMFs from proposed structural reform because these MMFs are not susceptible to the risks of mass redemptions during periods of market stress. At the same time, we recognize that there may be an increase in demand for Eligible Government Securities (as defined below) resulting from a potential shift of assets from MMFs subject to structural reform to government MMFs. As DERA's study and our own analysis demonstrate, however, we anticipate that the market will effectively handle this anticipated demand increase. In this section, we suggest how to measure the impact of such changes by establishing the size of the market in which government MMFs invest, examining the likely volume of flows into government MMFs and considering some other factors that mitigate the impact of changes in the supply and demand balance in the short-term government securities market.

A. The Universe of Government Securities Eligible for Government MMFs to Purchase is Ample

The first step in the demand and supply analysis is to understand the pool of available assets that a government MMF may purchase under Rule 2a-7 ("Eligible Government Securities").[9] In the Safe Asset Supply Study, DERA measures the availability of global "safe

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[8] The terms "municipal" and "tax-exempt" are used interchangeably throughout this letter to refer to MMFs that meet the definition of "Tax Exempt Fund" under 17 C.F.R. § 270.2a-7(a)(26).

[9] Eligible Government Securities include any security that (i) is issued or guaranteed by the United States, or any person acting as an instrumentality of the government of the United States, such as securities issued by government-sponsored entities including, among others, the Federal Home Loan Banks ("FHLB"), Fannie Mae and Freddie Mac (to the extent included within the definition set forth in Section 2(a)(16) of the Investment Company Act of 1940 ("Government Securities")) and (ii) otherwise meets the maturity, credit quality and liquidity requirements of Rule 2a-7 of the Investment Company Act of 1940 ("Rule 2a-7"). MMFs are permitted, subject to certain conditions, to treat repurchase ("repo") agreements collateralized by Government Securities as an acquisition of the underlying Government Securities. Accordingly, our analysis includes repo agreements collateralized by Government Securities.

assets" at approximately $74 trillion.[10] This number includes securities that MMFs cannot purchase under Rule 2a-7, such as securities that are not denominated in U.S. dollars and securities of issuers that do not present minimal credit risk.[11] We think it would be more appropriate and helpful to confine the analysis to a study of the supply and demand issues that impact the availability of only Eligible Government Securities. As of February 28, 2014, we calculate the total market asset value of all available Eligible Government Securities to be approximately $6.31 trillion, as set forth below in Exhibit 1.

Exhibit 1 – Government Securities Eligible for Purchase by MMFs

Investment Type:	**Total Market (Trillions):**
Treasury Bills/Coupons<13 months[12]	$3.25
Agency Discount Notes/Coupons<13 months[13]	$0.85
Repurchase agreements collateralized by U.S. Treasuries or other government securities[14]	$2.21
Total:	**$6.31**

The larger universe of securities that DERA considered captures all short-term assets available to investors who choose to purchase securities directly, rather than move to a government MMF. The majority of those securities, however, are not substitutes for the types of securities in which a MMF shareholder typically would invest. Even using our approach, with a more limited focus on Eligible Government Securities, there is compelling evidence of an extremely deep and liquid market with more than adequate supply to absorb a significant increase in demand.

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[10] Safe Asset Supply Study at 3. This estimate is based on an International Monetary Fund estimate in April 2012.

[11] Safe Asset Supply Study at 2-3.

[12] Monthly Statement of Public Debt (Feb. 28, 2014), *available at* http://www.treasurydirect.gov/govt/reports/pd/mspd/2014/2014_feb.htm (includes Treasury Floating Rate Notes).

[13] Based on data compiled by Fidelity using Bloomberg, and balance sheet information from FHLB, Fannie Mae and Freddie Mac (February 28, 2014), *available at* http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/fhlbank-financial-data-36, http://fanniemae.com/portal/about-us/investor-relations/quarterly-annual-results.html, and http://www.freddiemac.com/investors/sec_filings/?intcmp=AFIRSF. For simplicity, we took a conservative approach in our estimates and included only the amount of agency debt issued by FHLB, Fannie Mae and Freddie Mac.

[14] Based on data compiled by Fidelity using New York Federal Reserve Primary Dealer Statistics Historical Search (Feb. 26, 2014), *available at* http://www.newyorkfed.org/markets/statrel.html.

B. Shareholders are Expected to Shift From Prime and Municipal MMFs to Government MMFs

In the Proposed Rules, the SEC seeks to impose either a floating NAV or redemption fees/gates on municipal and prime MMFs.[15] Fidelity's customer surveys have shown that either of these reforms in municipal and prime MMFs will result in shareholders exiting those MMFs.[16] Many of these shareholders may move their assets to government MMFs, which the SEC has proposed to exempt from structural reform.[17]

To understand the impact of this shift on government MMFs, it is important to determine the expected size of the inflows and evaluate the impact on the Eligible Government Securities market. The first step is to consider how much of the Eligible Government Securities supply MMFs currently hold. Government MMFs currently hold approximately $900 billion in assets,[18] which is roughly 14 percent of the $6.31 trillion total market asset value of Eligible Government Securities.

Prime MMFs currently hold a substantial portion of their assets in Eligible Government Securities. Prime MMFs own $306 billion of Eligible Government Securities, which represents 19.5 percent of prime MMF assets. Exhibit 2 shows the distribution of three main categories of Eligible Government Securities across government and prime MMFs.[19] These prime MMF holdings are 5 percent of the $6.31 trillion in total market asset value of available Eligible Government Securities. In general, prime MMFs hold Eligible Government Securities to meet the Daily Liquid Asset and Weekly Liquid Asset requirements of Rule 2a-7.[20] It is reasonable to assume that prime MMFs will sell some of these Eligible Government Securities to meet redemptions from customers who seek to move to a government MMF. Those sales, in turn, will increase the supply of available Eligible Government Securities for government MMFs to buy. Thus, as investors shift from prime MMFs to government MMFs, not all of the flows out of prime MMFs will result in new demand for Eligible Government Securities.

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[15] As we stated in our September 2013 Letter, we support the SEC's exemption of both Treasury and government MMFs from the proposed fundamental structural changes.

[16] Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, (Feb. 3, 2012) at 4-5 ("Fidelity 2011 Survey"), *available at* http://www.sec.gov/comments/4-619/4619-116.pdf. Fidelity recently surveyed its customers again in September 2013 and the results were similar to prior surveys conducted in 2009, 2010, and 2011.

[17] For the purposes of this letter, any reference to "government MMFs" includes both Treasury and government MMFs.

[18] *See* Crane Data (Feb. 28, 2014), *available at* http//wwwcranedata.com/products/money-fund-intelligence.

[19] The three main categories are: (1) U.S. Treasury securities, including bills as well as notes and bonds that mature within 13 months; (2) U.S. Government agency (Fannie Mae, Freddie Mac and FHLB, etc.) discount notes and longer-term securities that mature within 13 months; and (3) repurchase agreements that are collaterized by either (1) or (2).

[20] 17 C.F.R. 270.2a-7(c)(5)(ii), 17 C.F.R. 270.2a-7(c)(5)(iii).

Exhibit 2 – Current Government Securities Holdings by Prime and Government MMFs:[21]

Investment Type:	**Total Market (Trillions):**	**Govt MMFs Total Assets (Billions):**	**% of Total Market**	**Prime MMFs Total Govt Assets (Billions):**	**% of Total Market**
Treasury Bills/Coupons <13 months	$3.25	$364	11%	$102	3%
Agency Discount Notes/Coupons <13 months	$0.85	$251	30%	$90	11%
Repurchase agreements collateralized by U.S. Treasuries or other government securities	$2.21	$281	13%	$114	5%
Total:	**$6.31**	**$896**	**14%**	**$306**	**5.0%**

C. The Government Securities Market Can Absorb a Significant Increase in Demand

The Safe Asset Supply Study concludes that there is plenty of supply of Eligible Government Securities to absorb the anticipated shift of assets from prime MMFs to government MMFs. We agree. Significant flows to government MMFs will not create a problem in short-term markets, even when considering more conservative supply and demand estimates that we think more accurately represent what the market dynamics will look like if the SEC implements structural reform in prime MMFs.

DERA estimates that 20 percent, or approximately $315 billion, of prime MMF assets will move to government MMFs. Of that $315 billion, $63 billion is already invested in Eligible Government Securities. Using DERA's assumptions, the estimated new demand for Eligible Government Securities created by the investment shift to government MMFs would be $252 billion, which represents approximately 4 percent of current total available Eligible Government Securities.

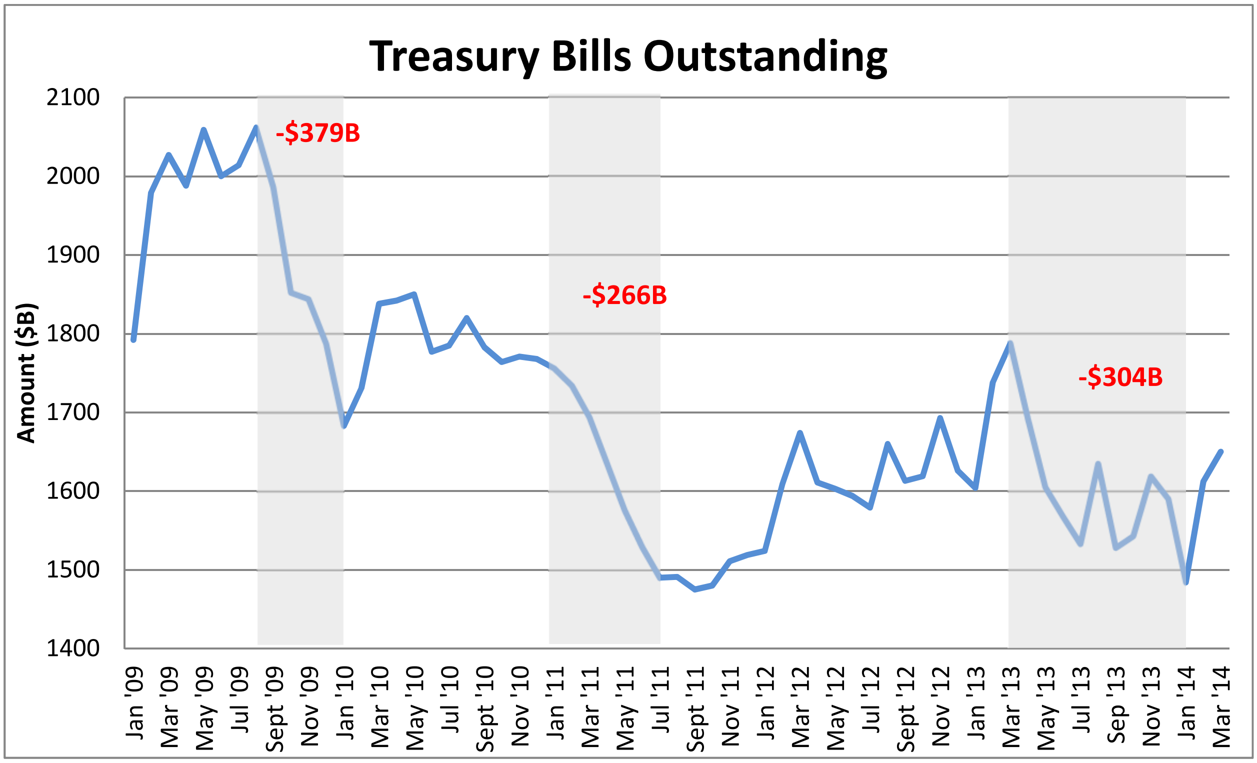
Based on our own analysis and customer surveys, we believe that approximately 64 percent of Fidelity's prime MMFs assets may shift into Fidelity's government MMFs. Applying this 64 percent figure to the MMF industry, instead of DERA's 20 percent estimate, results in an increased demand of approximately $806 billion, which is only about 8 percent of current total available Eligible Government Securities. Even with our higher assumptions regarding the level of assets that may shift to government MMFs, the supply of Eligible Government Securities is more than adequate to meet anticipated demand.

Data show that the short-term government securities market can handle significant changes in supply and demand dynamic. For example, Treasury bill issuance patterns have varied widely in recent years. Exhibit 3 illustrates the changes in Treasury bill supply between

[21] *See* Crane Data (Feb. 28, 2014).

January 31, 2009 and March 31, 2014 (the "relevant period").[22] The line represents the amount of outstanding Treasury bills in the government securities market during the relevant period. On three separate occasions during the relevant period the supply of Treasury bills declined in excess of $250 billion, each within a short period of time.[23] In each of these instances the government securities market was able to adjust for these reductions without any dislocations.

Exhibit 3 – Treasury Bills Outstanding



Historical Treasury bills issuance patterns demonstrate that the market can tolerate significant flows of prime MMF assets, given that the equivalent of a single digit percent change in demand does not constitute an unusual change in the supply and demand dynamics absorbed historically by the market, and any shift is likely to take place over a longer period of time.

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[22] Monthly Statement of Public Debt (March 2014 & historical), *available at* http://www.treasurydirect.gov/govt/reports/pd/mspd/2014/2014_feb.htm.

[23] The first two material instances of reduced supply were related to debt issuances under the Treasury's Supplementary Financing Program, and the last instance was related to a higher than expected Treasury revenue resulting from stronger than usual tax receipts. *See* U.S. Treasury Presentation to the Treasury Borrowing Advisory Committee at 14 (Aug. 2, 2011), *available at* http://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Documents/TBAC%20discussion%20charts%20Aug%202011.pdf.

D. Other Factors May Increase the Supply of Eligible Government Securities

Several factors indicate that the domestic government securities market may increase in size in the future, which in turn suggests that the above analysis is conservative, because the future available supply of Eligible Government Securities may be even larger. As noted in the Safe Asset Supply Study, the increase in demand for high-quality safe assets is due in part to the global financial crisis that began in 2008. As economies improve, however, market participants expect that U.S. interest rates will normalize, which should change the supply and demand dynamics of short-term government securities.

Examples of market changes that may reduce demand for, and increase supply of, Eligible Government Securities include:

- reductions by corporations of their record amounts of cash equivalents held, by means of selling short-term government securities as corporations seek better investment opportunities;
- wind down of open market bond purchases by Central Banks, such as the Federal Reserve, which may cause investors to sell short-term government securities and purchase longer-term securities to benefit from higher interest rates;[24]
- use by the Federal Reserve Bank of New York of its Overnight Reverse Repo Program as part of its quantitative easing exit strategy to help control short-term rates will provide additional supply in the form of government repurchase agreements;[25] and

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[24] *See* Federal Reserve Chairman's Press Conference (June 19, 2013), *available at* http://www.federalreserve.gov/mediacenter/files/FOMCpresconf20130619.pdf (As the Federal Reserve begins to taper its government securities purchases and will likely discontinue purchases later this year, it will allow its existing holdings of government securities to mature as part of its exit strategy); *See also* Federal Reserve Chairman's Press Conference (June 19, 2013), *available at* http://www.federalreserve.gov/mediacenter/files/FOMCpresconf20130619.pdf (The Federal Reserve has over $1 trillion in Treasury securities that will mature by the end of 2019); *See also* Federal Reserve's Maturity Profile of Treasury Securities – New York Federal Reserve System Market Account weekly holdings (Mar. 26, 2014), *available at* http://www.newyorkfed.org/markets/soma/sysopen_accholdings.html (It is likely that these securities will need to be refinanced with further securities issuances).

[25] This program, currently being tested, has proven to help support overnight rates and has also provided MMFs with additional government supply especially on days where supply can be limited (quarter/year ends, over $242 billion on March 31, 2014). *See* Announcements from Temporary Open Market Operations at the Federal Reserve Bank of New York, *available at* http://www.ny.frb.org/markets/omo/dmm/temp.cfm?SHOWMORE=TRUE. Currently 93 of the largest MMFs have direct access to overnight repo with the Federal Reserve through this program, which has a potential to offer hundreds of billions in additional overnight supply.

- possible changes in U.S. Treasury issuance such as increased supply of Treasury Floating Rate Notes that were specifically designed to be eligible for, and attractive to, MMF investors.[26]

In contrast to the potential positive supply factors, DERA identifies a few market changes that may give rise to constraints on the supply of safe assets, including Eligible Government Securities.[27] It is our view that these factors will only modestly reduce the supply of Eligible Government Securities, if at all. For example, the mandated wind down of issuances by Government Sponsored Entities ("GSE") reduced the supply of short-term agency securities, which is expected to continue to decline.[28] The market, however, has absorbed this reduction in supply continuously without disruption, and should continue to absorb it over time. Moreover, the proposed GSE reforms may result in the creation of new government securities, which would increase the supply. In addition, The Federal Home Loan Bank is not subject to the wind down or reform efforts, and has recently issued an increasing amount of agency securities as new issuances by Freddie Mac and Fannie Mae have declined.

II. The SEC Should Limit Any Government MMF Exemption From Structural Changes to Those Government MMFs That Hold Exclusively Government Securities

In the Proposed Rules, the SEC proposes to exempt government MMFs from structural changes including the floating NAV and the liquidity fees and gates alternatives.[29] Fidelity supports this approach.[30] The Government MMF Study demonstrates that government MMFs invest in non-government securities on a very limited basis.[31] Fidelity's government MMFs have

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[26] U.S. Treasury has made a significant push to lengthen its average debt profile over the past number of years. Historically, Treasury Bills have represented about 20 percent of the Treasury's public debt. Even a small move toward that average would increase Bill supply significantly (a two percent increase would represent nearly $240 billion). The Treasury Floating Rate Notes program is expected to grow to approximately $328 billion (based on current quarter of $41 billion). *See* Monthly Statement of the Public Debt of the United States (Mar. 31, 2014), *available at* http://www.treasurydirect.gov/govt/reports/pd/mspd/2014/opds032014.pdf.

[27] We also note that DERA raises concerns regarding potential negative interest rates in the government securities markets. The length of the expected implementation period for MMF reform should mitigate such concerns, especially when the timing of the anticipated interest rate changes of the Federal Reserve Open Markets Committee is taken into account.

[28] *Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac,* U.S. Treasury Press Release (Aug. 17, 2012), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx.

[29] *See* Proposed Rules at pages 36897 and 37028.

[30] *See* Proposed Rules at 36855 and 36993.

[31] *See* Government MMF Study at 3($2.8 billion out of $511 billion in total government MMF assets were invested in non-government securities as of November 2013; that $2.8 billion was held across 14 of the 97 government MMFs).

long invested 100 percent of their assets in government securities, and we believe that this practice meets the expectations of government MMF shareholders. We urge the Commission to limit the exemption for government MMFs to those MMFs that hold exclusively government securities.

III. The SEC Should Set the Redemption Fee Rate at One Percent if it Proceeds with the Liquidity Fee and Redemption Gates Alternative for Institutional Prime MMFs

A. Determining Liquidity Cost During Crisis Periods

The SEC's proposed liquidity fee and redemption gate alternative would impose a two percent liquidity fee on redemptions in prime and municipal MMFs[32] if a fund's Weekly Liquid Assets fall below 15 percent of total assets.[33] As we stated in our September 2013 Letter, Fidelity believes a two percent fee would be unnecessarily punitive to institutional MMF shareholders who are willing to pay a fee to redeem their shares during times of extraordinary market stress.[34] Instead, we recommend that any liquidity fee that a MMF imposes on shareholders be one percent.

The SEC did not offer any data in the Proposed Rules to support setting a redemption fee at two percent.[35] The Liquidity Cost Study examines empirical market data. This data is critical in order for the SEC to determine the size of a liquidity fee. The Liquidity Cost Study demonstrates that a one percent fee would cover approximately twice the average cost of liquidity to MMFs during times of market stress. The methodology in the Liquidity Cost Study, however, overstates the estimates of absolute spreads. As we discuss in this section, taking several additional factors into account reduces those estimates.

The Liquidity Cost Study found that the average non-crisis period, same-day, buy-sell spread is approximately 25 basis points for both "Tier 1" and "Tier 2" securities, and that this spread increases during crisis periods to approximately 70 basis points for Tier 1 securities and 160 basis points for Tier 2 securities.[36] These numbers are higher than we have seen in our experience. In non-crisis periods, for example, we have observed bid-offer spreads on non-government securities in MMFs of no more than five basis points. We attribute this discrepancy to the SEC's use of TRACE data on secondary-market corporate bond transactions, which are not representative of transactions that occur between MMFs and their trading counterparties.

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[32] Retail and municipal MMFs should be exempt from any such fee and/or gate proposal, as evidenced by the data provided in our September 2013 Letter at 25.

[33] Proposed Rules at 36848.

[34] September 2013 Letter at 27.

[35] Proposed Rules at 36886-36887.

[36] Liquidity Cost Study at 1.

The SEC used data composed of trades of a much smaller size than typical MMF transactions and in securities that MMFs rarely hold.

We believe a better approach is to examine the difference between crisis-level and non-crisis-level spreads in actual Tier 1 securities held by MMFs for an estimate of liquidity cost. We do not believe that Tier 2 data is relevant to the liquidity cost analysis because Tier 2 securities are not a primary source of liquidity during crisis periods.[37]

B. Fidelity's Analysis of Liquidity Cost Shows That One Percent is the Right Fee Level

Fidelity conducted an independent analysis of crisis-period liquidity cost, the results of which support a one percent liquidity fee. To estimate the liquidation cost for Fidelity MMFs that sold securities during the week immediately following the Lehman Brothers bankruptcy (the "crisis week"),[38] we compared prices as marked in the portfolio on September 11, 2008, with the corresponding actual sale prices. We attributed the difference to a liquidity premium demanded by the market at the time of sale.[39] We examined all sales of non-government securities by our prime MMFs during the crisis week and determined that our average spread was 12 basis points and our maximum spread was 57 basis points. Fidelity recognizes that liquidation cost in future market stress scenarios may be greater, that there may be a degree of imprecision in our cost estimation method, and that execution in times of market stress can vary widely among market participants. Fidelity also realizes that part of the Commission's goal in imposing a liquidity fee is to provide a disincentive for shareholders to redeem. We think, therefore, that a liquidity fee of 100 basis points, or one percent, is a reasonable and conservative level based on the results of our analysis.

Exhibit 4 graphically depicts the results of our analysis. Each diamond represents an actual sale in a Fidelity prime MMF during the crisis week. The sale transactions are grouped into five categories[40] as shown on the bottom of the chart. The y-axis shows the difference,

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[37] We believe the Liquidity Cost Study's inclusion of the analysis of Tier 2 securities is not reliable for the purpose of making MMF policy decisions. Tier 2 securities make up only a small fraction, approximately 0.17 percent, of MMF assets and MMFs are limited by Rule 2a-7 to hold no more than three percent. Further, MMFs do not typically sell Tier 2 securities to meet redemptions during crisis periods. Tier 2 securities mature within 45 days and typically maintain value stability during a crisis, but they tend to be more costly to liquidate than other types of securities.

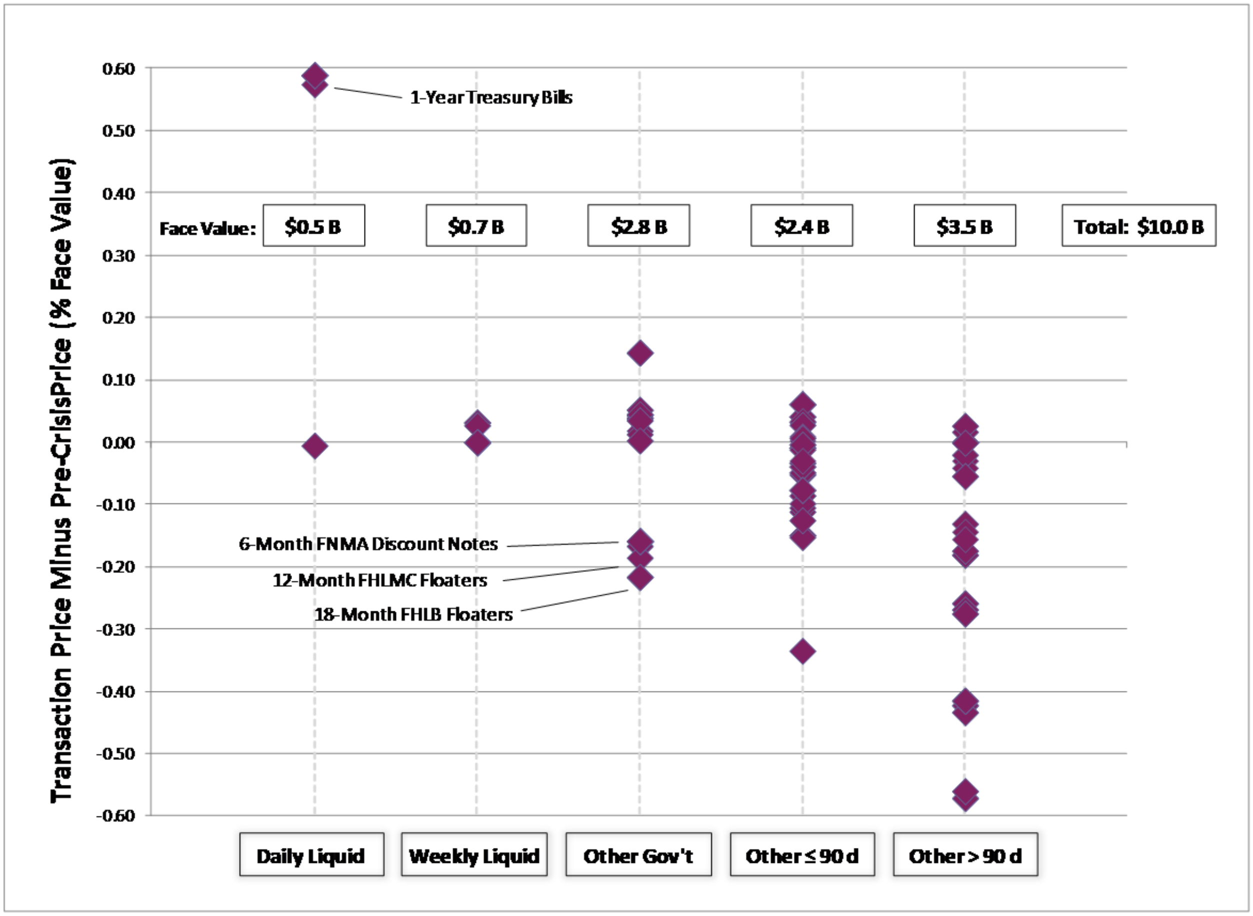
[38] September 15, 2008 – September 19, 2008.

[39] There are other factors, such as interest rate changes or spread movements that could have impacted sale prices, but nonetheless, our method reveals the actual cost to the fund to sell the security which meets the SEC's stated policy goal. *See* Proposed Rules at 36881 ("fees paid by those that do redeem should, at least partially, cover liquidity costs incurred by funds and may even potentially repair the NAV of any funds that have suffered losses"). We used market prices, not amortized cost.

[40] Categories:

- Daily Liquid – Daily Liquid Assets, as defined by Rule 2a-7(a)(8) expressed as a percentage of face value, between the market price on September 11, 2008 and the sale price. This chart shows how a redemption fee of greater than one percent is not supported by empirical data from the peak of the financial crisis period in 2008.

Exhibit 4 – Security Sales During Crisis Week (September 15, 2008 – September 19, 2008):



IV. The SEC Should Not Eliminate the 25 Percent Demand Features and Guarantees Basket

As we stated in our September 2013 Letter, the SEC should not eliminate the "25 percent basket" that allows MMFs to have more concentrated exposure to Demand Features and Guarantees from a single guarantor.[41] Instead, we urge the SEC to retain this basket at 15

- Weekly Liquid – Weekly Liquid Assets, as defined by Rule 2a-7(a)(32)
- Other Gov't – Government Securities as defined by the Investment Company Act (15 U.S.C.A. § 80a-2(a)(16)), but not included in the first two categories
- Other ≤ 90d – Non-government securities with a final maturity of 90 days or less
- Other > 90 d – Non-government securities with a final maturity greater than 90 days

[41] *See* September 2013 Letter at 43; *See also* Proposed Rules at 36953; *See also* 17 C.F.R. 170.2a-7(d)(3)(iii).

percent to balance the goals of diversification and risk management with investment flexibility, while not imposing unnecessary costs on investors in the short-term markets.[42] DERA's analysis in the Muni MMF Guarantor Study supports this position and demonstrates that there would be real costs to MMFs if the 25 percent basket were eliminated or reduced by too much.

A. Municipal MMFs Widely Use The 25 Percent Basket

In the Proposed Rules, the SEC asserts that eliminating the 25 percent basket "would have little impact on the majority of money market funds"[43] and further argues in the Muni MMF Guarantor Study that "few funds make full use of the 25% basket."[44] This interpretation of the data – and resulting policy conclusion that the SEC can eliminate the basket with little consequence – is misguided because the Muni MMF Guarantor Study includes statistics relating to taxable MMFs (which do not widely use the 25 percent basket), and therefore skews the results of the study.

Consistent with our own analysis, DERA's study demonstrates that municipal MMFs, and in particular Single State Funds, use the 25 percent basket regularly. Specifically, the Muni MMF Guarantor Study reflects that 81 percent of Single State Funds and 53 percent of Other Tax-Exempt Funds had a least one guarantor guarantee over 10 percent of their portfolios in November 2012.[45] The most common use of the basket is between the 10 percent and 15 percent levels and this usage level is consistent over time.[46] The Muni MMF Guarantor Study reflects that 54 percent of Single State Funds and 25 percent of Other Tax-Exempt Funds had a least one guarantor guarantee above the 10 percent threshold <u>every</u> month of the 24 month period examined during the study.[47] In addition, as noted in the Muni MMF Guarantor Study, 80 percent of Single State Funds in the survey had at least one guarantor exposure exceed 10 percent at some point during the period under review. The same is true for 50 percent of Other Tax-Exempt Funds.[48]

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[42] *See* September 2013 Letter at 44.

[43] *See* Proposed Rules at 36961.

[44] *See* Muni MMF Guarantor Study at 11.

[45] As of November 30, 2012 (as of the end of the 24 month study period analyzed by DERA), there were approximately 110 Single State Funds and 73 Other Tax-Exempt Funds. *Id.*

[46] *See* Muni MMF Guarantor Study at 4. As of November 30, 2012 (as of the end of the 24 month study period analyzed by DERA), there were approximately 110 Single State Funds and 73 Other Tax-Exempt Funds (*See* Data Compiled by Fidelity Using iMoneynet's Money Fund Analyzer, *available at* http://www.imoneynet.com).

[47] *See* Data compiled by Fidelity using iMoneynet's Money Fund Analyzer (November 2012), *available at* imoneynet.com (data reflects the number of Single State and Other Tax-Exempt Funds as of the end of the 24 month study period analyzed by DERA).

[48] *See* Muni MMF Guarantor Study at 5.

The SEC should focus on those MMFs that currently utilize the 25 percent basket to determine whether the costs of eliminating the basket are balanced appropriately against any potential benefits. Based on our experience managing MMFs for more than 40 years, we believe the costs of such a change would outweigh the benefits.[49] We urge the SEC to preserve the basket, but at a reduced size of 15 percent.

B. There is Not Enough Supply of Eligible Securities in the Market to Support a Reduction of the 25 Percent Basket to a Limit Lower Than 15 Percent

Fidelity does not support eliminating the 25 percent basket or reducing it to any level below 15 percent, as such an extreme reduction would negatively impact the short-term markets and impose restraints on municipal MMFs that are not beneficial to investors. We estimate that, as of March 28, 2014, a reduction to a 10 percent basket would require Fidelity's municipal MMFs to reallocate or sell over $2.2 billion in municipal MMF securities compared to the sale or reallocation of $244 million to comply with a 15 percent basket.

The reduction of the 25 percent basket to a level below 15 percent would severely restrict municipal MMFs' ability to be fully invested. According to DERA's analysis, a 10 percent basket would mean that Other Tax-Exempt Funds would have to reinvest $4.18 billion and Single State Funds would have to reinvest $2.56 billion in alternative eligible securities for municipal MMFs.[50] While these dollar amounts are small in relation to the size of the total MMF industry, which includes taxable MMFs, they are meaningful in the context of the amount of tax-exempt inventory available to replace those holdings in a municipal MMF. During the period from September 26, 2013 through March 26, 2104, the average aggregate amount of variable rate demand notes and tender option bond inventory available for purchase was $5.9 billion. That is $900 million less than what municipal MMFs would be forced to sell and attempt to replace in order to comply with a 10 percent basket.[51] Additionally, Fidelity determines only a portion of this aggregate inventory number to represent minimal credit risk, and an even smaller portion represents supply for Single State Funds.

Eliminating the 25 percent basket will cause dislocations in the short-term municipal securities market because there is not sufficient supply available to replace the securities that MMFs would sell. Although some might expect new minimal credit risk guarantors to enter the market in response to increased demand, there is no evidence suggesting that will occur. In fact, increased bank regulation, regular bank consolidation and the limited regional scope of banks

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[49] As discussed in our September 2013 letter at 44, we reiterate that the SEC should consider extending the implementation period for modifying the 25 percent basket from nine months to three years to avoid significant market disruption and to take into account liquidity provider commitments that are typically in place for a three- to five-year period.

[50] *See* Muni MMF Guarantor Study at 9.

[51] Based on market surveillance data compiled by Fidelity using Bloomberg for the period September 26, 2013 to March 26, 2014.

that provide guarantees to Single State Funds lead to the conclusion that new supply may not develop. We urge the SEC, in making its decision on whether to eliminate the 25 percent basket, to balance the considerable costs to MMFs that use the basket up to 15 percent against the uncertainties of future market conditions.

C. A Reduction of the 25 Percent Basket to a Limit Lower than 15 Percent May Force MMFs to Consider Guarantors with Lower Credit Quality

The Muni MMF Guarantor Study states that even with a 10 percent guarantor limit, any increase in guarantor diversification should not lead to deterioration in guarantor credit quality.[52] We do not agree. DERA evaluated credit risk using credit default swap spreads and composite credit rating. These two sources are lagging indicators of credit quality. They do not indicate that the guarantors or the securities represent minimal credit risk and they do not take into account any liquidity analysis. These are important factors in the analysis of whether municipal MMFs may purchase securities under Rule 2a-7.[53]

A municipal MMF cannot invest in an issuer, guarantor or security that is not determined to present minimal credit risk.[54] Investment advisers, however, differ in their determinations of which guarantors represent minimal credit risk. Not all securities enhanced by the guarantors identified in the Muni MMF Guarantor Study are necessarily available for investment by Fidelity's municipal MMFs. For example, if Fidelity does not believe that two of the top 20 guarantors identified in the Muni MMF Guarantor Study represent minimal credit risk for our municipal MMFs, the market share of the other 18 guarantors would be higher than if we had invested in the other two lower-quality names. There are times when it is prudent for a MMF to reduce guarantor diversity to increase credit quality. During the 2008 financial crisis and the 2011 Euro zone concerns, it was beneficial for MMFs to have the flexibility to respond to credit deterioration in the market and reinvest in stronger credits over time. Without some flexibility to reinvest in a single guarantor subject to at least a 15 percent diversification limit, MMFs may stay in weaker credits longer or MMFs will go un-invested, both outcomes that are detrimental to the interests of the shareholders of those MMFs.

If municipal MMFs feel forced to consider credits that do not necessarily represent the highest standards of minimal credit risk, then this result would not achieve the SEC's goal of balancing diversification with risk management. Moreover, the credit quality of the guarantor is not the only consideration in a minimal credit risk determination. Rule 2a-7 requires that the

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[52] *See* Muni MMF Guarantor Study at 15.

[53] 17 C.F.R. 270.2a-7(c)(3)(iv)(B), 17 C.F.R. 270.2a-7(c)(5).

[54] In our September 2013 Letter at 11-14, we discuss in detail why municipal MMFs have low credit risk and that both issuers and guarantors must present minimal credit risk. We also discuss why we think the banks providing credit support for the securities purchased by municipal MMFs are even stronger today, supporting our position that it is unnecessary for the SEC to reduce the 25 percent basket to a 10 percent limit.

conditions to any demand feature be remote and monitorable.[55] Often, the demand feature conditions do not meet the investment adviser's standard of monitorability, causing the security to be ineligible for purchase regardless of the guarantor's credit quality.

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We appreciate the opportunity to comment on the Reports. Fidelity would be pleased to provide any further information or respond to any questions that the SEC staff may have.

Sincerely,

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

Norm Champ, Director, Division of Investment Management
Craig M. Lewis, Director and Chief Economist, Division of Economic and Risk Analysis

[55] 17 C.F.R. 270.2a-7(c)(3)(iv)(B).