Securities and Exchange Commission
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United States
www.sec.gov

Chris Barnard

27 August 2013

- 17 CFR Parts 210, 230, 239, 270, 274 and 279
- File No. S7-03-13
- Money Market Fund Reform; Amendments to Form PF

Dear Sir.

Thank you for giving us the opportunity to comment on your proposed rule: Money Market Fund Reform; Amendments to Form PF.

You are proposing two alternatives (which you could adopt in combination) for amending rules that govern money market mutual funds (MMFs) under the Investment Company Act of 1940. The two alternatives are designed to address MMFs' susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, the benefits of MMFs. The first alternative proposal would require MMFs to transact at a floating NAV. The second alternative proposal would allow MMFs to impose a liquidity fee if a fund's liquidity levels fell below a specified threshold and would permit the funds to suspend redemptions temporarily, i.e., to "gate" the fund under the same circumstances. You are also proposing additional amendments that are designed to make MMFs more resilient by increasing the diversification of their portfolios, enhancing their stress testing, and increasing transparency by requiring MMFs to provide additional information to the SEC and to investors. For the record I enclose my comment letter on the Financial Stability Oversight Council's (FSOC) Proposed Recommendations Regarding Money Market Mutual Fund Reform[1] that were published in November 2012.

In general I would not support a floating NAV approach for the reasons outlined in my FSOC comment letter: that MMF investors are sophisticated and are aware of the nature of MMFs,

[1] See 77 FR 69455.

and that they are not "guaranteed"; and that maintaining a stable NAV is one of the key attractions of MMFs. However, I would be more inclined to support the floating NAV approach for prime institutional MMFs only, as these invest predominantly in corporate paper with its higher credit risk and interest rate volatility compared with the investments backing Government MMFs, and higher shareholder redemptions compared with Retail MMFs.

Of the two proposed alternatives, the second alternative that introduces liquidity fees and redemption gates would be more practicable and operationally easier to implement. It would also more directly mitigate the risks of runs on MMFs in times of market stress. For these reasons I would support alternative two over alternative one, as this would provide greater benefits at lower cost compared with alternative one.

I strongly support the increased diversification requirements for MMF portfolios proposed under Rule 2a-7. These increased requirements will promote and support MMF risk diversification and reduce concentration risk, and will also reduce the volatility of MMF returns. I also strongly support the enhanced stress testing requirements proposed under Rule 2a-7. These will enable MMF management to monitor, evaluate and manage MMF risk more effectively and will therefore increase understanding of MMF risk, which will promote better risk anticipation and mitigation as a result. The proposed introduction of combined and correlated stresses[2] will provide a more complete stress-testing analysis, which is sufficient for risk management purposes.

In summary, the introduction of proposed alternative two in conjunction with the other proposed amendments, particularly the increased diversification requirements and enhanced stress testing, will reduce MMFs' susceptibility to heavy redemptions and improve their risk profile and risk management procedures. These proposals build on the SEC's 2010 amendments to Rule 2a-7, and are certainly sufficient to improve the reliability of MMFs and make them less susceptible to short-term market risks.

Yours faithfully

C.R.B.

Chris Barnard

[2] Proposed 2a-7(g)(7)(i)(F).

APPENDIX

Financial Stability Oversight Council
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Chris Barnard
Germany

04 January 2013

- FSOC-2012-0003
- Proposed Recommendations Regarding Money Market Mutual Fund Reform

Dear Sir.

Thank you for giving us the opportunity to comment on your Proposed Recommendations Regarding Money Market Mutual Fund Reform.

Overview

Following the 2007-2008 financial crisis, which demonstrated that money market mutual funds (MMFs) are susceptible to runs and are a source of potential systemic risk, the Securities and Exchange Commission (SEC) amended Rule 2a-7 in 2010 to make MMFs more resilient to certain short-term market risks, and to provide greater protections for investors in a MMF that is unable to maintain a stable net asset value per share.[1] MMFs are now less risky and less susceptible to short-term market risks as a result of these measures.

In November 2010 the SEC issued a formal request for public comment on additional reforms propose by the President's Working Group on Financial Markets, including floating

[1] The amendments tightened the risk-limiting conditions of rule 2a-7 by, among other things, requiring funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reducing the maximum weighted average maturity of portfolio holdings, and improving the quality of portfolio securities; require money market funds to report their portfolio holdings monthly to the Commission; and permit a money market fund that has "broken the buck" (i.e., re-priced its securities below $1.00 per share), or is at imminent risk of breaking the buck, to suspend redemptions to allow for the orderly liquidation of fund assets.

net asset values and capital buffers.[2] However, in August 2012, the SEC announced that it would not proceed with a vote to publish a notice of proposed rulemaking to solicit public comment on potential structural reforms of MMFs.[3]

You are now proposing to use the authority under Section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[4] to recommend that the Securities and Exchange Commission proceed with structural reforms of money market mutual funds. You have made three primary proposals for MMF reform:

- Alternative one: Floating net asset value;
- Alternative two: Stable NAV with NAV buffer and minimum balance at risk; and
- Alternative three: Stable NAV with NAV buffer and other measures.

Each of these proposals is fundamentally flawed, and would not necessarily achieve your objective of "structural reforms of MMFs that reduce the risk of runs and significant problems spreading through the financial system". Firstly it should be noted that MMF investors are sophisticated and are aware of the nature of MMFs, and that they are not "guaranteed". Secondly, maintaining a stable NAV is one of the key attractions of MMFs since their introduction in the 1970s. Finally, given the low yields attainable in current money markets, imposing significant capital costs on MMFs would be detrimental to fund performance and investor demand.

Proposal

The SEC's 2010 amendments to Rule 2a-7 are sufficient to improve the reliability of MMFs and make them less susceptible to short-term market risks. The introduction of stringent stress testing requires fund managers to stress test their portfolios against potential economic shocks such as sudden increases in interest rates, heavy redemptions, and potential defaults. It is important that stress testing is sufficient to ensure that MMFs are able to withstand stresses similar to those experienced in 2007-08. For example, research shows that a MMF with a weighted average maturity of 60 days could withstand an interest rate change of 300 basis points without breaking the buck.[5]

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[2] See Money Market Fund Reform Options, Report of the President's Working Group on Financial Markets, October 2010, available at: http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf

[3] See SEC press release 2012-166, August 2012: "because three Commissioners have now stated that they will not support the proposal and that it therefore cannot be published for public comment, there is no longer a need to formally call the matter to a vote at a public Commission meeting".

[4] See Section 120 (a) of Dodd-Frank: "The Council may provide for more stringent regulation of a financial activity by issuing recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards, including standards enumerated in section 115, for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their respective jurisdictions, if the Council determines that the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities."

[5] An interest rate shock of 300 basis points over a short period has not occurred since the late 1970s. See Federal Reserve Bank of New York, Historical Changes of the Target Federal Funds and

For stress testing to be most credible, it should naturally allow for shocks and variations along the following lines:

1) changing individual assumptions and parameters (sensitivity testing);
2) changing several assumptions and parameters at the same time, where the assumptions and parameters could reasonably be expected to change together (scenario testing);
3) changing the dependencies assumed between assumptions and parameters.

The importance of point 3 above is often underestimated. I would recommend that regulators specifically emphasise the importance of considering dependencies and correlations under stress testing, particularly as typically observed and expected dependencies may not apply in the tail conditions and events that underlie many stress conditions and scenarios.

Finally, I would be prepared to support a requirement for MMFs to have an NAV buffer of up to ½ %, as this would be sufficient to absorb day-to-day fluctuations in the value of MMFs' portfolio securities and allow the MMFs to maintain a stable NAV. This would also be economically supportable. Requiring an NAV buffer much higher than this would make MMFs uneconomical to offer.

Yours faithfully

C.R.B.

Chris Barnard

Discount Rates, 1971 to present, available at
http://www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html