MFDF

MUTUAL FUND DIRECTORS FORUM

The FORUM for FUND INDEPENDENT DIRECTORS

September 8, 2009

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

Re: Proposed Rulemaking Regarding Money Market Fund Reform, File No S7-11-09

Dear Ms. Murphy:

The Mutual Fund Directors Forum ("the Forum")[1] welcomes the opportunity to comment on the recent proposal by the Securities and Exchange Commission ("Commission") to amend Rule 2a-7, the rule that governs money market funds.[2]

The Forum, an independent, non-profit organization for investment company independent directors, is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through continuing education and other services, the Forum provides its members with opportunities to share ideas, experiences, and information concerning critical issues facing investment company independent directors and also serves as an independent vehicle through which Forum members can express their views on matters of concern. A significant number of the Forum's members are responsible for overseeing money market funds and so are deeply interested in the outcome of the Commission's reform proposal.

Recent events indicate that it is time to re-examine the regulatory regime governing money market funds to the extent necessary to restore investor confidence in these funds, and we commend the Commission for its substantial and significant proposal. In spite of the problems experienced by money market funds during the past year, we continue to believe, as we have previously stated, that money market funds are one of the most significant innovations in the history of the mutual fund industry and these funds offer investors a useful and important choice

1 The Forum's current membership includes over 600 independent directors, representing 82 independent director groups. Each member group selects a representative to serve on the Forum's Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum's Board of Directors, although it does not necessarily represent the views of all members in every respect.

2 Proposed Rulemaking: Money Market Fund Reform, Release No. IC-28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("Release").

for their cash management and play a central role in our capital markets.[3] Given the importance of these products both to individual investors and the capital markets broadly, the Commission, fund boards, and investment advisers need to work together to maintain investor confidence in money market funds.

Moreover, we broadly support the proposed rule amendments that seek to tighten the credit quality, durational and liquidity limits placed on money market fund portfolios. While we do not directly address these proposals in our comment letter, the Forum believes that if adopted, they will result in money market funds being even better able to withstand broad declines or other stresses in the credit markets. Like the Commission, we understand that the risk of a money market fund "breaking the buck" cannot totally be eliminated. Given this fact, we support the effort, implicit in the Commission's proposals, to strike an appropriate balance between eliminating as much of that risk as possible while still permitting money market funds to provide an appropriate yield to their investors.

Rather than commenting more specifically on these portfolio management issues, the balance of this comment letter focuses on those aspects of the rule proposal that affect either the role of money market fund directors or the nature of money market funds.

► *The Role of Directors in Money Market Funds*

As is the case with other investment companies, the directors of money market funds play an essential role in protecting and advancing the interests of the funds' shareholders. In addition to protecting shareholders from conflicts of interest, directors provide oversight of many of the key activities of funds, including oversight of their funds' portfolio management and returns. Importantly, however, directors generally oversee these activities by hiring qualified providers and experts, not by performing those tasks directly. In short, in order to be most effective, directors need to respect the difference between effective oversight and micromanagement. Regulatory provisions that deal directly with the role and duties of the directors also should respect this distinction.

Most rules under the Investment Company Act strike the appropriate balance, requiring independent directors to oversee a fund's activities, not manage them. However, both the current Rule 2a-7 and the proposed amendments continue to pose a risk that the lines may become blurred. For example, in its discussion of asset-backed securities ("ABSs"), the Commission seeks comments on what steps "fund boards of directors (or their delegates)" should take in evaluating and assessing the credit quality of these securities. While we agree with the Commission that assessing the credit quality of ABSs in money market fund portfolios is an important issue, the Commission should not state or even imply that credit quality determinations should be the direct responsibility of the board. In particular, looked at functionally, making a credit determination is a day-to-day task that is a key part of the investment decision-making process, most appropriately performed by an investment adviser hired and, equally importantly, overseen by the board. It makes little sense to assign responsibility to the board for what should be core functions of a fund's investment adviser.

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3 *See*, Letter from Susan Ferris Wyderko, Executive Director of the Forum, to SEC Chairman Mary Schapiro dated May 22, 2009 (available at http://www.mfdf.com/site/pages/documents/MMFreform.pdf).

Rule 2a-7 does permit a board to delegate these tasks, and money market fund boards do, virtually always, delegate such tasks to the adviser (or to other qualified service providers). Arguably, therefore, there is no practical distinction between imposing a requirement that can be delegated and requiring that particular functions be performed subject to board oversight. It is important, however, for the Commission's rules to accurately reflect the board's proper role, even if it would not result in a practical difference in how funds are operated on a day-to-day basis. Accordingly, we urge the Commission to amend its proposal and the existing rule as appropriate, in order to clarify that the board's role is one of oversight, not management.

► *Use of NRSRO Ratings*

The Commission is again seeking comment on whether it should eliminate the use of Nationally Recognized Statistical Rating Organization ("NRSRO") ratings as a means of establishing a minimum standard of credit quality that securities must meet to be included in a money market fund portfolio. We (along with many other industry participants) urged the Commission last summer not to take this step.[4] As we stated at that time, the fact that NRSRO ratings are used as a floor does not automatically permit a fund to acquire the security or otherwise relieve the adviser from the obligation independently to assess its credit quality. Rather, the use of NRSRO ratings in the rule eliminates a subset of securities from the universe of possible investments. While ratings may be imperfect, they nonetheless perform a useful function that should be retained in the rule. Nothing that has occurred in the past year has altered our view that these provisions in Rule 2a-7 do, in fact, serve a valuable limiting function. Therefore, for the reasons that we stated in our previous letter, we again urge the Commission not to further consider or adopt changes of this type.[5]

Separately, we support the concept of designating particular NRSROs that funds will use to monitor the credit ratings of securities in which they invest. However, as with other aspects of the rule, we believe that it would be preferable to have this function performed by the adviser, subject to the board's oversight, rather than directly by the board itself. In particular, designating appropriate SROs and, even more importantly, monitoring the quality of those SROs' rating processes on an ongoing basis, requires technical skills similar to those employed in making individual credit quality determinations at the fund level. The adviser and its personnel are thus much more qualified to make the necessary determinations as an initial matter. Nonetheless, to protect against conflicts, we agree that the designation and monitoring of the SROs should be done pursuant to policies and procedures that are approved and overseen by the board and that the board should review the results of the designation as appropriate.

► *Maintenance of Appropriate Portfolio Liquidity*

The Commission's proposed amendments would require that all money market funds hold sufficient highly liquid securities to meet all reasonably foreseeable redemption requests. We

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4 *See* the Forum's Comment Letter re: References to Nationally Recognized Statistical Rating Organizations dated September 5, 2008 (available at http://www.mfdf.com/site/pages/documents/s71908-30.pdf).

5 As we noted in our letter last year, we believe that it would be preferable for the Commission to take additional steps designed to improve the quality and integrity of the ratings issued by NRSROs.

agree that a fund must have sufficient liquidity to meet redemption requests without being forced to sell securities, particularly during times of market stress, when holdings either may be temporarily illiquid or have impaired market value, with the result that their sale may jeopardize share value or trigger a run on the fund.

The key question is what other steps should be mandated to help assure that money market funds maintain adequate liquidity. The Release suggests two approaches. The first would require the classification of funds as either institutional or retail, and then impose different portfolio liquidity requirements on each class of fund. The second approach would, in effect, impose a "know your shareholders" requirement on funds and then require that funds maintain appropriate liquidity based on what they know about their shareholders, and particularly what they know about the likely size and timing of shareholder redemption requests.

Most broadly, the classification system articulated in the rule proposal will result in funds classified as "retail" having slightly higher returns than those classified as "institutional." We agree, as a general matter, that institutional shareholders are more likely to redeem large holdings quickly, and thus that institutional shareholders, as a group, pose greater liquidity risks on funds. However, creating a two-tier system of funds may lead to other competing problems, such as an incentive for institutional investors to seek ways to invest in retail funds, making it more difficult for a fund to understand its true liquidity risk.

Most important, the classification requirement would strip funds and boards of the flexibility to address their particular liquidity needs, without accomplishing the Commission's critical goal of ensuring adequate liquidity to meet anticipated redemption requests. We question whether institutional shareholders, uniformly, are more likely to make large redemptions on short notice. Institutional investors employ money market funds for different reasons, have different liquidity needs themselves and have different investment approaches. Each of these factors can cause an institutional investor to manage its money market investments in a variety of ways. Imposing a specific requirement on funds (in this case, that 10% of the fund's portfolio must be highly liquid) based on broad assumptions about uniform investor behavior seems suspect.

Further, if the Commission were to adopt the approach of classifying funds, we urge it not to assign the responsibility of doing so directly to boards. The information required to make this decision is uniquely within the operational responsibility of the adviser, and accordingly, if this decision is required, the adviser or appropriate service provider should make that determination. The Release requires that the determination be made "no less frequently than once each calendar year," implying that the characteristics of a given fund are likely to vary over time. The adviser has the day-to-day knowledge of the cash flow and other characteristics of the fund, and is in the best position to assess these factors on a sufficiently frequent basis.

We therefore urge the Commission to rely on the "know your shareholder" procedures that are discussed elsewhere in the Release. We believe that this approach will best allow funds to use their knowledge about (i) their fund's historical needs for liquidity; (ii) their fund's inflows; (iii) where those inflows are coming from; (iv) who their shareholders are and (v) what the likely liquidity needs of those shareholders are.

In our view, a flexible, more nuanced approach is likely to produce greater benefits for fund shareholders while at the same time better accomplishing the Commission's aims. We therefore recommend that the Commission adopt this approach.

► *Suspension of Redemptions and Fund Liquidation*

If adopted, the Commission's proposal would permit fund boards to suspend redemptions in order to permit an orderly liquidation of a fund. The Commission also seeks comment on whether fund boards should, in addition, be permitted to suspend redemptions temporarily in order to deal with exigent circumstances. We support providing fund boards with both of these options.

First, and most importantly, we note that, unlike some of the other matters discussed in this comment letter, the decisions to liquidate a fund and to suspend redemptions are properly within the board's duties. These are decisions that will threaten the continued existence of the fund and have potentially serious consequences for shareholders who will potentially be denied the liquidity they expected. Independent directors, who are free of conflicts and who must act in the best interests of all the funds' shareholders, should be permitted to make these decisions.

Second, we agree that permitting directors to suspend redemptions may help support an orderly liquidation of a fund. Once a board decides to liquidate a fund, many of the fund's shareholders will wish to redeem their investments immediately. By doing so, however, they may force the fund to sell securities at fire sale prices or to distribute securities in-kind. Directors, armed with relevant information provided by the adviser with respect to how quickly their fund will be able to liquidate its portfolio, are able to balance the competing desires of the fund's shareholders in deciding whether to suspend redemptions.

For similar reasons, we encourage the Commission to propose and adopt rules permitting (but not requiring) directors of a fund that is liquidating to divide it into two tranches, one for shareholders who would like to redeem immediately at current market prices and one for shareholders who wish to hold onto the investment in hope of a higher recovery. While this option will not work in all cases, directors will be in the best position to ascertain whether it can be accomplished operationally, whether a split would benefit shareholders and whether the desires of the fund's individual shareholders could be ascertained quickly enough to make a split feasible. In addition, assuming that a fund is split between two sets of shareholders, directors will be in a strong position to ensure that the fund's portfolio is divided fairly between the two tranches and to ensure that all shareholders continue to be treated fairly during the liquidation process.

Third, we also support giving the board the ability to suspend redemptions temporarily under exigent circumstances. Because the consequences of doing so would be so great, we do not believe that the Commission needs to place highly specific limiting conditions on the board's ability to take this step. Indeed, because it is likely that any fund that takes this step will face a large number of redemption requests immediately following lifting the suspension, granting boards this power will not necessarily enable them to achieve the Commission's stated goal of stabilizing the fund. However, a short suspension would permit the board and adviser to consider a number of possible approaches, ranging from a merger with a more stable fund to liquidation, making it worthwhile to give the board this power.

► *Ability to Transact at Prices other than the Stable Net Asset Value*

Given that it is impossible to completely eliminate the risk that a money market fund will "break the buck," we agree with the Commission's proposal that all money market funds should have the capacity to effect transactions at prices of other than $1. Although the Commission proposes to make this mandatory by requiring that fund boards make an annual determination that their fund has this capability, boards lack the operational expertise to make this determination directly. A more effective solution would require the appropriate service provider to certify to the board on an annual basis that the fund has the capability to transact at prices other than $1/share. By imposing the requirement in this form, the Commission appropriately will give the board oversight responsibility.

► *Stress Testing*

We agree with the Commission that all money market funds should engage in regular stress testing and that effective stress testing should identify, as accurately as possible, the combination of variables that could cause a fund to "break the buck." We therefore support this proposal. However, as with many other provisions in Rule 2a-7, it is important that the rule carefully define the role of the board in stress testing, so as not to either unduly limit the board's oversight nor cause the board to micromanage the fund. We offer the following suggestions.

First, the Commission should make clear that the board's oversight authority extends to stress testing. Because stress testing should be a fundamental element in the successful management of a money market fund, the board should understand and oversee the policies and procedures that govern the testing.

Second, we agree that the board should have a strong understanding of the results of the stress testing, including, perhaps most importantly, what combination of factors or variables would likely cause the fund to "break the buck." However, the board's understanding of these factors (and, indeed, the fund's administration of stress tests) must include a recognition that it is impossible to predict the future or to accurately foresee the types of highly unlikely events that may have significant consequences for prices on liquidity in the securities markets. The board should thus have the authority to review the result of stress testing and, as a matter of best practice, likely should review the results of the tests no less frequently than annually.

Finally, the Commission should not require overly-frequent reporting of routine results directly to the board. While a board likely should review stress test reporting at least annually and should also be advised between annual reviews of any significant changes in either the results of routine stress testing or changes in the nature of the testing, the board should generally be free to determine for itself both the form of and how frequently it wishes to see reports of the stress testing. Imposing an inflexible reporting requirement may inundate the board with unnecessary information and distract it from other more important tasks. It also risks that the board will overlook key information in the otherwise routine reports. The board can determine the procedures governing stress testing based on factors such as the nature of the fund's investors, to the ability of the board to use other resources available to it, including the fund's Chief Compliance Officer, in managing its oversight of the stress testing process.

► *Proposed New Disclosure Requirements*

As a general matter, the Forum supports the new disclosures proposed by the Commission. We agree fully that providing the Commission, other regulators, and the public further information about the activities and portfolio holdings of money market funds will both make regulators more effective and increase investors' understanding of how money market funds operate. At the same time, care should be taken to avoid unnecessary or excessive costs on money market funds (particularly in the current low interest rate environment) and disclosure requirements should not, as a practical matter, impede their portfolio management. We therefore urge the Commission to consider carefully the comments it receives on these issues from money market fund advisers.

We would, however, have significant concerns about any proposal to require money market funds to disclose a market-based net asset value per share ("NAV"). In particular, we believe that this disclosure is more likely to be confusing than helpful to retail investors in money market funds. One of the key benefits of money market funds to retail investors is the certainty they provide about the price at which transactions occur – money market funds are easy to use largely because of their stable $1/share NAV. Providing information about the market-based NAV when a fund has a stable NAV in accordance with Rule 2a-7 will only serve to confuse investors regarding the significance of a deviation between market value and amortized cost value and may lessen investor confidence in a fund. Indeed, this is an area in which the board plays a key role – by reviewing a money market fund's market-based NAV and otherwise overseeing its compliance with applicable regulations, the Board stands in for and protects the shareholders of the fund from any harm that might result from there being a material deviation between the market-based NAV and the stable $1/share reported NAV of the fund.

► *Request for Comment on a Floating NAV*

In the concluding section of its Release, the Commission seeks comment on whether money market funds should be barred from seeking a stable NAV, and instead sell and redeem shares based on a floating NAV. We fundamentally oppose changing money market funds in this manner. First, and most importantly, we believe that the overwhelming success of money market funds – one of the most important innovations in the mutual fund marketplace in the past thirty years – is rooted in a stable NAV of $1. Especially from the perspective of retail investors, a stable NAV makes money market funds much easier to use and understand, particularly when parking cash in anticipation of making other investments or other purposes. Were the stable NAV eliminated, many investors would likely abandon money market funds for other vehicles, thereby weakening an investment that has held great appeal to investors and provided a ready market for issuers.

Second, if the Commission is seriously committed to considering this step, it should carefully evaluate potential collateral consequences that could well reduce the size of money market funds. In today's capital markets, money market funds are an important source of short-term funding for numerous banks, businesses and governmental entities. If investor money moves out of money market funds, these entities will potentially have much greater difficulty raising short-term funds, and both our country's capital markets and economy could be harmed. Before taking steps of such a fundamental nature, we believe that the Commission would need to assess and quantify these critical risks.

Finally, we believe that the rule amendments that the Commission proposes in the Release significantly reduce the need to consider more fundamental changes like a shift to a floating NAV. Clearly, the ongoing viability of money market funds depends upon their ability to manage their portfolios in a way that achieves an acceptable return for shareholders while still minimizing to the largest extent feasible the risk that a fund will "break the buck." Up until the recent turmoil in the markets, Rule 2a-7 has been highly successful in achieving the goal and, even during the difficult market conditions of the past 18 months, the vast majority of funds have been able to maintain a stable NAV of $1. The amendments that the Commission is now proposing will make it even more likely that funds will be able to maintain a stable NAV, even in highly difficult market conditions. Given this, we simply do not believe that there is a strong basis for the Commission to consider fundamental change to a product that has been highly successful and is clearly highly desired by both individual and institutional investors.

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We very much appreciate the opportunity to comment on this important proposal and thank the Commission for considering our comments. Please feel free to contact Susan Wyderko, the Forum's Executive Director, at 202-507-4490 or me at 202-507-4491 if you would like to further discuss our comments.

Sincerely,

David B. Smith, Jr.
Executive Vice President and General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

Andrew J. Donohue, Director, Division of Investment Management