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VIA E-MAIL rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Money Market Fund Reform (Release No. IC-28807; File No. S7-11-09)

Ladies and Gentlemen:

This letter is submitted by the Committee on Federal Regulation of Securities (the "Committee"), Section of Business Law (the "Section") of the American Bar Association (the "ABA") in response to a request for comment by the U.S. Securities and Exchange Commission (the "Commission") on the proposed amendments (the "Proposed Amendments") to Rule 2a-7, as well as other rules, under the Investment Company Act of 1940 (the "1940 Act"), which are described in Release No. IC-28807, published in the Federal Register on July 8, 2009 (the "Proposing Release"). This letter has been prepared by members of the Subcommittee on Investment Companies and Investment Advisers (the "Subcommittee"). All terms used in this letter which are not specifically defined herein are as defined in the Proposing Release.

We commend the Commission for proposing the Proposed Amendments and agree that their adoption should help, as the Proposing Release states, "make money market funds more resilient to certain short-term market risks, and . . . provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value per share." We also appreciate the opportunity to comment on the Proposed Amendments. The Proposing Release poses many questions of a technical, economic or highly specific nature that are better addressed by those with more business, economic, operational or marketing expertise. Accordingly, we have limited our comments to select legal issues that relate to the Proposed Amendments and their implementation. Specifically, and as discussed below, the Committee is submitting comments addressing issues that relate to: (a) the responsibilities of money market fund directors, (b) floating net asset values, (c) in-kind redemptions, (d) disclosure of market-based fund share prices and portfolio holdings and (e) proposed Rule 22e-3 under the 1940 Act. In addition, the Committee is submitting for the Commission's consideration a proposal to create two categories of money market funds, one category for money market funds that are permitted to maintain a stable share price, and another category for funds that are required to have a floating share price.[1]

Our response particularly focuses on our view of the proper role of fund boards of directors. We believe that boards should not be vested with responsibilities better addressed by professional money managers. Nevertheless, we believe that the recent credit crisis has revealed that fund boards would benefit from additional tools for facing large-scale redemptions or significant market stress. Additionally, we believe that boards and investors would benefit from having different types of money market funds available, including both stable value money market funds and floating rate money market funds.

The Committee also believes that the Commission is more likely to achieve its goals of making money market funds more resilient to market risks and provide greater investor protections if Rule 2a-7 encourages money market funds with floating share prices to be more competitive to funds with stable share prices in the manner proposed by the Committee.

The comments expressed and the statements made in this letter represent the views of the Committee only and have not been approved by the House of Delegates or Board of Governors of the ABA and, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section (or any other ABA Section), and it does not necessarily reflect the views of all members of the Committee.

1. Responsibilities of Fund Directors

Rule 2a-7 currently imposes many responsibilities on money market fund directors. The directors may delegate some of these responsibilities to a fund's investment adviser or others; it may not delegate certain enumerated responsibilities.

In view of the seemingly ever-growing list of responsibilities being imposed on mutual fund directors, we urge the Commission to be mindful that any new duties they create do not amount, individually or collectively, to micromanagement by fund boards. Moreover, we suggest that the Commission clarify when directors may delegate specific tasks that the rule requires them to undertake.

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[1] The Committee recognizes that currently and as proposed by the Proposed Amendments, Rule 2a-7 permits a money market fund to have a floating share price for the purposes of issuing and redeeming fund shares. It also recognizes that currently and as proposed in the Proposed Amendments, a money market fund that has a floating share price is subject to the same risk-limiting conditions under the rule as a money market fund that maintains a stable share price. As discussed below in Part 6 of this letter, the Committee is proposing that different risk-limiting conditions apply to a money market fund that has a floating share price than to a fund that maintains a stable share price.

Rule 2a-7(e) (currently and as proposed) specifies when a fund's board of directors may delegate "the responsibility to make any determination required to be made" under the rule. In particular, non-delegable determinations include:

(1) Board findings that:

a. It is in the best interests of the fund and its shareholders to maintain a stable share price by virtue of either the amortized cost value or penny rounding method (current and proposed Rule 2a-7(c)(1)); and

b. The fund or its transfer agent has the capacity to sell and redeem shares at the current net asset value (proposed Rule 2a-7(c)(1) only);

(2) Whether to promptly dispose of downgraded securities (current Rule 2a-7(c)(5)(ii) and proposed Rule 2a-7(c)(7)(ii));

(3) To establish general written procedures reasonably designed to stabilize the fund's share price (current Rule 2a-7(c)(7)(i) and proposed Rule 2a-7(c)(8)(i));

(4) To establish specific procedures addressing shadow pricing (current Rule 2a-7(c)(7)(ii)(A) and proposed Rule 2a-7(c)(8)(ii)(A));

(5) To determine what action to initiate in the event that the amortized cost per share exceeds one-half of one percent (current Rule 2a-7(c)(7)(ii)(B) and proposed Rule 2a-7(c)(8)(ii)(B));

(6) To determine what action to take to eliminate or reduce dilution or unfair results to investors or existing shareholders (current Rule 2a-7(c)(7)(ii)(C) and proposed Rule 2a-7(c)(8)(ii)(C)); and

(7) To assure that the price per share of funds using the penny rounding method, rounded to the nearest one percent, will not deviate from the single price established by the board (current Rule 2a-7(c)(8) and proposed Rule 2a-7(c)(9)).

Rule 2a-7, as amended, would impose new responsibilities on money market fund directors. It is not clear the extent to which the directors may delegate these responsibilities. For example, proposed Rule 2a-7(c)(5)(v) would require fund directors, not less than annually, to determine whether the fund is an Institutional Fund for the purposes of meeting the minimum liquidity requirements set forth in paragraphs (c)(5)(iii) and (iv). While the text of the Proposing Release implies that the Rule requires directors to make specific determinations,[2] proposed Rule 2a-7(c)(8) would not specifically designate this duty as non-delegable.

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2 Proposing Release at 61-62: "Our proposed amendments would require that a money market fund's board determine, no less frequently than once each calendar year, whether the fund is an institutional money market fund for purposes of meeting the liquidity requirements. (Footnote omitted.) In particular, the fund's board of

In most cases, it would be relatively easy for money market fund directors to make this determination. But this is beside the point. Fund investment advisers or distributors may be in a better position to make this determination, especially when the determination is not so clear (e.g., money market funds with both retail and institutional classes). To require fund directors to make this determination adds another incremental responsibility that is best undertaken by someone else, in this case, by the fund's adviser or distributor.

Similarly, Rule 2a-7(c)(8)(ii)(D)(i) would require the board of directors of each money market fund using the amortized cost method to adopt procedures providing for periodic stress testing of the fund's portfolio. These procedures would require that stress tests be conducted at intervals (that the board "determines appropriate and reasonable in light of current market conditions") to test for certain hypothetical events. The Proposing Release states that the rule "would leave to the money market fund's board of directors (*and* the fund manager) the specifics of the scenarios or assumptions upon which to base the tests."[3]

We do not dispute the value of stress testing, which is a concept borrowed from the banking world to test the safety and soundness of insured depository institutions. However, this example of a "principles-based" rule within the "rules-based" framework of Rule 2a-7 raises some concerns when applied to money market fund directors. In particular, this requirement approaches micromanagement on the part of the board.

The stress test requirement, as proposed, likely would drive diligent fund directors to become mired in the technical details of establishing and monitoring "appropriate" measures of stress, which involve a level of expertise that more likely resides with portfolio managers and risk managers rather than most fund directors. The absence of specific guidance will leave directors guessing whether their procedures are adequate.

We suggest that the Commission place the responsibility for adopting as well as conducting stress test procedures with money market fund portfolio managers, investment advisers and their compliance officers or risk management officers, where this function more appropriately belongs. We note that Rule 2a-7(e), as proposed, would not specifically prevent fund directors from delegating this responsibility, which seems contrary to the intent of the Proposing Release.

We also suggest that determinations of the appropriate types and features of asset-backed securities or other securities in which a money market fund may invest continue to be made by the fund's directors or, as they deem appropriate, its portfolio managers. A fund's directors or portfolio managers are in the best position to determine whether particular investments are appropriate for a particular fund and to make the necessary risk judgments. They can do so, we believe, without additional guidance specific to asset-backed securities. This approach would be

directors would determine whether the money market fund is intended to be offered to institutional investors or has the characteristics of a fund that is intended to be offered to institutional investors" based on several enumerated factors."

[3] Proposing Release at 68 (emphasis added).

consistent with regulators' customary reluctance to single out specific asset classes for class-by-class treatment.

The following are our responses to some of the questions posed in Part V.a.2 and II.a.4 of the Proposing Release.

The Commission asked for comment on an approach in which the fund board would designate three or more nationally recognized statistical ratings organizations ("NRSROs") that the fund would look to for all purposes under Rule 2a-7.

We believe that portfolio managers or an adviser's risk managers are in a better position than fund directors to evaluate and designate appropriate NRSROs, and thus, this requirement should not be imposed on fund directors. To impose this requirement on fund directors would be to add yet another incremental responsibility on fund directors involving a highly technical area in which they generally lack specific expertise.

The Commission also asked for comment as to whether Rule 2a-7 should explicitly require fund boards of directors (or their delegates) to evaluate whether an asset-backed security includes any committed line of credit or other liquidity support.

While we believe that this suggestion has merit, we believe that portfolio managers are in a better position to make such evaluations, and thus, fund directors should have the ability to delegate this responsibility to the fund's adviser.

2. Floating Net Asset Value

We believe that requiring all money market mutual funds to float their share prices would fundamentally alter a highly successful type of mutual fund that investors have utilized since the early 1970s. As of August 19, 2009, money market mutual funds had $ 3.581 trillion in assets.[4] The principal reason for this success is the stable share price model. We believe investors that rely on the stability of the current money market fund amortized cost pricing model will substitute other non-mutual fund products in place of stable share price money market funds if those money market funds are required to let their share prices float. Instead of providing a valuable liquidity tool for institutional and retail investors, requiring all money market funds to use a floating share price would diminish the utility of stable share price money market funds as a cash management vehicle for millions of investors.

Money market mutual funds are an important investment component for investors and a significant purchaser of corporate and government debt. Retail and institutional investors rely on money market funds for liquidity, stability and a market-based yield. According to the Investment Company Institute (the "ICI"), more than 80 percent of U.S. companies use money

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[4] *See* Investment Company Institute, Money Market Mutual Fund Assets, http://www.ici.org/research/stats/mmf/mm_08_20_09.

market funds to help them manage their cash balances.[5] As noted on page eight of the Proposing Release, money market funds hold 23 percent of all repurchase agreements, 65 percent of state and local government short-term debt, 24 percent of short-term Treasury securities and 44 percent of short-term agency securities. Money market funds also are the largest purchaser of commercial paper, holding 41 percent of outstanding commercial paper as of March 31, 2009.[6] A major exodus of money market fund investors would, therefore, have far-reaching implications in the broader economy and may cause a major disruption of the credit markets.

Moreover, by requiring a floating share price, the Commission would eliminate one of the main attractions of a stable share price — the lack of a capital gains tax impact to a shareholder's investment. We believe the absence of such a tax benefit would contribute to a decline in the popularity of money market funds in favor of non-mutual fund investments. Such a decline also would negatively impact institutions that rely upon money market funds to finance short-term spending requirements. We also note that many investors rely on money market funds held in brokerage accounts to hold cash for the settlement of securities transactions, which require the payment of a set amount at a certain period in time. Similarly, bank trust departments may use money market funds as part of arrangements where the interests of the remainderman and the income beneficiary are different. As the remainderman would normally expect to seek preservation of principal, a floating rate money market fund would no longer be a suitable investment. A floating share price in all situations would not provide the certainty needed in these situations and a complete transition to a floating share price might prove disruptive to existing arrangements.

Instead of mandating that all money market funds have floating share prices, we believe the Commission should require that large redemption requests be distributed in-kind. As explained in Part 3 of this letter, below, requiring money market funds to distribute large redemption requests in-kind would provide money market funds with a valuable liquidity maintenance tool during periods of significant market turmoil, thereby ensuring that large investors may not redeem their shares to the disadvantage of smaller retail investors.

Furthermore, in the event the Commission finds a floating share price necessary, we believe as described in Part 6 of this letter that money funds should be able to opt for either a floating net asset value or a stable net asset value within Rule 2a-7. Money market funds would then have the option of determining which pricing model works best for their purposes. For the reasons discussed in Part 6 below, we believe that a two-category approach would achieve the Commission's goals of stabilizing the money markets, thus giving investors an option to choose

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5 Investment Company Institute, Report of the Money Market Working Group, at 28 (2009) [hereinafter, "ICI Report"], available at http://www.ici.org/pdf/ppr_09_mmwg.pdf.

6 *See* Christopher Condon, *Volcker Says Money-Market Funds Weaken U.S. Financial System*, Bloomberg, Aug. 25, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a5O9Upz5e0Qc

a money market fund with a stable net asset value that is subject to more stringent risk-limiting conditions.

The following are our responses to some of the questions posed in Part III.A of the Proposing Release.

(a) ***Would requiring a floating share price result in more investment stability*?**

We do not believe that requiring a floating share price for all money market funds would ensure that they would become a more stable investment. In fact, a floating share price may have the opposite effect, because the volatility of a money market fund's portfolio will be more transparent. If investors continue to use money market funds as a cash management tool after the implementation of a floating share price then these investors may be more likely to withdraw their money in response to short-term volatility in a particular money market fund portfolio. Large withdrawals based on the movements of a floating share price would have the unintended consequence of making money market funds more susceptible to "runs." These redemptions would exacerbate market crises at times when market stability is needed, causing investor losses and making it difficult for issuers of money market instruments to obtain investment capital. This pattern of redemptions has been historically experienced by short-term bond funds. Nevertheless, for certain types of investors the competition between stable share price and floating share price money market funds may be beneficial. The availability of both stable share price and floating share price funds would provide more options to account for different risk and yield preferences among investors.

(b)*What impact might such a change have on the short-term credit markets and issuers of short-term debt securities?*

For the reasons noted above, requiring a floating share price may result in businesses and other investors utilizing alternative vehicles for their short-term liquidity needs, such as commercial bank accounts. A major shift away from money market funds as a liquidity vehicle would negatively impact the businesses, states and municipalities that rely on money market funds for short-term financing. These entities would have to find other purchasers for their short-term debt, which considering the significant percentage of their debt currently held by money market funds, would be a considerable task and the search for other purchasers most likely would take a considerable amount of time. Until that search is complete, the adverse effect of such a transition on state and local government finances could be substantial. A similar adverse impact could be expected in the commercial paper market. As noted in Part 3 of this letter, below, we believe that requiring money market funds to distribute large redemption requests in-kind would be a preferable way of providing a "buffer" to money market funds in times of significant market stress.

3. In-Kind Redemptions

Redemptions of large quantities of liquid securities by the holder of a significant percentage of a money market fund's shares could leave only illiquid securities available to satisfy redemption requests from the fund's smaller shareholders.[7] We believe that requiring money market funds to satisfy these large redemption requests through in-kind distributions would provide the liquidity necessary to satisfy subsequent retail investor redemption requests in cash.[8] This requirement, however, should be subject to a determination by the fund's board that the fund could satisfy the large redemption request without the necessity of redeeming in-kind. If the board determines for a particular redemption request that a cash payment is appropriate for the fund, then the board could amend the threshold above which redemptions must be satisfied through in-kind payment.

We believe that money market funds would not use this feature frequently, but it would be beneficial during markets like those experienced during the past year. Most importantly, in-kind redemptions would provide a mechanism by which money market funds could maintain a stable net asset value. Retail shareholders would be able to withdraw their money market fund contributions on a dollar-for-dollar basis, which is what the public expects when investing in a money market fund. Requiring money market funds to distribute large redemption requests in-kind may also reduce the amount of "hot" institutional money accumulating in any one fund (as institutions voluntarily diversify their holdings across multiple funds), without making funds have additional one-day or one-week liquidity, and thus lower yields, for institutional shareholders.

The following are our responses to some of the questions posed in Part III.B of the Proposing Release.

(a) *What would be the advantages and disadvantages of this approach?*

We believe there are many advantages in requiring money market funds to satisfy redemption requests in excess of a certain size through in-kind redemptions, including the following:

Stable Share Price. Allowing or requiring funds to satisfy redemption requests above a certain threshold through in-kind distributions provides a mechanism by which money market funds can maintain a stable share price during times of market distress, ensuring dollar-for-dollar withdrawals for all investors.

Protection of Retail Investors. During a liquidity crisis, large cash redemptions from institutional investors that cause a money market fund that maintains a stable share price to

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7 As discussed below, we believe that "large quantities of liquid securities" means quantities that could harm a money market fund, its remaining shareholders, or the money markets themselves.

8 We recognize that certain shareholders would be precluded from investing in a fund that allows in-kind redemptions, including funds relying on section 12(d)(1)(E) of the 1940 Act, such as master/feeder funds and certain insurance company separate accounts offering variable annuity or variable life insurance contracts.

break the buck could prevent retail investors from accessing their investments for days, weeks or even months. Large redemptions during last year's market turmoil in the wake of the Lehman Brothers bankruptcy caused liquidity crises for many funds. If the parent companies of many of these money market funds had not stepped in to support the net asset values of the funds, many more funds would have been forced to liquidate. By satisfying large redemption requests through in-kind distributions, cash will remain for those money market funds to distribute to retail shareholders (particularly in light of the additional liquidity requirements that the Commission has proposed).

<u>Burden Shifts to Redeeming Shareholder.</u> In-kind redemptions would shift the burden of providing liquidity from money market funds to the large redeeming shareholder. A large shareholder would bear the true cost of its own significant redemptions.

We believe that the disadvantages of requiring in-kind distributions in certain circumstances to large withdrawing investors are outweighed by the advantages of such withdrawals. Large withdrawing investors with liquidity needs that receive in-kind redemptions may sell these securities at "fire sale" prices, further depressing the market. If money market funds are not permitted to redeem large redemptions in-kind, then the funds will have to sell their portfolio securities into the market (whether the funds have fixed or floating rates). The market will therefore be adversely affected regardless of whether a money market fund distributes large redemption requests in cash or in-kind. In the former scenario, however, it is the large redeeming shareholders, not the smaller retail shareholders, which will bear the burden of their own need for extraordinary liquidity. Consequently, more liquid securities would be available to satisfy redemption requests from retail investors. Further, if the Commission sets the in-kind redemption threshold too low, many investors may use other products for cash management purposes.

(b) *What type of threshold redemption request should trigger this requirement?*

As stated above, we believe that the threshold for mandatory in-kind redemptions should be set at such a level that it would only apply to redemptions large enough to harm a money market fund, its remaining shareholders, or the money markets generally. The possibility of receiving an in-kind redemption provides a negative incentive for a sophisticated investor that holds a large majority of the shares of a particular fund to redeem such shares before retail investors have an opportunity to exit the fund. The requirement also will deter institutional investors from owning too large a percentage of the assets in any one money market fund. This diversification of a fund's investor base further diminishes the chance that a money market fund will experience liquidity problems as the result of redemptions from a large shareholder.

(c) *Would these shareholders be able to assume ownership of such securities?*

As long as the threshold for in-kind redemptions is set at a sufficiently high level, the only shareholders affected by an in-kind redemption rule would be large sophisticated investors, who generally should qualify for "qualified institutional buyer" status under Regulation 144A under the Securities Act of 1933, as amended, and would be able to hold and dispose of securities that are not publicly traded. These investors are best placed to dispose of the illiquid securities in the market.

4. Disclosure of Market-Based Fund Share Prices

In the Proposing Release, the Commission requested comment on whether money market funds should be required periodically to disclose their market-based net asset value per share and the market-based prices of their portfolio securities. The potential benefits of doing so are cited as (a) enabling investors to understand the fund's exposure to distressed securities, (b) helping investors to understand the risk that the fund could "break the buck" and (c) "leveling the playing field" between institutional investors with the capacity to estimate this information themselves and retail investors who cannot. The Proposing Release recognizes, however, that disclosure of shadow pricing could cause "greater instability" should investors substantially increase redemptions if the shadow price deviates too far below amortized cost. The Commission also seeks comment on the frequency of shadow pricing disclosure.

The Committee's view is that disclosure of shadow prices of money market funds that maintain a stable share price does not provide meaningful information to investors, whether provided on a monthly basis (as for other portfolio disclosures, as proposed) or more frequently, and creates a real risk of confusion, unfairness to non-redeeming investors and investment management disruption.[9]

Disclosure of Shadow Prices Does Not Provide Meaningful Benefits

Section (c)(7)(ii) of Rule 2a-7 currently requires the board of directors of a money market fund that maintains a stable share price to adopt procedures to periodically review the current net asset value per share using available market quotations ("shadow pricing")[10]. Deviations from the fund's amortized cost price per share exceeding one-half of one percent require the board to consider what, if any, actions to take. It is our experience that most fund boards are notified at higher thresholds and actively participate in evaluating any needed action. Rule 2a-7 appropriately gives the board the responsibility to monitor deviations and decide on any appropriate remedial actions, as the board both understands the limitations on prices provided by pricing services and has responsibility for acting in the interest of the fund and all investors.

The credit quality, maturity and other risk-limiting conditions currently in Rule 2a-7 and as proposed serve to render the potential deviation in most instances irrelevant to an appreciation of the risk of investing in the fund or of the extent of the fund's exposure to securities facing credit issues. Assuming that the risk-limiting conditions proposed for money market funds that

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[9] Obviously, no issues are raised for money market funds that have floating share prices as they will transact at market-based prices on a daily basis.

[10] Under the Proposed Amendments, this requirement is in Section 2a-7(c)(8)(ii).

maintain a stable share price are adopted in large measure, the potential for significant deviations between amortized cost and market prices can be expected to be reduced. Consequently, the disclosure of a shadow price would not provide any meaningful information to investors. For money market funds that maintain a stable share price and invest primarily in U.S. Treasury or U.S. Government agency securities, market price deviation from amortized cost is a temporary phenomenon based on interest rate changes and not credit deterioration. For so-called "prime" and tax-exempt money market funds, the deviation often tends to be related to interest rate changes (or as recently experienced, a lack of liquidity in the market for underlying securities) and not deterioration in credit quality. If the credit quality of one or more holdings is impaired to the extent that the adviser no longer believes the securities will mature at par, the board in collaboration with the fund's investment adviser is in a position to access whether action is needed. If the impaired holdings will have a material effect on the fund, the fund would be required to make disclosure in accordance with existing securities laws. Moreover, if the losses are of a magnitude sufficient to cause the fund to "break the buck", the Commission has proposed providing boards with the power to liquidate the fund in an orderly manner to protect the interest of all investors.

The disclosure "playing field" requires leveling only if the information available to institutions (and not to retail investors) is material and likely to be acted-upon if made available. As stated in the Report of the ICI's Money Market Working Group, the recent past showed that institutional investors pose more of a "flight risk" than retail investors[11]. Whether this was due to an information advantage is not clear; it could have been due to a greater sensitivity to the risk of loss if the institutions were investing in the funds in a fiduciary capacity on behalf of their own clients or if the institutions held very large amounts in the money market funds and feared the consequent dollar impact of any net asset value decline. Institutional investors can be expected to perform greater due diligence on funds and their advisers than retail investors and to have resources devoted to analyzing fund holdings on an on-going basis. Portfolio composition (and the market outlook for particular categories of debt issuers), rather than current shadow price information, likely was a significant factor in the decision of institutional investors to flee from prime funds to government funds. We suspect that retail investor behavior would not have been materially impacted had the shadow price been available to them.

Disclosure of Shadow Pricing Creates Risk of Confusion, Unfairness to Non-Redeeming Investors and Investment Management Disruption

Not only would shadow pricing not benefit investors, but our view is that it may well lead to investor confusion. Many investors, particularly retail investors, may not realize that the market-based net asset value of a money market fund's shares may be lower (or higher) than the $1 share price published by the fund or that the fund's portfolio securities, if held to maturity, are expected to be paid at par. Educating investors that money market funds that maintain stable share prices can "break a buck" would probably be more useful than providing fluctuating data

[11] ICI Report, at 113.

that, except in the most extraordinary circumstances, will have no bearing on the price at which they will transact in fund shares.

More importantly, however, as noted in the Proposing Release, disclosing market-based values could cause a "run on the fund" once the shadow price falls below a specific threshold. To meet these redemptions, the fund could be forced to sell securities, potentially realizing losses, which could exacerbate the pricing deviations. In addition, the early redeemers -- who can be expected to be the institutional investors -- receive $1.00 per share while the later redeemers -- more likely to be the retail investors -- may not, thereby not only unfairly penalizing those less quick to act but creating greater incentives to act on any significant deviations. The threshold for triggering redemptions may rise in order to avoid being the last one out the door. Given the ongoing dispute among investors in the Reserve Primary Fund over the pricing of their redemption orders, investors may have learned that they need to react quickly in order to preserve the value of their investment or avoid delays in receiving their redemption proceeds.

Further, the potential for larger swings in fund assets as investors invest and redeem in response to changes in the shadow prices is potentially disruptive to portfolio management, which would adversely affect a fund's return. We suggest also that publishing market prices places undue prominence on pricing service prices, which may not at times reflect the most current trading or analytical information.

In sum, we do not perceive there to be a meaningful benefit to disclosing shadow prices, regardless of the timing of the disclosure. Monthly disclosure yields stale information that illustrates the general proposition that market prices and amortized cost can deviate from each other but gives no information pertinent to a real-time investment decision. More frequent disclosure is not warranted in light of the absence of benefit justifying the cost of the exercise.

Disclosure of Realized Losses is Relevant to Investors

In contrast to deviation from amortized cost reflecting unrealized losses (or gains) in the value of fund holdings, we believe that disclosure of realized losses is relevant to investors, and that funds should report the impact of any realized loss on the fund's amortized cost per share at the same time as it reports its portfolio holdings, or more frequently as the fund considers appropriate. Such a loss is embedded in the fund's share price, and, unlike changes in market value based on changes in interest rates or third party sales, reflect the actual loss experience of the fund. While any such loss is reflected in a fund's financial statements, it may not be readily apparent to investors and giving it more prominence seems appropriate.

5. Proposed Rule 22e-3

The Committee supports the adoption of proposed Rule 22e-3, with certain recommended changes as noted below. The Committee also recommends that the Commission consider broadening the application of proposed Rule 22e-3 to include all registered open-end investment companies, not just those investment companies operating as stable value funds pursuant to Rule 2a-7.

(a) *General Need for Rules Addressing Market Liquidity Crises*

The promise of daily liquidity at net asset value is a key feature of the open-end mutual fund structure. This is particularly true in the case of money market funds, which typically offer investors same-day access to their funds. A fund's ability to meet investor expectations in this regard is, however, highly dependent on the liquidity of markets in which its portfolio investments are traded. In the days following the bankruptcy filing by Lehman Brothers, liquidity for many high quality money market instruments virtually disappeared and many money market funds facing significant redemption requests found themselves unable to obtain bids for their portfolio holdings except at distressed levels. In a few instances, funds facing major redemption requests from institutional investors found themselves unable to finance these redemptions in the ordinary course of business and were forced to suspend redemptions or pursue liquidation.

Section 22(e) of the 1940 Act specifically contemplated that a fund might need to suspend redemptions, or delay redemption payments for more than seven days, in circumstances when "an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets." This language is not self-operative, however, and Section 22(e) also charged the Commission with making "rules and regulations [to] determine the conditions under which . . . an emergency shall be deemed to exist with the meaning of [the statute]." The Commission has not issued any such general rules or regulations.

The rapid deterioration of liquidity in the money markets following the Lehman bankruptcy filing demonstrates, in our view, that it is not always practical for the Commission or its staff to respond in a timely fashion on a case by case basis during a rapidly evolving financial crisis. In such circumstances, we believe that the board of directors of each individual fund is in the best position to respond quickly to a developing emergency by evaluating the facts and circumstances of the particular fund and taking such action as it believes reasonably necessary to protect investors. Thus, we recommend that the Commission consider the promulgation of a general rule under Section 22(e) that would allow a mutual fund board to suspend redemptions, or delay payment of redemptions, during such emergency conditions as the board believes reasonably necessary to avoid harm to investors. As in the case of proposed Rule 22e-3, the Commission could require that notice of any such action be provided promptly to the Commission and reserve the power to overrule or modify the board's decision as it determined to be appropriate. We expect that mutual fund boards would use this discretionary authority sparingly, recognizing that a suspension of redemptions will likely result in many cases in the ultimate liquidation of the fund.

(b) *Elimination of Pre-Condition for "Breaking the Buck"*

Proposed Rule 22e-3 would apply only to money market funds that have calculated a price per share that is less than the fund's stable net asset value or, in common parlance, that "break the buck." We believe that this aspect of the proposed Rule is unduly restrictive and fails to recognize that, apart from the sudden and massive devaluation of financial obligations issued by Lehman Brothers, the issues faced by money markets funds during the ensuing days related primarily to liquidity and not pricing. Funds that faced a need to sell major blocks of high quality commercial paper were simply unable to find market bids at other than distressed prices. Since these "fire sale" quotations were not considered representative of the fair value of such holdings, as a general matter funds did not reflect such quotations in their pricing calculations. Otherwise, many more money market funds would have "broken the buck" during this period.

A fund that is unable to find sufficient liquidity at reasonable prices in the marketplace to meet redemption orders may reasonably conclude that liquidation is the best approach to assuring all investors of equal treatment, as opposed to continuing to process redemption orders in an environment where pricing and the ability to realize fair value on disposition of portfolio holdings is becoming increasingly uncertain. Thus, we believe that a board's finding that such conditions exist should be sufficient to trigger the application of the proposed Rule and that there is no need to require that fund's board actually price its shares below stable value in order to obtain the protections of the proposed Rule.

(c) *Implications of State Law Requirements; Broaden Application to Include All Open-End Funds*

As noted in the Proposing Release, the 1940 Act does not specify procedures for the liquidation of a mutual fund, which is generally a matter governed by state law. We believe it is important for the Commission to recognize the requirements of state law in crafting its general regulatory approach under Section 22(e) and in the promulgation of proposed Rule 22e-3.

While the specific procedures for liquidation may differ, depending on the applicable state law and the terms of the governing instruments, we believe that the following observations are generally pertinent. First, it is important to note that the right of redemption per se is not created by the 1940 Act, but rather arises as a matter of state law under the specific terms of a fund's governing instruments. (See the definition of "Redeemable Security" in Section 2(a)(32) of the Act, as well as Section 22(e) of the 1940 Act. Both sections refer to the "terms" of the security.) Upon the effective date of a liquidation of a fund, the operations of the fund and the rights of shareholders are fundamentally altered. The fund no longer conducts investment operations in the normal course of business and is solely engaged in the liquidation of its portfolio assets and the settlement of its obligations. The rights of shareholders of common shares are converted into a right to share on a pro rata basis in the net assets available for distribution upon completion of the liquidation. Thus, the right of redemption in the normal course cannot continue to be exercised following the effective date of liquidation, as that would interfere with the basic mandate that all shareholders participate ratably in the proceeds of the liquidation. As a practical matter, a liquidation represents a forced redemption of the shares of all shareholders pursuant to the terms of the fund's governing instruments and applicable state law.

The only remaining question is whether it is practical in the circumstances to complete the liquidation process and make final payments to shareholders within the seven-day period contemplated by Section 22(e). In the normal course of business, mutual fund organizations find it necessary from time to time to liquidate funds for various reasons. Most such cases involve funds that have failed to attract sufficient investor interest to reach viable size or, for reasons of performance or changes in market demand, have diminished in size to a level that is no longer viable. In these circumstances, the liquidation is normally implemented with ample notice to shareholders and following a plan that allows adequate opportunity to dispose of portfolio holdings in an orderly fashion, and to determine and pay all outstanding liabilities, prior to the effective date of the liquidation. In unusual circumstances, such as those faced by some funds during the recent financial crisis, implementation of a plan of liquidation in an orderly fashion may take considerably more than seven days, especially if relatively illiquid assets are involved or the fund requires additional time to resolve pending claims. For these reasons, we believe that it is inappropriate to view Section 22(e) as a rigid federal mandate that requires that all mutual fund liquidations be fully completed during a seven-day period, regardless of the potential impact on shareholder interests. The natural result of such a mandate would be to require a fund to accept less than full fair value for its assets and to overpay in order to settle its liabilities. Accordingly, we strongly support the Commission's proposal for a rule that recognizes that a fund is not required to process redemption requests following a adoption of a plan of liquidation and that allows fund boards to take more time, if deemed necessary to allow for an orderly liquidation, than the seven days required for payment of redemption proceeds in the normal course of business. Moreover, we do not believe that these considerations are necessarily limited to the particular context of money market funds and recommend that the Commission consider broadening the application of proposed Rule 22e-3 to all open-end funds.

Finally, we note that the application of proposed Rule 22e-3 is predicated on the approval of the liquidation of a money market fund by its board of directors. Most money market funds are organized as Massachusetts business trusts or Delaware statutory trusts under governing instruments that permit the board to approve a liquidation of the fund without shareholder approval. In such instances, the effective date of the liquidation can be immediate, with the legal consequences described above. In some cases, however, such as funds organized as Maryland corporations, shareholder approval may be required to implement a plan of liquidation. In such cases, the requirements of Section 22(e) would continue to apply pending receipt of shareholder approval until the effective date of the liquidation. Proposed Rule 22e-3 would clearly be necessary to allow for any suspension of redemptions by board action during the interim period.

(d) *Prior Notice should not be a Requirement*

We believe that the requirement for notification of the Commission prior to the suspension of redemptions under the rule is not necessary and could constrain the ability of fund boards to take actions they believe reasonably necessary to protect shareholder interests. For example, in the case of a board meeting held late in the day, allowing the fund's normal pricing time to pass could result in the fund being obligated to honor redemption requests at prices determined on that day, which might be more advantageous that prices available on following days, thereby frustrating the central objective of assuring equal treatment of all shareholders. We believe that prompt notice to the Commission after the fact should be sufficient to allow the Commission to intervene as necessary as contemplated by the proposed Rule.

(e) *Interim Offers of Liquidity to Shareholders Pending Completion of Liquidation*

The Proposing Release requests comment on whether a fund should be permitted to offer shareholders opportunities to liquidate their shares on specified terms prior to the completion of a plan of liquidation. As noted above, the general legal effect of adoption of a plan of liquidation is to convert the interests of all common shareholders into a right to receive a pro rata share of the ultimate net assets of the fund. We see no reason why a fund should not be permitted to make an offer to shareholders to repurchase their share on specified terms as long as the board believes that making such an offer is in the best interests of the fund and shareholders generally. Such an offer would be legally indistinguishable from a self-tender by any other issuer. While such offers may present issues as to the fairness of the terms of the offer, both from the perspective of tendering shareholders and remaining shareholders, we do not see this as presenting any novel issues that are not present in many other issuer tenders. As long as normal tender offer rules are followed, shareholders would not be coerced into accepting an offer and any offer that is over-subscribed would be pro-rated among all tendering shareholders. Such an offer might, for example, provide for payment in-kind through a pro-rata slice of the fund's portfolio holdings. Larger shareholders having the capability to accept and liquidate their share (or a portion of their share) of the fund's holdings might prefer to pursue that course rather than wait for the fund to make payment to all shareholders, while smaller shareholders generally would not be disadvantaged by such an offer. Such offers would become more problematic in circumstances where there are unresolved claims against the fund, but we believe that fund boards are capable of considering the implications of such claims in determining whether to make such an offer.

6. Proposal to Permit Two Categories of Money Market Funds

The Committee is proposing that there be two categories of money market funds: a category that maintains a stable net asset value and complies with the risk-limiting conditions similar to the Proposed Amendments ("Stable NAV Funds") and a category that has a floating net asset value based on market prices and complies with the less stringent risk-limiting conditions in current Rule 2a-7 ("Floating NAV Funds"). The Committee also is offering several suggestions to address potential investor confusion that may result from the bifurcation of what has traditionally been regarded as a single broad market category of fund investments.

(a) *The Committee's Proposal Creating Two Categories of Money Market Funds*

As discussed in Part 2 of this letter, above, the Committee believes that requiring all money market funds to float their shares prices would fundamentally alter money market funds as an investment product, especially to those retail and institutional investors who have come to rely on the stable share prices that most money market funds currently offer. The Committee acknowledges, however, that during the market turbulence in 2007 and 2008, a number of money market funds faced considerable difficulty in trying to maintain their stable share prices, and that the most significant difficulties were the result of heavy redemption activity by institutional investors. Moreover, the Committee agrees with the Commission's position as stated in the Proposing Release that additional restrictions might have averted many of the difficulties faced by money market funds during the recent market turbulence.

The Committee's proposal attempts to address the Commission's concern by conditioning the ability to maintain a stable share price on a money market fund's compliance with the terms of whatever new risk-limiting conditions ultimately are adopted. At the same time, however, a new category of Floating NAV Funds would be subject only to risk-limiting conditions substantially similar to those conditions contained in current Rule 2a-7, revised as the Commission deems appropriate.

The Committee agrees with the Commission's position that applying new risk-limiting provisions along the lines of those in the Proposed Amendments should reduce a Stable NAV Fund's credit, interest rate, spread and liquidity risks and thus make it easier for the fund to withstand market turbulence and maintain a stable share price. Recognizing, however, that "spikes" in institutional investor redemptions have been a common ingredient in each of the most significantly stressed money market fund scenarios recently experienced, the Committee believes that it would be productive also to consider additional steps that more directly address that particular risk. For the reasons set out below, we suggest that one means of doing so would be to allow Floating NAV Funds to be a truly differentiated money market investment option that would be attractive to institutional investors. The Committee's proposal - to subject Floating NAV Funds to risk-limiting conditions less-restrictive than those that apply to Stable NAV Funds - would allow Floating NAV Funds to pursue more flexible investment strategies than Stable NAV Funds, and thus, create the potential for higher yields, while at the same time continue to market themselves as "money market funds."

The growth of Floating NAV Funds side-by-side with Stable NAV Funds could, over time, result in a reordering of money market fund shareholder bases in which at least some meaningful segment of institutional investors seeking higher yields gravitate to Floating NAV Funds, while at the same time more conservative investors gravitate to Stable NAV Funds. Such an outcome would, the Committee believes, represent a kind of natural "safety valve" for the industry in which the investors most likely to trigger sharp redemption activity channel themselves, under market-based incentives, to a type of vehicle that would be less affected by such redemption activity.

It is the experience of the Committee members that many institutional investors favor money market funds that have the potential for high yield, even if that means that the fund pursues an investment strategy that is aggressive relative to other types of money market investments. In other words, for those institutional investors, the stability of the fund's share price could be less important than its yield. Yet Rule 2a-7 – both currently and as proposed in the Proposed Amendments – offers few incentives for institutional investors to invest in Floating NAV Funds.

Because the rule applies its risk-limiting conditions similarly to all money market funds, without regard to whether the funds maintain a stable share price or have floating share prices, money market funds with floating net asset values are unlikely to be able to adopt an investment strategy that offers enough potential to outperform a stable net asset value money market fund that an institutional investor would assume the added risk of a floating share price. Only if Rule 2a-7 imposes less rigorous risk-limiting conditions on the Floating NAV Fund relative to a Stable NAV Fund will institutional investors prefer Floating NAV Funds to Stable NAV Funds.[12]

Floating NAV Funds thus would be an important new avenue for money market fund sponsors to differentiate their offerings. By serving as an alternative investment option for some of the most mobile and yield-focused investors, the Committee believes Floating NAV Funds have the potential to structurally reduce stresses on Stable NAV Funds and to do so by leveraging natural competition in the industry.

(b) *Potential Problems with Permitting Two Categories of Money Market Funds*

The Committee recognizes that encouraging mutual fund sponsors to offer two types of money market funds - Stable NAV Funds and Floating NAV Funds - may create certain problems for fund sponsors as well as investors. For example, there are practical problems when a money market fund that historically has maintained a stable share price using the amortized cost method

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[12] The Committee believes that mutual funds that invest primarily in short-term, investment grade bonds ("short-term bond funds") generally are not a substitute for Floating NAV Funds. The Committee expects that Floating NAV Funds would be specifically managed as alternatives to direct investments in cash and money market instruments. Moreover, in order to call themselves "money market funds," Rule 2a-7(b) would require that Floating NAV Funds comply with the risk-limiting conditions relating to portfolio quality, portfolio maturity and portfolio diversification specified in Rule 2a-7(c)(2), (c)(3) and (c)(4), conditions that are intended to minimize share price volatility. In accordance with Rule 2a-7, currently and as proposed, those conditions would apply to all instruments held by a money market fund rather than just a significant portion of them.

Short-term bond funds, in contrast, are not necessarily intended as alternatives to investments in cash and money market instruments, even if they would invest in many of the same types of instruments as Floating NAV Funds. Moreover, short-term bond funds are not required to comply with any of the risk-limiting conditions applicable to money market funds. Many short-term bond funds permit investment in any investment grade security rather than in just securities that have received a rating in one of the two highest short-term ratings categories, and many permit investments in securities with longer remaining maturities than in which money market funds are permitted to invest. Even those short-term bond funds that are required to comply with Rule 35d-1 under the 1940 Act because their names refer to their investments in short-term, high grade bonds are only required to invest at least 80 percent of their portfolios in those types of securities. In accordance with the 1940 Act, the remainder of those portfolios may be invested in instruments of almost any quality or remaining maturity, and the portfolios as a whole are not subject to any average remaining maturity requirement, except those requirements that may be self-imposed.

transitions to a share price based principally on the market values of the underlying investments. Among other things, at the time of that transition, the money market fund's share price would have to reflect any realized losses previously incurred by the fund that, in the aggregate, are less than one-half of one percent of the fund's net assets.[13] We note, however, that transition problems are not unique to the Committee's proposal, and that the Commission would have to address them if it prohibited money market funds from maintaining a stable share price.

Moreover, there are problems of bifurcating a broad product market that investors have historically viewed as exhibiting particular characteristics. For decades, investors in registered funds have had assurance that a "money market fund" with "cash," "liquid," "money," "ready assets" or similar terms in its name meets one set of standards, and because of the proliferation of funds that maintain stable share prices, they have come to relate those names and that set of standards with money market funds that maintain stable share prices.[14] Therefore, a key question for the Commission and the public in considering the Committee's proposal is whether that long history equating money market funds with stable share price will cause insurmountable investor confusion. We believe that it will not, but admit that the task will be a challenging one. We outline proposals in the next section of this Part 6 that are intended to mitigate the potential for investor confusion.

(c) *Other Suggested Changes under a Two-Category System*

Should the Commission ultimately provide for both Floating NAV Funds and Stable NAV Funds, we suggest that the Commission (i) require specific disclosures intended to alleviate investor confusion between the two products, (ii) require Floating NAV Funds to have, at inception, a share price of $10 or greater, and (iii) consider applying investment minimums in Floating NAV Funds.

> <u>Disclosure Matters</u>. Again, we recognize that a key issue for the Commission and the public to consider in evaluating a two-category approach is that of whether investors can be brought to cleanly distinguish the two products. This is critical in that a founding principle of the Commission has been investor protection, with a longstanding corollary of seeking to prevent undue investor confusion. These issues also may be especially fresh in light of recent investor confusion arising out of target-date funds that have similar dates in their names, but follow different "glide paths."

The prospect of investor confusion is, of course, inherent in any approach that the Commission might take relating to money market funds that will modify long-settled practice. Regardless of the approach ultimately taken, investor education initiatives to be implemented by the money market fund industry are one option and should be encouraged under any circumstances that

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[13] In other words, these losses would be insufficient to cause the fund to the "break the buck."

[14] *See* Current Rule 2a-7(b)(3).

might significantly change the current landscape. But we acknowledge that it can be notoriously difficult for an initiative of this kind to achieve broad understanding of new concepts.

Accordingly, we believe that with respect to Floating NAV Funds offered alongside Stable NAV Funds, rigorous disclosure guidelines should be adopted. Potential approaches in this regard include requiring: (i) standardized disclosure on the cover of Floating NAV Fund's prospectus, such as "This is not a stable net asset value fund. The net asset value of this fund may change each day. Your investment may be worth more or less than the invested amount upon redemption of your shares."; (ii) inclusion of a standardized key word or phrase in a Floating NAV Fund's name (for example, "Current Price" or "Floating Price," as in the "ABC Prime Reserve Current Price Fund"); and (iii) inclusion of a standardized letter in a Floating NAV Fund's ticker symbol in the same way that the letter "X" in a ticker symbol typically denotes a mutual fund. While we do not believe standardization is necessary as to this last set of disclosures, we do believe that sponsors of Floating NAV Funds should be clear in the presentations regarding their funds that Floating NAV Funds are subject to different, and less stringent, risk-limiting rules than Stable NAV Funds. Of course, the final judgment as to the merits of a Floating NAV Fund versus a Stable NAV Fund is, from the investor's perspective, one of individualized suitability – disclosures of the type we suggest that clearly delineate the two types of offerings will help drive that home.

Floating NAV Starting Value. We believe that Floating NAV Funds should be required to have initial share prices of $10 or greater, and that permitting Floating NAV Funds to have initial share prices of $1.00 would defeat the purpose of the floating share price. It is our experience that mutual funds round their share prices used for calculating purchase and redemptions amounts to the nearest penny. As a result of such penny rounding, a mutual fund that has a net asset value per share of $1.00 would have to have a 50 basis point change in the value of the fund's portfolio securities (or a change of $5 million for a fund with $1 billion in net assets) before some or all of that change is reflected in the published share price. In contrast, a mutual fund that has a net asset value per share of $10 would have to have a 5 basis point change in the value of the fund's portfolio (or a $500,000 change if the fund has $1 billion in net assets) before some or all of that change is reflected in the published share price. As the Commission stated in the Proposing Release, a net asset value per share maintained by a money market fund at $1.00 may be insufficiently sensitive to market changes to prevent a run on the fund similar to the runs that occurred in September 2008. As demonstrated above, a $10 per share price is ten times more sensitive to changes in the values of the fund's portfolio securities than a $1.00 per share price, and in our experience, it is more consistent with share prices of mutual funds that have floating share prices.

Investment Minimums for Floating NAV Funds. Under the Committee's Proposal, it might be desirable to establish an investment minimum of, for example, $500,000 in a Floating NAV Fund (applied on a look-through basis in the case of omnibus accounts). Doing so would be a practical way to take Floating NAV Funds out of the hands of small investors. Because small investors are likely to face greater potential confusion about differences between Floating NAV Funds and Stable NAV Funds, investment minimums thus may have a role in addressing the investor confusion concerns we discussed above. If investment minimums were implemented, the Committee believes they would operate as a de facto "floor," with fund firms acting to, at least some degree, develop their own tailored requirements.[15]

(d) *Process for Rulemaking to Implement the Two-Category System*

The considered deliberation of any two-category system of money market funds on the part of the Commission and the public, whether the Committee's proposal or otherwise, will be critical to establishing such a system's merits or demerits as well as the efficacy of such a system relative to other proposals that may be offered. In the view of the Committee, establishing a two-category system therefore requires another formal Commission rulemaking proposal and another public comment period. Part of that process reasonably could include the input of investor focus groups of the type the Commission has relied on in developing other recent rule proposals.

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We appreciate the Staff's attention to this matter and its consideration of the issues we have raised. We would be pleased to discuss with you and other members of the Staff any aspect of this letter. Questions may be directed to Jay G. Baris at (212) 715-7515.

Respectfully submitted,

/s/ Jeffrey W. Rubin

Jeffrey W. Rubin
Chair

Committee on Federal Regulation of
Securities

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[15] In addition to fund firms developing their own tailored minimum investment rules for Stable NAV Funds, we expect that some firms will opt to control subscription levels for Stable NAV Funds. We do not, however, recommend that the Commission adopt a requirement that would limit the discretion of individual fund boards to establish subscription requirements for Stable NAV Funds. Rather, fund-by-fund determinations appropriately reflect the variety of market positions and investor profiles across the industry, and we see no basis for deviating from that long-standing principle. We note that there has been substantial recent activity in this area, demonstrating that money market fund boards and sponsors closely attend to the level of subscriptions appropriate to their particular funds. *See, e.g.*, Maxey, Daisy, "Low Treasury Yields Buffet Money Funds --- Some Managers Opt to Close Doors for a Bit," *The Wall Street Journal*, C11 (Dec. 11, 2008).

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