USAA®

September 8, 2009

VIA ELECTRONIC SUBMISSION ON FILE No. S7-11-09

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

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

Dear Secretary Murphy:

United Services Automobile Association (USAA) appreciates the opportunity to provide its comments to the U.S. Securities and Exchange Commission's (Commission) proposal to amend certain provisions of Rule 2a-7 (and certain other related rules) regulating money market funds (the Proposed Rule).[1]

USAA is a member-owned association that seeks to facilitate the financial security of its members and their families by providing a full range of highly competitive financial products and services, including insurance, banking and investment products. USAA Investment Management Company (IMCO), an indirect wholly owned subsidiary of USAA, serves as the investment adviser and distributor of the USAA family of no-load mutual funds, including the USAA money market funds (the Funds).

I. Summary:

We applaud the Commission's commitment to ensuring the continuation of money market funds as an investment vehicle of choice for many Americans. Money market funds provide a reliable short-term investment vehicle for the average investor. Money market funds also play a critical role in funding the short-term capital requirements for domestic corporations, and municipalities, as well as the federal government and its agencies. It is noteworthy that through the recent financial crises, money market funds on the whole were able to maintain their stable value without infusion of government money. Accordingly, we believe any reform in this area should be modest at most.

We support certain aspects of the Proposed Rule, but do not agree with others, as discussed more fully below. As USAA money market funds are all retail, it is particularly of note to us that the Proposed Rule contains a distinction between retail money market funds[2] (Retail Funds) and institutional money market funds[3] (Institutional Funds). USAA agrees with this distinction because as a general matter, Retail Funds: (1) require less liquidity, due to their smaller average daily cash

[1] *See Money Market Fund Reform,* SEC Release No. IC-28807 (June 30, 2009).
[2] Proposed Rule 2a-7(a)(24).
[3] Proposed Rule 2a-7(a)(17).

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flows; (2) pose less systemic risk, due to their substantially smaller average account size; and (3) have investors with goals that are different from those of Institutional Fund investors. We believe these distinctions should be further developed and reflected within any adopted amendments to Rule 2a-7.

II. USAA's Comments to the Rule 2a-7 Proposed Amendments:

A. Second Tier Securities: USAA opposes the proposed prohibition on investments in second tier securities. The Commission provides no empirical evidence to suggest that second tier securities played any role in the strains on money market funds in September 2008. To the contrary, the Commission acknowledged that "second tier securities were not directly implicated in the recent strains on money market funds."[4] The securities that caused disruptions to money market funds over the last two years, including structured investment vehicles (SIVs) and Lehman Brothers commercial paper, had first tier ratings until they defaulted.

Second tier securities can provide money market fund investors with attractive risk-return ratios. Given this characteristic, USAA believes the Commission should continue to empower advisers to make minimal credit risk determinations with regard to second tier securities, as opposed to relying solely on the rating agencies whose incentives are different than the fiduciaries responsible for investment decisions in money market funds.[5] Elimination of second tier securities takes a level of investment discretion out of the hands of the money market fund adviser and instead places exclusive reliance on the rating agencies' determination.

Second tier securities also enable the capital markets to function more efficiently by providing access to capital for certain corporations and municipalities. For example, a number of utilities with favorable business profiles, issue second tier securities. Without money market funds, these issuers would have difficulty raising capital.

Prohibition of second tier securities may also negatively impact first tier securities that are at risk of being downgraded, or conversely, second tier securities that are expected to soon be upgraded.

Issuers in the financial sector, which represents a large quantity of first tier issuers, typically comprise substantial holdings of money market fund portfolios. Second tier securities broaden money market funds' investment opportunities to more issuers outside of the financial sector. Therefore, a prohibition on second tier securities would likely further increase money market funds' concentration of credit risk within the financial sector.

Finally, any concerns with second tier securities could be addressed with a more targeted approach. For example, the Commission could limit the maturity of eligible second tier securities to 90 days or less. Such a requirement would meet the Commission's goal of reducing interest rate and market risk linked to second tier securities, but would also continue to allow money market fund investors access to the benefits of second tier securities.

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[4] *See Money Market Fund Reform*, Investment Company Act Release No. 28807 (June 30, 2009) at p. 26.

[5] The Commission previously raised this potential conflict of interest. *See Speech by SEC Chairman Shapiro; Statement at SEC Roundtable on Credit Rating Agencies*, (discussing the need for efforts to better align the credit rating agencies' interests with those who use the ratings, (the investors) as opposed to those who pay for the ratings) *available at*: http://www.sec.gov/news/speech/2009/spch041509mls.htm.

B. Liquidity: We believe overall portfolio liquidity is best addressed through the maturity limitations (*discussed in Section II.C)* and the daily and weekly liquidity requirements (*discussed in Section II.B.2)*, in the Proposed Rule, and not through the prohibition of investment in illiquid securities.

1. Illiquid Securities. USAA opposes the prohibition on illiquid securities in the Proposed Rule. USAA believes that the current level of investment in illiquid securities under Rule 2a-7 is appropriate. Illiquid securities provide money market funds with further diversification opportunities, which can reduce investors' credit risk.

From a market perspective, innovative security types are often introduced to the market as illiquid securities until a market develops. Without money market funds investing in illiquid securities, innovation in the issuance of new money market eligible securities would be stifled. Considering the value illiquid securities provide to money market fund investors and innovation in the securities market, and the fact that illiquid securities did not cause the market disruption in September 2008, imposing such a prohibition seems unwarranted.

2. Daily and Weekly Liquidity. USAA supports the Commission's efforts to increase liquidity in money market fund portfolios and agrees that the liquidity needs of Retail Funds and Institutional Funds should be distinct.

C. Portfolio Maturity: USAA agrees with the Commission's effort to shorten the limitations on weighted average maturity (WAM) within Rule 2a-7, but USAA believes Retail Funds' WAM should be greater than the level provided for Institutional Funds. In certain circumstances, longer maturity portfolios will benefit investors by allowing them access to higher yields. To balance the sensitivity of a money market fund portfolio's liquidity against investors' desire for acceptable yields, we would suggest a maturity of 75 days for Retail Funds.

D. Disclosure: USAA supports transparent and effective disclosure to investors. However, the Proposed Rule would cause Retail Funds and their investors to incur substantial costs. The benefit of this additional disclosure should be weighed against the cost to Retail Fund investors.

In this case, we believe that the benefits from monthly disclosure of portfolio holdings are outweighed by the costs to Retail Fund investors, who may be less likely to gain meaningful insight from such information, as compared to an Institutional Fund investor, with access to sophisticated systems and analytics. And, given the shortened maturity requirements in the Proposed Rule, as well as the portfolio turnover within money market fund holdings, the information could be stale as soon as it is posted.

Finally, if the Commission nevertheless adopts the proposed additional disclosure requirements, we urge the Commission to provide money market funds with substantially more than the two days currently allotted within the Proposed Rule.

E. Weighted Average Life: USAA opposes the concept of a weighted average life (WAL) within the Proposed Rule as it does not appear to address the current concerns of the Commission. We believe credit risk and liquidity risk are independent of and not influenced by a periodic interest rate reset feature. The WAL concept addresses interest rate and credit spread risk, but does not appear to address either credit or liquidity risk.

We believe that a more appropriate WAM calculation should reflect the earlier of the actual maturity of the instrument or the date upon which principal and interest is expected to be paid upon tender, instead of the security's next interest rate reset date. Therefore, in addition to opposing the WAL concept, we ask that the Commission reconsider the maturity shortening provisions in the WAM calculation currently in Rule 2a-7.

F. Portfolio Quality: USAA opposes the changes to the long-term ratings requirements of Rule 2a-7 relating to long-term securities with a remaining maturity of 397 days or less, and securities subject to conditional demand features.

We feel that long-term securities rated in the highest three rating categories would, upon a proper determination by the adviser, present minimal credit risk. Often securities rated in the top short-term rating category can also have a long-term rating in the single-A category. In addition, municipal securities rated in the single-A category often present significantly less risk than corporate securities rated several levels higher. We recommend the Commission leave the section of the rule relating to long-term securities with remaining maturities of 397 days or less unchanged.

For the same reasons we feel that securities subject to conditional demand features, whose underlying security or guarantee has received a rating in the two highest short-term or three highest long-term ratings could also present minimal credit risk. Therefore, we oppose the change within the Proposed Rule and in addition, request that the Commission consider allowing the purchase of securities subject to conditional demand features where the underlying security or guarantee has received a rating within the (two highest short-term or) three highest long-term ratings in any final rule.[6]

III. <u>USAA's Response to the Commission's Specific Requests For Comment</u>:

A. Floating NAV: USAA opposes any amendment to Rule 2a-7 that would require money market funds to enter into transactions at a floating net asset value (NAV).

The stable $1.00 NAV provides the tax reporting, accounting and operational efficiency that has made money market funds such a popular product with investors. Floating NAV transactions have different and more complex accounting standards and tax implications than stable NAV transactions, such as the calculation of gains and losses, wash-sales and "available-for-sale" designations. This ease of use is critical to money market funds' popularity. In addition to recordkeeping challenges for funds and investors, there would likely be costs related to the reconfiguration of systems that are hard-coded for a $1.00 NAV.

The stability of capital and the assurance provided to investors by the dollar-in versus dollar-out nature of the $1.00 NAV are hallmarks of the money market fund industry, which currently attracts $3.8 trillion in capital. In our opinion, once the stable NAV is eliminated, much of the capital currently invested in money market funds would flow to alternative investment vehicles that are beyond regulatory reach, or that do not fulfill the specific needs of investors.

[6] Conditional demand features (including municipal tender-option bonds) represent a significant portion of tax-exempt money market fund holdings.

B. Public Disclosure of Market Based NAV (the Shadow Price): USAA is opposed to a requirement to disclose Shadow Price. Such disclosure would not provide a meaningful benefit for Retail Fund investors, and to the contrary, could have unintended negative consequences. The disclosure of a Shadow Price below $1.00, but still in the acceptable range for Rule 2a-7, could cause the unpredictable flows and runs on assets that the Proposed Rule is intended to curtail.

In addition, there is a risk of undue influence by savvy investors that seek to take advantage of a depressed Shadow Price by redeeming prior to a formal breaking of the buck. In extraordinary market conditions, such pre-emptive behavior would create further abnormal volatility in cash-flows and increase the instability of the fund.[7]

C. Obligor/Guarantor Diversification: We oppose further restrictions on issuer and guarantor diversification. Changes to the single-issuer and guarantor diversification provisions within Rule 2a-7 are unnecessary.

Further reductions in issuer and guarantor limits within Rule 2a-7 would reduce flexibility in credit decisions and impair money market funds' ability to stay invested in high quality securities (where such securities are scarce) while also meeting regulatory diversification constraints. The impact of these provisions would be poignant in municipal and state specific money market funds where quality securities are even scarcer.

We also oppose the adoption of the Proposed Rule's provisions relating to guarantor diversification, urging further examination into the effect of such changes on the different types of money market funds before any rule proposal.

D. Industry Concentration: The Commission asked for comment with regard to the creation of an industry concentration limitation for money market funds. We oppose such an industry concentration for money market funds.

In closing, the turmoil in the financial markets in 2008 was caused by multiple unique circumstances that we do not believe necessitate an extensive overhaul of money fund regulation and Rule 2a-7. Money market fund investors, with one exception, suffered zero losses in the crisis of the previous year.[8] We believe that the crisis in 2008 was more causally related to the lax lending practices of banks, exacerbated by the securitization of sub-prime loans sold with "AAA" ratings, as opposed to any regulatory defect in the treatment of money market funds.

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[7] USAA notes that the disclosure of Shadow Price seems to be contrary to the proposed amendment to Rule 17a-9, which would allow affiliated persons of a money market fund to purchase distressed "eligible" securities from the fund. One of the purposes of Proposed Rule 17a-9(a) would be to avoid situations where a run on a money market fund is unintentionally caused by a potentially toxic asset within the fund's holdings that is still an eligible security. However, the purpose of Proposed Rule 17a-9(a) would be thwarted by the disclosure of a depressed Shadow Price, which may inadvertently lead to such a run.

[8] Investors in The Reserve Primary Fund are likely to receive almost 99 cents on the dollar. <u>The Wall Street Journal</u>, August 26, 2009 *available at* http://online.wsj.com/article/SB125122908210557947.html.

USAA appreciates the opportunity to provide comments on this proposal. If you have any questions regarding our comments, or would like additional information, please contact me at (210) 498-6508 or Chris Laia at (210) 498-4103.

Sincerely,

/s/ Clifford A. Gladson
Clifford A. Gladson
Senior Vice President, Fixed Income Investments
USAA Investment Management Company