Investment Management
522 Fifth Avenue
New York, NY 10036

Morgan Stanley

April 8, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Money Market Fund Reforms (SEC Release No. IC-34441)

Dear Ms. Countryman:

Morgan Stanley Investment Management Inc. ("MSIM")[1] appreciates the opportunity to provide feedback on the Securities and Exchange Commission's ("SEC" or the "Commission") proposed amendments to certain rules that govern money market funds under the Investment Company Act of 1940, as amended ("Investment Company Act").[2]

MSIM was an early provider of money market funds in the United States, having offered them since 1975. Today we manage government, prime and tax-exempt money market funds based in the United States ("US") — the Morgan Stanley Institutional Liquidity Funds — as well as internationally domiciled money market funds.[3] Our Global Liquidity Solutions business, which includes US money market funds operating pursuant to Rule 2a-7 under the Investment Company Act, international money market funds, ultra-short bond funds, and separately managed accounts, had a total of $393 billion in assets under management as of December 31, 2021. US money market funds account for the majority of the AUM of Global Liquidity Solutions ($297 billion).

The Morgan Stanley Institutional Liquidity Funds serve as a source of liquidity for large financial intermediaries, retail investors, US mutual funds, and fiduciaries, among others. Based on our history of managing and distributing a broad array of money market funds held by different types of fund investors across different jurisdictions, we believe we have a unique and valuable perspective and respectfully submit our views on the Release.

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1 MSIM is an SEC-registered investment adviser and is an indirect, wholly owned subsidiary of Morgan Stanley (NYSE: MS). As of December 31, 2021, MSIM, together with its affiliated asset management companies, had approximately $1.6 trillion in assets under management or supervision. Morgan Stanley is a global financial services firm that, through its subsidiaries and affiliates, provides products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

2 *See* Money Market Fund Reforms, SEC Release No. IC-34441 (December 15, 2021) ("Release"), available at https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.

3 MSIM sponsors funds operating under the European Union's Undertakings for Collective Investment in Transferable Securities ("UCITS") and its Money Market Fund Regulations ("MMFR"). UCITS that operate in conformity with MMFR have similar investment strategies to US money market funds managed by MSIM under Rule 2a-7.

I. Executive Summary

MSIM fully supports the SEC's goals of enhancing money market fund resiliency during stressed market conditions and of improving the transparency of money market funds. We agree with the Commission that the events of March 2020 demonstrate reforms are needed to Rule 2a-7. MSIM supports eliminating incentives for preemptive redemptions from institutional prime and tax-exempt funds and allowing those funds to use liquidity buffers more effectively to satisfy heavy redemptions that occur during stressed market conditions.

As discussed in more detail below, our letter focuses on the following key provisions of the Release:

- MSIM supports the SEC's proposed enhancements to certain reporting requirements for money market funds, including the proposed changes to the calculations of weighted average maturity ("WAM") and weighted average life ("WAL") of a money market fund portfolio.

- MSIM supports increasing daily and weekly liquid assets requirements. However, for the reasons discussed herein, the SEC should adopt a minimum weekly liquid assets threshold of 45% rather than the proposed 50% threshold.

- MSIM believes the increased liquidity minimums, coupled with the removal of the possibility of redemption gates, may be sufficient to meet the SEC's stated goal of mitigating the effects of large redemptions, and further efforts to address shareholder dilution may not be warranted. Indeed, before imposing significant additional regulatory burdens on money market funds, such as swing pricing or another anti-dilutive measure ("ADM"), we strongly encourage the SEC to further study the effects of increased liquidity minimums on improving the resilience of money market funds.

- Nonetheless, if the Commission believes that an ADM is necessary at this time, MSIM believes a simpler and more direct form of ADM would be far more effective than the swing pricing framework proposed in the Release. Instead of swing pricing, MSIM strongly supports an evidence-based non-discretionary liquidity fee of 2% triggered by net redemptions, the same metric the Release has proposed for swing pricing. To this end, MSIM supports the proposed removal of the redemption gate provisions from Rule 2a-7 and the delinking of liquidity fees and redemption gates from weekly liquid assets. An ADM using a liquidity fee – divorced from weekly liquid asset levels or the possibility of redemption gates – specifically charges first redeemers for the cost of their activity at a time of severe stress. Calibration of the trigger should be tied to levels of net redemptions that in fact indicate severe stress. MSIM's experience indicates this level should be 15% net redemptions over two consecutive trading days, which is substantially higher than the 4% proposed market impact threshold set forth in the Release. To facilitate implementation of any ADM, the SEC should require a standard T+1 settlement cycle for transactions in institutional prime and tax-exempt money market funds.

- MSIM strongly opposes the proposed amendments to address negative interest rates that would (i) prohibit a government or retail money market fund (a "stable NAV money market fund") from implementing a reverse distribution mechanism ("RDM") or routine reverse stock split and (ii) expand a stable NAV money market fund's obligation to confirm in advance that its financial intermediaries can fulfill shareholder transactions if the fund converts to a floating net asset value ("NAV") per share. As evidenced by European money market funds, RDM provides a more streamlined, practical and elegant solution to address the potential for negative interest rates than requiring stable NAV money market funds to convert to a floating NAV per share, with less unnecessary and damaging disruption to fund distribution. Seeking up-front assurances from intermediaries regarding their ability to handle conversions (and deconversions) between stable and floating NAVs is not necessary nor is it supported by the market and historical facts in the United States. We believe that the obligation to seek assurances from financial intermediaries would unnecessarily reduce assets in government and retail money market funds and could force investors to hold cash in demand deposit accounts, which likely would be harmful both to the investors making such deposits and to the banks receiving them, especially in a low or negative interest rate environment and under current prudential regulatory standards.

- In addition, the SEC should consider requiring financial intermediaries holding omnibus positions to provide data periodically and consistently to money market funds regarding the ten largest underlying clients (excluding identities) to assist money market funds in managing liquidity.

II. Updates to Certain Reporting Requirements

The SEC proposes to update reporting requirements for money market funds, including, among other things: (i) specifying that a money market fund must calculate the WAM and WAL of its portfolio using weightings based on the percentage of each security's market value in the portfolio; (ii) requiring a money market fund to publicly file a report on Form N-CR if the percentage of its total assets in daily or weekly liquid assets falls below 50% of the required levels; and (iii) adding several new disclosure items in Form N-MFP. MSIM generally supports these new reporting requirements.

III. Increased Daily and Weekly Liquid Assets

The SEC proposes to increase minimum daily liquid asset requirements from 10% to 25% and weekly liquid assets requirements from 30% to 50% for all money market funds and to remove provisions in Rule 2a-7 that permit (or under certain circumstances, require) a money market fund to impose liquidity fees or redemption gates.

MSIM supports the proposed increase in the daily liquid assets requirement to 25% of a money market fund's assets. Funds use daily liquid assets as the primary source of liquidity to meet redemptions, and by increasing the daily liquid assets requirement to this level, money market funds would have an adequate liquidity buffer to meet investor redemptions in stressed markets. Increasing the weekly liquid asset requirement to 50%, however, would have the negative effect of eliminating investment opportunities for investors with a higher risk appetite to achieve higher yields. As a result, we recommend that the SEC maintain the current 20% differential between daily and weekly liquid assets and adopt a weekly liquid asset threshold of 45% of a money market fund's assets.

The increased liquidity minimums, along with the removal of the possibility of redemption gates and the delinking of liquidity fees and redemption gates from weekly liquid assets as discussed below, may be sufficient to meet the SEC's goal of mitigating the effects of dilution from large redemptions. Money market funds regularly handle large redemption requests, and the SEC's proposals to increase the liquid assets requirements will make money market funds even more resilient to large outflows. In the SEC's stress testing of hypothetical portfolios, under the new proposed liquidity minimums alone, 91% of money market funds would not have been at risk of depleting their liquidity reserves even during the most stressed market conditions.[4]

Given this analysis, it may not be necessary to adopt further measures to address the potential for money market fund portfolios to become diluted. We strongly encourage the SEC to further study the effects of increased liquidity minimums on improving the resilience of money market funds before imposing significant additional regulatory burdens on money market funds.

IV. Anti-Dilutive Measures

As the SEC noted in the Release, when a fund must sell securities to meet investor redemptions, it can incur certain costs, such as spread and transaction costs, that may be effectively borne by remaining shareholders. An anti-dilutive measure, or ADM, is a tool used by a fund to seek to capture the costs of selling portfolio securities to meet shareholder redemptions and to mitigate the dilutive effects of large shareholder redemptions. An ADM can take many forms, such as a liquidity or redemption fee, levy, or swing pricing.

In the Release, the SEC proposed to adopt a swing pricing regime for institutional prime and tax-exempt money market funds to act as an ADM for those funds. Under the proposed regime, institutional prime and tax-exempt money market funds would be required to implement policies and procedures that require such a fund to adjust its NAV per share downward by a "swing factor," which reflects spread and transaction costs (and market impact, if net redemptions exceed a market impact threshold), when it experiences net redemptions during a "pricing period." The "pricing period" is the period of time in which an order to purchase or sell securities issued by the fund must be received to be priced at the next computed NAV.

We note that other regulatory bodies and organizations have presented an agnostic approach toward ADMs for money market funds. For example, the European Securities and Markets Authority ("ESMA") has recommended the availability of at least one ADM coinciding with the advice it received from its Securities and Markets Stakeholder Group ("SMSG") which states:

> Regarding the practical implementation, with swing pricing, a fund adjusts the NAV for inflows or outflows to take into account the costs of purchasing or selling assets of the fund. *The exact same result of cost allocation between investors is also achieved through anti-dilution levies (ADL), but it is implemented as an adjustment of the entry and exit charges of the fund, outside the NAV. Similarly, also a liquidity fee, on the exit side only, is implemented as an adjustment of the exit charges of the fund, outside the NAV*. These options should also be assessed from an operational standpoint. Time to market is essential for investors in [money market funds], as most [money market funds] offer same day liquidity. The more the practical specifications impose a high cost in time,

4 *See* Release at 92-93 (stating that under the proposed 25% and 50% daily and weekly liquid asset requirements, a fund would have only a 9% chance of running out of enough liquid assets to meet redemptions when faced with redemption levels similar to those experienced in March 2020).

expertise and complexity in calculation and implementation, frequency of use, etc., the higher the risk to generate side effects and make it inoperable.[5]

Additionally, the Financial Stability Board's ("FSB") final report on Policy Proposals to Enhance Money Market Fund Resilience endorsed alternatives to swing pricing to the extent that the alternatives will have similar economic effects. Specifically, FSB concluded that "it is possible to implement policies that are economically equivalent to swing pricing by imposing a cost on redeeming investors, *in the form of liquidity fees* or antidilution levies, rather than by changing the fund's NAV, when a fund's same-day outflows exceed a threshold."[6] FSB further stated that "if swing pricing is particularly difficult to put in place … it may be appropriate for that jurisdiction to adopt such economically equivalent policies as long as they are implemented in a manner that is likely to pass on to redeeming investors the costs they impose on the fund without creating incentives for pre-emptive runs."[7]

ESMA and FSB have recommended ADMs but are agnostic as to the form, and we believe the SEC should adopt the same approach by substituting for its proposed swing pricing regime a non-discretionary liquidity fee option as discussed below.

a. Non-Discretionary Liquidity Fee

If the Commission believes that an ADM is still necessary at this time in light of its other proposed changes (*i.e.*, increase in liquid assets requirements, removal of the possibility of redemption gates and delinking of liquidity fees and redemption gates from weekly liquid assets), MSIM believes a liquidity fee of 2% triggered by net redemptions is a simpler and more direct solution than swing pricing. In particular, the liquidity fee would be charged when such a fund experiences net redemptions of 15% over the course of two consecutive trading days, which is a level that, in MSIM's experience, could indicate severe market stress.[8] In order to assist funds in effectively implementing an ADM, the SEC should also consider requiring a standard T+1 settlement cycle for transactions in institutional prime and tax-exempt money market funds.

A non-discretionary liquidity fee—removed from the current liquidity fee framework that ties such fees to weekly liquid assets and redemption gates—can be a beneficial ADM. To this end, MSIM strongly supports the proposed removal of the redemption gate provisions from Rule 2a-7 and the de-linking of weekly liquid assets from the imposition of fees and gates. As the SEC acknowledged in the Release, it was the link between weekly liquid assets and the possible imposition of fees and gates that contributed most to investors' decisionsto redeem their shares

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5 Securities and Markets Stakeholder Group, SMSG response to the ESMA's Consultation Report on "EU Money Market Fund Regulation – legislative review" at 6 (emphasis added) (June 30, 2021), *available at* https://www.esma.europa.eu/sites/default/files/library/esma22-106-3439_smsg_advice_on_mmf_review.pdf.

6 *See* Financial Stability Board, Policy Proposals to Enhance Money Market Fund Resilience – Final Report at 26 (emphasis added) (Oct. 11, 2021), *available at* https://www.fsb.org/wp-content/uploads/P111021-2.pdf. ("FSB Report").

7 *See* FSB Report at 26.

8 MSIM recommends that the 15% trigger exclude certain events such as an intermediary reorganization, intermediary platform reconfiguration or other known or planned event unrelated to fund or market stress.

in money market funds in March 2020.[9] Investors were most concerned with the possibility of not being able to access their funds due to the imposition of a redemption gate rather than the cost of obtaining their funds (i.e., via a liquidity fee).[10] The existing liquidity fee/redemption gate framework masked the utility and precision of the liquidity fee to mitigate the "first mover advantage" during the market stress of March 2020. A non-discretionary liquidity fee based on net redemptions, without the association with weekly liquid assets or redemption gates, is a more surgical, understandable, and transparent tool to prevent material dilution of a shareholder's investment during severe market stress.

With respect to the amount of the non-discretionary liquidity fee, when the SEC adopted the liquidity fee and redemption gate provisions in 2014, it discussed at length its reasoning for requiring a 1% fee when a fund's weekly liquid assets dropped below 10% of its assets as well as the maximum fee of 2% when weekly liquid assets fall below 30% of the fund's assets.[11] The 2014 Adopting Release discussed a study conducted by the Division of Economic and Risk Analysis ("DERA") that concluded that market stress increases the average cost of obtaining liquidity by roughly 1%.[12] The SEC set the default liquidity fee at 1% and allowed fund boards to impose fees of up to 2%.

Other provisions in the Investment Company Act and rules thereunder have applied a 2% fee. Rule 22c-2 under the Investment Company Act permits a maximum 2% redemption fee. In adopting Rule 22c-2, the SEC stated that a 2% redemption fee was "designed to strike a balance between … preserving the redeemability of mutual fund shares while reducing or eliminating the ability of shareholders who rapidly trade their shares to profit at the expense of their fellow shareholders."[13] A non-discretionary liquidity fee would serve similar goals in the context of institutional prime and tax-exempt money market funds. Additionally, Section 10(d)(4) of the Investment Company Act allows a mutual fund board to be composed of interested persons of the investment adviser subject to certain conditions, including that "any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on redemption thereof, shall not in the aggregate exceed 2 per centum."

Since the adoption of the liquidity fee provision of Rule 2a-7 in 2014, money market funds and their sponsors have invested significant time and resources on investor education regarding liquidity fees. In addition, investors in other registered funds are already familiar with the concept of redemption fees under Rule 22c-2, which is a fee regime that has been in place for over 15 years. Likewise, sales charges and contingent deferred sales charges have been a staple of registered funds for many years. We believe investors understand and are comfortable with a fee-based regime, especially as compared to swing pricing.

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9 Release at 28.

10 Release at 29

11 Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014) at 95, available at www.sec.gov/rules/final/2014/33-9616.pdf ("2014 Adopting Release").

12 2014 Adopting Release at 97.

13 Mutual Fund Redemption Fees, Investment Company Act Release No. 26782 (March 11, 2005) at 12, available at https://www.sec.gov/rules/final/ic-26782.pdf ("Rule 22c-2 Release").

b. Liquidity Fees as an Alternative ADM to Swing Pricing

We believe that liquidity/redemption fees, which have been thoroughly researched by the SEC and DERA on multiple occasions, will be a more effective ADM than a novel swing pricing regime that has not been given the same level of analysis. Starting from scratch with swing pricing, when no US mutual fund has ever used it, is not supported by either appropriate study or market data. In addition, the proposed rule would require affected funds to use good faith estimates of market impact factors. As the Commission explained in the Release, it may be difficult to value assets without an active secondary market in times of severe liquidity stress in order to estimate these market impact factors.[14] These estimates would be up to the discretion of the funds and could lead to artificial manipulation of a fund's NAV. A liquidity fee—which does not impact a money market fund's NAV—is a better solution.

The SEC also has previously expressed the view that, in the context of money market funds, a fee-based system is more appropriate than swing pricing. Indeed, in adopting Rule 22c-1, the SEC determined not to include money market funds in a permissive swing pricing regime, stating that the current liquidity fees "serve a similar purpose as the NAV adjustments contemplated by swing pricing."[15] The SEC acknowledged "[w]e also believe that the liquidity fee regime permitted under rule 2a-7 is a more appropriate tool for money market funds to manage the allocation of liquidity costs than swing pricing" because of their "unique minimum liquid investment requirements."[16] The SEC further stated that swing pricing is ill-suited for money market funds because "money market fund investors … are particularly sensitive to price volatility."[17] We agree. The SEC was correct when it expressed its view in the Rule 22c-1 Release that a liquidity fee is a more appropriate tool in the money market fund context because of money market funds' unique liquidity profiles and their shareholders' sensitivity to principal volatility. The SEC should not reverse this position.

We also note that the swing pricing requirement, if adopted, could further drive assets away from institutional prime and tax-exempt money market funds that already suffered an exodus of assets after the 2014 reforms. In the 2014 Adopting Release, after acknowledging that money market fund investors are particularly sensitive to principal volatility, the SEC recognized that investors may reallocate assets away from institutional prime and tax-exempt money market funds that are required to float their NAVs. Indeed, as is noted in the Release, the 2014 reforms had the effect of reducing assets in these funds by roughly half.[18] By adopting a swing pricing regime that would further increase principal volatility in institutional prime and tax-exempt money market funds' NAVs, the SEC will further diminish assets in these products.

The proposed swing pricing requirement is also at risk of causing widespread investor confusion when shareholders redeem their shares for less value than they anticipated if swing pricing is in effect. Swing pricing would be entirely new to investors in the US market, as no US mutual fund

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14 Release at 186.

15 Investment Company Swing Pricing, Investment Company Act Release No. 32316 (October 13, 2016) at 24, available at https://www.sec.gov/rules/final/2016/33-10234.pdf ("Rule 22c-1 Release").

16 Rule 22c-1 Release at 24. We note that the SEC is concurrently proposing to increase and enhance these "unique minimum liquid investment requirements."

17 Rule 22c-1 Release at 25.

18 Release at 12.

has chosen to implement swing pricing even though it has been permitted since 2018. Swing pricing is less transparent than a liquidity fee and may have unpredictable effects on the value of an investor's redemption on a given day, which may lead to confusion on the part of investors.

One of the SEC's stated benefits for its swing pricing framework is that, when a money market fund's NAV is adjusted downward due to swing pricing, investors would be incentivized to buy shares of the fund, which would enhance the fund's liquidity during times of market stress. We do not believe that investors will buy shares of a money market fund during periods of market stress just because the fund's NAV has been slightly lowered. In fact, the SEC noted in the Release that investors redeemed over $100 billion—representing 30% of assets—from institutional prime and tax-exempt money market funds[19] despite the fact that these funds experienced declines in their market-based prices.[20] The SEC's assertion that swing pricing may help stabilize net redemptions is not supported by the data.

There is also the real risk that swing pricing presents the possibility that a fund's NAV could be adjusted by an unexpected amount when estimating market impact costs. MSIM believes that the lack of transparency related to unlimited market impact costs will lead to variations among funds and will only contribute to investor aversion to affected funds. By contrast, a modified fee regime at a fixed 2% would address these concerns. As discussed in more detail above, current Rule 2a-7 and other provisions in the Investment Company Act and rules thereunder have set an upper limit of the amount of a redemption or liquidity fee a mutual fund may charge at 2%. In the releases for Rule 22c-2[21] and the 2014 Amendments to Rule 2a-7,[22] the SEC stated that 2% was the appropriate level to balance an investor's need to redeem while protecting remaining investors from the effects of dilution.

c. Trigger for Application of an ADM

The trigger for implementing an ADM should be calibrated so that it is only in effect during periods of severe market stress. A trigger of net redemptions of 15% over the course of two consecutive trading days is appropriate, because, in our experience, it signifies severe market stress similar to the stress experienced in March 2020. Further, until this level of redemptions occurs, there is no meaningful dilution to remaining shareholders and, thus, an ADM would not need to be assessed until that time.[23]

As proposed, an institutional prime and tax-exempt money market fund would include market impacts as part of the swing factor when net redemptions reach 4% of fund assets. In the Release, the SEC stated that "[t]he proposed application of swing pricing … is intended to ensure that swing pricing is deployed *in times of severe stress* by all affected funds" (emphasis added).[24] A 4% market impact threshold is incongruent with severe market stress and is not an

19 Release at 15.

20 Release at 21.

21 *See* Rule 22c-2 Release at 12.

22 *See* 2014 Adopting Release at 97.

23 As noted in the Rule 22c-1 Release, "[the SEC anticipates] liquidity fees will be used only in times of stress when money market funds' internal liquidity has been partially depleted." *See* Rule 22c-1 Release at 25.

24 Release at 186-187.

appropriately calibrated ADM trigger, particularly when divided by multiple pricing periods as is currently proposed. For example, if an institutional prime or tax-exempt money market fund prices its securities three times per day, the threshold per pricing period would be 1.33%, which in our experience is not indicative of a severely stressed market. An institutional prime or tax-exempt money market fund may experience higher redemptions at certain times of day (*i.e.*, redemption orders may predominate in the morning), which increases the likelihood that a routine redemption request of 1.34% of the fund's NAV would trigger the calculation of market impact. This would occur even if the fund had no other redemptions for the rest of the day; an inappropriate result completely uncorrelated with severe market stress.

Institutional prime and tax-exempt money market funds are designed to handle large and frequent redemptions easily with minimal transaction costs. Redemptions of this level are frequent, such as when large institutions redeem to make payroll, pay taxes, and fulfill other payment obligations throughout the year. In some cases, fund managers are aware of large redemptions in advance and are able to plan for them in a way that eliminates the potential harm to remaining shareholders.[25]

The SEC estimated that the 4% threshold would only be triggered in roughly 5% of trading days.[26] However, the SEC also acknowledged in the Release that its analysis may over- or under-estimate how frequently the market impact threshold would need to be applied.[27] We believe the analysis greatly underestimates the number of times that the market impact threshold would be triggered for affected money market funds.

In discussing the March 2020 market events, the SEC noted that publicly offered institutional prime funds experienced outflows of approximately 20% of assets during the week of March 20, with the largest weekly and daily redemption rate being 55% and 26%, respectively.[28] Our proposed trigger of net redemptions of 15% over the course of two consecutive trading days is more indicative of this type of severe market stress.

A net redemption test for triggering a liquidity fee is unlikely to have the negative effects associated with the current weekly liquid assets threshold link to redemption gates or liquidity fees. As explained in the Release, the connection between liquidity fees and redemption gates and the 30% weekly liquid assets threshold acted as a damaging "bright line."[29] Investors accelerated redemptions from institutional prime and tax-exempt money market funds in March 2020 in order to avoid potential liquidity fees and, most notably, redemption gates. As a result, as the Release explained, many fund managers sold assets with longer maturities to maintain their funds' weekly liquid asset levels above the 30% threshold.

Unlike the weekly liquid assets threshold, a net redemption trigger would avoid this phenomenon. Investors would not have an incentive to redeem their investments before the fund crossed a certain level of liquid assets. Moreover, fund managers would not have an

25 As discussed in Section VI below, we are also suggesting that the SEC require omnibus intermediaries to provide information on large client activity to assist money market fund managers in planning for large redemptions.

26 Release at 193.

27 Release at footnote 362.

28 Release at 15.

29 Release at 29.

incentive to sell longer maturing assets in order to avoid crossing the weekly liquid assets threshold because the two would no longer be connected, reducing the risk that money market fund portfolios would become artificially diluted. A non-discretionary liquidity fee, moreover, would be automatic and would not require emergency action by a money market fund's board of directors.[30]

d. T+1 Settlement

The SEC should require a standard T+1 settlement cycle for transactions in institutional prime and tax-exempt money market fund in order to allow money market fund managers to more effectively implement an ADM.[31] Requiring T+1 would condition investors who desire immediate liquidity to invest in government money market funds. Institutional prime and tax-exempt money market funds would no longer be appropriate for an investor who immediately needs access to cash but would serve as a vehicle for an investor who is seeking a higher yield.

V. Impact of Potential Negative Interest Rates on Stable NAV Money Market Funds

The SEC proposed to expressly prohibit a stable NAV money market fund from reducing the number of its shares outstanding to maintain a stable share price (*e.g.*, through an RDM or a routine reverse stock split) in a negative interest rate environment. Additionally, the SEC proposed to require stable NAV money market funds to determine that their financial intermediaries are able to process share transactions at a floating NAV per share, and, if not, to prohibit those financial intermediaries from purchasing the fund's shares in nominee name.

As noted in the Release, the Federal Reserve has established the lower bound of the target range for the federal funds rate at 0.00% twice during the past 15 years. While the US has not pursued a negative interest rate policy in the past, negative interest rates have been used in both Europe and Japan. The Release stated that if interest rates and the gross yield of a stable NAV money market fund's portfolio turn negative, it would be challenging or impossible for the fund to maintain a stable share price. As currently in effect, Rule 2a-7 does not address how stable NAV money market funds must operate if and when interest rates are negative.

Rule 2a-7 permits stable NAV money market funds to use the amortized cost and/or penny-rounding accounting methods so long as the fund's board of directors believes that the stable share price fairly reflects the fund's market-based NAV per share. Stable NAV funds that use the amortized cost method are nevertheless required to periodically calculate the market-based value of their portfolio ("shadow price") and compare it to the fund's stable share price. Rule 2a-7 requires such a fund's board to consider what action should be taken (if any) in the event that the deviation between the stable share price and shadow price exceeds ½ of 1 percent. In addition, Rule 2a-7 requires the board to consider what actions should be taken to prevent material dilution or other unfair results to current shareholders, regardless of the extent of the deviation. In the Release, the SEC stated its belief that if negative interest rates turn a stable NAV fund's gross yield negative, the board of a stable NAV money market fund could

30 The proposed liquidity fee would be automatically removed when fund flows normalize.

31 Requiring a T+1 transaction cycle could also have benefits if the SEC chooses to adopt the swing pricing framework as proposed. Under the SEC's proposed swing pricing framework, the SEC notes in the Release that funds may need to move to earlier cut off times for redemption orders in order to calculate and apply the swing factor and market impact threshold, if any. By moving to a T+1 cycle, funds would have additional time to calculate these factors and process transactions.

reasonably require the fund to convert to a floating NAV to prevent material dilution or other unfair results to its shareholders.

a. RDM or Routine Reverse Stock Split

An RDM is a process in which a stable NAV money market fund reduces the number of its outstanding shares in an amount equal to the negative yield each day. These negative distributions are allocated to shareholders on a *pro rata* basis. Similarly, a reverse stock split is a process that reduces the number of shares in an investor's account in order for the fund to maintain a stable NAV per share. European money market funds implemented RDM during a period of time when the European Central Bank pursued a negative interest rate policy. RDM is no longer used in Europe following a series of regulatory reforms completely unrelated to the effectiveness of RDM.

MSIM strongly opposes the proposed amendments to address negative interest rates that would prohibit a stable NAV money market fund from implementing an RDM, routine reverse stock split, or other device that would periodically reduce the number of the fund's outstanding shares to maintain a stable share price. RDM is simple and cost-effective tool that has been proven to work in negative rate environments. The board of a stable NAV money market fund should continue to be able to use its reasonable business judgment to determine that the use of an RDM is in the best interest of investors to address a deviation in the fund's shadow price or to prevent a material dilution or other unfair results to current shareholders. We believe that an RDM can be implemented in the United States in the same manner as it was used in Europe during periods of negative rates without widespread investor confusion. We also note that forcing money market funds to move from a stable NAV to a floating NAV would likely have the unintended consequence of making money market funds inaccessible to retail brokerage investors.

MSIM believes RDM may be preferable in a negative interest rate environment for several reasons. First, RDM is a more streamlined and practical solution than transitioning to a floating NAV per share. In this regard, we note that it is possible that a negative interest rate environment could be short lived. If a stable NAV money market fund were required to transition to a floating NAV per share, and then the interest rate environment quickly returned to positive levels, it would be desirable for the fund to transition back to a stable NAV per share. It would be reasonable and within the business judgment of a board of a stable NAV money market fund to determine that implementing an RDM would result in better outcomes for investors than converting to a floating NAV or liquidating when faced with a negative yield environment.

Second, investors will not be misled or confused by the use of RDM, as it can be implemented in a manner that is clear to retail and institutional investors alike. Stable NAV money market funds that may consider using RDM could disclose this fact in plain English in their registration statements and can alert investors of the use of an RDM through supplements, website disclosures, or other investor communications. While the Release noted that European money market funds that implemented an RDM were primarily held by institutional investors rather than a mix of retail and institutional investors (as is the case in the US), we note that the US retail investor market is heavily intermediated and such intermediaries also will be well equipped to explain the consequences of RDM to their clients/customers.

Third, we note that many investors may prefer to invest in a stable NAV money market fund using RDM as opposed to one with a floating NAV per share or other cash management vehicles, such as demand deposit accounts, when faced with a negative rate environment. Stable NAV money market funds, especially government money market funds, offer a safe haven for investor in times of uncertainty. Indeed, investors flocked to government money market funds in March 2020. Moreover, as discussed below, because stable NAV money market funds are often used in sweep programs and many intermediaries are not currently able to transact in floating NAVs, prohibiting RDM as a tool to combat negative rates could have the effect of removing these funds as an option for many investors. Additionally, stable NAV money market funds may be preferable to investors because they often carry additional features, such as check writing or ATM access. If a stable NAV fund was forced to convert to a floating NAV fund, many of these features would no longer be available to investors.

Overall, MSIM believes the SEC should not move forward with a proposal that would remove a tool that has been proven effective at helping money market funds operate in negative interest rate environments. Given that stable NAV money market funds are often the investment of choice for investors in times of great uncertainty, we believe that effectively removing that choice in what would be a profoundly unprecedented situation is not in the best interests of stable NAV money market funds or their shareholders.

b. Agreements with Intermediaries

We also oppose the SEC's proposal to require stable NAV money market funds to confirm in advance that their intermediaries can fulfill shareholder transactions if they convert to a floating NAV per share. MSIM notes that many sweep programs, such as those for retail brokerage platforms, operate on a "dollar in, dollar out" infrastructure that cannot accommodate a floating NAV. Those intermediaries would be required to build that infrastructure, which could be prohibitively costly. To the extent they do not dedicate resources to be able to price a stable NAV money market fund at a price other than $1.00, those intermediaries may not be able to provide the required representations to the fund and, thus, will not be eligible to offer shares of the fund. This would remove stable NAV money market funds as an option for investors, which as discussed above, are often the vehicle of choice for investors in uncertain market conditions, and would unnecessarily reduce assets in those funds, which were not subject to the large redemption pressures in March 2020.

We also note that retail and government money market funds regularly work with their financial intermediaries to meet the needs of various types of investors. If a stable NAV money market fund were to convert to a floating NAV per share, the fund and its intermediaries would work together to implement the change, taking into account the needs of investors. If interest rates were to turn negative, a stable NAV money market fund may still be able to generate positive yields on its other portfolio investments for a period of time while it and its financial intermediaries determine the best course of action. As discussed above, a negative rate environment could be short lived and may not in effect turn a fund's gross yield negative over a long period of time. Under these circumstances, the costs of requiring intermediaries to confirm up front their capability to handle a floating NAV for stable NAV funds far outweigh any perceived benefits by a wide margin. Therefore, we do not believe it is necessary or appropriate for the SEC to adopt a new provision of the rule to address an unlikely event that has never occurred in the US.[32]

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[32] The costs associated with this proposal appear to be significant, and include the administrative burden on funds to obtain the required certifications and maintain records regarding the certifications for dozens or even hundreds of intermediaries. Intermediaries also face the possibility of costs associated with building the infrastructure needed to accommodate a floating NAV fund, or if they are unable or unwilling to build such infrastructure, the attendant costs to the funds and their shareholders of having these distribution channels cut off.

We also note that money market funds derive a significant portion of their assets through financial intermediaries. If the intermediary channel were disrupted, investors who would otherwise have held shares in a stable NAV money market fund could be forced into holding cash in demand deposit accounts. Such a development likely would be harmful both to the investors making such deposits and to the banks receiving them, especially in low or a negative interest rate environment. From the banks' perspective, we have observed that banks, as prudent managers of their balance sheets and capital positions and subject to comprehensive regulation, may not be in a position or otherwise willing to accept large deposits of cash if investors are forced to abandon government money market funds. In this respect, the banks' traditional concern about their ability to safely and profitably invest such deposits is exacerbated by the fact that intermediated deposits are likely to be considered brokered deposits under the FDIC's regulations, subjecting banks to higher insurance costs. From the investors' perspective, replacing stable NAV government money market funds with bank deposits will expose them to the credit risk of the banks to the extent the deposits exceed FDIC insurance limits and/or increased costs from programs that seek to spread deposits among multiple banks. In short, by driving assets away from government money market funds, the proposed amendments could disrupt one of the most significant sources of short-term credit for public and private investors alike and impose additional costs on an already stressed banking system. We strongly urge the SEC to consider carefully the potentially far-reaching consequences of this change and the global banking standards implicated.

VI. Additional Considerations

We recommend that the SEC consider mandating that financial intermediaries holding omnibus positions provide money market funds with additional information regarding large underlying shareholders to assist money market funds in managing liquidity. When an institutional investor purchases shares directly from a fund, fund managers can work with the investor to understand their liquidity needs and plan for large scale purchases and redemptions, such as when proceeds from a bond issuance are ready to be invested or when shares need to be redeemed to meet tax payments or employee payroll. By contrast, when funds are invested via omnibus accounts of financial intermediaries, money market fund managers have less information regarding the underlying holders of the securities or their liquidity needs. As a result, MSIM recommends that the SEC consider requiring financial intermediaries holding shares in an omnibus account to provide data periodically and consistently to money market funds regarding the ten largest underlying clients (not the clients' identities). This data would be helpful to money market fund managers in better managing the overall liquidity of the funds they manage and ultimately make the funds more resilient.

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MSIM appreciates your consideration of its perspective on these important issues facing money market funds and their investors. We would welcome the opportunity to provide any additional information that the Commission might find useful. Please do not hesitate to contact the undersigned with any questions.

Respectfully submitted,

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Jonas Kolk

Managing Director, Chief Investment Officer and Co-Head of Global Liquidity Solutions
Morgan Stanley Investment Management Inc.

cc: The Honorable Gary Gensler
The Honorable Allison Herren Lee
The Honorable Caroline A. Crenshaw
The Honorable Hester M. Peirce
William A. Birdthistle, Director, Division of Investment Management