April 11, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: Money Market Fund Reforms (Release No. IC-34441; File No. S7-22-21)

Dear Ms. Countryman:

Charles Schwab & Co, Inc.[1] ("CS&Co") and Charles Schwab Investment Management, Inc.,[2] ("CSIM" and, collectively with CS&Co, "Schwab") appreciate the opportunity to provide comments on the December 2021 proposals by the Securities and Exchange Commission (the "Commission") to reform money market funds (the "proposal").[3]

CSIM is one of the largest managers of money market fund assets in the United States, with 11 money market funds and $146.5 billion in assets under management as of December 31, 2021. Approximately $78 billion of those assets are in prime money market funds (including an institutional fund with a floating net asset value); $12 billion are in tax-exempt money market funds (or "municipal money market funds"); and $56 billion are in government and treasury money market funds ("government money market funds"). Money market funds provide investors with stability, convenience, liquidity and yield. CSIM's money market fund offerings are primarily used by clients of CS&Co and other Schwab affiliates. The Schwab Money Fund offerings appeal to individual retail investors and investment advisers who service individual investors to help manage their cash. Cash is a critical component of the portfolios of individual investor clients, offering a level of flexibility that helps them both manage their day-to-day

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[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with 33.3 million active brokerage accounts, 2.2 million corporate retirement plan participants, 1.6 million banking accounts, and $7.8 trillion in client assets as of January 31, 2022. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiaries, CS&Co, TD Ameritrade, Inc., and TD Ameritrade Clearing, Inc., (members SIPC, https://www.sipc.org), and their affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent, fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its primary banking subsidiary, Charles Schwab Bank, SSB (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at https://www.aboutschwab.com.

[2] As of December 31, 2021, Charles Schwab Investment Management, Inc., dba Schwab Asset Management™ ("Schwab Asset Management") managed approximately $635.8 billion on a discretionary basis and approximately $41.5 billion on a non-discretionary basis. Schwab Asset Management provides non-discretionary advisory services to the Schwab Trust Bank Collective Investment Trusts, including research and recommendations relating to asset allocation, portfolio construction, cash-flow monitoring and advisor selection and retention. Some trusts include multiple unit classes. More information is available at www.schwabassetmanagement.com.

[3] 87 Fed. Reg. (February 8, 2022) at 7248.

finances and reach their longer-term financial goals. It is through our clients' eyes that we respond to the reform proposals.

Overview

As we detailed in our 2021 letter[4] in response to the Commission's request for comment on the President's Working Group ("PWG") on Financial Markets December 2020 report[5] on money market fund reform, Schwab has been an active voice in the ongoing debate over money market fund regulation for more than a decade. We supported the 2010 and 2014 reforms to Rule 2a-7 of the Investment Company Act of 1940 (the "1940 Act") and believe those changes have, for the most part, increased transparency, reduced the risk of runs and enhanced the stability of money market funds. As the market has evolved since the implementation of those improvements to Rule 2a-7, so too has our thinking about the regulatory environment for money market funds evolved. Market volatility in March 2020 underscored that additional measures are needed. We believe that additional reforms could further strengthen the resiliency of these funds, particularly during periods of market volatility, and we welcome the Commission's latest attempt to do so.

Our letter addresses these key points:

- The SEC should require all prime and tax-exempt money market funds to operate with a floating net asset value ("NAV").
- Government money market funds should continue to operate with a stable NAV, given the backing of their assets by the full faith and credit of the federal government and their importance to sweep functionality.
- Schwab supports removing the liquidity thresholds for imposing liquidity fees and redemption gates, but recommends that the Commission permit funds to retain the option of imposing liquidity fees in extraordinary market circumstances.
- Schwab opposes requiring certain funds to implement swing pricing and requiring stable NAV funds to convert to a floating share price in negative yield environment.
- Schwab does not oppose the Commission's proposals for increased daily and weekly liquidity requirements and generally supports the additional stress testing and reporting requirements.

Schwab continues to believe that the best approach for enhancing the resilience and transparency of money market funds is to require all funds, with the exception of government money market funds, to have a floating net asset value. We recognize that the Commission considered this approach in its 2021 proposal and decided to promulgate other solutions. We urge the Commission to reconsider the floating net asset value approach. Requiring a floating NAV addresses the fundamental structural issue in money market funds: that these funds, like all investments, fluctuate in value in different market conditions but are marketed and priced as though their price does not fluctuate. The combination of the anachronistic stable NAV and a history of Federal Reserve intervention in times of stress has created a misperception that assets in a money market fund are guaranteed to maintain a stable price of $1.00 per share. This fundamental disconnect makes money market funds more susceptible to runs in periods of

[4] See comment letter from Rick Wurster, then-executive vice president, Schwab Asset Management Solutions, April 12, 2021, available at: https://www.sec.gov/comments/s7-01-21/s70121-8664049-235346.pdf ("Wurster comment letter").
[5] 86 Fed. Reg. (February 10, 2021) at 8938.

market volatility, exacerbates stress in the short-term funding markets, and increases the likelihood that government institutions and taxpayer dollars will again be needed to reduce future potential stresses. We continue to believe that government money market funds, which do not have the same vulnerabilities, should continue to be permitted to operate as stable NAV products with a constant price of $1.00 per share.

Schwab believes that its recommendation of requiring a floating NAV for all prime and tax-exempt money market funds obviates the need for two of the Commission's other proposals: requiring certain funds to implement swing pricing and requiring that stable NAV funds convert to a floating share price if market conditions result in negative fund yields. Both proposals involve enormous operational cost and complexity in order to be able to execute price adjustments *only in certain circumstances*. These elements of the Commission's proposal will increase, rather than decrease, investor confusion. A more logical solution is to make it clear to all investors in prime and municipal money market funds that the share price floats *in all circumstances*. Schwab's proposed solution simplifies money market funds for all investors. We do believe that there should continue to be a distinction between prime retail and prime institutional funds, even if both types of funds have a floating NAV. As March 2020 demonstrated, institutional investors tend to redeem more quickly than retail investors in times of market stress. If retail and institutional investors are co-mingled in the same fund, the result can be that institutional investors will retain a first-mover advantage over retail investors. Continuing to separate the two alleviates this problem.

At the same time, we believe several of the other proposals put forward by the Commission are sensible and, when combined with requiring all prime and tax-exempt money market funds to have a floating NAV, will significantly enhance the stability and transparency of the money market fund sector. We support increasing daily and weekly liquidity requirements for all money market funds. We support the elimination of the bright-line trigger for the imposition of liquidity fees and redemption gates, as well as the elimination of redemption gates from the rule entirely[6], but recommend retaining liquidity fees as an option for fund boards to utilize in periods of extraordinary market stress. We support the additional stress testing and reporting requirements. Together with a floating NAV requirement for prime and tax-exempt money market funds, we believe these proposals will meet the Commission's primary goal of creating a stable and sustainable regulatory environment that will ensure that money market funds remain an important option for individual and institutional investors. This combination of proposals will also mitigate the concerns in volatile markets that have required Federal Reserve intervention – and forced the Commission to propose adjustments to Rule 2a-7 for the third time in 12 years.

Floating NAV for all Prime and Tax-Exempt Money Market Funds

At the heart of Schwab's recommendation to the Commission is requiring all prime and tax-exempt money market funds to operate with a floating NAV – all the time, in all market circumstances. The primary benefit of requiring all prime and tax-exempt money market funds to operate with a floating NAV is to make it clear to investors that investing in such funds carries risk and that the complete return of an investor's principal is not guaranteed. It also eliminates any chance of a fund "breaking the buck" by seeing its share price drop below $0.995, the

[6] As noted below, we recommend retaining the ability of funds to suspend redemptions as part of an orderly liquidation process.

threshold below which a fund can no longer continue rounding its price to the stable $1.00 per share under current rules. Only one major fund has broken the buck[7], in 2008, but it sparked a widespread run on money market funds that required Federal Reserve intervention and launched a series of revisions to Rule 2a-7 with the goal of preventing such a scenario in the future. No funds broke the buck, or even came particularly close to breaking the buck[8], during the March 2020 volatility. But the possibility continues to exist as long as these funds continue to rely on an anachronistic accounting technique. As the Commission states in the proposal, "To the degree that investors in stable NAV funds are currently treating them as if they were holding U.S. dollars due to a lack of transparency about risks of such funds, enhancing the scope of the floating NAV requirements may enhance investor protections and enable investors to make more informed investment decisions."[9] We agree and, further, believe that this should be the Commission's overarching goal in the reform of money market funds: to enhance investor protections and help investors make better investing decisions.

The current structure of stable NAV prime and tax-exempt money market funds creates the potential for a significant first-mover advantage, wherein early redeemers are likely to get full value for their shares, while losses are concentrated among later redeemers and non-redeemers. With a floating NAV, fund sponsors simply redeem each investor's shares at the calculated NAV. To be clear, a floating NAV does not remove the first-mover advantage. Early redeemers are likely to get a better price than late redeemers in a falling market, but this is true with all investments and thus familiar to investors. Indeed, Schwab believes the Commission has set for itself an impossible goal when it discusses in the proposing release the concept of "eliminating" the first-mover advantage. In the Commission's discussion of its reasoning for not proposing an expansion of the scope of floating NAV requirements for a broader array of money market funds, the Commission states that "floating the NAV may reduce, but does not eliminate, the first mover advantage and corresponding run incentives during selloffs."[10] That is true. But if the goal of the Commission is to eliminate the first-mover advantage, the Commission will be sorely disappointed. The very nature of investing is such that the first investor to sell his or her shares in a downward-moving market is likely to get a better price than the investors who do so seconds, minutes, hours or weeks later. We do not believe the Commission should be in the business of trying to *eliminate* risk for investors. Rather, we believe the Commission should be focused on ensuring that investors *understand* the risk of the products they are investing in. Indeed, it is a part of the Commission's core mission to protect investors. A floating NAV would make it clear to prime and tax-exempt money market fund investors that there is risk – modest risk, perhaps, but risk nonetheless – to investing in these products. Requiring retail prime and tax-exempt money market funds to have a floating NAV would also reduce the likelihood that official sector interventions and taxpayer support will be needed to halt future money market fund runs. Similar to other types of floating NAV mutual funds, there would be no expectation by investors of government support or intervention.

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[7] It is also the case that a number of funds received sponsor support during the 2008 financial crisis to ensure that they did not break the buck.

[8] In the proposing release, the Commission notes that only one retail tax-exempt fund and no institutional funds saw their price drop below $0.9975 in March 2020, while only when a fund's price drops below $0.9950 is the fund considered to have "broken the buck." (87 Fed. Reg., at 7254).

[9] 87 Fed. Reg., at 7317.

[10] 87 Fed. Reg., at 7318.

We also reject the Commission's assertion that "floating the NAV would not incentivize stable NAV fund managers to hold enough liquid assets and to have low enough credit risk to meet redemptions in times of stress."[11] The Commission's proposal addresses this issue by requiring increased daily and weekly liquid asset minimums. As we discuss below, we support these increased liquid asset requirements for floating NAV money market funds. We believe that pairing these liquidity requirements with a floating NAV should ensure that these funds have enough liquidity to meet redemption needs in even the most extraordinary market circumstances.

The Commission outlines other concerns with requiring a floating NAV for a broader array of money market funds. One is that it "may reduce attractiveness of affected money market funds to investors and may result in significant reductions in the size of the money market fund sector."[12] We agree that it is likely that prime and municipal money market funds will experience outflows while stable NAV government money market funds are likely to see inflows, particularly early in this transition. Some of those dollars may flow to banks that can offer deposit insurance. But we think a transition to a floating NAV will be much smoother than the transitions that would be required under some of the Commission's other proposals. Education about the transition will be necessary for retail investors, just as institutional investors were educated when institutional prime money market funds became floating NAV funds after the 2014 reforms. But as we discuss below, we believe that requiring swing pricing for certain types of funds and requiring all money market funds to suddenly convert from stable NAV to floating NAV if market conditions result in negative yields will be much more disruptive. In those cases, the move from a stable $1.00-per-share price to a floating share price would happen abruptly, with virtually no warning for investors or transition period for fund managers. We think such a situation would be confusing for investors and a far greater systemic risk than an orderly transition for all prime and tax-exempt money market funds to a floating NAV during a thoughtful implementation period. We also think that floating NAV money market funds would continue to be a competitive option with other cash management vehicles, particularly as investors understand that price fluctuations will continue to be minimal given the liquidity and credit quality requirements of Rule 2a-7. Investor demand for money market funds will continue to thrive, as investors seek better returns for their cash than they can get from banks.

The Commission also raises concerns with the operational, accounting and tax challenges that would stem from a switch from stable NAV funds to floating NAV funds. However, the Commission's proposal with regard to swing pricing and the ability of a fund to switch from a stable NAV fund to a floating NAV fund in a negative yield environment raise the same complications. Under either scenario, the industry will need to tackle the operational, accounting and tax challenges. But these have been addressed before, in the context of the transition for institutional prime money market funds from stable NAV to floating NAV under prior reforms. If the Commission's final rule requires all prime and tax-exempt money market funds to have a floating NAV, as we are advocating, these operational challenges can and will be addressed. If the Commission proceeds with its current proposal, those operational challenges will also need to be addressed, since the rule as proposed would require all funds to have the *capability* of making the switch from stable NAV to floating NAV in certain market circumstances. Either way, all

[11] 87 Fed. Reg., at 7318.
[12] 87 Fed. Reg., at 7317.

intermediaries would need the capability of transacting at floating prices, so these issues are not unique to either scenario.

Finally, the Commission observes that requiring a floating NAV may be incompatible with current cash management practices. We agree and it is for that reason that Schwab continues to recommend that government money market funds be permitted to remain as stable NAV funds. This limited exception is warranted because these money market funds are required to invest almost entirely in government-backed securities and Treasury bills, which are backed by the full faith and credit of the United States. They do not raise the credit issues faced by prime and municipal money market funds, and it is clear from investor behavior in March 2020 that both institutional and retail investors continue to have strong faith in these funds as a place of safety. We believe they should remain an option for investors.

We acknowledge that significant investor education will have to take place before any transition from a stable NAV to a floating NAV for retail prime and municipal money market funds occurs. The industry will need to spend time and effort to educate investors that floating NAV funds can and should remain a core element of an investor's cash-management strategy, but that, like all investments, returns are not guaranteed. A lengthy transition period is likely to be necessary to ensure investors understand the changes.

We also acknowledge concerns that this change could have wider implications for the financial system, particularly the banking sector, which could see significant deposit inflows from investors seeking a stable return and the guarantee against losses provided by federal deposit insurance. Those inflows have a variety of implications for banks, including the need for banks to increase capital to meet capital buffer requirements. Depending on market circumstances at the time of these inflows, banks could use deposits to fund new loans, spurring macroeconomic growth. However, large and sudden deposit inflows from investors are not likely to be considered stable, "core" deposits and thus may be housed as reserves with the Federal Reserve. These "excess" reserves earn interest, at a cost to the federal government and posing significant challenges for smooth monetary-policy transmission.

Retaining government money market funds as a stable NAV product should address these concerns, as investors would continue to have a reliable, cash-like investment option that has historically produced better returns for clients than bank deposits without the macroeconomic consequences of sudden bank-deposit inflows.

Daily and Weekly Liquidity Requirements

Schwab does not oppose the proposal to increase the daily liquid asset requirement for money market funds from 10 percent to 25 percent and the weekly liquid asset requirement from 30 percent to 50 percent. We believe this would boost investor confidence that the fund holds adequate liquidity to meet redemption needs even in the most extreme of circumstances, and therefore would meet the Commission's goal of making "money market funds more resilient during times of market stress."[13] In the proposing release, the Commission notes that some "commenters [to the request for comment on the PWG Report] argued that such a change would

[13] 87 Fed. Reg. at 7275.

likely decrease the yield of prime money market funds."[14] We agree that is a risk, as an increase in the liquidity requirements would likely require funds to increase their holdings of government securities. We think, however, that a modestly lower yield is a small price to pay for the added security and confidence that comes with a more liquid portfolio.

Liquidity Fees and Redemption Gates

Schwab strongly supports the Commission's proposal to remove the tie between money market fund liquidity and the thresholds created in the 2014 reforms for the imposition of fees and gates. Current rules, finalized in 2014, give fund boards the discretion to impose a liquidity fee or temporarily suspend redemptions by imposing a "gate" if a fund's weekly liquid assets ("WLAs") fall below 30 percent. This was a well-intentioned rule, designed, as the Commission notes, to "provide a 'cooling off' period to temper the effects of a short-term investor panic and preserve liquidity levels in times of market stress, as well as better allocate the costs of providing liquidity to redeeming investors."[15] Unfortunately, that was not how the requirement played out in reality.

As Schwab and numerous other commenters pointed out in the 2021 responses to the PWG Report, it became clear that investors perceive the requirement that a fund must hold at least 30 percent of its total assets in instruments that could be redeemed within a week as a "bright line" for fund boards' imposition of liquidity fees and/or redemption gates. Indeed, as the Commission notes in the proposing release, "Evidence suggests that concerns about the potential for fees or gates contributed to some investors' redemption decisions"[16] in the March 2020 crisis. There is little question that institutional investors, in particular, closely monitored funds' liquidity status and saw the threshold as something to avoid, as they were fearful that they would be caught on the wrong side of a gate and be either unable to redeem at all or be forced to redeem at a loss. Faced with that potential outcome, they redeemed well in advance of a fund actually hitting the threshold, thereby exacerbating the panic the rule was designed to mitigate. As the Commission notes, at least one academic research paper confirmed that "institutional prime money market fund outflows accelerated as funds' weekly liquid assets went closer to the 30% threshold."[17] To avoid this situation, CSIM portfolio managers increased WLAs during the March 2020 crisis in order to avoid even approaching the 30 percent threshold, which managers were concerned would spark redemptions. As we noted in our PWG comment letter, in March and April 2020, portfolio managers of Schwab Variable Share Price Money Fund increased weekly liquidity to as high as 43%.[18] That increase, however, was driven by a desire to indicate to investors that the fund was not anywhere near the threshold at which fees or gates would be imposed. That excess liquidity might better have been used to meet redemptions. Indeed, had portfolio managers across the industry been less concerned about the relationship of their fund's liquidity to an arbitrary threshold, they might have been able to more effectively use that liquidity to address redemptions, and the March 2020 market stress on the sector could have been easily minimized. While the WLA threshold was designed to ensure investor redemptions could be met without

[14] 87 Fed. Reg. at 7273.
[15] 87 Fed. Reg. at 7256.
[16] 87 Fed. Reg., at 7253.
[17] *Ibid,* at 7253.
[18] Wurster comment letter, at note 17.

imposing additional strains on the funds, the threshold did the opposite: it acted as an incentive to redeem.

Schwab continues to believe that fund boards should have the option of imposing liquidity fees when it is in the best interest of the fund and its investors, not when the weekly liquid assets level reaches 30 percent or some other arbitrary threshold. Portfolio managers would have the flexibility to use the excess liquidity in the fund to meet redemptions. It would be simply another tool in the toolkit to utilize in extraordinary circumstances when the board determines it is in the best interest of the fund. We recommend that funds wishing to use this tool adopt board-approved policies and procedures that outline the circumstances in which the fund might consider imposing liquidity fees. We think it unlikely that a fund would need to utilize this tool, especially if all prime and tax-exempt money market funds were required to have a floating NAV, as we recommend. But if the Commission feels that an additional anti-dilutive measure is needed to deter runs, we see little downside to providing fund boards with this flexibility.

Importantly, the imposition of a liquidity fee ensures that the cost is borne by the redeeming investor, not by investors who remain in the fund. Investors are familiar with liquidity fees, which have been part of Rule 2a-7 since 2014. They are similar to redemption fees imposed when investors sell shares of certain non-money market mutual funds, which are also familiar to investors. We note also that the operational structure for liquidity fees already exists, so there would be no additional cost to funds to maintain them as an option. In addition, a liquidity fee would not require additional technology effort or build by financial intermediaries, such as CS&Co, which already spent significant dollars and resources to support liquidity fees and redemption gates in support of the 2014 amendments to Rule 2a-7.

Finally, while we recommend the removal of redemption gates from Rule 2a-7, we continue to support allowing funds to suspend redemptions under Rule 22e-3 of the 1940 Act to ensure the orderly liquidation of a fund.

Swing Pricing

Schwab opposes the requirement that institutional prime and institutional tax-exempt money market funds impose swing pricing when the fund experiences net redemptions. Swing pricing would require a fund to adjust its current NAV so that the cost of redeeming a share is borne by the redeeming shareholders, not by the investors remaining in the fund. However, we believe swing pricing would impose a cost on both investors – the redeeming investor receives an adjusted price when a swing factor is applied, while the remaining investors have seen the value of their holding decline due to the adjusted price despite not having contributed to the redemptions. As noted above, we believe that Schwab's proposed requirement that all prime and tax-exempt money market funds have a floating NAV obviates the needs for a swing pricing requirement for those funds. But even if the floating NAV recommendation is not adopted by the Commission, we oppose the swing pricing proposal. We believe swing pricing would impose enormous costs on firms (and shareholders) to build and operate and that implementation would raise uncertainty for money market fund investors and the short-term funding markets more broadly.

Swing pricing produces a significant lack of transparency for investors, who would literally not know whether a swing factor was being applied to their redemption until well after they made the redemption request. The swing factor is designed to reflect the spread and transaction costs, as well as market impacts in certain circumstances where net redemptions exceed a defined threshold. But an investor would never know at the time a redemption request is made whether a swing factor might be applied, since that would depend on the actions of other investors in the fund. It is unclear to us, then, how an investor would be deterred from redeeming if the investor was not even aware of whether the redemption would receive full price or would be reduced by a swing factor. Indeed, the uncertainty of whether a swing factor might be applied is likely to make these funds an unattractive option for institutional investors, increasing consolidation in the money market fund space and reducing options for the short-term funding markets.

The proposal would require a swing factor to be calculated and applied whenever there are net redemptions, regardless of the amount of those net redemptions. The very nature of money market funds, which are designed to be used by investors for daily cash management purposes, results in frequent large redemptions by institutional investors, even in the most normal of market circumstances. Yet we believe that a swing factor would rarely be applied. In 2020 and 2021, the Schwab institutional prime fund had net redemptions on 63% of the days the market was open. The average for those days that had net redemptions was 0.6% of assets under management. The fund's excess liquidity was more than enough to accommodate that level of redemptions. On only two days over those two years did net redemptions in the Schwab institutional prime fund exceed 4% of assets under management, the level at which the "market impact threshold"[19] in the proposed rule would have been exceeded. The Commission's proposal targets the very rare days in which there are larger-than normal redemptions with a solution that would unnecessarily impact the vast majority of days with routine redemptions. As other commenters have noted,[20] the proposal is not consistent with how money market funds operate or meet redemptions.

We also believe that the operational challenges associated with swing pricing could have the effect of closing off certain investors' access to these money funds altogether, particularly those investors who purchase through a financial intermediary, such as retirement plan participants. Funds are reliant on these financial intermediaries to provide purchase and redemption information in a timely manner to allow for a determination of whether a fund has net redemptions for the pricing period. Financial intermediaries may choose to no longer offer these funds to their clients rather than adjusting their processes or building systems to support this additional flow of data.

Adopting increased liquidity requirements would further mitigate the need for swing pricing, especially when combined with our proposal to require a floating NAV for all prime and tax-exempt money market funds. As discussed above, the increased daily and weekly liquidity requirements would ensure that more liquidity is available for money market funds to meet redemptions, even in periods of market stress. We believe this would make money market funds

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[19] Under the proposal, if the market impact threshold is exceeded, a "fund's swing factor would also be required to include good faith estimates of the market impact of selling a vertical slice of a fund's portfolio to satisfy the amount of redemptions for the pricing period." (87 Fed. Reg., at 7262.)

[20] See, e.g., the comment letter of the Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG).

more resilient, such that meeting redemptions would not be an issue even in volatile markets. If money market funds have enough liquidity to easily meet redemptions in a variety of market circumstances, swing pricing becomes unnecessary.

Finally, we would suggest that if a swing pricing requirement for institutional prime and tax-exempt money market funds is adopted by the Commission, the result would be to significantly shrink the market itself – and potentially eliminate it entirely. CSIM currently manages one variable NAV institutional prime money market fund, with $2.7 billion in assets as of December 31, 2021. If a swing pricing mechanism is required for this fund, we would likely close the fund and exit the prime institutional money market fund business, as the cost of building and implementing the capability to impose swing pricing would far outweigh the benefits. If other asset managers follow suit, the institutional money market fund space could be significantly reduced. That, in turn, could potentially have dramatic implications for the short-term funding markets, reducing the financing options available to companies, universities, hospitals, non-profit organizations, state and local governments and other institutions. The commercial paper markets would likely shrink because there would be fewer purchasers available. In the end, the potential application of a swing factor is likely to discourage the use of funds by institutional investors as a cash management tool because of the uncertainty it creates. That in turn would likely discourage providers from offering the product due to market uncertainties and the high implementation cost. The combination would result in fewer choices, higher costs and less efficiency for borrowers in the short-term funding markets.

Requiring Funds to Convert from Stable NAV to Floating NAV in Negative Yield Environment

Schwab strongly objects to the proposal that would require funds to convert from a stable NAV to a floating NAV when market conditions produce nominal negative yields. This would be enormously confusing to investors, particularly retail investors, who would find that their stable NAV fund has suddenly become a floating NAV fund without any notice. Retail investors would likely receive disclosures apprising them of this risk in the fund prospectus. In practice, such disclosures are likely to confuse many investors and have the effect of discouraging use of money market funds that may offer the potential for better returns than other options under ordinary circumstances.

Building the operational structure for a fund to be able to make this conversion requires building the same structure as our proposal for all prime and tax-exempt money market funds to have a floating NAV permanently. One of the advantages of our proposal to require prime and municipal money market funds to have a floating NAV is that there would be a transition period before the rule became effective that asset managers could use to educate investors about what is coming and explain the implications of the change. In the scenario that the Commission is proposing, there would be little to no time for such an education program since the conversion could happen anytime at a moment's notice.

Moreover, if and when the circumstances arrive that trigger the conversion, we do not believe there would be any going back to a stable NAV. We do not believe it would be realistic or prudent for funds to go back and forth between floating NAV and stable NAV depending on

market circumstances. The operational complexity of doing so is daunting, but the confusion for investors would be even more damaging.

If the Commission believes that a structure is needed for money market funds to respond in a negative yield environment, we strongly recommend permitting funds to use the reverse distribution mechanism. In Schwab's proposal, in which all prime and tax-exempt money market funds would have a floating NAV, the reverse distribution mechanism would be applicable to stable NAV government money market funds in a negative rate environment. The reverse distribution mechanism allows a fund to maintain its stable share price by reducing the number of outstanding shares at the portfolio level. The Commission proposes to prohibit the use of the reverse distribution mechanism because it would potentially be confusing to investors. While we acknowledge there would likely be some investor confusion, it would be incumbent upon the fund manager to communicate with clients about what is happening. And we would note that the Commission's proposal – in which an investor in a stable NAV product could suddenly find herself in a floating NAV product at a moment's notice – would be far more confusing. Either would require timely and clear communication with the investor. We see little value in prohibiting the use of a tool because it would be confusing for investors when the other option is likely to be even more confusing to investors.

We believe that the Commission's proposals to implement swing pricing for institutional prime money market funds and require funds to convert from stable NAV to floating NAV in a negative yield environment will decimate the prime and tax-exempt money market fund sectors by making the funds both unattractive as an investment to investors and unattractive as a business to sponsors. A significant portion of the resulting outflows would likely go to banks, yet there appears to have been little consideration by the Commission as to whether this is something banks want, given the additional capital requirements that would be triggered by a rapid increase in deposits, whether banks would find ways to reject deposit inflows, or whether the increased concentration of assets raises broader financial system and macroeconomic risks. Indeed, in March 2020, the Federal Reserve and other banking regulators temporarily loosened bank leverage ratio rules because of the amount of cash that was flowing out of certain types of money market funds and into banks. Our view is that requiring money market funds to convert from stable NAV to floating NAV in a negative yield environment would cause a repeat of this scenario, sparking an even more pronounced outflow of cash from funds and into banks or, potentially, other less regulated cash pools. This could pressure the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation to intervene again by relaxing bank capital requirements, but the March 2020 action was controversial and current decisionmakers could refuse to do so.

Moreover, the abrupt change from stable NAV to floating NAV in these circumstances would also disrupt the Treasury market, since these money market funds are key buyers of Treasury securities. If money market funds are forced to recognize volatile market pricing that sharply increases investor outflows and demands greater cash to handle redemptions, it is possible that another "dash-for-cash" scenario could threaten overall market liquidity, putting the Treasury market, major banks, and even the financial system at grave risk. We respect the Commission's hard work with other U.S. agencies to stabilize the Treasury market to withstand dash-for-cash repeats, but none of the reforms outlined in a recent inter-agency working group's report has

been implemented.[21] To require a sudden restructuring of money market funds to a floating NAV without a broader review of the Treasury market may prove destabilizing.

Schwab's proposal of requiring a slow transition to floating NAV for all prime and tax-exempt money market funds, but retaining the stable NAV for government money market funds alleviates these concerns.

Reporting Requirements and Stress Testing

Schwab generally supports proposals that enhance transparency for investors. The proposed amendments to Forms N-CR and N-MFP seek to provide investors with additional detail about the funds in which they invest and provide regulators with additional information with which to monitor money market funds. We question, however, whether all of this information is beneficial to investors such that it needs to be publicly disclosed. We believe some elements of the proposed amendments should remain confidential, such as the requirement that a fund report on Form N-CR when a liquidity threshold event occurs and the requirement that funds disclose personally identifiable information on Form N-MFP about shareholders who own 5 percent or more of the outstanding shares. We share the perspective of the Investment Company Institute on the proposed enhanced reporting requirements, and we also support their recommendation to extend the filing period from five days to seven business days to reduce the burden on funds. We would note also that we do not support the proposed reporting requirements that are related to swing pricing because, as noted above, we do not believe swing pricing is an appropriate mechanism for money market funds.

Schwab does support the enhanced stress testing proposed by the Commission. Across the financial sector, stress testing has proven to be a useful tool for regulators to analyze potential risks and the proposal here is in keeping with that goal.

Implementation Period

The proposing release calls for a 12-month implementation period after the date of adoption. Given the complexity of the changes the Commission is proposing, we do not believe this is adequate. Indeed, we think a 24-month implementation period would be challenging for most fund complexes to meet, particularly smaller asset managers, as well as challenging for the financial intermediaries where the funds are custodied. We believe 24 to 36 months after adoption is a much more realistic timeframe to ensure that all funds are ready for what would be an extremely complicated transition. A longer implementation period would also result in better communication with and education of investors in advance of the transition. Our view on extending the implementation period would be the same if the Commission were to reconsider and ultimately adopt the proposal to require all prime and tax-exempt money market funds to adopt a floating NAV, as we recommend.

Conclusion

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[21] See US Department of the Treasury, *Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report,* (November 8, 2021). Available at: https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf.

Schwab recommends that the Commission reconsider requiring prime and tax-exempt money market funds to convert to a floating net asset value. Making this a permanent change would render unnecessary the proposals to require institutional prime money market funds to adopt swing pricing and to require stable net asset value money market funds to convert to a floating net asset value when market conditions produce negative yields. Doing so would increase transparency and enhance resiliency by accurately reflecting that money market funds carry risk and that their price is not guaranteed. We believe this requirement would complement several of the Commission's other proposals, including increasing daily and weekly liquidity requirements; eliminating the connection between weekly asset liquidity and the imposition of liquidity fees and/or redemption gates, but retaining liquidity fees as a tool fund boards could utilize if they determined it was in the best interest of the fund; enhancing stress testing; and increasing reporting requirements. The combination of these steps would significantly strengthen the stability and resiliency of money market funds in all types of market circumstances, increase investor confidence, improve the functioning of the short-term markets and reduce the likelihood of government intervention in times of market stress.

Thank you very much for the opportunity to offer our perspective on these issues. We would be happy to answer questions or provide any additional information as the Commission continues to explore this topic.

Sincerely,

Rick Wurster
President, The Charles Schwab Corporation

cc: Gary Gensler, Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Allison Herren Lee, Commissioner, Securities and Exchange Commission
Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission

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