WESTERN ASSET

April 11, 2022

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

RE: Proposed amendments to certain rules that govern money market funds under the Investment Company Act of 1940 (December 2021) (File Number S7-22-21)

Dear Ms. Countryman:

Western Asset Management Company, LLC (Western Asset) welcomes the opportunity to submit its comments regarding the Securities and Exchange Commission's (the Commission) proposed amendments to rules that govern money market funds under the Investment Company Act of 1940 (Release No. IC-34441; File No. S7-22-21) (Proposing Release). [1]

Western Asset and its jointly managed non-US affiliates operate together as one of the world's leading fixed income managers, with $492bn in assets under management as of December 31, 2021. Western Asset has extensive experience in investing cash and short-term assets on behalf of institutional and retail investors. For over 30 years, Western Asset has supported the cash management needs of its investors through a range of taxable and tax-exempt money market fund investment strategies. As of December 31, 2021, Western Asset managed around $58bn in liquidity vehicles with $55bn invested in portfolios complying with Rule 2a-7 under the Investment Company Act of 1940 (Rule 2a-7).

Western Asset strongly supports a number of the changes in the Proposing Release which we believe will strengthen the Rule 2a-7 framework and improve the resilience and transparency of money market funds. Specifically, we support:

- Revisions to existing liquidity fee and redemption gate provisions;
- Increases to daily liquid asset and weekly liquid asset minimum liquidity requirements from the current levels of 10% and 30%, but to levels of 20% and 40%, respectively (in place of the proposed levels of 25% and 50%), in combination with a thoughtfully constructed liquidity fee anti-dilutive mechanism; and
- Some of the amendments to reporting requirements on Form N-MFP and Form N-CR which improve the availability of information about money market funds.

At the same time, we are concerned that a number of the proposals will reduce the effective functioning of short-term funding markets, cause significant risks and unnecessary disruption to shareholders and

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[1] Western Asset previously submitted a comment letter on April 12, 2021, titled "Re: Report of the President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds (December 2020)," in which we outlined a number of suggested amendments to Rule 2a-7 which we believed would further the objectives of policymakers in improving the resiliency of short-term funding markets, maintain money market funds' usefulness to retail and institutional investors, and reduce money market funds' potential contribution to systemic risk.

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the economy, and likely impair the usefulness of money market funds for both retail and institutional investors, without advancing the Commission's goals of improving the resilience and transparency of the product.

In particular, we do not support:

- The introduction of swing pricing requirements for institutional prime and tax-exempt funds;
- New requirements for fund companies to assess whether financial intermediaries are able to effect shareholder transactions at floating net asset values per share (NAVs) for retail and government money market funds, and to prohibit financial intermediaries from purchasing fund shares in nominee name should they be unable to do so; and
- Proposed timelines for conforming with rule changes, which do not realistically account for the complexity that would be involved with creating compliant systems and protocols and other related implementation challenges that will impact fund companies, intermediaries, service providers and other stakeholders.

Western Asset is broadly supportive of the comments and proposals outlined in the Investment Company Institute's (ICI) and the Asset Management Group of Securities Industry and Financial Markets Association's (SIFMA AMG) comment letters concerning the Proposing Release. In this letter, we take the opportunity to highlight key areas, reflecting feedback from our clients, including both institutional investors and financial intermediary partners, and our own extensive experience in managing liquidity investments for institutional and retail shareholders.

Western Asset Supports the Removal of Current Liquidity Fee and Redemption Gate Provisions from Rule 2a-7.

Based on client feedback, our own experience, and the commentary of participants across the industry, we believe that the link between daily liquid asset and weekly liquid asset levels and the introduction of fees and gates was a significant contributory factor to the outflows experienced by institutional prime money market funds during the March 2020 crisis. The various requirements within Rule 2a-7 for introducing fees and/or gates created a "bright line," which encouraged investors to redeem their shares when funds approached the 30% weekly liquid asset level. We believe removing the explicit link to the weekly liquid asset threshold is a valuable enhancement to current regulation.

However, while we support the removal of the explicit link between fees and gates as currently written within Rule 2a-7, we strongly support the continued availability of liquidity fees as an anti-dilutive defensive mechanism. We recommend the following two-tiered approach to liquidity fees (in combination with increased levels of daily liquid and weekly liquid assets): [2]

Tier 1 – Board-approved discretionary fees.
We propose that funds' Boards of Directors have discretion to introduce anti-dilutive liquidity or

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[2] We also support the Commission's proposal to limit the use of gates to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, consistent with Rule 22e-3 under the Investment Company Act of 1940, which permits a money market fund to suspend redemptions *only* to facilitate an orderly liquidation of the fund.

redemption fees, subject to a maximum cap of 2% of the value of shareholder redemptions at any time, should a board regard introduction of liquidity fees to be in the best interests of fund shareholders. Fund boards are best placed to evaluate the composition and likely behavior of investors in the funds they oversee.

Tier 2 – Mandatory fees introduced should weekly liquid assets decrease to 30%
With levels of daily and weekly liquid assets increased to 20% and 40%, respectively, we believe that fund managers should be better able to weather periods of market stress. We reiterate that we believe it is important to avoid "bright lines" that encourage investors to redeem, but acknowledge that in extraordinary circumstances the use of an anti-dilutive mechanism may protect remaining shareholders in a fund experiencing high levels of outflows. We also believe that it is important that funds are able to utilize their extensive liquidity buffer positions at our recommended 40% weekly liquid asset level without the risk of investors redeeming close to this level due to the imminent risk of liquidity fees.

As such, we recommend that the introduction of liquidity fees should be mandatory if a fund's weekly liquid assets decline 10% below our proposed 40% threshold level (to 30% weekly liquid assets). We believe that introducing mandatory liquidity fees at the required 40% weekly liquid asset level is likely to lead to a similar "bright line" effect as experienced during the March 2020 market volatility. Instead, we recommend the introduction of mandatory fees at the 30% weekly liquid asset level, which should provide fund managers an increased ability to utilize their liquidity buffer without imminent shareholder redemptions and to better re-position portfolios during difficult market conditions.

We also believe that a scaled approach to mandatory fees may mitigate over-reaction by investors as funds potentially experience reduced liquidity levels. We recommend the following mandatory tiered fee approach:

- Weekly liquid asset levels between 20% and 30%: 0.5% liquidity fee
- Weekly liquid asset levels between 10% and 20%: 1% liquidity fee
- Weekly liquid asset levels at or below 10%: 2% liquidity fee

Western Asset Does Not Support the Introduction of Swing Pricing for Money Market Funds.

Based on our assessment of the mechanics outlined within the Proposing Release, and feedback from our clients and industry participants, we see the likely outcome from the introduction of swing pricing to be sharp reductions in, if not substantial elimination of, the institutional prime and tax-exempt money market fund sectors with corresponding flows into bank deposits, government money market funds, ultra-short fixed income funds, separately managed accounts and direct securities.

Whether or not swing pricing may be effective and appropriate for long-term fixed income mutual funds where investors have a different, and usually longer, investment horizon and may generally be investing for retirement or other longer-term investing purposes, its rationale does not apply to money market funds, which are first and foremost cash management vehicles.

We highlight below a number of key and significant issues that we believe will result from implementation of the swing pricing mechanism as described in the Proposing Release, including:

a. Swing Pricing is Inconsistent with the Manner in which Money Market Funds are Managed.

Rule 2a-7 already creates an extensive regulatory framework designed for institutional money market funds' accommodation of large cash flows, while fund managers are highly experienced in managing overnight and weekly liquidity levels to support investor subscription and redemption activity. Given their maturity structures and use of available cash and maturing securities to provide liquidity for redemptions, as well as their "know your customer" procedures, prime money market funds are typically able to operate without transaction costs, and under normal market conditions, limited to no spread costs, even on days when a fund experiences net redemptions. As the Commission explains in the Proposing Release, given that the net asset values for the funds in question are not fixed like other money market funds but float to reflect market conditions and the limited costs that typically arise from funds' transactional activities, swing pricing would generally have minimal impact and benefit during normal market conditions. Moreover, swing pricing would penalize a shareholder who redeems on a net redemption day even if the fund does not incur transaction costs because of that day's redemptions. Accordingly, we believe that the introduction of swing pricing is unnecessary. It would impose significant costs and uncertainties on the funds and their shareholders, greatly impairing the utility of institutional prime and tax-exempt funds as cash management vehicles, without a sufficient benefit to offset the negative effects of swing pricing.

For example, during periods of market stress, or in less usual situations where funds seek to sell securities in the secondary markets, it is highly unlikely that swing pricing will accurately reflect spread costs which are driven by the ability or willingness of dealers to provide bids. We believe that liquidity fees, in combination with increased daily and weekly liquid asset levels, represent a far stronger anti-dilutive construct for institutional money market funds.

b. Swing Pricing Increases Investor Uncertainty around Return of Capital.

Institutional investors rely on money market funds, particularly floating NAV institutional prime funds, to manage cash for a wide variety of purposes, including day-to-day operating expenses, liquidity held pending acquisitions, reserves set aside for projects, dividend payments and other general administrative purposes.

We believe that the introduction of swing pricing to cash investment products that already carry a degree of principal risk from their floating NAV valuation methodologies will simply result in institutional investors opting to exclude them from their range of investment options, given investors' perception that there is a higher potential degree of principal volatility due to the use of swing pricing. Based on investor feedback, we believe that investors will find the application of swing pricing to money market funds whose NAVs already float to be highly unattractive.

c. Swing Pricing has the Potential for Unequitable Shareholder Treatment.

The use of estimates in arriving at net redemptions may also unfairly result in a market impact factor being applied erroneously. From time to time, investors or their intermediary partners notify fund companies of large outflows only to cancel their instructions late in the trading day based on unforeseen factors. Institutional money market funds have a long history of maintaining extensive liquidity and prudently positioning their portfolios to ensure unexpected changes can easily be accommodated without impact to the fund and its shareholders. The inclusion of an erroneous estimate in a market impact factor creates a new risk and the potential for economic loss where none needed to exist. In addition, swing pricing inequitably penalizes a shareholder who redeems on a net redemption day even if the fund does not incur transaction costs as a result of that day's redemptions.

d. Swing Pricing Introduces Operational Complexity and Reduces Product Utility.
Currently, many institutional prime money market funds operate with multiple NAV strikes, or pricing periods, during the trading day in order to accommodate the intra-day liquidity needs of institutional investors. Generally, our experience is that investors' redemption and shareholder activity will follow a reliable pattern based on the investors' knowledge of their cash needs and receipts during a trading day. Investors will often redeem shares in the morning based on their knowledge of impending payments that they need to make, and subscribe in the evening as they receive inflows from normal business activities. This activity pattern may result in more frequent swing pricing adjustments in the earlier trading sessions for a multi-strike institutional prime money market fund.

Due to the potential for these types of patterns in shareholder activity during the day, together with the additional processes required to accommodate investor flows and calculation of a swing price and potential market impact factor, it is likely that a number of funds may decide to move to one pricing period per day. We believe the additional processes required to incorporate swing pricing mechanics into NAV pricing procedures will be incompatible with a multi-strike product construct, which, in turn, will reduce the utility of the product for institutional investors as a cash management vehicle able to provide intra-day liquidity.

In addition, for many investors the expectation of same-day settlement is an important element of deciding to invest in institutional prime money market funds for cash management purposes. The additional complexities associated with swing pricing (including determining whether a "market impact threshold" has been triggered) may cause some funds to implement earlier transaction cut-off times in order to provide same day settlement through the Fedwire system, reducing the cash management utility of these funds.

e. Swing Pricing Will Result in Unnecessary Shareholder Expense.
Incremental costs of implementing swing pricing are difficult to quantify but will likely result from systems development and process enhancements for service providers and asset managers, together with the engagement of a swing pricing administrator, and potential changes to communication processes with intermediaries in particular, to arrive at more accurate information around cash flows. Ultimately these costs will be borne by shareholders, fund companies, financial intermediaries and other industry participants

We believe that these costs are unnecessary given the availability of sufficient risk mitigation mechanisms within the existing regulation and the fact that the NAVs for these funds are already floating, combined with changes which we have described above to daily and weekly liquid asset requirements and revisions to other measures, such as use of liquidity fees for anti-dilutive purposes, which should have limited additional development and cost to shareholders, fund companies, service providers and intermediaries.

f. Swing Pricing Does Not Solve for First Mover Advantage and Creates Unintended Impacts to Shareholder Activity.
We believe that, in periods of market stress, swing pricing will increase, rather than decrease, volatility in the institutional prime funds sector and will likely encourage investors to redeem as

market pressures increase and when investors perceive that the risk of increased credit spreads and decreased liquidity may negatively impact the value of their cash assets. We also believe that swing pricing may result in unexpected consequences as investors seek to arbitrage funds during predictable periods of shareholder activity such as tax-dates, month-ends, quarter-ends and year-ends.

g. Swing Pricing May Result in Inconsistencies in Swing Pricing Calculations.
Application of swing pricing and the calculation of a market impact factor is likely to vary across the industry. Fund companies and service providers engage with a number of pricing firms, and the procedures followed by swing pricing administrators may vary. This may have negative impacts across the industry, where swing pricing administrators potentially follow varying processes to estimate market impacts and securities/sector pricing.

In conclusion, we believe that the use of swing pricing is fundamentally counter to money market funds' utility as cash management products and their ability to support investors' primary objectives, namely capital preservation, availability of liquidity and competitive money market returns. We believe that the introduction of swing pricing is contrary to the best interests of shareholders in the products and overall may result in the elimination of the sector.

Western Asset Supports Increased Daily Liquid Asset and Weekly Liquid Asset Requirements for Money Market Funds.

In our previous letter dated April 12, 2021, we recommended that the Commission maintain daily liquid asset and weekly liquid asset levels at the current levels of 10% and 30%, respectively, albeit acknowledging that an increase of weekly liquid assets to 40% may be prudent, if deemed necessary based on extensive data analysis. Although we continue to believe that current liquidity levels within Rule 2a-7 are appropriately calibrated, we support the Commission's proposal to increase daily liquid asset and weekly liquid asset levels, but believe that levels of 20% for daily liquid assets and 40% for weekly liquid assets would be more appropriately calibrated to enhance the resilience of money market funds while maintaining their utility to investors. If the proposed changes are adopted, the commercial impact will depend on market conditions and other factors. It is likely, however, that the increases in daily liquid assets and weekly liquid assets will result in a decrease in fund yields relative to competing bank deposit products, and will also decrease the yield "spread" prime funds are able to maintain relative to government funds.

The decrease in yield spread for prime funds is important in the context of the ongoing viability of the product. Institutional investors have become comfortable investing in floating NAV prime funds in the knowledge that their relatively higher yields over constant NAV government funds will compensate for potential downward movements in prime funds' NAVs. With the higher daily and liquid asset thresholds, prime funds will likely generate less yield differential, which will reduce their ability to "break-even" following a reduction in the floating NAV. With less utility for investors, the attractiveness of institutional prime funds relative to government money market funds, bank deposits and other products will likely diminish, and the sector may become marginalized. Western Asset believes in the fundamental principle of retaining investor choice where possible. Effectively foreclosing different investing strategies would inherently limit choice and frustrate the Commission's goals of capital formation.

Western Asset Does Not Support Provisions Requiring Money Market Funds to Confirm that Financial Intermediaries Can Support Trading in Shares at Non-Stable NAVs.

The Commission additionally has introduced a new proposed requirement for government or retail funds to validate that financial intermediaries are able to process orders for shares that do not maintain a stable NAV. If this cannot be validated, funds would be required to prohibit the intermediaries from purchasing shares in nominee name. Based on feedback from financial intermediary partners, we believe that the introduction of this regulatory requirement may result in a material number of retail and institutional financial intermediaries removing money market funds as an investment option on their platforms.

Faced with the choice of enhancing systems, infrastructure and reporting to anticipate an interest rate environment that has so far not been experienced in the U.S. market, intermediaries will choose to limit cash investment choices for their clients, in particular to bank deposit products. Given the regulatory implications, market participants will be required to prepare the same for a hypothetical scenario as for a real market structure change. The financial investment in systems alone could be significant and a deterrent to continuing to offer products that are already operating with thin to no margins in recent years.

Depending on the materiality of a shift away from stable NAV money market funds, banks may be faced with significantly increased balance sheet deposits, which in turn may reduce their ability to support the effective functioning of the short-term funding markets.

We propose that the Commission can enhance the resilience of the money market fund industry through engaging with industry participants to develop regulations that permit the use of reverse distribution or other mechanisms in anticipation of negative interest rates. The reverse distribution mechanism is a well-tested mechanism which has been successfully employed in the European Union and similarly could be successfully used in the US market. This approach will preserve the utility of money market funds without passing on significant costs to industry participants unnecessarily. Our view is that with appropriate disclosure and investor education, a reverse distribution mechanism adequately preserves the utility of money market funds to shareholders and their important role as intermediary monetary transmission mechanisms without mandating significant and expensive system changes across the industry to prepare for an environment that may never materialize.

We suggest that the Commission should pursue the least-restrictive and least-impactful means by which to accomplish policy objectives, not the most operationally impactful.

Western Asset Supports Some of the Changes to Form N-MFP, Structured Data and N-CR Reporting Requirements.

We support enhancements intended to increase transparency of money market funds for institutional and retail investors, including amending Form N-CR to require a fund to report when a liquidity threshold event occurs, new Structured Data Requirements, and new Form N-MFP requirements for portfolio securities reporting. These measures should improve the availability of key metrics allowing regulators and other policy-makers to better assess the state of the financial system. Western Asset suggests, however, that any reporting be evaluated periodically to ensure that it continues to serve policy objectives and remains useful.

The Commission has additionally proposed amendments to Form N-MFP requiring that money market funds disclose the name and percent ownership of each person beneficially owning 5% or more in the outstanding shares of a share class of a money market fund. The Commission considers that increased disclosure around potential shareholder concentrations will better support assessments of the likely redemption risks inherent in a fund.

We do not believe that introduction of this requirement will result in any material benefit to the risk framework supporting money market funds, and may lead existing and prospective shareholders in institutional prime and tax-exempt money market funds to act based on inaccurate interpretations of the risk involved in larger shareholder positions.

Investors do not have enough information available to them to determine the risks involved in single shareholder positions in a money market fund. They have no information about the purpose, duration and possible redemption profile of the investors in a fund. By requiring this information, the Commission may inadvertently heighten market risk through prompting investors to avoid or to redeem from a well-functioning money market fund based on inaccurate interpretations.

We would also suggest that for institutional prime and tax-exempt money market funds the high levels of intermediary omnibus accounts and utilizations of nominee names may make interpretation of this data highly subjective, and potentially inaccurate.

Western Asset Urges a Longer Implementation Timeline if Certain Changes are Made.

Should the Commission move forward with the introduction of swing pricing and regulations prohibiting the use of reverse distribution and other mechanisms designed to maintain stable NAVs during periods of negative interest rates, we encourage the Commission to reconsider timelines outlined in the Proposing Release due to the significant impact such changes will have on fund companies, service providers and intermediaries' systems, infrastructure and operational processes. If such changes are made, we recommend extending the implementation period to 24 months, which will allow fund companies, service providers, intermediaries and other stakeholders sufficient time to assess, prepare for and implement required infrastructure, systems and process changes.

Conclusion

Western Asset strongly supports the Commission's objectives of improving the resilience and transparency of the money market fund industry. We believe that a number of the Commission's proposals will make considerable progress toward those objectives. We also believe, however, that the Commission's current proposals, in aggregate, may significantly impair the effective functioning of the short-term markets and result in unintended negative consequences.

We reiterate that there may be significant unnecessary volatility in money market funds should the Commission move forward with its combined plans to introduce swing pricing, to prohibit reverse distribution mechanisms, and to require fund companies to engage only with financial intermediaries that can support floating NAV money market funds during periods of negative interest rates. We believe that, over time, such changes will result in negative economic consequences for investors, borrowers and the wider economy. Among other things, such measures could accelerate the past trend of consolidation in the industry, diminish competition, frustrate capital formation and limit investor choice.

We believe increased daily liquid asset and weekly liquid asset requirements, in combination with a discretionary and non-discretionary liquidity fee construct, is a more prudent framework for meeting the Commission's objectives. We also believe that with appropriate disclosure for retail and institutional investors, the codification of the ability to apply a reverse distribution mechanism during periods of negative interest rates is prudent and should meet the needs of policy-makers and regulators in ensuring appropriate contingencies are in place.

Very truly yours,

Charles A. Ruys de Perez
General Counsel and Secretary