Occupy the SEC

www.occupythesec.org

February 15, 2013

Financial Stability Oversight Council
Attention: Amias Gerety
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

RE: Financial Stability Oversight Council Proposed Recommendations Regarding Money Market Mutual Fund Reform (FSOC-2012-0003)

Dear Financial Stability Oversight Council:

Occupy the SEC[1] appreciates the opportunity to comment on the Council's recommendations[2] for money market fund ("MMF") reform. As we noted in our letter of November 5, 2012,[3] we are concerned by the systemic risk posed by money market funds, and are particularly concerned by the direct and indirect impact of that risk on the 99%.

Our objective in submitting this comment letter is to provide our recommendations on how the government can best control systemic risk in MMFs in a way that aligns with the principles of transparency, fairness and value. That is, we seek to ensure that the costs associated with protecting against systemic risk are apportioned in a way that is fair and transparent, so that the value of money market funds can be properly assessed in light of those costs.

Before delving into specifics, we first wish to emphasize the importance of following through on MMF reform. As the President's Working Group report[4] and the Council's recommendations make clear, there is still substantial systemic risk related to the structure of the money-market

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[1] Occupy the SEC (www.occupythesec.org) is a working group within the New York-based Occupy Wall Street ("OWS") protest movement. This letter represents the opinion of the group's members, and does not represent the viewpoints of OWS as a whole.

[2] Proposed Recommendations Regarding Money Market Mutual Fund Reform, 77 Fed. Reg. 69,455 (proposed Nov. 19, 2012).

[3] Letter from Occupy the SEC to Timothy Geithner, Secretary of the Treasury and Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission, (Nov. 5, 2012), *available at* http://www.sec.gov/comments/4-619/4619-275.pdf.

[4] President's Working Group on Money Market Reform, 75 Fed. Reg. 68636 (proposed Nov. 8, 2010).

fund industry and further reform is needed. We know that some commenters have questioned the FSOC's authority to make recommendations in this matter but we assert that this is exactly the type of action that Congress, in passing Section 120 of the Dodd-Frank Act, intended the FSOC to be actively engaged in.

As we note below, the problems inherent to the MMF industry are very broad in scope, and are best addressed comprehensively. Regarding the FSOC's specific proposals, we believe that a combination of floating NAV funds as proposed in Alternative One, and NAV Buffers, as proposed in Alternative Three, would be a sensible approach. The two alternatives together are better than either one as each has relative advantages. Thus, offering the choice of both alternatives to fund sponsors (and ultimately to investors) ameliorates the flaws in either alternative in isolation. We think it is also important that the diversification and disclosure rules be strengthened beyond what has already been accomplished under SEC Rule 2a-7 or is described in your proposed recommendations.

Furthermore, we believe that the areas covered in the Proposed Recommendations are not sufficient, because the systemic vulnerabilities of MMFs are multifaceted, and so the approach to addressing those risks must be as well. The following section of this letter discusses additional areas that we believe require your attention, and highlights the most salient aspects of our response to your proposals. Our formal replies to the questions you pose in the Proposed Recommendations are incorporated as Appendices that accompany this letter.

1. Risks in the Money Market Fund Industry

As currently constituted, MMFs appear to reconcile the competing objectives of capital preservation and the provision of market yields by offering an allegedly stable NAV while investing in open-market securities. MMFs' ability to accomplish this is a direct result of measures such as penny rounding and amortized accounting that produce an artificially rounded – rather than a truly stable – NAV, the maintenance of which is based on the discretion of fund boards.

While the 2010 reforms adopted by the Securities and Exchange Commission ("SEC") were a welcome change in many regards, they granted even more discretion to fund boards, even as a recent Supreme Court ruling[5] determined that fund management companies are not liable for the actions of individual funds. The result is a combination of extraordinary rights that negate both legal and market discipline while making the evaluation of a fund's true risks impossible until it is too late.

While we welcome the FSOC's commitment to reforming the dynamic these issues have created, we question some of the premises underlying the current proposal. Specifically, we join one commenter[6] in noting that many of the proposed measures assert that maintaining the viability of MMFs as a source of funding for short-term markets is imperative. While we agree that the stability of short-term funding markets is a systemic concern for all, we strongly disagree that the

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[5] *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

[6] Comment letter of John M. Winter, CFA re: Proposed Recommendations Regarding Money Market Mutual Fund Reform (Dec. 18, 2012), *available at* http://www.regulations.gov/#!documentDetail;D=FSOC-2012-0003-0015.

maintenance of low-cost funding for issuers should be a primary aim of regulation of consumer investment products. Responsibility for maintaining the stability of those markets should not be shifted to MMF shareholders, as some proposals (e.g. liquidity fees) would effectively do, but rather should reside with regulators. This position is supported by recent academic research[7] that has found that direct intervention by the Federal Reserve into commercial paper markets was a significant factor in stabilizing those markets.

We are also concerned that the focus on floating versus other types of NAVs obscures other features of money market funds that contribute to risk. Although the FSOC's proposal admirably lays out the full range of systemic risks posed by money market funds, the measures proposed in essence focus on the behavioral drivers of runs. We believe that the other risks – interconnectedness with the financial system, concentration of exposures, and lack of transparency – remain to be addressed, even in the wake of the 2010 reforms. This belief is the driver of the proposals outlined in Section 2 below.

2. Universal Measures: Addressing Loopholes from the 2010 Reforms

While the nature of both the FSOC document and other commenters' letters have focused on the tradeoffs between various types of funds, we strongly believe that several weaknesses in the current regulatory framework should be addressed in ways that apply to all money market funds.

A. Concentration of Risk

The FSOC's proposal described the extraordinary concentration of exposure among MMFs to the financial sector. One recent study found that prime money market funds were particularly exposed, with only 50 issuers (all but two from the financial sector) accounting for roughly three quarters of Prime MMF assets, and 93% of all non-government exposure.[8] Among these, the largest exposure was to Barclays Capital, which accounted for 3.99% of all Prime MMF assets.

Dramatic as those figures may be, they only account for direct exposure. Funds that invest in instruments with guarantees, demand features or the like are also exposed to financial institutions that provide those guarantees. Funds are also exposed to the credit-worthiness of counterparties in repo transactions. The diversification framework should restrain credit exposure in a manner that encompasses both direct and indirect credit exposures.

The current regulatory framework is inadequate in its approach to limiting this level of interconnectedness between MMFs and the financial sector. First, issuer-level diversification limits do not directly address the potential for aggregate exposure across subsidiaries of the same firm, allowing for significant aggregation effects. Second, the existing limit of 10% exposure to providers of demand features and guarantees does not take into account the potential overlap with direct exposure.

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[7] John V. Duca, Did the Commercial Paper Funding Facility Prevent a Great Depression Style Money Market Meltdown?, Working Paper 1101 (Federal Reserve Bank of Dallas), Feb. 2011, *available at* http://www.dallasfed.org/assets/documents/research/papers/2011/wp1101.pdf.

[8] Samuel Hanson, David Scharfstein, & Adi Sunderam, *An Evaluation of Money Market Fund Reform Proposals* (Dec. 2012), *available at* http://www.people.hbs.edu/shanson/MMF_Reform_20121220_FINAL.pdf.

We propose that regulators implement a 5/10 rule that would function at two levels:

1. Direct exposure to any issuer would be capped at 5% of assets, aggregated across all subsidiaries and including repo transactions involving non-conforming collateral.
2. Cumulative exposure to any single financial institution across both direct holdings as well as holdings of securities for which that institution provides a demand feature or guarantee could not exceed 10% of assets.

While we believe that this proposal will help reduce the exposure of MMFs to the failure of any one financial institution, it does not address the broader issue of MMF exposure to systemic failures in the financial system. We expect that a regulatory policy which approaches the issue from the direction of the issuers (rather than the buyers) of financial paper will be more effective in reducing the scope of linkages between MMFs and the financial sector, as it will limit the potential impact of weaknesses at banking institutions on wholesale funding markets. We recognize that the recently revised liquidity coverage ratio (LCR) requirements within Basel III will require banks to hold 100% capital against debt of less than 30 days' maturity,[9] while the net stable funding requirements will penalize banks for over-reliance on funding maturing in less than one year.[10] While we hope that these measures will prove sufficient to reduce systemic risks, we note that they are not scheduled to come online for many years, and may well be watered down as a result of lobbying in the interim. Therefore, we prefer that regulators impose greater controls now rather than relying on an uncertain future.

B. *Misleading Pricing*

The two fund types we propose are both predicated on full transparency of underlying market NAVs. However, current measures within Investment Company law would make such transparency a fiction if left unchanged. Under existing rules, securities with maturities of less than 60 days can be priced using amortized accounting.[11] This approach is acceptable in the context of the equity and traditional bond funds for which it was designed, given that cash securities represent a small portion of their assets. However, the FSOC has suggested that up to 80% of securities in money market funds have an under-60-day maturity profile. As a result, the continued allowance of amortized pricing for short-term securities within MMF portfolios would severely undermine the reliability of fully transparent market NAVs.

We propose that this exemption be removed for all categories of money market funds, so that all securities in their portfolios would be priced using market (rather than amortized) prices. The lack of a secondary market for many holdings could be easily addressed by using the same techniques (e.g. matrix pricing) used by traditional bond portfolios to address a similar lack of secondary market pricing for bonds.

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[9] Bank for International Settlements, Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools (Jan. 2013), *at* http://www.bis.org/publ/bcbs238.htm.
[10] Bank for International Settlements, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (Dec. 2010), *at* http://www.bis.org/publ/bcbs189.htm.
[11] Investment Company Act Release No. 9786 (May 31, 1977).

C. Enhanced Liquidity

We support the FSOC's proposal of increasing the required holdings of daily liquid assets to 20%, and weekly liquid assets to 40% of portfolio holdings. These measures would increase the ability of funds to weather liquidity events, and would also provide extra time to exit less liquid positions in the event of mass redemptions.

D. Discretion and Uncertainty

The level of discretion currently allowed to MMF boards around the provision of NAV support only creates uncertainty, and should be eliminated. In the case of floating NAV ("FNAV") funds, boards should be barred from providing discretionary support for fund NAVs. In the case of buffered NAV ("BNAV") funds, boards should be allowed to maintain the fund's buffer to the stated level, but should not be allowed to provide discretionary support beyond that amount in the event of a sudden loss that exceeds the buffer.

E. Lack of Disclosure

In addition to the measures intended to govern the management of funds, we propose three rules to enhance the transparency and risk profile of funds to their shareholders:

1. All MMFs should incorporate their NAV treatment into their name, along with the size of their buffer if relevant (e.g. ABC 3% Buffered Money Market Fund, XYZ Floating NAV Money Market Fund, etc.), to make clear to investors the nature of the fund in which they are invested. This would complement, but not replace, the current approach of attaching legal verbiage to shareholder communications.
2. All shareholder reports should include the nature and provider of additional guarantees or other features for each security, so that portfolio holding disclosures include information about both the underlying security and any additional counterparties involved.[12]
3. Form N-MFP should be amended to provide a summary view of the top 10 financial institutions to which a given fund is exposed, spanning both direct and indirect exposures. This information should also be incorporated into annual and semiannual shareholder reports.

3. Fund structures: Floating and Buffered

While those commenting on behalf of the fund industry have been uniform in their resistance to moving away from allegedly stable NAVs, it is telling that their arguments are often rooted in conflicting claims about fund investor preferences. Some have pointed to the tendency of MMF investors to be driven by yields relative to bank accounts, while others have insisted that MMF investors prioritize capital preservation.

This lack of agreement about the preferences of fund investors as a group has two clear implications. First, it implies that MMF shareholders are not a monolithic group, but rather

[12] While some fund sponsors are already providing this information, it is not a universal practice.

include investors with varying preferences. By extension, forcing all MMF investors into a single type of fund may result in a mismatch that could prove destabilizing in a period of market stress.

We propose that the FSOC create two types of approved fund structures to be offered side by side, with both incorporating the measures proposed above. We believe the optimal solution is to offer fund structures segmented by risk profile so that fund shareholders can sort themselves by risk tolerance. While not a panacea, such an approach would reduce the risk of a panic by allowing investors to more closely match their own preferences to the funds in which they invest.

To that end, our proposal envisions an industry offering two kinds of MMFs, as discussed below.

A. Floating NAV (FNAV) Funds

In keeping with the FSOC's first proposal, we encourage the FSOC to allow fund sponsors to offer FNAV funds. Since these vehicles would not be required to incorporate a buffer, they would presumably offer greater yields than buffered NAV funds, in return for shareholders' willingness to accept fluctuations in the NAV at which their shares trade. To reinforce the distinction between FNAV funds and purer cash management products, we encourage the FSOC to bar FNAV funds from providing bank-like features such as check writing and ATM cards.

Industry has predictably reacted strongly against offering FNAV funds. Some industry figures have pointed to the potential challenges of an FNAV structure, particularly in terms of accounting, tax and administrative concerns. To the extent that such concerns are realistic, we encourage the SEC to work with the Financial Accounting Standards Board to ensure that FNAV MMFs also receive cash-equivalent treatment, and with the Internal Revenue Service to develop realistic exemptions from wash rule requirements.

Others have pointed to surveys of institutional and retail investors indicating a strong aversion of FNAV.[13] These survey results should be considered in the context of two facts. First, many of those surveys were conducted during the Temporary Asset Guarantee program, which means that institutions at the time had access to unlimited portfolio insurance for bank deposits, providing them an attractive alternative. That program is no longer in effect. Second, the market structure at the time envisioned only one type of fund, which meant that those surveyed responded in the context of an all-or-nothing proposition. Industry offerings of more than one type of fund would presumably address the diverse preferences of all shareholders, not just those concerned with capital preservation.

B. Buffered NAV (BNAV) Funds

We propose that the industry also be allowed to offer BNAV funds as an alternative for more conservative shareholders. We strongly prefer "buffered NAV" as a descriptive name rather than "stable NAV." These funds would incorporate a risk-weighted buffer that would absorb first

[13] Comment letter of Treasury Strategies, Inc. re: Proposed Recommendations Regarding Money Market Mutual Fund Reform (Jan. 15, 2013), *available at* http://www.regulations.gov/#!documentDetail;D=FSOC-2012-0003-0049.

losses from fluctuations in the underlying portfolio. This structure would protect shareholders in most events, while allowing some risk of loss to remain, in case of catastrophic market failures.

To fund this buffer, we propose that fund sponsors be allowed to use a combination of direct support as well as the issuance of subordinated shares, all to fund a segregated escrow account. Funding this account in part using sponsor support would ensure that fund sponsors were directly exposed to the impact of any losses in their funds. Combining such sponsor support with capitalization from subordinated shares would offer several benefits.

1. Subordinated shares spread the risk from a given portfolio, and effectively shift much of it away from conservative MMF investors to those more willing to bear it.
2. Shares also mitigate against further consolidation of an already concentrated MMF industry by allowing fund sponsors of all sizes to participate.
3. Finally, rather than working against the current low interest rate environment as a retained earnings approach would, issuing subordinated shares capitalizes on that environment by offering yield-oriented investors a way to access high-quality, low-duration portfolios without commingling their assets with those of more conservative MMF shareholders.

MMF buffers should not be funded by retained earnings, as that approach essentially places the onus of market risk and fund mismanagement on investors.

As for the size of the buffer, we agree with the FSOC's approach of risk-weighting according to the composition of the portfolio. However, we also encourage the FSOC to examine the proposal embodied in the submission of Scharfstein, et al. of Harvard Business School,[14] which considers an additional layer of buffer scaled depending on the underlying portfolio's concentration.

Finally, we propose that BNAV funds post daily mark-to-market NAVs of their underlying holdings, in addition to their buffered NAVs. This would give both fund shareholders and regulators a clearer picture of the health of the underlying portfolio, and would reduce the potential for surprises that might induce panic and runs.

4. Conclusion

If enacted, our proposal would offer investors a choice that would allow them to align their investments with their needs and preferences. Those willing to accept some variation in their redemption NAV in return for a slight yield advantage could choose FNAV funds, while those whose preferences center on capital preservation and cash management could choose lower-yielding BNAV funds.

Both shareholders and the larger financial system will also benefit if our proposed extensions to the 2010 reform are enacted. By limiting concentration risk, increasing transparency and addressing loopholes in rules regulating pricing, we believe that regulators can enhance the

[14] Scharfstein, *supra* note 8.

stability of the financial system while also ensuring that money market fund investors have access to the information they need to make informed decisions.

The remainder of this document includes our more detailed answers to questions asked by FSOC regarding each of its three proposed alternatives. We look forward to further discussions once the SEC has decided on its next course of action.

Sincerely,

/s/

Occupy the SEC

Anchard Scott
Akshat Tewary
Eric Taylor
Josh Snodgrass
et al

Via Internet Submission

APPENDIX A: ALTERNATIVE ONE, FLOATING NAV (FNAV)

SUMMARY POSITION:
We propose that the SEC introduce a floating-NAV option with the following guidelines:

- *An initial repricing to $100.00 per share.*
- *Fully floating NAV, with no discretionary support by fund boards.*
- *Full mark-to-market accounting for all portfolio securities (rather than allowing amortized accounting for securities maturing in < 60 days) to ensure a meaningfully floating NAV.*
- *Increased diversification, liquidity and disclosure requirements as outlined in Appendix C to make the funds still more resilient to credit and other market events.*

Would requiring that all MMFs operate with a floating NAV make them less susceptible to runs? Would it reduce or increase the potential financial instability associated with MMFs? Would it enhance their resiliency? Would floating the NAV alter investor expectations and make them substantially more willing to bear losses from their MMF investments? Alternatively, would shareholders become accustomed only to relatively small fluctuations in value but redeem heavily in the face of more significant losses?

The question of preventing a run is a complicated one given that herding is a complex phenomenon that can derive from a number of triggers. One dimension to consider is temporal - some measures will be more effective in stopping a run before it has begun, while others will be more effective in dissuading redemptions once the run has begun.

We believe a floating NAV will be effective in the first instance.

The current strategies for maintaining a stable NAV – rounding and discretionary fund sponsor support – both serve to conceal important market signals of mounting problems within the fund's portfolio. First, they mischaracterize a rounded NAV as "stable." While this may be a distinction without a difference in most circumstances, it nonetheless promotes a misconception of principal safety. It also creates a step-function or cliff effect, in which any change in a fund's NAV from "breaking the buck" is sudden and relatively large. Second, these practices reinforce the widely held belief that no fund sponsor will allow its fund to "break the buck," which is one of the primary sources of shareholder misconceptions about the safety of their principal in these vehicles.

The illusion of stable NAVs also capitalizes on two behavioral heuristics that can lead to herd behavior. Anchoring is a behavioral pattern in which individuals base their assessments of risk on the most recently available information.[15] In the case of MMF NAVs, anchoring implies that a history of pricing the NAV at $1.00 will – in the absence of any countervailing information – lead shareholders to base their decisions on the assumption of the NAV remaining at $1.00. Other research has shown that individuals use a form of mental accounting in which they segregate "safe" assets from others when thinking about their overall portfolio.[16] By implication, any shift in the NAV away from $1 under these circumstances would violate these expectations, especially if it came without warning. The resulting shock would likely exacerbate any pre-existing instability in the market, and would contribute to runs.

Finally, the maintenance of a rounded NAV at $1 creates an impression that all MMFs are subject to the

[15] Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, Science, Sep. 27, 1974.
[16] Richard Thaler, *Anomalies: Saving, Fungibility and Mental Accounts*, Journal of Economic Perspectives, Winter 1990.

same portfolio risks. If shareholders during a time of crisis are unable to determine whether their fund is experiencing losses, they are far more likely to redeem on news of problems at other funds. The inability to differentiate between struggling and more secure funds, coupled with a very risk-averse investor base, all but ensures runs in periods of credit market dislocation.

Taken together, these patterns suggest that the combination of current industry practices and behavioral patterns make the maintenance of a $1 NAV – in the absence of additional safeguards – a particularly fragile foundation for stability in commercial paper markets. Changing to a floating NAV would significantly alter the expectations that create this fragility by removing the potential for a surprise shift in NAV. Although it is impossible to predict with certainty, it is also likely that a change to a floating NAV would lead some of the most conservative shareholders to move their assets elsewhere. The resulting change in the population of shareholders could lead to greater resiliency to moderate changes in fund NAVs.

The extent to which this will be sufficient to stem runs will depend on a range of factors, not least of which is the extent of significant changes in fund NAVs. If variation is minimal the majority of the time, then it will likely lead investors to anchor their expectations around a continuation of this pattern. This would leave MMF more resilient to small changes, but still vulnerable to runs in the event of larger changes.

Would some MMF sponsors support their MMFs despite the elimination of rule 17a-9 (for instance, by contributing capital) under this option and thereby prevent their share prices from deviating materially on a day-to-day basis? If so, would this mitigate the achievement of reform objectives? Should sponsor support of MMFs be prohibited?

Discretionary sponsor support of MMFs should be prohibited. The current rounding convention under Rule 2a-7 incorporates two layers of discretion for fund boards. First, the board is allowed discretion in its response to the default of a portfolio security. Second, the board is allowed to determine both whether and how to act in the event that a fund's NAV falls below the rounding hurdle. This level of discretion is effectively a subsidy to fund sponsors who benefit from offering products with illusorily "stable" NAVs while retaining the right to choose their level of commitment to supporting that stability. Such discretion should be ended, and replaced with a firm rule that no sponsors of floating NAV funds should be allowed to camouflage problems that would otherwise be reflected in the market price.

Would initially re-pricing MMF shares to $100.00 per share help sensitize investors to fluctuations in fund value and better change investor expectations? Should they be initially re-priced to a different value than $100.00 to best achieve this goal, for instance, $10.00?

Yes, repricing MMF shares to $100.00 initially would make variations in the NAV more psychologically meaningful than a similar variation in a much smaller NAV would be. A repricing to $10.00 would be an improvement over the current situation, but would still require more rounding than a $100.00 NAV.

Should existing MMFs be grandfathered for a limited phase-in period, as discussed above, or should they be grandfathered indefinitely? What length of time should be the optimal phase-in period? What length of time would be appropriate after which the SEC would prohibit any new share purchases in stable-NAV MMFs, and any new investments would have to be made in floating-NAV MMFs?

Grandfathering existing funds will introduce confusion and complexity for little benefit. Two years should be adequate time to implement the rule. When the rule is implemented, it should apply to both new and existing shareholders.

Should the current basis reporting rules applicable to other mutual funds be extended to MMFs in their present form, or can those rules be simplified in a manner that better reflects the comparatively larger volume of transactions in MMF shares and the greater likelihood that gains or losses arising from those transactions will be relatively small on a per-share basis? Are there changes to the basis-reporting rules, such as the use of rounding conventions, that would reduce compliance costs for MMFs while providing shareholders with the information they would need?

Yes, we believe that simplification of the basis reporting rules would be desirable and have little material effect.

If the Treasury Department and the IRS were to provide administrative relief for *de minimis* losses on wash sales of shares in MMFs, what should be the terms of that relief?

We favor waiving the wash sales rule for prices above $99.00, on the assumption that small variations in MMF share prices would produce little in the way of tax revenue relative to the cost of tax and reporting.

How significant are the accounting and operational considerations relating to floating-NAV MMFs? To lessen possible issues arising from these considerations, what recommendations would commenters have for possible changes to accounting treatment for floating-NAV MMFs? What amount of operational costs would fund groups incur to implement a floating NAV for MMFs? To what extent are funds and their intermediaries currently prepared to operate floating-NAV MMFs on an ongoing basis due to the current requirement that MMFs be able to transact at a price other than the fund's stable price per share and as a result of the group's existing systems for their other mutual funds?

While there may be some costs involved in the transition, almost all sponsors of MMFs also sponsor other types of mutual funds and so already have ample experience accounting for varying NAVs.

Our proposal also envisions offering two types of MMF - one with a floating NAV, and one with a buffered NAV. This dual approach would allow sponsors for whom floating NAVs might be burdensome to offer a stable NAV fund with appropriate safeguards.

Would investors and their accountants consider floating-NAV MMFs to be cash equivalents under relevant accounting guidance without clarification by accounting standard setters? If not, what are the implications for a shareholder that treats MMF shares as an investment for accounting purposes? If not, and if there were relief on the potential accounting considerations, would these funds be an attractive investment to investors?

We believe that MMFs with floating NAVs should continue to be considered cash equivalents for accounting purposes.

The current accounting treatment of money market funds as cash equivalents is based on the same fiction that has led individual shareholders to expect that these vehicles have "stable" rather than rounded NAVs. Under our proposal, MMFs with floating NAVs would be managed more conservatively than under the current requirements of Rule 2a-7, and would remain invested in most of the same assets (e.g. open market paper, etc.) that comprise "cash equivalents" in the current accounting treatment of corporate cash.

Should any types of MMFs be exempt from a requirement that they operate with a floating NAV, such as retail MMFs, Treasury MMFs, or government MMFs? If so, why? If there were an exemption for retail funds, how should the SEC define a retail MMF?

No categories of MMFs should be exempt from this requirement based on their investments or investor types. The only exception should be for fund sponsors that choose to offer buffered NAV funds as proposed in Alternative 3 (with improvements that we note in that section).

Should MMFs be required to mark-to-market all assets in their portfolios under this option and be limited in using the amortized cost method of valuation to the same extent as other mutual funds? Why or why not? If the SEC required MMFs to use floating NAVs like other mutual funds, should it nonetheless continue to permit different valuation practices regarding portfolio securities for MMFs versus other mutual funds? How effective would this be during times of stress, when markets for such securities may be less liquid or transparent?

Marking all MMF assets to market is inconsistent with "floating NAVs like other funds" given the enormous loophole provided by Rule 2a-7, which allows mutual funds to use amortized accounting for securities with maturities of less than 60 days. As the FSOC's proposal notes, the bulk of MMF assets have maturities of less than 60 days. Moreover, the 2010 revision to Rule 2a-7 mandates that MMFs have a Weighted Average Maturity ("WAM") of less than 60 days. As a result, if the current exemption allowing amortized accounting for securities with maturities of less than 60 days were to remain in force, the validity of an allegedly floating NAV would be undermined by the reality that changes in the NAV would only reflect developments in a portion of the underlying portfolio.

We recommend that this loophole be eliminated for MMFs, and replaced with a requirement that all portfolio holdings be marked to market on a daily basis so that the NAV is a full reflection of the market pricing of the funds' portfolios.

Should a floating NAV requirement be combined with any other regulatory reform options, such as redemption restrictions, to further lessen funds' susceptibility to runs? If so, which restrictions and why?

As described in the prior section, we propose that floating NAV funds also incorporate stricter portfolio requirements for disclosure, diversification and liquidity as laid out in the Other Measures section of Alternative Three. These requirements would make individual funds more robust to individual credit events, address many of the systemic issues posed by MMF, and provide investors with greater transparency.

We also recommend that floating NAV funds be barred from participating in the payment system through the provision of bank-like features such as check writing. Although this would not address the funds' susceptibility to runs, it would address the larger and more important concern of systemic risk due to the interconnectedness of money market funds with various components of the financial system. Our proposal envisions offering two kinds of funds – one with a floating NAV, and one with a buffered NAV – in order to give shareholders a choice of fund types. In this framework, stable NAV funds would have loss-absorption capacity that would make them more appropriate for offering check-writing and other payment features.

How would floating the NAV affect investor demand for MMFs? To what extent and why would investors discontinue investing in MMFs if they operated with a floating NAV?

Recent industry-sponsored surveys indicate that both retail and corporate money market fund shareholders have expressed an aversion to the idea of floating NAVs in the abstract. How these shareholders would react in reality remains to be seen.

Moreover, we think it is worth considering who is most likely to exit the funds. The shareholders most likely to avoid money market funds with floating NAVs would presumably be the most conservative and risk-averse. Since these would also likely be the shareholders most prone to flight at the first sign of risk, their exit from the asset class could help make money market funds somewhat more resilient. The FSOC should also bear in mind that both these shareholders and the industry that sponsored the surveys have benefited from the various subsidies embedded in the current structure, and are naturally unlikely to welcome the removal of those subsidies. Such resistance is not a valid reason to abandon regulatory reform.

Where would investors shift their investments and how would this mitigate or increase risks to financial stability?

We propose two fund types to address the issue of spreading risk more appropriately to those investors willing to bear it. Offering both floating and buffered options would allow investors unwilling to accept a floating NAV to choose a more appropriate option, while also clarifying the risk of both choices.

If the FSOC chooses to propose only FNAV funds, the question of where else current fund shareholders would place their assets will have answers that vary by investor type, the range of available options, and risk tolerance.

Retail investors who prioritize stability of principal above all would likely move their assets to FDIC insured bank accounts. This might increase the too big to fail ("TBTF") problem of concentration of assets among money-center banks, though the new resolution powers considered under the Dodd-Frank Act, coupled with the oversight of the FDIC and other regulators, is likely to lead to more stability than is currently offered by MMFs.

Other investors may seek more yield-oriented investments such as short-duration bond funds. The impact of such a shift on financial stability is difficult to determine. While these products also suffered from runs during the 2008 crisis, their assets are significantly smaller than those of MMFs.

We have some concern that less sophisticated investors working with financial advisors will be steered to products that seem to offer safety but do not. Auction-rate securities were one such product in the past decade, and caused widespread losses when these "safe" securities were suddenly impaired. However, the solution to this problem is adequate oversight of the process of security issuance and enforcement of fraud statutes. This concern should not be a reason to forestall needed reform of money-market funds.

High net worth individuals ("HNW") have access to more cash management options than do retail investors. While the most risk-averse could seek insured bank accounts, many HNW investors also have access to private "enhanced cash" vehicles offered through their trust companies or brokers. These funds are often able to escape regulatory oversight by taking advantage of the Section 3(c)(7) exemption for private funds.

Institutional shareholders have the largest accounts on the whole, which gives them the largest range of possible alternatives. Institutions have been net sellers of MMFs in recent years, likely in part because of the temporary [name of program] unlimited insurance program for bank accounts. The end of this program in December 2012 could well lead to an exit by many institutions from insured bank accounts, though it is too soon to know for the purposes of this letter. Those institutions who left money funds for bank accounts are likely those that will avoid floating NAV funds.

Like HNW investors, institutions would have access to unregulated Section 3(c)(7) funds. Institutions (particularly multinationals) also have access to offshore funds, STIFs and separately managed accounts.

As long as these vehicles remain outside of the regulatory framework established by the SEC, IOSCO and other agencies, the incentives embedded in the current structure are likely to persist.

All of the concerns related to movements of money out of MMFs will be greatly reduced if there is also an alternative, as we recommend, that offers a buffered NAV similar to that proposed as Alternative 3. In that case, investors of all types who prize principal stability, check-writing and other conveniences most highly will move to the buffered NAV funds.

APPENDIX B: ALTERNATIVE TWO, NAV BUFFER AND MINIMUM BALANCE AT RISK

SUMMARY POSITION:

The proposed Minimum Balance at Risk (MBR) requirement is problematic for several reasons. First, it forces investors to suffer certain losses that may be caused by portfolio manager mismanagement or adverse market conditions. This is particularly concerning for retail investors whose accounts have been aggregated into larger accounts that may be subject to the MBR. Also the MBR framework would be unduly complicated and expensive operationally. Moreover, it would decrease market discipline on fund managers. Additionally, we believe that institutional investors could evade the MBR's $100,000 threshold through the use of subsidiary accounts or other techniques. The proposed NAV buffer of 1% is also problematic. If a floating NAV is not adopted, the NAV's capitalization should be higher than 1%. NAV buffers should be funded through a combination of sponsor support and diversified third-party investment in subordinated MMF shares. Further, the NAV buffer should be coupled with additional safeguards, as discussed below under Alternative Three.

Would requiring most MMFs to maintain NAV buffers and MBRs make the funds less susceptible to runs? Would this alternative reduce the potential financial instability associated with MMFs?

The proposed NAV buffer and MBR requirement would be an improvement over the current state of MMF management, but they are not adequate measures to address susceptibility to runs or widespread financial instability.

Importantly, the proposed second alternative does not address the issue of transparency. A buffered NAV and MBR would provide some measure of protection to MMF investors. For instance, the MBR's delayed redemption feature could impede the onset of runs. However, under Alternative Two, investors would still be unaware of the true valuation of their investments until a catastrophic loss – that in excess of the NAV buffer and any first-loss protection under the MBR – has significantly impaired their financial positions. Once investors suddenly realize, en masse, that their investments have fallen over the NAV buffer "cliff," self-propelling runs are inevitable. In contrast, timely disclosure of the shadow NAV would temper the velocity of redemptions.

Furthermore, as discussed below, a 3% (or larger) buffer would be more appropriate than a 1% buffer. The latter may not be a sufficient buffer to adequately account for large-scale systemic or fund-specific shocks. Also, the MBR's convoluted formula actually places only a limited amount of money at risk, and so its capacity to forestall financial instability is concomitantly limited.

Would this alternative make MMFs more resilient by replacing the rounding conventions currently provided by rule 2a-7 with a transparent and prefunded NAV buffer?

Alternative Two would be an improvement over the current rounding convention in the sense that any gap between the shadow NAV and the $1 benchmark would have guaranteed funding up to the buffer amount, whereas at present such gaps are only implicitly absorbed by fund sponsors through accounting conventions. A buffer would reduce the first-mover advantage that (under the current arrangement) penalizes later redeemers by forcing them to absorb any losses, while granting early redeemers a $1 NAV.

The buffer as presented does not, however, address the problem of transparency. Without the posting of market NAVs, the presence of a capital buffer (like the current rounding system) will make it impossible for shareholders to assess developing risks in the underlying portfolio.

Moreover, the 1% buffer proposed in Alternative Two only provides a marginal benefit in terms of added resiliency. A larger buffer would provide more protection.

Would the buffer requirement help foster discipline for fund managers?

In the abstract, yes. However, the answer in reality is likely to be more complicated, and will depend on factors such as the exposure of the fund manager to losses and costs, as well as the amount of information provided to shareholders.

Fund managers who bear the costs of funding the capital buffer will be the most liable for potential lapses in discipline. In contrast, fund managers who create buffers by issuing subordinated securities to third party shareholders will pass much of the risk of portfolio losses to those shareholders, and will thus be less exposed to discipline. The same would be true of a fund manager relying on an investor-funded buffer, such as one based on retained earnings, or a buffer based on a third-party source of capital such as insurance.

Further, a buffer mechanism could reduce discipline relative to a floating NAV alternative or some other alternative in which the actual NAV is apparent. As noted above, in the absence of full transparency, fund shareholders would be unable to make the decision to redeem based on full knowledge of the risks in the fund. The optimal way for the buffer requirement to impose discipline on fund managers would be if at least some portion of the buffer were funded by the sponsor, and if fund shareholders were provided full transparency as to the actual NAV. Fund managers should, at minimum, be required to disclose the shadow NAV of the underlying fund, and ideally should also provide information on the frequency and severity of their funds' use of the buffer.

Would it reduce the uncertainty for investors caused by the current reliance on sponsor support to absorb minor losses in MMF portfolios? Would such uncertainty be maintained if sponsors, on a discretionary basis, provided financial support to prevent material decline of the required NAV buffer?

The buffer requirement reduces uncertainty for investors by making funding support non-discretionary, at least to the extent that the MMF portfolio's losses do not exceed the 1% mark. Investors should be provided full transparency as to a fund's NAV as well as the source and condition of the MMF buffer. Discretionary sponsor support in addition to the buffer amount would not lead to uncertainty, given that a transparent and well-funded buffer would provide investors with certainty as to the fund's value.

Should MMFs be required to maintain an NAV buffer of a different size?

As discussed below, a larger buffer would be preferable to a 1% buffer. To the extent that buffers are sponsor-funded, a higher buffer size would induce fund managers to make more prudent investment decisions. Any costs associated with maintaining a higher NAV buffer are justified given that MMFs are marketed as safe, bank-like products. A higher NAV buffer will help ensure that MMFs are indeed among the safest investment vehicles.

When combined with an MBR requirement, should the NAV buffer be larger or smaller?

As noted below, the MBR requirement is of limited utility in efficiently protecting money market funds, investors, and the markets in general. Consequently, the NAV buffer should be assessed independently of the MBR requirement.

Should the NAV buffer requirements applicable to various types of MMF portfolio assets be

different?

We recognize that treasury securities have historically been stable during prior MMF runs. Still, the European debt crisis highlights the fact that government debts are not immune to fluctuation. Any exemption crafted for treasuries should be limited to United States treasuries, and should not include sovereign debt from other countries. Moreover, state and local municipal bonds have defaulted at higher rates than federal debts, and so the NAV buffer should apply to muni assets as usual.

Furthermore, the NAV buffer should remain unabated for MMF portfolio assets in Treasury repos. Treasury repos introduce counterparty risk, and are therefore not as reliable as pure treasuries issued by the U.S. government.

We expect that the multi-trillion dollar Treasury markets will remain liquid despite any incremental capital burden imposed by a NAV buffer requirement for MMFs.

Should funds have the flexibility to raise the NAV buffer through a variety of funding methods? If not, which methods should funds be required to use and why? What governance, incentive, and other concerns are raised by each method of funding a buffer?

NAV buffers should not be funded through retained earnings, as that method essentially punishes investors for any losses occasioned by fund manager negligence. As noted above, NAV buffers that are at least partly funded by fund sponsors yield greater incentives for fund managers to proceed with the utmost diligence, as their "skin is in the game."

The NAV buffer should be funded in cash (possibly held in escrow), and should not be made contingent on some future payment stream. For instance, the buffer should not be funded based on a future guarantee for losses encapsulated in the form of a credit derivative, as that structure would unnecessarily introduce counterparty risk into MMFs. NAV buffers are meant to mitigate risks, and should not themselves be subject to unforeseen risks.

Moreover, MMFs should be encouraged to fund at least some portion of the NAV buffer from diverse, third-party sources, possibly through a subordinated share class as suggested by FSOC. Diversification of NAV buffer funding sources reduces the likelihood that capital costs associated with the NAV buffer will be passed on to investors by fund sponsors.

Opening the NAV buffer up to third party investment would help to ensure that the cost of capital for funding the NAV buffer is kept low, as multiple parties would be able to compete for the ability to take on the risk associated with the NAV buffer.

Are there additional funding methods that would require relief from the SEC, or particular methods that the SEC should preclude?

As noted above, NAV buffers should not be funded through insurance or insurance-like schemes. The collapse of the Asset-Backed Commercial Paper market in Canada in 2007 revealed that counterparty risk can freeze entire markets for capital. MMF NAV buffers should not be subject to such illiquidity.

Would the MBR requirement make MMFs more resilient by requiring some redeeming investors to remain partially invested in an MMF for 30 days?

The MBR requirement may delay redemptions and therefore slow the onset of runs, but it would do little to address the systemic causes behind MMF runs. If an MMF is operating under flawed management or is subject to catastrophic market risk, delaying redemptions will not improve the condition of the MMF's portfolio assets, and losses will eventually be suffered by investors.

Would a 3 percent MBR be sufficiently large to mitigate the risk of runs on MMFs? Should be it be larger or smaller? Should the length of the redemption delay be longer or shorter than 30 days? Does a 3 percent MBR with a 30-day redemption delay appropriately balance the objectives of reducing the vulnerability of MMFs to runs without burdening unnecessarily the funds and their shareholders? Does it preserve the role of redemptions in providing market discipline for MMFs?

The MBR requirement does not adequately enforce market discipline on fund managers. The MBR would require institutional investors to lock in certain portions of their investments into an MMF. While the right to flee can cause runs on otherwise solvent funds, that right also helps to ensure that fund managers have their "feet put to the fire" for mismanagement. Artificially locking in investor capital allows managers to continue earning fees without necessarily adding value during the lock-in period.

Are the exemptions from the NAV buffer and MBR requirements for Treasury MMFs appropriate?

As noted above, treasury repos should not be exempted from any such requirements. Also, while investors have previously flocked to U.S. treasuries during times of stress, such may not be the case during the next crisis.

Should the SEC provide exemptions for other types of funds?

No. Creating exemptions will only create loopholes that ultimately diminish the ameliorative effect of the proposed MMF reforms.

Some retail investors — those with balances of less than $100,000 — would not be subject to the MBR requirement because retail investors may be less likely to participate in a run. Are retail investors less likely to participate in a run? Would MMFs consisting primarily of retail investors not subject to an MBR requirement be at increased risk?

The MBR mechanism would not provide any benefit to MMFs comprised solely to retail investors (having less than $100,000 invested). Sophisticated retail investors are more likely to participate in runs than unsophisticated one. Thus, unsophisticated investors in retail-focused MMFs would still be subject to losses from runs.

Is it appropriate to define a retail investor for this purpose by reference to the size of the investor's account? If so, should the threshold be $100,000, or should it be higher or lower, and why?

The $100,000 threshold does not describe that average retail investor. If the SEC implements an MBR requirement, we suggest lowering the threshold to a more appropriate number that accommodates a larger number of retail investors.

Moreover, the MBR requirement is flawed to the extent that institutional investors will likely find ways to evade the requirement by splitting their investments into sub-$100,000 portions.

If not, what other characteristics would be more appropriate? How would MMFs apply this exemption to omnibus accounts? Should MMFs be required to have transparency through these accounts to apply the exemption?

Many small-scale retail investors have retirement accounts and other savings that are bundled into larger omnibus accounts. These investors would likely be shocked to learn of the 30 day delay and 3% loss potential contained in the MBR proposal. If the MBR is implemented, it should look through omnibus accounts to winnow true retail investors from institutional investors.

Should the SEC provide an exemption from the MBR for redemptions made in accordance with a plan that a shareholder has provided to the fund in advance?If so, how far in advance should a shareholder be required to notify the MMF of the shareholder's redemptions plans in order to prevent the shareholder from using the exemption to avoid redemption delays when MMFs are under stress?

Such an exemption is inappropriate because advance redemption plans may be structured as conduits for evading the MBR's requirements.

Are there ways to reduce the operational and other costs associated with implementing the NAV buffer and the MBR? What is a realistic timeframe for implementation of these changes from an operational perspective? Who would bear these one-time and recurring costs? Would these costs end up being absorbed by fund sponsors, financial intermediaries, or investors in these funds? To what extent would these costs affect MMF sponsors' willingness to offer non-Treasury MMFs under this alternative? To what extent are the costs associated with the NAV buffer new costs, as opposed to costs that have been borne by some fund sponsors?

The MBR formula is inordinately complex, and will impose many unnecessary operational costs on MMFs. While some fund sponsors may absorb such marginal costs, the reality is that most fund sponsors will likely pass on these costs to MMF investors. Investors will also face costs in modifying their cash management technology systems to comport with the MBR formula. Investors may also face hurdles in terms of accounting treatment and reporting. A simple Floating NAV structure would obviate the need for these costs.

While the NAV buffer may impose additional operational or other costs, such costs are warranted given that MMFs are marketed as bank-like products. Investors can fairly be expected to pay for mechanisms that ensure that MMFs are indeed low-risk vehicles.

How would the combined effects of any reduction in yield from the NAV buffer and inconvenience caused by restrictions on redemptions from the MBR affect investor demand for MMFs?

To what extent and why would investors discontinue investing in MMFs subject to these requirements? If a reduction in demand is anticipated, to which other investment vehicles would investors most likely shift money? What would be the net effect on financial stability?

An MBR requirement may incentivize investors to eschew MMF investment because of the added costs and the risk of delayed redemptions and potential first-loss positions.

A NAV buffer, in contrast, would be less likely to drive away demand as the costs associated with it can be readily calculated in advance, and can be incorporated into the price of an MMF share.

APPENDIX C: ALTERNATIVE THREE, BUFFER AND ADDITIONAL MEASURES

SUMMARY POSITION:
We propose that fund sponsors be allowed to offer MMFs that explicitly target a $1 NAV, as an alternative to (but not a replacement for) floating NAV funds. This structure - which is properly defined as offering a buffered, rather than a stable, NAV - would incorporate a risk-weighted capital buffer to absorb capital losses. This buffer would be funded by the manager through a combination of sponsor support as well as through diversified third-party investment in subordinated MMF shares. The presence of this loss-absorption capacity would not be sufficient in isolation to control risk, but would instead need to be supplemented by the same features envisioned for floating NAV funds, namely greater liquidity and diversification, enhanced transparency and disclosure, and the daily publishing of the mark-to-market NAV of the underlying portfolio.

The Council seeks comment on the size of the NAV buffer. Should the NAV buffer be larger or smaller?

We support the Council's proposal to support a buffered MMF structure, as well as its proposal to risk-weight the buffer according to the underlying exposures within a given portfolio. However, we do not think the Council's proposal goes far enough in accounting for the potential risks in the portfolio.

In this regard, we agree with a research paper submitted by Scharfstein et al.,[17] who note that an additional increment added to the buffer would account for the additional risk posed by over-concentration that is left unaddressed by the Council's proposed buffer. While we do not have a formal formula, we encourage the Council to consider imposing a two-layer buffer that is risk weighted at two levels:

1. As described in the Council's proposal, a buffer of up to 3% depending on the portfolio's credit and liquidity profile, as well as
2. Another layer of buffer, to be sized according to the concentration of the portfolio.

Does a larger NAV buffer address the structural vulnerabilities described in Section IV? What type of analysis of MMF portfolio exposures should be undertaken when considering an appropriate size for the NAV buffer?

A larger NAV buffer that took account of both exposures and concentration/diversification would fortify MMF portfolios and reduce the impact of market shocks. However, as described below, a buffered NAV must be complemented by additional safeguards relating to transparency and diversification.

How would this higher NAV buffer impact investors, short-term financing markets, and long-term economic growth? How would the NAV buffer requirement, and particular MMF's choices of buffer funding methods, affect MMFs' yields? To what extent would an NAV buffer funded solely through buffer shares and the retention of earnings affect a MMF's yield? Could it cause a prime MMF's yield to decrease below those offered by government or Treasury MMFs? In what circumstances could this occur and how likely is it to occur?

NAV buffers would add resilience to the MMF market, which is an important conduit for the execution of large-scale securities transactions between banks. This added resilience would ultimately improve liquidity overall as investors would be less averse to investing, given the knowledge that structural

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[17] *See supra* note 8.

mechanisms such as the NAV buffer are in place to protect their investment. Higher liquidity would promote long-term economic growth. Even if the fulfillment of a NAV buffer would require short-term investment costs that reduce MMF yields, it should be noted that MMFs are marketed primarily as safe, warehousing products rather than yield-generation products. MMFs are already an inappropriate product choice for investors seeking aggressive yields.

The Council also requests comment on the design and duration of the transition period to implement the NAV buffer. How long should the transition period be? Should the transition period be based on economic or market conditions rather than a pre-determined phase-in deadline?

The proposed phase-in period seems appropriate.

How would the larger NAV buffer in Alternative Three, alone or combined with investment diversification requirements and other measures as discussed below, affect investor demand for MMFs? To what extent and why would investors discontinue investing in MMFs subject to these requirements? Where would investors shift their investments and how would this mitigate or increase risks to financial stability?

A fortified NAV buffer that is coupled with additional structural safeguards would increase investor demand. Investors flock to MMF investments largely to safeguard their money. The reforms proposed by OSEC in this letter would promote safety in MMFs, which would make them a more attractive alternative for potential investors. Admittedly, investors seeking more aggressive yields may be dissuaded from investing in buffered NAVs due to slightly higher capital costs, but the exit of such speculators would most likely serve as a net benefit for the MMF industry as speculators are more likely than long-term investors to create runs through mass redemptions. Such speculators would be free to achieve their profit-seeking objectives through other products, such as the subordinated shares used to fund the buffer.

When considering the larger NAV buffer in Alternative Three, what mix of other measures described below can most effectively complement the NAV buffer? To the extent that more stringent investment diversification requirements reduce MMFs' vulnerabilities, as discussed below, could such requirements be combined with a lower minimum NAV buffer and, if so, what would be the appropriate minimum? Could other measures be combined with more stringent investment diversification requirements to provide additional protections? Should the Council consider additional risk-based tailoring of the NAV buffer, for instance, based on specific types of MMF assets? Should the required NAV buffer be larger for MMFs with more concentrated exposures, particularly those to financial institutions?]

See the following section for our views on other measures that should be instituted in combination with a buffered NAV requirement.

ALTERNATIVE THREE: OTHER MEASURES

We see the recommended measures addressed below as necessary complements to, rather than partial substitutes for, a risk-weighted buffer. The buffer alone would only help contain realized losses while doing nothing to reduce their likelihood, while the additional measures would address the opposite issue. The measures should be incorporated in whole rather than as a tradeoff, and should be applied to both floating and buffered NAV funds to enhance the overall resiliency of money market funds in general.

DIVERSIFICATION

What impact would these changes have on large issuers and on the short-term funding markets? To the extent that MMF investments are constrained or reduced in response to these restrictions, in what types of securities would MMFs invest?

We support changing the definition of the 5% cap to incorporate exposures to all affiliates. Simply reducing the cap without accounting for exposure to related firms would leave MMF portfolios exposed to unnecessarily high levels of risk from firms, particularly in the case of financial companies with multiple funding subsidiaries.

The proposal notes that such a move might result in funds switching their investments to either riskier issuers, or Treasuries. The existing constraints on second-tier issues limit the ability of any fund to take the former path, while the latter would lessen the credit risk profile of MMFs. The proposal also mentions the potential impact on larger issuers. As noted above, issuers in the financial sector are already likely to face increasing pressure to shift their capital structure to include more long-term sources of funding, so any reduction in short-term funding would be consistent with such a shift.

At what level should the issuer diversification requirements be set? Does adopting a "cover one" methodology — whereby each MMF would have sufficient loss absorption capacity to mitigate the failure of its largest investment — provide adequate protection to MMFs? How should these standards be compared to those used in other regulatory contexts?

We support the FSOC's recommendation of refining the definition of "issuer" to apply to cumulative exposure to subsidiaries and affiliates.

While adding a "cover one" requirement might be helpful, we believe that the measures in our other recommendations will be more effective in controlling systemic risk.

Should these standards be applied differently to different types of funds (for instance, prime MMFs, government MMFs, and tax-exempt MMFs)? What changes, if any, should be made with respect to the diversification requirements for demand features and guarantees? Should diversification limits apply to credit enhancements other than guarantees and demand features?

These standards should be applied consistently across all types of funds.

What changes should be made, if any, to the definition of "issuer" in the context of issuer diversification requirements? Are there other changes to the issuer diversification calculations that would further strengthen these reforms? For example, should diversification requirements for asset-backed securities generally treat as the issuer of the securities the special purpose entity that issued them, the sponsor of the asset-backed securities, or the issuers of the securities underlying the asset-backed securities?

Are there other credit exposure limits that should be tightened to reduce MMFs' risks? For example, should certain types of exposures, such as financial-sector exposures, be subject to limitations? If so, what should the limits be? How should such exposures be defined? Should limits on second-tier securities be tightened? If so, how? Should collateral requirements be more stringent? How should that be accomplished?

The question of how best to limit exposure to the financial sector is complicated by the fact that banks and other financial institutions are heavily involved in short-term funding markets in a number of capacities, which means that they may appear in multiple roles (e.g. issuer of commercial paper, provider of demand features, etc.) in the same portfolio. These multiple roles mean that diversification limits that only address direct exposure will be of limited effectiveness. They also imply that the effects of a run on any single MMF could have significant implications for a relatively small number of institutions.

To address this, we propose a 5/10 rule for diversification:

- At the issuer level, the 5% limit as proposed by the FSOC will apply
- At the aggregate exposure level, a 10% limit will apply to all exposure to a given financial institution, inclusive of that institution's role as a repo counterparty, provider of guarantees, and any other instrument or agreement that institution stands behind.

Under this structure, an MMF with a 4% position in the commercial paper of a bank could only hold 6% in other instruments that involved that that bank as counterparty, provider of guarantee or other features.

The constraints on second-tier securities introduced by the 2010 reform appear to be adequate to the purpose of controlling credit risk in diversified portfolios.

Should diversification requirements for providers of demand features and guarantees be tightened? How and to what extent? How might more stringent diversification requirements for providers of demand features and guarantees affect securities markets (particularly markets for tax-exempt securities) in which demand features and guarantees are important? Should limitations on other credit or liquidity enhancements be tightened?

Diversification for providers of demand features are guarantees are addressed in the prior question.

LIQUIDITY

Would enhanced liquidity requirements mitigate the impact of increased redemptions on a fund? Are the proposed minimum liquidity requirements sufficient for funds to meet redemption requests during times of stress? Would higher or lower requirements be more appropriate? Rather than increasing both the daily and weekly liquid asset requirements, are there greater benefits or costs associated with increasing one or the other? Should tax-exempt funds continue to be exempt from any daily liquidity requirement?

We support the FSOC's proposal of increasing the required holdings of daily liquid assets to 20%, and weekly liquid assets to 40% of portfolio holdings. These measures would increase the ability of funds to weather liquidity events, and would also provide extra time to exit less liquid positions in the event of mass redemptions.

What harmful impacts would higher liquidity requirements have? How might they impact the funding markets in which MMFs participate? Would these requirements result in the institutions that borrow from MMFs shifting to shorter-term borrowing, increasing the risk that they may be unable to refinance their outstanding debt when necessary? If so, how might this impact financial stability? How would this impact the ability of borrowers to address new liquidity and stable funding requirements contemplated in Basel III?

Recent research has identified a market-wide shift by MMFs to shorten the maturities of their holdings as a key factor in the 2008 liquidity crisis in commercial paper markets. However, more recent data from the industry indicate that MMFs have not changed their behavior since, and in fact are maintaining levels of daily and weekly liquid securities that either approximate or exceed the levels proposed by the FSOC. Since commercial paper and other issuers are already working within these constraints, there is little reason to think that formalizing the existing state of affairs would pose a threat.

With regard to Basel III, the revised liquidity coverage ratio (LCR) proposal released by the Bank for International Settlements (BIS) on January 6, 2013 incorporated a requirement that banks be capable of absorbing a loss of up to 40% of non-insured corporate/institutional deposits within a 30-day period. While not directly analogous to money market funds, requiring MMF to hold 40% of their portfolios in similarly liquid paper would both align them more closely with global banking rules developed with the benefit of extended discussion and research by the BIS.

As for the implication of an enhanced liquidity requirement for financial issuers of short-term paper, to ask the question is to implicitly legitimize the same over-reliance on short-term funding (and the resulting maturity transformation) that doomed Lehman Brothers. If anything, reducing the reliance of the financial sector on money market funding is becoming a common refrain among both domestic and global regulators. Federal Reserve Governor Daniel Tarullo noted in a recent speech that there is a strong case for requiring banks to increase the share of long-term debt in their capital structure to facilitate orderly restructuring of insolvent institutions. The 2011 revision of the Basel III capital requirements explicitly states that "the predominant form of Tier I capital must be common shares and retained earnings." In that light, any reduction in reliance on short-term funding by banks would be a marker of greater resilience in the global financial system, not less.

The current definitions of MMFs' "weekly" and "daily" liquid assets used in the minimum liquidity requirements include all assets that can be converted into cash within pre-defined timeframes, including unsecured and secured exposures to financial institutions. An alternative would be to exclude all non-government securities (and repo backed by non-government securities) from these definitions. This would potentially reduce the risk of credit or liquidity strains in the securities counted towards these buffers. This may also alleviate the concern, discussed above of, of potential unintended consequences such as pushing financial institutions into shorter duration borrowing. Should such a change to the definitions of daily and weekly assets be made? If so, should this be in place of, or in addition to, higher minimum liquidity requirements?

As the Eurozone debt crisis has shown, not all government securities are alike. This implies that categorizing securities (and/or collateral in the case of repo) as government vs. non-government risks glosses over these important distinctions in risk. The SEC's current approach of categorization by liquidity is preferable.

Should MMFs be required to gather more information about their beneficial owners? MMFs also could be required to perform certain risk management procedures and consider information about beneficial owners' historical redemption behavior when stress testing their funds. To what extent can MMFs currently increase investor transparency? If regulatory changes would be necessary to facilitate this level of transparency, how could this be done most effectively by the SEC under its current statutory authority?

See following question.

Should MMFs be prohibited from having too concentrated an investor base, or should additional limitations apply if a fund has a concentrated investor base? For example, should an MMF investor be limited to owning no more than a specified percentage of any particular MMF? What limit would be appropriate?

This is an appealing idea in theory, but the lack of data on concentration levels within individual funds (as opposed to available data on concentration of assets at the industry level) provides little evidence that this would be effective.

Rather than focusing on the behavior of shareholders within funds, we recommend that the SEC supplement monthly information it gathers with data on the concentration of investors within funds as part of its ongoing surveillance. This would provide a potential early warning signal regarding vulnerabilities at individual funds while also building a base of data from which to determine whether a formal rule is merited.

How might higher minimum liquidity levels complement the NAV buffer? Would they reduce the risks present in MMFs' investment portfolios? Would they reduce the probability that an MMF investor would redeem its shares based upon concerns about the MMF's portfolio liquidity?

We believe that increased liquidity levels are a necessary component for both floating and buffered funds

DISCLOSURE

Would more frequent reporting of the portfolio holdings, mark-to-market NAVs, and liquidity levels help investors and others differentiate among MMFs? If so, what would be the appropriate frequency (e.g., daily or weekly)? How might investors respond to daily changes in an MMF's mark-to-market NAV or liquidity levels? Should MMFs be required to disclose the mark-to-market value of their investments? Would enhanced disclosure decrease or increase the probability of indiscriminate runs across MMFs? Would MMFs be adversely affected by the need to provide enhanced disclosure of their portfolio holdings? Would enhanced transparency have unintended consequences?

We propose that both floating and buffered NAV versions of MMFs publish their market-to-market NAVs daily. As noted in the section on floating NAV funds in Alternative 1 above, giving investors access to transparent daily NAVs (based on full mark-to-market, rather than partially amortized accounting) would work against indiscriminate selling by isolating those funds whose portfolios are under stress. This is just as important for buffered NAV funds, whose shareholders also deserve to have access to this important information when making their own investment decisions. Daily transparency of NAV would also provide regulators with important information about potential sources of risk in money markets.

While some fund sponsors may claim that this adds unnecessary expense, five of the largest sponsors of money market funds announced in early January that they plan to publish daily mark-to-market NAVs for their funds. If these firms are willing and able to publish this data, then it presumably is achievable for the rest of the industry.

Should MMFs be required to notify their investors and the public each time they receive support from their sponsors? This would include, for example, purchases of distressed securities under rule 17a-9 under the Investment Company Act, if that rule is not rescinded in connection with any structural reforms. What other kinds of support warrant disclosure? Would this kind of disclosure help investors and others better understand and appreciate the risks in particular MMFs? How should this disclosure be made (e.g., on an MMF's website or in its prospectus)? Should MMFs be required to disclose their performance absent sponsor support? Where SEC relief is required for sponsor support, should the SEC no longer entertain requests for the relief? Should the SEC otherwise prohibit sponsor support?

We do not believe fund sponsors should be able to support their funds beyond the provision of the capital buffer. Uncertainty over the provision of support for NAVs has been cited by the SEC and FSOC as a key source of risk, and would remain a risk factor if fund sponsors were allowed to provide discretionary support beyond that mandated by the buffer.

Moreover, by publishing the mark-to-market NAV daily, the extent of use of the buffer by stable NAV funds would be implicit in the difference between $1 and the mark-to-market NAV.

Should MMFs be required to provide increased disclosure on their valuation methodologies? Should MMFs be required to provide greater information about the factors that their boards of directors (or the boards' delegates) take into account, or the processes they follow, when assessing whether a security poses minimal credit risk? How might more robust disclosure requirements complement the NAV buffer? Would they reduce the risks present in MMFs' investment portfolios or improve investors' ability to differentiate between funds?

While more information about a given fund's investment process and methodologies would be helpful in theory, in practice it would be useful to a very small minority of investors. Instead, we propose that sponsors enhance disclosure in three ways.

First, we advocate for is the inclusion of language in the name of the fund itself to distinguish between floating NAV and buffered NAV funds. The current practice of affixing language to the prospectus limits formal disclosure to a document that few shareholders actually read. Instead, we propose that floating NAV funds include the word "floating" in their name, and buffered funds include the word "X% buffered" in their name, along with the operative level of buffer.

Second, we propose that the sponsors of buffered NAV funds make public the results of the periodic stress tests mandated by the 2010 revision to 2a-7. This would add an additional dimension of ex-ante risk transparency to the market-based information provided by the mark-to-market NAV, and would be particularly useful to investors in buffered NAV funds given their presumed preference for principal safety. It would also enhance market discipline.

Third, we propose that the semiannual disclosure of portfolio holdings required by 2a-7 be expanded to clarify the full nature of a given fund's holdings. In addition to the information currently provided on issuer name, etc., we propose that the disclosure include the names of any other organizations involved in providing a guarantee or demand feature, particularly in cases where these are provided by a third party. On a related note, we propose that funds disclose a breakdown of their ten largest repo counterparties over the prior six months.

<u>LIQUIDITY FEES AND GATES</u>

Would investors' concerns about the potential triggering of a standby liquidity fee or gate increase the likelihood of preemptive runs? Would one fund imposing fees or gates lead to runs at other funds? Would a fee, as some have suggested, serve as a sufficient deterrent to investor redemptions such that MMFs' liquidity buffers would prove able to absorb shareholder redemptions in times of stress?

We are concerned that standby liquidity fees or gates could be counter-productive at times. We do believe that a run could occur if investors fear that the trigger points are approaching. We also believe that the triggering of standby fees or gates in one fund could cause a pre-emptive run on similar funds.

More broadly, we consider liquidity fees and gates to be inadequate. Maintaining a fixed NAV without sufficient funding committed to cover losses is a fiction that will inherently lead to difficulties in stressful periods.

As we discuss above, we strongly prefer floating NAVs calculated with precision, as proposed in Alternative A, or having a buffer available to absorb losses. An adequate, and well-funded buffer should make standby liquidity fees or gates unnecessary.

Should the trigger be based on a fund's NAV, levels of daily and weekly liquid assets, or both? At what levels and why? Are there other triggers that would be more effective?
What would be the appropriate size of a standby liquidity fee? Should the fee's size be based on the magnitude of losses or liquidity costs, or should it be a fixed percentage of the investor's redemption? How would they affect the composition of funds' portfolios and funds' risk-taking? Would a flat fee based on the size of the investor's redemptions fairly allocate liquidity costs?

While some rules are worse than others, any such rules will inherently have flaws that will be disruptive to the market in some circumstances. Therefore, we are opposed to liquidity fees or gates.

Should standby liquidity fees or gates be applied automatically based on pre-determined thresholds or instead at the discretion of the fund's board of directors (or its independent directors)? Would a fund's board fail to impose a fee or gate even when it would benefit the fund and its shareholders? How could such discretion be structured to make it more likely that it would be imposed when appropriate?

Discretion in these rules is a particularly bad idea. It will introduce uncertainty from investors not knowing what a fund sponsor might do, and unfairness as investors in different funds will be treated differently.

Would a gate be more effective combined with a liquidity fee? If so, how should the combination be structured? For example, should a fund impose a liquidity fee first, allowing investors to continue to redeem, but impose a gate if the fund is unable to sufficiently recover and reaches a higher level of stress? How would investors view gates? Should there be exemptions to a fee or a gate based on the type of fund or investor? For example, should retail accounts or funds be exempt? If so, should such an exemption be based on account size? How could such exemptions work with omnibus accounts? Should there be exemptions for very small withdrawals? If so, what size? Should there be exemptions for Treasury or government MMFs?

We oppose the use of gates or standby liquidity fees in any form. We believe that either they would not be adequate to prevent runs or they would lock investors into funds unnecessarily at times. Their contingent nature also has the potential to cause or accelerate runs counterproductively.

As stated above, we consider floating NAVs or an adequate and securely-funded buffer to be preferable.