

MEMO# 27532

August 30, 2013

ICI Draft Comment Letter on SEC's Money Market Fund Proposal; Comments due September 10

[27532]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 25-13
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 27-13
BROKER/DEALER ADVISORY COMMITTEE No. 40-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-13
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 21-13
OPERATIONS COMMITTEE No. 42-13
SEC RULES COMMITTEE No. 33-13
SMALL FUNDS COMMITTEE No. 17-13
TRANSFER AGENT ADVISORY COMMITTEE No. 65-13 RE: ICI DRAFT COMMENT LETTER ON
SEC'S MONEY MARKET FUND PROPOSAL; COMMENTS DUE SEPTEMBER 10

As you know, the SEC has proposed amendments to rules under the Investment Company Act of 1940 and related requirements that govern money market funds. * Specifically, the SEC is considering two fundamental reform alternative approaches that could be either adopted alone or in combination: (i) require prime and tax-exempt institutional money market funds to “float” their net asset values (“floating NAV proposal”); or (ii) require all non-governmental money market funds to impose liquidity fees of up to 2 percent and have the option to temporarily suspend redemptions (or “gate” the fund) upon the occurrence of specified events indicating that the fund may be under stress (“liquidity fee/temporary gate proposal”). The Release also includes a number of less fundamental, yet significant, reforms that would apply under either proposal. These include enhanced disclosure and reporting requirements; more stringent diversification requirements; enhanced stress testing; and improved private liquidity fund reporting.

ICI has prepared a draft comment letter, which is attached and briefly summarized below. Any comments on the draft letter should be in writing and sent to jheinrichs@ici.org by Tuesday, September 10.

In summary, our comments are as follows:

Application of Fundamental Structural Reforms to Government and Tax-Exempt Money Market Funds

- The SEC correctly acknowledges that no case can be made for applying fundamental changes to government (including Treasury) money market funds. We strongly believe that such changes likewise should not apply to tax-exempt funds. These funds, held primarily by retail investors, provide critical and affordable short-term funding for states and local entities across the United States. The SEC provides no evidence that these funds are vulnerable to significant redemptions or otherwise pose systemic risk (Section II).

Liquidity Fee/Temporary Gate Proposal

- We strongly support the SEC's liquidity fee/temporary gate proposal: allowing money market funds to continue to transact at a stable share price under normal market conditions but under certain circumstances demonstrating that a fund may be stressed (i) requiring the fund to institute a liquidity fee designed to deter further redemptions and (ii) permitting the fund to temporarily suspend redemptions. These tools, together with enhanced disclosure, directly address regulators' concerns about redemption pressures on prime money market funds (Section III).
- To make these tools even more useful to fund boards, we recommend that the SEC expand the circumstances under which a board may impose a liquidity fee or temporarily suspend redemptions to cover situations when heavy redemptions are already underway or are clearly foreseeable (Section III).
- Notwithstanding our strong support, the proposal has potential drawbacks, including whether investors would use a money market fund with liquidity fees and gates; the impact of this proposal on certain transaction types; the potential tax implications for money market funds and their shareholders of a liquidity fee; and the system modifications that fund transfer agents and intermediaries would need to make to handle liquidity fees and temporary gates (Section III).

Floating NAV Proposal

- We continue to strongly oppose requiring prime and tax-exempt institutional money market funds to have a floating NAV instead of a stable NAV. Simply put, forcing funds to float their NAVs does not address the problem that most preoccupies many regulators—how to avert heavy redemptions from money market funds. It also is an inefficient way to educate investors that money market funds may lose value—costly to fund complexes, to intermediaries, to investors, and to the economy as a whole. Effective disclosure accomplishes the same goal, without the potential for troubling disruptions to our economy and fundamentally altering the key features that investors value most (Section IV).
- Forcing money market funds to float their NAVs would impose significant burdens on funds and investors in the tax and accounting treatment of gains and losses. It is crucial that the changes necessary to alleviate these burdens be implemented before any floating NAV requirement takes effect. The operational and systems changes needed to implement a floating NAV also would entail significant costs, and would raise the prospect that floating NAV funds would be unable to provide certain core services to shareholders (Section IV).
- We are concerned about the SEC's proposal to require floating NAV money market funds to comply with a pricing standard that is at least 10 times more onerous than the standard articulated by long-standing SEC accounting guidance for all other

floating NAV mutual funds. We question why sponsors would offer and investors would buy such funds (Section IV).

- We support the SEC's recognition that its proposals should be targeted, and appreciate that it has proposed to exempt "retail" funds from the floating NAV requirement. We have concerns, however, that the SEC's proposal to define retail funds through a redemption limit would be more onerous operationally and less investor-friendly than other methods. Using a maximum account balance limit instead would be beneficial to investors, intermediaries, and fund sponsors. Based on a survey that gathered retail investor asset information from members and intermediaries, we recommend that the maximum account balance limit be \$5 million. Regardless of the method used to define a retail fund, we also recommend that the SEC consider defining accounts invested in money market funds through tax-advantaged savings accounts as per se retail investments (Section IV).
- We support retaining the exemptive rules that permit money market funds to engage in certain affiliated transactions subject to strict conditions (Rule 17a-9) and authorize money market fund boards of directors to suspend redemptions in narrow circumstances (Rule 22e-3). We explain why we believe Rule 17a-9 transactions are in the best interests of shareholders, whether a fund's NAV is stable or floating, and Rule 22e-3 provides needed flexibility for emergency situations when it would be difficult for the SEC to provide individual exemptive orders as quickly as a fund's board might need to react to protect shareholders' interests (Section IV).

Potential Combination of Floating NAV and Liquidity Fee/Temporary Gate Proposals

- We strongly oppose the combination of the two proposals. A rational investor would not purchase a fund that is saddled with the combination of a floating NAV, the prospect of having to pay a fee to redeem or of being prohibited from temporarily redeeming, and the strict portfolio requirements imposed by Rule 2a-7 when other, less onerous, options are readily available (Section V).

Elimination of Amortized Cost Method of Valuation for All Funds

- We do not support the SEC's proposal to no longer permit stable NAV money market funds under either proposal to use the amortized cost method of valuing securities. The amortized cost method (rather than the penny rounding method) facilitates the current same-day settlement process—a feature available for all types of money market funds including government funds that is vitally important to many investors (Section VI).

Enhanced Disclosure and Reporting

- ICI has consistently supported efforts to increase the public disclosure of money market fund portfolio information and risks, and enhance the SEC's access to money market fund data. Our support for further disclosure and reporting enhancements is largely contingent, however, on money market funds being permitted to maintain a stable NAV. If the SEC requires money market fund NAVs to float, the proposed disclosure requirements will be unnecessary and we oppose them. Furthermore, we question the benefit of the current level of money market fund disclosure and reporting—which is far more detailed and frequent than that of other floating NAV funds—for money market funds that are required to float their NAVs. We thus offer our overall support for enhancing the disclosure requirements for stable NAV money market funds. We do, however, have a number of comments, which are discussed in

detail in Section VII.

More Stringent Diversification Requirements

- **Aggregation of affiliates.** We support the SEC's proposal to require money market funds to aggregate affiliated issuers and count those issuers as one exposure. Limiting money market funds' exposure to affiliated entities appears to be consistent with the purposes of the Rule 2a-7 diversification requirements—to spread the risk of loss among a number of securities (Section VIII).
- **Asset-backed securities.** We do not support the SEC's proposal to require money market funds (subject to an exception) to treat the sponsor of a special purpose entity issuing asset-backed securities as a guarantor of the securities subject to Rule 2a-7's diversification limitations applicable to guarantors and demand feature providers. Rule 2a-7 already counts toward a company's diversification limit any asset-backed security for which the company actually provides a guarantee or demand feature. The proposal would change this result by treating a sponsor of an asset-backed security as a guarantor of the entire amount of the security held by the money market fund, even if the sponsor's guarantee or demand feature is limited to a smaller amount or if the sponsor has no legal obligation to support its asset-backed security (Section VIII).
- **Removal of 25 percent basket.** We do not support the SEC's proposal to eliminate the so-called "25 percent basket," which currently allows up to 25 percent of the value of securities held in a money market fund's portfolio to be subject to guarantees or demand features from a single institution. Eliminating the basket would increase funds' reliance on less creditworthy credit support providers and unduly decrease the flexibility currently afforded funds (Section VIII).
- **More stringent investment diversification requirements.** Due to unprecedented market conditions and consolidations since the financial crisis, the number of institutions issuing or providing guarantees or liquidity for eligible money market securities has dwindled. We are concerned that further restricting these diversification limits may only heighten this problem by potentially forcing money market funds to invest in less creditworthy issuers, which could increase the risk within money market funds' portfolios, rather than decreasing it (Section VIII).

Issuer Transparency

- The SEC requests comment on whether it should require money market funds to obtain financial data on the underlying issuers whose securities are subject to guarantees. ICI members report that they typically obtain financial data about the issuers of securities subject to guarantees, if available, but continue to face major challenges in obtaining timely and complete secondary market disclosure for municipal securities issuers. Any SEC rule requiring money market funds to obtain financial data about the issuers of securities subject to guarantees would need to acknowledge and address these challenges (Section IX).

Revised Stress Testing

- We do not support a dramatic overhaul of the current stress testing requirements. The SEC should consider the limitations of stress testing and of fund directors' capacity to review and interpret stress tests when reforming these provisions. Stress testing also does not provide any meaningful protection to shareholders in a floating NAV money market fund (Section X).

Amendments to Form PF Reporting Requirements

- We support the SEC's proposal to amend Form PF to require large liquidity fund advisers to file virtually the same information with respect to their private liquidity funds' portfolios holdings on Form PF as money market funds are required to file on Form N-MFP. We believe that the information would be more useful to regulators, however, if advisers were required to file it monthly rather than quarterly. Monthly filings would allow regulators more accurately to compare the information on Form PF with the monthly Form N-MFP filings that money market funds make. We also believe that it would be beneficial to the marketplace (and at the same time not harmful to liquidity funds) if the information relating to liquidity funds were publicly available, similar to the data available on Form N-MFP (Section XI).

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[Attachment](#)

endnotes

*See Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-30551 (June 5, 2013), 78 FR 36834 (June 19, 2013) ("Release"), available at <http://www.sec.gov/rules/proposed/2013/33-9408.pdf>.

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