

## COMMENT LETTER

January 10, 2011

# IDC Comment Letter on President's Working Group Report on Money Market Fund Reform (pdf)

January 10, 2011 Ms. Elizabeth M. Murphy Secretary U.S. Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549-1090 Re: President's Working Group Report on Money Market Fund Reform (File No. 4-619) Dear Ms. Murphy: The Independent Directors Council<sup>1</sup> appreciates the opportunity to provide its views on the options for possible money market fund reforms discussed in the President's Working Group on Financial Markets' report.<sup>2</sup> Independent directors—whose primary responsibility is to look after the interests of fund shareholders, including money market fund shareholders—have a keen interest in the policy issues raised in the PWG Report and the potential impact of any of the proposed options on fund shareholders. IDC supports efforts to continue to enhance money market funds' resilience to severe market stresses so long as the essential benefits of these funds are preserved. Money market funds have provided incomparable benefits to investors and the capital markets for nearly thirty years. They offer investors daily liquidity, a high degree of safety, and competitive yields, while providing a critical source of funding to businesses and state and local governments. 1 IDC serves the fund independent director community by advancing the education, interaction, communications, and policy interests of fund independent directors. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of \$12.31 trillion and serve over 90 million shareholders, and there are approximately 2,000 independent directors of ICI member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors. 2 See Securities and Exchange Commission ("SEC") Release No. IC-29497; File No. 4-619 (November 3, 2010) attaching the Report of the President's Working Group on Financial Markets on Money Market Fund Reform Options (October 2010) ("PWG Report"). Ms. Elizabeth M. Murphy January 10, 2011 Page 2 of 7 Although the market stresses of 2007 through early 2009 were highly unusual and extreme, they highlighted concerns about potential runs on money market funds and led both the industry and regulators to examine ways to make these funds more resilient under extreme market conditions.<sup>3</sup> In January 2010, the SEC adopted significant reforms that include new standards for the liquidity, maturity, and credit quality of money market funds' holdings. IDC supported the SEC's goal of increasing money market funds' resilience to short-term market risks.<sup>4</sup> As the PWG Report states, the SEC's new rules reduce the likelihood of runs on funds, increase the size of runs that money market funds can withstand, and mitigate the systemic risks they pose. The reforms are now in

effect, and IDC believes they will go a long way in strengthening the resilience of money market funds. The PWG Report states, however, that “more should be done” and discusses policy options that may help further mitigate the susceptibility of money market funds to runs. Although the PWG does not recommend any particular option, it cautions that “the significance of [money market funds] in the U.S. financial system suggests that changes must be considered carefully.”<sup>5</sup> In light of the importance of money market funds to investors and the economy, these cautionary statements are well-founded. As discussed more fully below, of the options discussed in the PWG Report, IDC believes that a private emergency liquidity facility offers the greatest potential for mitigating the susceptibility of money market funds to runs while preserving the essential benefits that these funds provide investors and the capital markets today. In contrast, the floating net asset value (NAV) option would eradicate what the PWG describes as the “key element of the appeal” of money market funds to investors—the stable NAV. Any option that eliminates (or significantly reduces the availability to a group of investors of) the stable NAV would increase the likelihood of a “flight of assets” from money market funds to other cash management vehicles, to the detriment of both fund shareholders and the capital markets. IDC strongly opposes any such option. <sup>3</sup> In March 2009, ICI issued the Report of the Money Market Working Group, an industry study of money market funds that included recommendations for reform. The report is available at

[http://www.ici.org/pdf/ppr\\_09\\_mmwg.pdf](http://www.ici.org/pdf/ppr_09_mmwg.pdf). <sup>4</sup> See Letter from Michael S. Scofield, Chair, IDC Governing Council, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, regarding Money Market Fund Reform; File No. S7-11-09 (Sept. 8, 2009) (“IDC Sept. 2009 Letter”). <sup>5</sup> See PWG Report, *supra* n. 2, at 1 and 13. Ms. Elizabeth M. Murphy January 10, 2011 Page 3 of 7 Board Oversight of Money Market Funds When considering potential options for reform, policymakers should keep in mind that all money market funds are overseen by a board of directors, composed primarily of independent directors. SEC regulations impose significant and specific responsibilities on money market fund directors, and the SEC’s recent reforms continue to rely on directors to protect shareholders’ interests in important ways. Among other things, directors approve the procedures for periodic stress testing of the fund’s ability to maintain a stable NAV based on certain hypothetical events and receive reports on the stress test results. Directors also would play a key role if a money market fund were at imminent risk of “breaking the buck.” If directors make certain determinations, a fund may suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund. This critically important new authority is intended to reduce the vulnerability of investors to the harmful effects of a run on a fund and minimize the potential for disruption in the securities markets. Money market fund directors have executed their responsibilities on behalf of shareholders with diligence and care over the past thirty years, including during the recent challenging market environment. They will continue to do so under the SEC’s new requirements, as well as under any future reforms that may be adopted. PWG Options Of the options discussed in the PWG Report, IDC believes the private emergency liquidity facility—though not without obstacles—offers the greatest potential for reducing systemic risk while preserving the essential benefits and value of money market funds. We believe the other options presented would not solve the problem at hand, could increase rather than decrease systemic risk, would adversely impact the market, or would result in some combination of the foregoing.<sup>6</sup> Private Emergency Liquidity Facility. ICI’s comment letter describes in more detail the framework for a liquidity facility that has been developed by the industry.<sup>7</sup> It is the product of significant research by experienced and thoughtful members of the fund

industry, legal counsel, and consultants, and IDC supports their efforts in developing this viable option. 6 IDC agrees with the descriptions of the concerns associated with the other options discussed in the PWG Report and the Investment Company Institute's comment letter. See Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission regarding President's Working Group Report on Money Market Fund Reform (File No. 4-619) (January 10, 2011) ("ICI Letter"). 7 See ICI Letter, *supra* n. 6. Ms. Elizabeth M. Murphy January 10, 2011 Page 4 of 7 The facility is intended to serve as a liquidity backstop for prime money market funds during times of unusual market stress. All prime money market funds would be required to participate in the liquidity facility. The facility would be formed as a state-chartered bank or trust company and capitalized through a combination of initial contributions from prime fund sponsors and ongoing commitment fees from member funds. It would gain additional capacity from the issuance of time deposits to third parties. During times of unusual market stress, the facility would buy high-quality short-term securities from prime money market funds at amortized cost. This would enable funds to meet redemptions while maintaining a stable \$1.00 NAV. It also would protect the broader money market by allowing funds to avoid selling into a challenging market, mitigating a downward spiral in the market prices of money market instruments. The facility is designed to provide a liquidity backstop only after a substantial portion of a fund's legally mandated liquidity positions are utilized. The facility is intended to meet liquidity needs brought on by market stresses through the acquisition of high-quality instruments; it is not intended to provide credit support. A money market fund's portfolio securities are subject to robust credit quality determinations. The liquidity facility option is not without cost and, thus, would be supported by IDC only so long as money market funds are able to retain their essential benefits and value to investors. As discussed below, a floating NAV would eradicate the essential benefits; thus, there should be no floating NAV requirement under this option. In addition, the cost to funds and their sponsors would need to be reasonable given the current yield environment. IDC believes that, with these conditions met, the liquidity facility option is the one with the greatest potential of achieving the policy goals of the PWG.

**Floating NAV.** As the PWG Report noted, eliminating the stable NAV would be a "dramatic change." IDC strongly opposes this option, particularly when it is unlikely to reduce systemic risk; it may increase systemic risk; it would adversely impact the capital markets; and a less drastic, more viable option is available in the liquidity facility. Requiring money market funds to have a floating NAV is unlikely to reduce systemic risk in any meaningful way for a number of reasons. First, floating NAV money market funds would still provide maturity and liquidity transformation as intermediaries between shareholders who want liquid investments and borrowers that desire term financing. In addition, investors' views about whether money market funds are low-risk investments are unlikely to change if the funds were required to float their NAVs. Moreover, floating NAV money market funds would continue to be exposed to interest rate and credit risk. The \$2.8 trillion that both retail and institutional shareholders have invested in money market funds, compared to the \$170 billion invested in floating-value short-term bond funds (as of September 2010), demonstrates the value shareholders place on the stable NAV. If the stable NAV were Ms. Elizabeth M. Murphy January 10, 2011 Page 5 of 7 eliminated, many investors would likely abandon money market funds in favor of other investment options, to the detriment of both investors and the capital markets. Money market funds are a preferred vehicle for cash management for institutional investors such as businesses, nonprofit organizations, and governmental agencies. Indeed, some institutional investors are permitted to invest only in cash pools that maintain a stable NAV. The stable NAV provides shareholders with convenience and simplicity in terms of tax, accounting, and recordkeeping. Through stable NAV money market funds, retail investors are able to gain access to the higher-yielding

money market while having such features as ATM access and checkwriting. Money market funds also are a critical source of financing for business and governments: they hold nearly 40 percent of the commercial paper that businesses issue to finance payrolls, inventories, and other short-term operating needs and nearly two-thirds of the short-term debt that finances state and local governments and such public projects as roads, bridges, and hospitals. If the stable NAV were eliminated, investors (particularly institutional investors) may shift their assets from money market funds to less-regulated or unregulated cash pools, including those beyond the jurisdictional reach of domestic regulators, which could increase systemic risk. Investors might also shift their assets to traditional banks, resulting in a significant reduction in the supply of short-term credit to U.S. corporations. Moreover, because banks cannot pass through tax-exempt income to depositors, they could not replace tax-exempt money market funds and, as a result, municipalities would lose an important source of financing in the short-term markets.

**Two-Tier System with Stable NAV Money Market Funds Reserved for Retail Investors.** The PWG Report discusses two options for a two-tier system of money market funds. One option would require distinguishing between retail and institutional investors and make stable NAV funds available only to retail investors. IDC previously noted the significant difficulties in attempting to distinguish between retail and institutional investors and our concerns with the SEC's proposal that fund boards be assigned with this task.<sup>8</sup> In addition, institutional investors have demonstrated with their dollars their desire for a stable NAV fund; the PWG report notes that institutional money market funds account for about two-thirds of assets under management in money market funds. This approach would shut institutional investors out of a valuable investment option and force them to look to other non-floating cash management vehicles—again, to the detriment of the capital markets. Requiring a significant component of money market funds to have a floating NAV would create the same problems that requiring floating NAVs for all money market funds would create, and IDC opposes this option.

<sup>8</sup> See IDC Sept. 2009 Letter, *supra* n. 4. Ms. Elizabeth M. Murphy January 10, 2011 Page 6 of 7 Mandatory Redemptions in Kind. Funds currently are permitted to provide redemptions in kind, and IDC believes money market funds should continue to have the discretion to do so on a case- by-case basis. An across-the-board mandatory requirement presents a number of problems. First, this option is unlikely to solve systemic risk concerns and, in fact, could exacerbate market dislocations. A redeeming shareholder needing liquidity would be forced to sell into a declining market, adversely impacting not only the shareholder and the redeeming fund (and its remaining shareholders), but also all other money market funds holding the same portfolio instruments. Second, redeeming money market fund share securities in kind presents operational problems for both the fund and its shareholders. For instance, a fund may not be able to transfer title to certain securities or instruments held in the fund, such as privately placed securities. Limitations on the transferability of some of a fund's portfolio securities may result in a greater proportion of other securities not subject to such transfer restrictions being distributed. This could leave the fund more concentrated in non-transferable, restricted securities and odd lots, to the detriment of remaining shareholders. Finally, redemptions in kind are very unpopular with shareholders, some of whom are not well positioned to accept them because of the relative difficulty of liquidating such assets efficiently. Money market funds, their shareholders, and the capital markets would be better off if funds had the discretion to redeem in kind when the particular circumstances make doing so feasible and appropriate. IDC, thus, opposes a mandatory redemption-in-kind requirement.

\* \* \* If you have any questions about our comments, please contact Amy B.R. Lancellotta, Managing Director, at (202) 326-5824, or Annette M. Capretta, Deputy Managing Director, at (202) 371-5436. Sincerely, Dorothy A. Berry Chair, IDC Governing Council cc: The Honorable Mary L. Schapiro The Honorable Kathleen L. Casey The

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