

September 8, 2009

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Money Market Fund Reform; File No. S7-11-09

Dear Ms. Murphy:

The Independent Directors Council<sup>1</sup> appreciates the opportunity to comment on the Securities and Exchange Commission's money market fund reform proposal.<sup>2</sup> IDC supports the Commission's objective to amend Rule 2a-7 and other rules under the Investment Company Act of 1940 ("1940 Act") to increase money market funds' resilience to short-term market risks and provide greater protections for shareholders of a money market fund that is unable to maintain a stable net asset value per share. Money market funds have provided substantial benefits to U.S. investors and this country's capital markets for more than twenty-five years, and IDC applauds the Commission's prompt review of recent market events and consideration of reforms that would strengthen this important component of the financial markets.

IDC's comments will focus primarily on the proposals that impact the role of the money market fund board. IDC previously urged the Commission to re-examine entirely the role of money market fund boards and recommended specific rule modifications to reflect that the appropriate role of

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<sup>1</sup> IDC serves the fund independent director community by advancing the education, interaction, communication, and policy positions 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 \$11.02 trillion and serve over 93 million shareholders, and there are over 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.

<sup>2</sup> Money Market Fund Reform, SEC Release No. IC-28807 (June 30, 2009) (available at <http://www.sec.gov/rules/proposed/2009/ic-28807.pdf>)

boards is to oversee, and not to manage, funds.<sup>3</sup> While IDC supports the Commission's attention to more pressing reforms and agrees that strengthening the risk-limiting provisions of Rule 2a-7 is more urgent, we are troubled that the proposal perpetuates past tendencies of the Commission to address perceived regulatory gaps by assigning to fund boards specific, management-level responsibilities.<sup>4</sup>

The Division of Investment Management's statement in its 1992 study of investment company regulation ("1992 Study") provides a useful framework for IDC's comments in this regard:

Rules that impose specific duties and responsibilities on the independent directors should not require them to "micro-manage" operational matters. To the extent possible, operational matters that do not present a conflict between the interests of advisers and the investment companies they advise should be handled primarily or exclusively by the investment adviser.<sup>5</sup>

The proposal would impose on fund boards the following *new* responsibilities:

- Determine no less frequently than once each calendar year whether the money market fund is intended to be offered to institutional investors or has the characteristics of a fund that is intended to be offered to institutional investors;

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<sup>3</sup> Comment Letter from Robert W. Uek, Chair, Independent Directors Council, to Florence E. Harmon, Acting Secretary, U.S. Securities and Exchange Commission, regarding References to Ratings of Nationally Recognized Statistical Rating Organizations; File No. S7-19-08 (August 29, 2008) ("IDC Comment Letter").

<sup>4</sup> IDC's previous recommendations regarding ways to modernize the money market fund board's role could be considered in connection with the staff's Director Outreach Initiative, under which the staff is examining what the Commission can or should do to aid fund directors in the performance of their duties. See Andrew J. Donohue, Director, Division of Investment Management, SEC, Keynote Address at Investment Company Directors Conference (November 28, 2007) (available at <http://www.sec.gov/news/speech/2007/spch112807ajd.htm>); and Letter from Robert W. Uek, Chair, IDC to Andrew J. Donohue, Director, Division of Investment Management, SEC, regarding Director Outreach Initiative (February 26, 2008) (available at <http://www.idc.org/pdf/22275.pdf>).

<sup>5</sup> Division of Investment Management, Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation* (1992) at 266.

- Adopt procedures providing for stress testing of the money market fund's portfolio;
- Evaluate the creditworthiness of the counterparty to a repurchase agreement, regardless of whether the repurchase agreement is collateralized fully (a responsibility that could be delegated); and
- Determine in good faith, at least once each calendar year, that the fund (or its transfer agent) has the capacity to redeem and sell its securities at a price based on the current net asset value per share.

Money market fund boards take seriously their oversight responsibilities on behalf of shareholders, and they executed these responsibilities during the events of the past year with great diligence and care. Recognizing that, in light of recent market events, the money market fund rule should be strengthened, fund directors would expect their oversight responsibilities to expand as money market funds become obligated to comply with new requirements. But the board's role under the strengthened rule should be to provide appropriate and meaningful *oversight*, and not cross the line into *management* of the fund.

As discussed more fully below, IDC objects to certain provisions of the proposed amendments that would require boards to "micro-manage" certain operational matters. Most importantly, IDC strongly objects to the proposal to require fund boards to determine whether a fund is an "institutional fund" for purposes of determining the liquidity standards applicable to the fund. These and other comments relating to the proposed amendments are elaborated upon below.

The Commission also has sought comment on more "far-reaching changes . . . including whether money market funds should move to a floating net asset value," and IDC provides its views on these matters as well. As discussed more fully below, IDC objects to moving to a floating NAV and to requiring money market funds to satisfy redemption requests through redemptions in kind, which IDC believes would have a negative impact on fund shareholders.

#### 1. *Portfolio Liquidity*

The Commission proposes to add a liquidity standard to Rule 2a-7's risk-limiting provisions, and IDC supports the addition. As the Commission observed, the rule has not included a specific provision regarding liquidity because, until recently, money market funds had not experienced a severe liquidity shortfall. IDC agrees with the Commission that the events of the fall of 2008, during which large portions of money market fund portfolios became illiquid when buyers of asset backed and

traditional commercial paper fled the market, suggest that Rule 2a-7 should be amended to address money market fund liquidity risks.

The proposed amendment to Rule 2a-7 would prohibit money market funds from acquiring illiquid securities and impose explicit daily and weekly liquidity requirements for “retail” and “institutional” money market funds. As proposed, institutional and retail funds would be subject to different liquidity standards, and the fund board would be responsible for determining whether a fund is an institutional fund for these purposes. The proposal also would add a general liquidity requirement that would require a money market fund to hold highly liquid securities sufficient to meet reasonably foreseeable shareholder redemptions in light of the fund’s obligations under Section 22(e) of 1940 Act and any commitments the fund has made to shareholders. Finally, the proposal would require the board of each money market fund using the amortized cost method to adopt procedures providing for periodic stress testing of the fund’s portfolio.

IDC supports requiring money market funds to comply with certain minimal liquidity standards and to conduct periodic stress testing of the fund’s portfolio. Such enhancements would strengthen money market funds’ ability to manage through any market turmoil in the future. We express no view as to the appropriate minimum daily and weekly liquidity levels. IDC strongly objects, however, to the proposal that fund boards be responsible for determining whether a fund is an institutional fund. In addition, we suggest that the proposal concerning stress testing be modified so that the fund—and not the board—is required to adopt procedures providing for stress testing.

a. Distinguishing Institutional and Retail Funds

The most troublesome aspect of the Commission’s proposal concerns the establishment of different liquidity standards for institutional and retail funds. The Investment Company Institute’s Money Market Working Group previously considered the idea and concluded that it was “simplistic, unworkable, and could disadvantage both types of investors.”<sup>6</sup> The Commission also concedes that, in practice, the distinctions between institutional and retail funds “are not always clear.” For various reasons, the Commission may determine not to adopt different liquidity standards for institutional and retail funds. But if the Commission determines to do so, it should be the adviser—not the board—that makes the distinction between institutional and retail funds for this purpose.

Under the proposal, the fund’s board would be required to determine no less frequently than once each calendar year whether the money market fund is intended to be offered to institutional

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<sup>6</sup> See Report of the Money Market Working Group (“Working Group Report”), at 117 (available on the ICI’s website at [http://www.ici.org/pdf/ppr\\_09\\_mmmwg.pdf](http://www.ici.org/pdf/ppr_09_mmmwg.pdf)).

investors or has the characteristics of a fund that is intended to be offered to institutional investors, based on the (i) nature of the record owners of fund shares; (ii) minimum amount required to be invested to establish an account; and (iii) historical cash flows, resulting or expected cash flows that would result, from purchases and redemptions. A retail fund would be defined as any money market fund that the board has not determined within the calendar year to be an institutional fund.

The level of inquiry required to assess the nature of record owners and historical cash flows would take fund boards beyond an oversight role into operational matters of the fund. Moreover, because the shareholder composition of a fund can fluctuate during the course of a year, fund boards would be required to monitor shareholder activity and reassess the fund's status on a regular basis, drawing fund boards into micro-management activities.

We see no reason to impose this responsibility on the board rather than the adviser (with board oversight). The adviser has the expertise and day-to-day involvement with the fund's investment and operational functions. A fund board lacking such expertise might, out of an abundance of caution, tend to identify more funds as "institutional," which could be to the detriment of the fund's shareholders.

The "institutional" fund determination does not involve a conflict of interest between the adviser and the fund. The interests of the adviser and the fund in being able to maintain a stable NAV and to satisfy redemption requests are fully aligned. The impact on the reputation of an adviser to a fund that "breaks the buck" would be extremely high if not catastrophic. Moreover, even getting close to breaking a buck may cause an adviser to incur the cost of infusing capital into a fund or purchasing securities from the fund.

The determination regarding whether a fund is an institutional fund, upon which a minimum liquidity standard is proposed to be based, is an operational matter, and, consistent with the 1992 Study's framework, should be the responsibility of the adviser. If the Commission determines to require different liquidity standards for institutional and retail funds, the board's role should be to oversee the implementation of that requirement by the adviser.

b. Stress Testing

Although IDC supports requiring funds to conduct periodic stress testing, we suggest that the rule be modified to make the *fund*, rather than the board, responsible for adopting the procedures providing for the stress testing. The Commission's purpose of providing "money market fund boards a better understanding of the risks to which the fund is exposed [and to] give managers a tool to better

manage those risks” would still be accomplished if the fund adopts the procedures, with approval and oversight by the board.<sup>7</sup>

The change may seem minor but is important to reflect the board’s appropriate oversight role. The change in emphasis from the board to the fund is also important in connection with the required reporting. The reports to the board regarding the results of the stress testing should be at a level that allows boards to oversee the process and give guidance, as appropriate, and not be involved in technicalities, such as the appropriate intervals for testing and the “specifics of the scenarios or assumptions on which the tests are based,” as the Commission suggests in its release. A board’s responsibilities in connection with shadow pricing are distinguishable. Whereas fund boards have specific, statutory responsibilities with respect to valuation, their responsibilities with respect to risk management (or stress testing) derive from their overall oversight responsibilities.

## 2. *Portfolio Quality*

### a. Use of NRSROs

The Commission requests commenters to again address its previous proposal to eliminate the use of the ratings of NRSROs in Rule 2a-7. IDC strenuously objected to the proposed elimination of NRSRO ratings from the Rule 2a-7 framework, as did several boards of money market funds.<sup>8</sup> Even in light of recent market developments, IDC’s views have not changed, and, in fact, have been strengthened.<sup>9</sup> We continue to believe that removing the NRSRO rating requirement would weaken the investor protections embodied in Rule 2a-7, to the detriment of fund shareholders. The rating requirement establishes an objective, industry-wide baseline for money market fund eligibility, and the rating agency reforms that the Commission is pursuing are a more appropriate avenue for addressing its concerns in this area.

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<sup>7</sup> Rule 38a-1 under the 1940 Act requires funds to adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws and to obtain the board’s approval of the policies and procedures.

<sup>8</sup> See IDC Comment Letter, *supra* note 3; see also Comment Letters to Florence E. Harmon, Acting Secretary, U.S. Securities and Exchange Commission, regarding References to Ratings of Nationally Recognized Statistical Rating Organizations; File No. S7-19-08 from Michael S. Scofield, Chairman, Evergreen Board of Trustees (August 29, 2008); William L. Armstrong, Chairman of the Board, Denver-based Board of Trustees of Oppenheimer Funds (August 29, 2008); Virginia Stringer, Board Chair, First American Funds, Mount Vernon Securities Lending Trust (August 29, 2008); and Anthony W. Deering, Chairman of the Committee of Independent Directors, T. Rowe Price Mutual Funds (September 2, 2008) (on behalf of the board’s independent directors).

<sup>9</sup> See Letter from Amy B.R. Lancellotta, Managing Director, Independent Directors Council to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, regarding Roundtable on Credit Rating Agencies; File No. 4-579 (May 6, 2009).

The Commission also seeks comment on an alternative approach it is considering under which the money market fund's board would designate three (or more) NRSROs that the fund would look to for all purposes under Rule 2a-7 in determining whether a security is an eligible security. Under the Commission's approach, the board would be required to determine at least annually that the NRSROs it has designated issue credit ratings that are sufficiently reliable for that use. While the designation of a limited number of NRSROs for purposes of a money market fund's compliance with Rule 2a-7 may be advisable, IDC objects to the proposal to involve fund boards in this operational function. The adviser has the requisite expertise to evaluate the reliability of the NRSROs, and the designation of an NRSRO does not raise conflict of interest concerns that would otherwise warrant involving the board in this function.

b. Asset Backed Securities

The Commission seeks comments on whether, and if so how, it should amend Rule 2a-7 to address risks presented by structured investment vehicles ("SIVs") or similar asset-backed securities. With respect to fund boards, the Commission requests comment on whether the rule should explicitly require fund boards (or their delegates) to evaluate whether the security includes any committed line of credit or other liquidity support and whether there are other factors the Commission should require fund boards to evaluate when determining whether SIV investments or other new financial products pose minimal credit risks. IDC believes such detailed direction from the Commission could suggest that fund boards be involved in an inappropriate level of credit analysis, inconsistent with their oversight role. Moreover, even though a board could delegate this evaluation, the board still ultimately would be responsible for the determinations that are made. IDC recommends that the Commission not adopt amendments requiring boards to evaluate such specific factors.

3. *Repurchase Agreements*

The Commission proposes two amendments to Rule 2a-7 affecting a money market fund's investment in repurchase agreements, one of which involves the role of the board. The proposal would require that a money market fund board or its delegate evaluate the creditworthiness of the counterparty, regardless of whether the repurchase agreement is collateralized fully. IDC believes that the proposed amendment is unnecessary, in light of the determination that must already be made that a security presents minimal credit risks, which would encompass this evaluation. For that reason, the proposed amendment should not be adopted. If the Commission nevertheless determines to add this provision, the responsibility for evaluating the creditworthiness of the counterparty should be placed on the adviser, which has the requisite expertise, and not the board. Permitting fund boards to delegate the responsibility just perpetuates the fiction of imposing responsibilities directly on fund boards that are nonetheless expected to be delegated.

#### *4. Transaction Processing*

The Commission proposes to require that all money market funds be able to process purchases and redemptions electronically at a price other than \$1.00 per share. Specifically, the proposal would require that each fund's board determine in good faith, at least once each calendar year, that the fund (or its transfer agent) has the capacity to redeem and sell its securities at a price based on the current net asset value per share. For the reasons previously stated, IDC recommends that the rule be amended simply to require the fund to have the requisite capacity, rather than require the board to make the determination that it does. Then, the fund's (or transfer agent's) policies and procedures for complying with the requirement would appropriately fall within the purview of the fund's chief compliance officer, with oversight by the board.

#### *5. Authority to Suspend Redemptions*

The Commission is proposing a new rule that would permit money market funds to suspend redemptions in order to facilitate an orderly liquidation of the fund.<sup>10</sup> The proposed rule would permit a money market fund to suspend redemptions upon breaking a dollar, if the board, including a majority of independent directors, approves liquidation of the fund, in order to effect this liquidation in an orderly manner, and the fund, prior to suspending redemptions, notifies the Commission by electronic mail of its decision to liquidate and suspend redemptions.

IDC supports permitting the suspension of redemptions. If the board decides to liquidate the fund, redemption requests can outpace the fund's ability to sell its portfolio instruments, to the detriment of the non-redeeming shareholders. IDC believes that permitting funds to suspend redemptions better protects the interests of the fund's shareholders, including the non-redeeming shareholders.

The Commission seeks comment on whether to include a provision that would permit fund directors to temporarily suspend redemptions during certain exigent circumstances other than liquidation of the fund. IDC believes that this mechanism would provide additional protection for fund shareholders. As the Commission suggests, such a "time out" could give money market funds some time during turbulent periods to assess the viability of the fund. IDC believes that the framework suggested by the Commission in its release (i.e., permitting temporary suspension for up to five days, requiring a fund that could not restore its NAV within that period to begin the liquidation process, and permitting funds to exercise the option only once every five years) is workable and recommends that the

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<sup>10</sup> Proposed Rule 22e-3 would exempt money market funds from Section 22(e) of the 1940 Act to permit money market funds to suspend redemptions in order to facilitate an orderly liquidation of the fund.



Commission permit such temporary suspensions. IDC also believes that it is appropriate for the board to be responsible for approving the temporary suspension of redemptions, because the determination is *essential* to the operation of the fund—in contrast to decisions that relate to day-to-day operational matters.<sup>11</sup>

#### 6. *Request for Comment*

The Commission seeks comment on reforms that it is exploring in light of the events of the last two years. In particular, the Commission requests comment on whether money market funds should be required to float their net asset values and/or whether funds should be required to satisfy redemption requests in excess of a certain size through redemptions in kind. Both of these ideas were considered by the Working Group, and IDC concurs with the Working Group's conclusion that such fundamental changes to the regulatory structure for money market funds go too far and could create new risks.<sup>12</sup>

##### a. Floating NAV

Money market funds provide incomparable benefits to investors and the capital markets, and IDC strongly opposes any regulatory changes that would curtail these benefits. Money market funds offer shareholders convenience and simplicity in terms of tax, accounting, and recordkeeping, among other benefits. Moving to a floating NAV would undermine these benefits and raise new accounting, legal and tax hurdles. As the SEC noted, requiring a floating NAV could lead a substantial number of investors to move to other investment vehicles.

Indeed, asset managers would find other means to offer a stable NAV cash pool, leading to rapid disintermediation from money market funds into pools outside the protections of the 1940 Act, potentially increasing the systemic risk to the financial system. Moreover, cash held in money market funds would presumably flow to traditional banks, resulting in a significant reduction in the supply of short-term credit to U.S. corporations. Municipalities also would lose an important source of financing in the short-term markets because banks cannot pass through tax-exempt income and simply could not replace tax-exempt money market funds.

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<sup>11</sup> IDC noted this distinction in its previous comment letter regarding references to NRSROs, *supra* n. 3.

<sup>12</sup> Working Group Report, *supra* n. 6, at 103-111, 119.

With approximately \$3.5 trillion invested in money market funds, investors have spoken; they prefer this product over bank certificates of deposit, passbook savings accounts, and other comparable products. IDC supports the Commission's efforts to strengthen this product for investors and strongly objects to changes that could result in the wholesale elimination of it.

b. Redemption in Kind

The Commission states that one of its concerns relates to the ability of large institutional shareholders to rapidly redeem substantial amounts of fund assets, which can pose a threat to the stable NAV of the fund and can advantage one group of shareholders over another by requiring remaining shareholders to pay for the liquidity needs of large redeeming shareholders. IDC agrees with the Working Group's observation that redemptions in kind are very unpopular with investors and would place the burden of valuing and liquidating portfolio securities, with all the attendant costs, directly on the investor. IDC believes the option to redeem in kind should continue to be available and employed on a case-by-case basis as funds deem appropriate.

If you have any questions about our comments, please contact Amy B.R. Lancellotta, Managing Director, Independent Directors Council, at 202-326-5824.

Sincerely,



Michael S. Scofield  
Chair, IDC Governing Council

cc: The Honorable Mary L. Schapiro  
The Honorable Kathleen L. Casey  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
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