MFDF

MUTUAL FUND DIRECTORS FORUM
The FORUM *for* FUND INDEPENDENT DIRECTORS

April 11, 2022

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

Re: Money Market Fund Reforms (File No. S7-22-21)

Dear Ms. Countryman:

The Mutual Fund Directors Forum ("the Forum")[1] welcomes the opportunity to comment on the Commission's recent rule proposals regarding its continuing efforts to reform and improve the resiliency of money market funds.[2] Given the important role that money markets play both for their investors and for borrowers in our capital markets, the manner in which funds are regulated and the impact that regulation plays in how they are used continues to be of fundamental importance.

The Forum is an independent, non-profit organization for investment company independent directors and is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through education and other services, the Forum provides its members with opportunities to share ideas, experiences and information concerning critical issues facing investment company independent directors and also serves as an independent vehicle through which Forum members can express their views on matters of concern.

I. Introduction

The current rule proposal represents the Commission's most recent attempt to improve the resiliency of money market funds in times of market stress. As such, the Commission is proposing further significant changes to the regulation of money market funds, particularly prime institutional funds. Most notably, the Commission is proposing to eliminate liquidity fees and redemption gates; mandate swing pricing for institutional prime and tax-exempt money market funds; and

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1 The Forum's current membership includes over 943 independent directors, representing 123 mutual fund groups. Each member group selects a representative to serve on the Forum's Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum's Board of Directors, although it does not necessarily represent the views of all members in every respect.

2 *See* Money Market Reforms, Release No. IC-34441 (File Nos. S7-22-21), 87 Fed. Reg. 7248 (Feb. 8, 2022) (*hereinafter* "Proposing Release").

other changes, including increasing the daily and weekly asset minimums for all money market funds except tax-exempt funds, requiring money market funds to adopt floating net asset values in certain market conditions and enhancing certain reporting requirements.

As an organization devoted to the interests of independent directors, we are generally limiting our comments to those proposals that would have an impact on the ability of directors effectively to oversee money market funds. However, we do wish to recognize other commenters' arguments that the proposed amendments, if adopted, will increase the cost and complexity of managing money market funds, will overly limit the appeal of some funds, especially prime funds, to their investors, will potentially increase the costs borrowers incur by limiting the number of buyers of their debt and may have negative effects on capital formation generally. We believe that these commenters raise fundamentally important issues that the Commission must carefully consider as it continues to review the wisdom of engaging in additional reform efforts.

II. Gates and Liquidity Fees

As part of the 2014 amendments to Rule 2a-7, the Commission granted authority to the boards of non-government money market funds to either impose liquidity fees or temporarily suspend redemptions if certain conditions were met in times of heavy outflows and market stress – namely, if the fund's weekly liquid assets fell below 30%. Based on market events during the initial months of the pandemic, the Commission has now concluded that these amendments were not only ineffective, but also had unintended negative consequences. In particular, the Commission notes that at least some sophisticated investors have been able to determine when a fund's weekly liquid assets are at risk of falling below this level, and thus redeem their investment in the fund quickly in order to avoid the costs of fees or a redemption suspension. In short, the Commission concluded these provisions create the risk of a run on fund assets that did not exist prior to the 2014 Amendments.

Although we supported the Commission giving this authority to boards in prior comments, we noted that "this alternative does include the risk that sophisticated investors may be able to predict when a fund is approaching the point of triggering liquidity fees, and thus may time redemptions accordingly."[3] It is not surprising this has in fact occurred. Additionally, we suspect that boards would be reluctant to take these steps – especially to temporarily suspend redemptions – as doing so would likely result in additional investor flight once the fund was reopened, thereby potentially harming at least some investors in the fund, and almost certainly resulting in the fund being wound down. We therefore agree with the Commission's proposal in this area and commend the Commission for recognizing the risks of this approach and determining to revoke it.

III. Swing Pricing

Separately, the Commission is proposing a new swing pricing requirement. If adopted, this requirement would mandate that all institutional prime and tax-exempt money market funds apply a swing factor to redemptions at any time at which the fund experiences net redemptions in order both to fairly allocate the costs of redemptions and to prevent any first mover advantages. As part

[3] Mutual Fund Directors Forum Comment Letter, Proposed Rulemaking Regarding Money Market Fund Reform; Amendments to Form PF, File No S7-03-13 (available at https://www.sec.gov/comments/s7-03-13/s70313-138.pdf).

of this proposal, funds that would be subject to the requirement would need to adopt swing pricing policies and procedures that would be approved by the board and administered by a swing pricing administrator.

We oppose this mandate. First, we believe that a swing pricing mandate would add significant cost and complexity to the management of funds subject to the requirement, particularly to funds that price and offer redemptions to their shareholders multiple times during the trading day. Many money market funds are sold through distributors, which will make the process of determining whether the fund is in net redemptions in time to apply the swing pricing factor exceedingly difficult. Separately, the process of computing the swing factor, which is rooted in the estimated costs of selling pro rata amounts of every security in the money market fund's portfolio, is both complex and likely not representative of how funds actually meet routine redemption requests.

Second, because the application of swing pricing is inherently unpredictable from the investor's standpoint, mandating it whenever a fund is in net redemptions will render institutional prime and tax-exempt funds significantly less appealing to their investors. While an investor might be able to predict that a fund will be in net redemptions during periods of market stress, there is little ability to do so in ordinary circumstances, when flows into and out of these funds are, in effect, random. Because many investors use these funds as cash substitutes, this unpredictability will likely drive them into other products, costing them the additional return they might earn from a prime or tax-exempt fund. In addition, as these funds shrink, the costs imposed on those who remain in them will inevitably increase. Moreover, the potential for increasing costs, as well as the reduced appeal of these funds, might lead directors to conclude that it is not in their investors' interests to continue to offer them.

Third, it is unclear whether money market fund directors are well situated to approve and monitor swing pricing policies and procedures. While the Commission states that the requirements imposed on the board "contemplate[] a board role in compliance oversight, rather than board involvement in the day-to-day administration of a fund's swing pricing program,"[4] we are concerned that given the complexity both of designing the policies and procedures and the requirement to compute a swing factor based on a pro rata slice of the portfolio, the rules as proposed risk involving the board in the daily complexities of portfolio management and securities trading. In particular, the rules potentially require the board to build ongoing expertise in how short duration fixed-income instruments trade on a day-to-day basis and how the trading markets for these instruments are changing – the type of knowledge that is more typical of a trader or portfolio manager than a board member with oversight responsibilities. Hence, asking boards to insert themselves into this process risks involving them in the day-to-day management of the fund.

Finally, while we believe the Commission should not mandate swing pricing, if it chooses to move forward, we believe it should make clear that in many circumstances, a fund subject to the rule could rationally determine that its swing factor is zero. In the ordinary course of business, when flows are positive on some days and negative on others, days in which there are minor net redemptions impose no costs on other fund investors, as the funds are able to satisfy these redemption requests from their available liquidity. We understand that the Commission is

[4] Proposing Release at 7264.

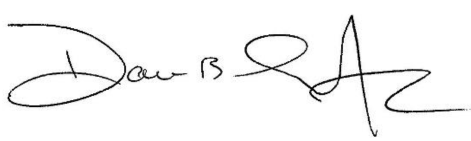
concerned that even in non-stressed periods, net redemptions can still impose costs on remaining investors by depleting liquidity and ultimately forcing the sale of portfolio securities. However, the Commission fails to address why a fund in these circumstances might rationally conclude that liquidity will be restored by net purchases in the ensuing days. Because investor activity flows both ways under ordinary business conditions in periods in which the markets are not stressed, we believe that many funds might conclude under the appropriate circumstances that no swing adjustment is necessary in spite of small levels of net redemptions. The Commission should therefore make clear that a swing factor of zero can be applied if a fund reasonably concludes that its liquidity is unlikely to be affected by "routine" days of net redemptions.

IV. Conclusion

For the reasons outlined above, we agree with the Commission's proposal to eliminate gates and liquidity fees from the regulations governing money market funds. However, we oppose mandatory swing pricing and urge the Commission to drop this part of its proposal. Finally, we believe that the Commission should more carefully consider what the impact of reducing the appeal of these funds will be on the capital markets generally and on the ability of those who issue the securities in which these funds invest to continue to effectively and efficiently raise capital.

We would welcome the opportunity to discuss these comments in further detail. Please feel free to contact David Smith, the Forum's General Counsel, at David.Smith@mfdf.org or 202-507-4491 or Carolyn McPhillips, the Forum's President, at Carolyn.McPhillips@mfdf.org or 202-507-4493.

Sincerely,



David B. Smith, Jr.
Executive Vice President & General Counsel