September 16, 2013

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549

Re: Proposed Rulemaking Regarding Money Market Fund Reform; Amendments to Form PF, File No S7-03-13

Dear Ms. Murphy:

The Mutual Fund Directors Forum ("the Forum")[1] welcomes the opportunity to comment on the recent proposal by the Securities and Exchange Commission ("Commission") to amend Rule 2a-7, the rule that governs money market funds.[2]

The Forum is an independent, non-profit organization dedicated to educating and informing independent investment company independent directors, and thereby enhancing the governance of mutual funds. Through continuing 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. The Forum is also committed to working with regulators and others to enhance the effectiveness of fund boards. A significant number of the Forum's members are responsible for overseeing money market funds and so are deeply interested in the outcome of the Commission's reform proposal.

I. Introduction

Money market funds represent perhaps one of the most significant and most successful innovations in the modern history of the mutual fund industry. A fund with a $1.00 stable net asset value ("NAV") offers investors a fund product they can use to invest cash that they may

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1 The Forum's current membership includes over 758 independent directors, representing 121 independent director 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 Proposed Rulemaking: Money Market Fund Reform; Amendments to Form PF, Release No. IC-30551 (June 5, 2013) [78 FR 36834 (June 19, 2013)] ("Release").

need immediately, provides important competition for banks and the checking accounts they offer, and is a significant provider of credit to government entities, financial institutions and other enterprises that play a key role in our economy. As such, the continuing success of money market funds is crucial to our economy.

In spite of their long-term success, the fact that one money market fund "broke the buck" during the financial crisis of 2008-2009 has led to calls for significant changes to the regulation and structure of money market funds. Indeed, the experience of numerous funds during that crisis demonstrated that a reexamination of the regulation of money market funds was necessary to ensure their ongoing viability. As a result, the Commission and industry took significant steps to strengthen money market funds – culminating in the successful strengthening of rule 2a-7 through the 2010 amendments adopted by the Commission.

The changes the Commission is now proposing could significantly change the structure of the funds, alter their appeal to their investors, and thus put at risk the important role they play in our economy and capital markets. These potential changes warrant careful consideration, and we are pleased to continue participating in this important process.

II. The Need for Money Market Reform

For reasons that we have outlined in our previous letters,[3] we remain skeptical that that the Commission or other financial regulators have conclusively demonstrated that money market funds, in and of themselves, pose a significant systemic risk. While it is true that money market funds have, on occasion, required sponsor support, the money fund industry has, as a whole, experienced only one significant crisis in its over 30-year history – the unprecedented financial and economic crisis of 2007 and 2008. That crisis, which engulfed our entire economic system, was not caused by money market funds -- in fact, money market funds were more victims of exogenous conditions in the financial markets than they were a significant cause of the crisis.

We recognize, however, that the Commission believes that it must continue to address the risk that money market funds experience runs in times of crisis as a means of reducing overall systemic risk. We certainly believe that the Commission should remain the primary regulator of money market funds and that the Commission continues to be best-positioned to address any risks posed by or problems experienced by these funds. However, given the continuing controversy over the nature and extent of the systemic risk posed by money market funds, the

[3] In order to deal more directly with the Commission's current proposals, we will not repeat our concerns here, and instead refer the Commission to our prior comment letters filed both at the Commission and to the Financial Stability Oversight Council. *See* Forum Comment Letter dated March 29, 2012 from David B. Smith, Jr. to Elizabeth Murphy (available at http://www.mfdf.org/images/uploads/newsroom/MFDF_Comment_Letter_March_29_2012.pdf) and Forum Comment Letter dated February 8, 2013 from David B. Smith, Jr. to Financial Stability Oversight Council (available at http://www.mfdf.org/images/uploads/newsroom/FSOC_Comments_MFDF_Feb_8_2013.pdf); *see also* David W. Blackwell, Kenneth R. Troske & Drew B. Winters, Money Market Funds Since the 2010 Regulatory Reforms (Fall 2012) (available at http://www.uschamber.com/sites/default/files/reports/FinalpaperwithCover_smalltosend.pdf) .

important role that money market funds play as a provider of credit in our economy and their importance to many investors, we urge the Commission to act in as focused and narrow a way as possible. In order to protect underlying credit markets and preserve investor choice, the rules that the Commission ultimately adopts should be designed to maintain, as much as possible, the fundamental benefits of money market funds.

At core, the Commission is proposing two potential alternatives for the restructuring of money market funds – requiring some types of money market funds, most notably, institutional prime funds,[4] to adopt a floating NAV or requiring most non-government money market funds to impose liquidity fees under specified conditions. As we discuss in more detail below, we understand that each of the alternatives in the Commission's proposal may, subject to some caveats, make money market funds less susceptible to runs. However, the Commission's proposals may create or heighten other risks to capital markets or the economy as a whole. In particular, each proposal would render prime money market funds less appealing to at least some investors, and thus would drive money that would otherwise be invested in prime funds to other cash substitutes, reducing both the credit provided by prime funds to underlying markets and investor choice. In essence, instead of reducing risk in the financial system, the Commission's proposals may do little more than shift risks between competing products in the capital markets while at the same time damaging the underlying credit markets in which money market funds invest.

We therefore strongly urge the Commission to consider these costs and risks in analyzing the proposed approaches and minimize, to the extent possible, regulatory incentives for current investors in prime money market funds to shift their cash elsewhere. As one way of addressing this, we also encourage the Commission to adopt both alternatives and allow funds to choose between the two regimes. Giving funds the choice of which alternative to adopt would permit each potential investor in a prime money market fund to determine which of these new limitations was most consistent with its investment needs. We see little reason for regulators to impose a top-down solution when allowing the markets to decide between the two proposals would reduce the run risk that funds face while at the same time preserving a greater degree of investor choice and reducing the amount of investor funds that will flow out of prime funds.

III. The Floating NAV Option

Under the Commission's first proposed alternative, institutional prime money market funds would be required to sell and redeem shares based on a floating NAV, rather than a stable $1.00 NAV. Money market funds also would be required to price to four decimal places rather than two. As the Commission outlines in its proposal, we agree that this approach may significantly reduce the incentive for money fund investors, particularly sophisticated investors, to redeem

[4] Importantly, this alternative would also apply to institutional money market funds that invest primarily in municipal securities. As a general matter, because most tax exempt funds are sold to retail investors, we do not discuss tax-exempt money market funds in detail in this letter. However, most of the concerns we raise regarding the imposition of a floating NAV on institutional prime funds apply equally to any tax exempt funds that would be subject to the alternative. More generally, given that investors place their money in municipal funds for very specific tax-oriented reasons, we believe that the Commission should fully exempt money market funds that invest primarily in municipal securities from the rule.

their shares because of concerns that the fund's shadow NAV is trending lower. However, neither a floating NAV nor any other approach to fund regulation can reduce or eliminate the reality that investors will redeem their shares if they believe that the underlying market is deteriorating. The Commission must therefore be careful to state what type of run risk it is attempting to reduce and why doing so will have systemic benefits.

We agree that retail funds should not be subject to a floating NAV requirement. As the Commission notes in its release, there is clear evidence that "retail investors tend to redeem shares slowly in times of fund and market stress or do not redeem shares at all."[5] There is thus significantly less need to impose measures designed to reduce the pace of withdrawals in times of stress. The Commission would distinguish retail from institutional funds by requiring that a retail fund not permit more than $1 million in redemptions by any record holder of fund shares in a single day. We agree that distinguishing retail funds through use of a daily redemption limit makes sense, even if the limit actually chosen is likely to be somewhat arbitrary. However, while a $1 million limit will likely be acceptable to retail investors in many circumstances, there are realistic situations (such as the purchase of a home) in which a retail investor might need to redeem more than $1 million from a money market fund in a single day. Moreover, it is difficult to imagine circumstances in which occasional larger redemptions (say, of up to $5 million) by a retail investor from a retail fund will pose a significant risk to either the fund's liquidity or the underlying markets as a whole. In addition, setting a redemption limit at a level like $5 million is unlikely to render retail funds attractive to large institutional investors. We therefore urge the Commission to consider raising this level.[6]

Finally, imposing a floating NAV may create significant new costs for investors in and advisers to money market funds, both in the implementation phase and on an ongoing basis. While others are better positioned to detail and quantify these costs than we are, the costs may range from tax costs to system changes at both advisers and investors to changes in the investment process at many institutional and corporate investors.[7] Each of these costs must either be borne by the investor, by the fund's adviser or creates an incentive for the investor to shift its funds to some other cash management product. Given the already significant steps taken to reduce the risk posed by money market funds, these costs should be carefully considered by the Commission, particularly given that the current proposal may, in addition to the direct costs it imposes, also increase risks elsewhere in the financial system without producing clear benefits, either for money market fund investors or the financial system as a whole.

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[5] Proposing Release at 75.

[6] *Cf., e.g.,* Letter from F. William McNabb III, Chairman and CEO, Vanguard Inc. to the Financial Stability Oversight Council (Jan. 15, 2013) at 9-10 (urging that the distinction be made by limiting retail accounts to $5 million in size).

[7] *See generally* Center for Capital Markets Effectiveness, Treasury Strategies Report on the Operational Implications of a Floating NAV across Money Market Fund Industry Key Stakeholders (Summer 2013).

IV. The Standby Liquidity Fee Option

a. The Option

As with the floating NAV alternative, we concur that this approach has the potential to reduce runs during times of stress or crisis. That said, as the Commission's proposal seems to recognize, 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. Despite the possible structural weaknesses of this approach, we support offering the liquidity fees alternative as an option if the Commission intends to change the manner in which money market funds are regulated.

Below, we offer more detailed comments on two components of this proposal: the Commission's proposal not to exclude retail funds from the scope of the requirement and the new authority fund boards would have to waive otherwise required liquidity fees or impose gates on redemptions.

b. Application to Retail Funds

In contrast to its proposal on floating NAV, the Commission does not propose excluding retail money market funds from the liquidity fees alternative. We urge the Commission to also exclude retail money market funds from this alternative. While the Commission is correct that the possibility of a liquidity fee or gate does not impact the daily experience of (or burdens associated with) investing in a money market fund in the same way as a floating NAV, the primary consideration should continue to be that retail investors behave differently in times of market stress than do institutional investors. Because retail investors are demonstrably slower to redeem their shares, the fund's adviser will have greater ability to manage the fund's liquidity in a way necessary to meet redemptions, even in times of market stress, without necessitating the cost of that liquidity being imposed on redeeming retail shareholders. Moreover, retail users of money market funds are less well situated to understand when such restrictions might be imposed and to plan for their imposition. Finally, retail investors, who often use money market funds as the equivalent of checking accounts to fund their needs on a daily and monthly basis, are more likely to be harmed by the imposition of liquidity restrictions than institutional investors who are better able to structure their investments to meet their liquidity needs.

c. The Role of the Board

The Commission proposes to give boards two important powers: the power to waive (or reduce) an otherwise required liquidity fee and the power to impose a gate on redemptions. The Commission suggests that in determining whether to exercise these new powers, fund directors should act in the best interests if the fund.

We agree that it is appropriate to give boards this option. In particular, we believe that boards have the necessary familiarity with the circumstances faced by the individual funds they oversee to determine whether a liquidity fee should be waived or a gate should be imposed. Moreover, while it is possible that boards will face enormous pressures and even potential conflicts when considering these options, boards are entrusted by the Investment Company Act of 1940 ("Investment Company Act") to address and decide the most fundamental issues faced by all investment companies. Directors understand the fiduciary obligations they have to the funds they oversee and the investors in these funds, and should be entrusted to act on behalf of the funds in highly stressful market conditions. Finally, granting boards these powers adds important flexibility to the Commission's proposal and reduces the risk that money market fund shareholders will be harmed through the unnecessary imposition of redemption restrictions.

We are comforted by the relatively minimal guidance that the Commission has initially provided on what factors a board might consider in making these determinations. Any determination by a board regarding fees or gates is likely to be highly fact-specific, and thus providing any guidance on what factors boards should consider (beyond the very general and non-exclusive examples in the proposing release)[8] is likely to be counter-productive. Boards make decisions about the best interests of a fund and its shareholders in many contexts, and can determine what factors are most relevant based on the particular facts and circumstances they face. Providing more specific guidance, in contrast, is likely to constrain a board's flexibility and lead to a "check the box" approach to decision-making that is sharply at odds with the flexibility and business judgment that boards are capable of bringing to complicated situations. In addition, the Commission should clarify that the "best interests of the fund" standard requires emphasis on the needs of the fund and its investors, and thus generally does not demand that boards place significant emphasis on broader systemic effects of their decision (apart, of course, from their consideration of the state of the financial markets at that time and how it will likely affect the fund they oversee).

Finally, and most importantly, the Commission should recognize expressly that boards will use their business judgment in making decisions of this type, and hence that the board's decision should be protected in all contexts by the business judgment rule. As a general matter, under the business judgment rule, a board should not be liable for a decision it has made as long as it acted in good faith, was reasonably informed, and reasonably believed that the decision it made was in the best interests of the fund and its shareholders. In this case, decisions regarding fees and gates will need to be made quickly in the context of complicated, rapidly-changing circumstances without all of the information that they might otherwise wish to consider as part of their decision-making process. The threat of litigation, whether by private litigants or the Commission, could chill the board's ability to act in a manner that would be highly counterproductive in times of market stress. Moreover, in granting boards these important powers, the Commission should express its confidence in boards' ability to act appropriately by expressly stating that this board decision, like virtually all others, is protected by the business judgment rule. Leaving boards vulnerable to being judged in hindsight, with the benefit of facts unavailable at the time of the decision, is a risk that boards should not have to face.

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8 The Commission notes a few factors that fund boards might consider, including the shadow price of the fund at the time, indicators of liquidity stress in the markets in which the fund invests, changes in spreads for portfolio securities, the liquidity profile of the fund and expectations of how the liquidity profile of the fund is likely to change in the very near future. *See* Proposing Release at 185. We agree that these are likely to be factors relevant to the board's decision, but are also sufficiently general as the give the board a broad ability to consider other factors and exercise its business judgment.

d. Disclosure of Board Decisions Regarding Fees and Gates

The Commission also proposes that money market funds be required to file a statement on new Form N-CR within one business day of triggering the threshold leading to imposition of liquidity fees or consideration of liquidity gates. Within four business days, funds would be required to file an amendment to form describing, among other things, how and why the board exercised its authority with respect to the fees and gates.

While we recognize the importance of a fund disclosing rapidly whether liquidity fees have been imposed or gates put in place, we do not believe that the board's analysis of the situation can or should be disclosed within four days. Specific discussions of board decisions are very rare under the Investment Company Act – indeed, the required annual discussion of the Board's reasons for renewing the advisory contract is virtually unique. There is a reason for this – boards need to be able to act freely, on the basis of active debate and discussion of all relevant factors, to reach a decision. The differing views and opinions of individual board members must be expressed as part of this debate in order for the board to reach a decision that it views as being in the best interests of the fund. Disclosure of these discussions and the reasoning that underlies them may chill the debate, particularly if there is a risk of future litigation. We believe, therefore, that there is a high burden for imposing disclosure requirements of this type – a burden that is not met here.

More specifically, these reports would likely need to be prepared in times of significant market stress – stress that may well persist for a period of time well in excess of four days. Distracting the board from its ongoing obligation to oversee the fund's continuing response to the crisis would potentially be counterproductive. Moreover, in a rapidly changing environment, the reasons for which the board acted may well change within a period of four days or significant amounts of additional information may be available to the fund and its board. In this context, a filing requirement focused on a prior decision risks inadvertently misleading fund investors and others about the state of the fund's operations.

Depending on the situation, fund investors may well have an interest in better understanding the circumstances that led to the imposition of redemption fees or gates. They will certainly have an interest in understanding the impact of these situations on fund operations and performance. We therefore believe that these questions can be more effectively addressed through the periodic disclosure funds provide. For example, funds might do so in an annual management discussion of fund performance.[9] In that context, the fund can provide more effective and better reasoned disclosure of the events surrounding the imposition of fees or gates in the context of a broader discussion of what occurred in the markets and the fund's portfolio, as

9 We recognize that money market funds are not currently required to file a management discussion of fund performance. The Commission may wish to consider requiring this discussion be filed by any fund that triggered the liquidity threshold within the prior 12 months.

well as the impact that the imposition of fees and/or gates had on the fund's portfolio and performance going forward.[10]

V. The Two Alternative Approaches Should Not be Combined

As we note above, we believe there are good reasons for the Commission to offer the two alternatives it proposes as options to prime money market funds, particularly prime institutional funds. We strongly believe, however, that there is no reason for the Commission to combine the proposals and impose both a floating NAV and liquidity fees or gates on these funds. The operations of a fund that adopts a floating NAV will be fundamentally analogous to those of a traditional mutual fund investing in similar securities. There is no other example in which the Commission requires a fund that transacts on the basis of its true NAV to impose liquidity fees in order to protect underlying securities markets in times of stress, and the Commission provides no legitimate reason to conclude that it ought to do so in this case. Indeed, even assuming that the Commission should act to protect the underlying markets, a fund that would otherwise be required to have both a floating NAV and liquidity fees could avoid regulation under the money market rules merely by changing its name to avoid the naming requirements of rule 2a-7 – indeed, under these circumstances, we suspect most such funds would do so, thus negating any impact the rule might otherwise have. The Commission should not adopt a combined approach.

VI. Other Issues

a. Website Disclosure of NAV

The Commission's proposal would require all money market funds to disclose their actual NAV on the website on a daily basis, irrespective of whether the fund is a stable value fund or trades on the basis of a floating NAV. Many fund complexes have already taken this step, and we agree that this disclosure will increase the transparency of money market funds and help investors in those funds better understand their investments. We therefore support this proposal.

b. Stress Testing of Money Market Portfolios

The Commission proposes to enhance the stress testing requirement currently in place by requiring that the stress tests address additional situations, mostly focused on assessing the fund's ability to avoid dropping below certain portfolio liquidity thresholds.[11] Under the Commission's proposals, fund boards would continue to be responsible for approving procedures under which the periodic stress tests would be conducted. In describing its approach to stress testing, the Commission notes its proposed scenarios should not be viewed as the exclusive set of factors that should be reviewed as part of stress testing, but rather as a minimum.

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10 To the extent that the Commission has a separate regulatory interest in the board's reasoning, that reasoning will be preserved in the minutes of the board meetings at which the imposition (or elimination) of fees and/or gates was discussed.

11 The Commission suggests slightly different scenarios and tests for each of its alternative proposals. Because we support the Commission offering funds a choice between the two alternatives rather than imposing one of the alternatives, we recognize that both stress testing alternatives may be adopted as well.

As a general matter, we have no objection to the stress testing scenarios that the Commission is proposing. They are generally sensible and closely linked to the regulatory requirements that would be imposed elsewhere in the proposed rules. That said, we believe that the Commission should exercise care not to mandate the precise form of stress tests. If the Commission imposes too many requirements on the stress tests or describes their scope in too much detail, it will effectively limit funds' flexibility to design stress tests that evolve to fit the ever-changing nature of the markets. Instead, the Commission should leave it to fund advisers, working with fund boards, to further fine tune the stress tests used by particular funds.

VII. Conclusion

Money market funds, like any other mutual fund or other investment, have risks associated with them, and like other investments, conditions in the economy or markets sometimes cause investors to move large amounts of cash to or from money market funds. Risk cannot be eliminated from money market funds any more than it can be from other forms of investment. While it makes sense for financial regulators to be wary of and attempt to reduce systemic risk in the capital markets, regulators should not try to eliminate risk from investments.

Moreover, as discussed above, money market funds play an integral role in the markets. Because regulatory choices impact investor choices, new regulations can have a significant impact on how assets are apportioned between different types of investments, and these investor choices can have large and unpredictable effects on both capital markets and the economy as a whole. The Commission should thus exercise great care in considering its proposal – a proposal that would mark a fundamental change in how money market funds are regulated.

The independent directors of money market funds recognize the importance of these funds and the complexity of the regulatory choices with which the Commission is faced. Independent directors also recognize that they have an important obligation to help ensure that money market funds are operated as effectively and as fairly as possible on behalf of their investors.

We would be pleased to discuss any of these issues with you in greater detail. Please feel free to contact me at 202-507-4491 or Susan Wyderko, the Forum's President, at 202-507-4490 at any time.

Sincerely,

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