American Bankers Association
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VIA ELECTRONIC MAIL

January 10, 2011

Ms. Elizabeth M. Murphy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: ***SEC File Number 4-619***
President's Working Group Report on Money Market Fund Reform
75 *Federal Register* 68536, November 8, 2010

Dear Ms. Murphy:

The American Bankers Association (ABA)[1] appreciates the opportunity to respond to the request for comment by the Securities and Exchange Commission (Commission) on the options discussed in the report presenting the results of the President's Working Group on Financial Markets' (PWG) study of possible money market fund reforms. The report, prepared at the request of the Treasury Department in the wake of the concerns about the money market funds (MMFs) leading to the extraordinary Treasury action in September 2008, sets forth possible fundamental changes to address the vulnerability of MMFs to systemic risk and to reduce the susceptibility of MMFs to runs.

ABA represents over a thousand banks with trust departments who invest in MMFs on behalf of their institutional and personal trust clients. Through these trust departments, as of December 31, 2009, banks have invested over $171 billion in MMFs.[2] In addition, over 100 banks offer proprietary MMFs which will be impacted directly should any of the options be adopted. Our members believe it critical that *all* of their clients be able to have access to funds with stable net asset values (NAVs).

The report presents a number of policy options that could be adopted with the intention to reduce the susceptibility of MMFs to runs that may, in turn, pose a systemic risk to the broader financial system. These options include:

- Requiring MMFS to adopt floating net asset values as opposed to maintaining stable, rounded NAVs as is the current practice;
- A two-tier system of MMFs with enhanced protection for stable NAV MMFs;
- A two-tier system of MMFs with stable NAV MMFs reserved for retail investors;

[1] The American Bankers Association (ABA) brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.
[2] FDIC *Quarterly Banking Profile,* December 2009 available at http://www2.fdic.gov/qbp/2009dec/all8a.html. This figure includes personal trust and agency accounts, investment management agency accounts, employee benefit accounts, retirement-related accounts, and all other managed asset accounts.

- Regulating stable NAV MMFs as special purpose banks;
- The establishment of a private emergency liquidity facility for MMFs;
- Mandatory redemptions in kind;
- Insurance for MMFs; and
- Enhanced constraints on unregulated MMF substitutes.

At this conceptual stage, our comments will focus primarily on our concerns with restrictions on the use of stable NAVs by MMFs and federal government support for MMFs. We would have more extensive comments should more detailed proposals be offered for comment.

Background

Money market funds are mutual funds that serve investors seeking liquid investments and borrowers seeking short-term funding. MMFs operate pursuant to SEC Rule 2a-7, which imposes credit quality, maturity, and diversity requirements and, importantly, permits these funds to maintain a stable NAV per share, typically $1. To serve their liquidity function for investors, MMFs pledge always to stand ready to redeem their shares for cash. MMFs keep a certain portion of their overall investments in cash-like instruments that, in normal market conditions, are sufficient to cover redemptions.

If the mark-to-market per-share value of a fund's assets (its shadow NAV) falls more than one-half of one percent (i.e., to below $0.995), the fund must reprice its shares, known as "breaking the buck." When repricing occurs or is feared, investors have an incentive to redeem their shares quickly before the supply of cash-like investments is exhausted, after which less liquid assets must be sold at fire-sale prices, lowering the NAV even more for remaining investors. When the Reserve Primary Fund broke the buck in September 2008 due to losses resulting from the Lehman Brothers bankruptcy, fears that other funds would follow suit led to a broad-based customer withdrawal of funds from MMFs with investors withdrawing approximately 15 percent of the assets of prime MMFs in a single week. As a result, MMFs held onto cash to cover redemptions and refused to lend to the short-term credit market, leading to a freeze in that market. To calm the markets, Treasury took the unprecedented step of providing a temporary full guarantee of investors' assets in MMFs that participated in the Treasury program. Unlike the Reserve Primary Fund, many other MMFs had sponsors with the means to provide financial support with the result that no other MMF broke the buck.

The Commission has since amended its regulations to, among other things, impose additional credit-quality standards, reduce the weighted average maturity of funds' portfolios, and permit a fund that is breaking the buck to suspend redemptions and liquidate its portfolio in an orderly manner. Nevertheless, it is asserted by some that additional actions are necessary to reduce MMFs' vulnerability to runs. However, we are unaware of any systemic risk issues (similar to those experienced in 2008 by MMFs) with respect to bank collective and common funds, which currently are comprehensively regulated and examined by the federal bank regulators. Accordingly, we believe that no additional remedial actions need be taken with respect to such entities.

Discussion

The PWG report ascribes the vulnerability of MMFs to runs to the interaction of five characteristics of these funds:

- Limited liquidity resources;
- Stable NAVs rounded to $1;
- Portfolios exposed to credit and interest rate risk;
- Discretionary sponsor capital support; and
- Investors' low risk tolerance and expectations.

Because MMFs maintain their net asset value at $1, they provide valuable cash management alternatives for both retail and institutional investors who seek to have readily liquid assets for day-to-day personal or business expenditures. In addition, because MMFs are required under SEC Rule 2a-7 to invest only in short-term high-quality assets, many investors have come to accept the trade-off of higher interest on MMF assets versus the lack of insurance for their accounts. Moreover, investors who need large sums for business expenditures, such as payroll, are exposed to the credit of the bank when the funds in bank accounts exceed the statutory deposit insurance limit which, until the crisis, was $100,000. The usefulness and the perceived safety of MMFs have made these funds particularly attractive to risk-averse investors, both retail and institutional.

1. Stable NAV Funds

The PWG believed that the use of stable NAVs has contributed substantially to perceptions that investments in MMFs carry little risk to either individual or institutional investors. Three of the policy options in the report involve this feature of MMFs: 1) replacing all stable NAV MMFs with floating NAV MMF's; 2) a two-tier system of MMFs of stable and floating NAV funds with enhanced protections for stable NAV funds, such as access to a private liquidity facility; and 3) a two-tier system with stable NAV funds restricted to retail investors.

ABA strongly believes that stable NAV MMFs should remain available to *all* investors, whether retail or institutional. The utility of stable NAV funds for investors as cash management vehicles and for transaction stability is evidenced by the amount of funds invested in them. In addition, many investors believe stable NAV funds are key to easing fund transactions and reporting. We have no objection to the addition of floating NAV MMFs – indeed, the market is already responding to the nascent demand for such investment vehicles. However, as discussed below, we believe the benefits of retaining the option of funds with a stable NAV are sufficiently great that the reduced potential risk of a broad run should be addressed by other means.

A stable NAV fund provides a level of simplicity for investors who wish to keep their assets fairly liquid for some period of time and gives them confidence that the value of the fund will remain constant no matter which day they may purchase or redeem shares. This is particularly important for accounts that are used for transactional purposes rather than as investments.

a. Transactional Stability

For example, in the institutional world, MMFs are used to fund transactions that occur over the course of the day. If the NAV floats, service providers would need to request that shares be redeemed prior to the close of the market (when the fund is priced), but the number of shares needed to be redeemed to fund the transaction would be uncertain. Estimating the number of shares needed to be redeemed will result in an end-of-day excess or shortfall. This leads to a potentially significant difficulty in calculating the end-of-day values. By contrast, a stable NAV provides certainty for funding the day's transactions. Similarly, municipal bond issuers who, under their indentures, are required to maintain reserves at a specified level can be assured that they will not have to advance cash to satisfy that reserve level because funds invested in MMFs will not fluctuate.

Finally, trust departments commonly sweep idle cash that must be made productive into MMFs on an overnight or longer basis. If such swept funds are intended to cover a future expense, such as college tuition, a floating NAV could result in an insufficient amount to cover the particular expense. Indeed, one commentator has likened a fund with a floating NAV to “a bank account whose balance could fall on a given day . . .”[3]

b. Legal Requirements

Certain trust investors may face legal or other constraints that require them to invest their cash balances in funds that maintain a stable NAV. For example, we are aware of at least three state statutes that specify MMFs with a stable NAV as permissible investments under indentures.[4]

Our members believe it imperative that stable NAV funds remain available to institutional investors. The report notes that institutional investors have increasingly been significant investors in MMFs and now account for approximately two-thirds of MMF shareholders. It further indicates that due to their ready access to market information, institutional investors are better situated to redeem their shares at the slightest hint of trouble, thereby disadvantaging retail investors. ABA believes, however, that the recently adopted SEC rules have diminished the vulnerability of stable NAV funds to runs and that other policy options are available to ameliorate further the risks from runs.

3. Mandatory Redemptions in Kind

ABA opposes mandating that large redemptions by institutional investors be made in kind. At this point in the discussion, this option is simply too vague to address with any specificity. Critically, there is no definition of what constitutes a “large” redemption, and as the report indicates this option is fraught with both equitable and operational difficulties.

4. Insurance for MMFs

ABA strongly opposes any form of public insurance for MMFs for a number of reasons. First, the solution would not fit the problem. Here we believe the experience of the system for federal deposit insurance coverage for bank deposits is instructive. The goal of federal deposit insurance program has been to make up for lack of information or understanding by small savers. Deposit insurance was designed to assure small depositors—the source of historic bank runs like those that occurred in the Depression – that their funds are safe so that they do not need to pull their funds from an otherwise healthy institution. This has been justified by the view that small savers are unable to be as well informed about the financial condition of a bank as would be larger savers. Accordingly, the amount of deposit insurance coverage available to account owners has always been relatively limited. The same policy approach in the case of MMFs would not fit, since MMMFs have been more vulnerable to actions by large investors, the very ones with better information to judge the financial condition of the fund.

Second, any investment or deposit insurance system carries moral hazard. It reduces the exposure of the investment vehicle to market discipline. For that very reason, deposit insurance coverage has been kept relatively limited in order to limit its muffling of market discipline. Moreover, that reduction in market discipline is to a significant degree offset by a very intrusive regulatory program, involving application of a

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[3] E21 – Economic Policies for the 21st Century, Commentary Series, *Do Money Market Mutual Funds Make Sense Anymore?,* Papagianis, Christopher (December 3, 2010).
[4] See Texas Public Funds Investment Act, Texas Government Code Sec. 225.014; see also, Louisiana Revised Statutes. RS 33:2955 A.(1)(e), and Colorado Revised States, Article 75 State Funds, Sec. 601.1(1)(K).

stringent system of safety and soundness supervision and examination. Providing a federal insurance program for large-scale MMMF investments would carry a correspondingly greater moral hazard, muffling market discipline, requiring a correspondingly greater and more intrusive regulatory program. We believe that the benefits of any such insurance program would not justify the costs either of diminished market discipline or the extensive regulatory program that would be needed to try to offset that moral hazard.

Second, the costs of creating such a public insurance system for MMFs would make such investments significantly less attractive and thus adversely affect an investment option that has functioned very well. Competitive fairness, as well as the risk of destabilizing banks' funding, dictates that any such system not provide advantages to investors in MMFs *vis-à-vis* owners of bank deposit accounts. As we have said, such a federal system for large investors would necessitate an even greater panoply of regulations and examinations (and their attendant costs) than those that comprise the deposit insurance system applicable to bank accounts. We believe it unwise given the current fiscal crisis even to contemplate the task of creating a new government agency to design an insurance program and develop the regulations and structure necessary to implement such a program. Because of these issues and costs, any further consideration given such an effort should involve extensive consultation with bank regulators, all affected elements of the financial services industry, and all the various MMF constituents.

Conclusion

As discussed above, ABA strongly opposes any requirement to convert stable NAV money market funds to floating NAV funds, and we believe institutional investors should continue to have access to stable NAV funds. Moreover, we oppose any form of public insurance for money market funds.

If you have any questions concerning the foregoing, please do not hesitate to contact the undersigned.

Sincerely,

Cristeena G. Naser

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Center for Securities, Trust & Investment