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COMPETITIVENESS

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Mr. Mohamed Ben Salem
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Subject: Money Market Fund Systemic Risk Analysis and Reform Options

Dear Mr. Salem:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation representing the interests of over three million companies of every size, sector and region in the United States. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory system for the capital markets to promote economic growth and job creation. The CCMC appreciates the opportunity to comment on the Technical Committee of the International Organization of Securities Commissions' ("IOSCO") consultation report entitled *Money Market Fund Systemic Risk Analysis and Reform Options* ("the Report") issued on 27 April 2012.

The CCMC appreciates the IOSCO's role in analyzing possible risks that money market mutual funds may pose to systemic stability, and supports U.S. and international financial regulators' goal of monitoring and mitigating threats to the global financial system. In doing so, however, regulators must act carefully to ensure that any changes to money market mutual fund regulations do not fundamentally alter the character or utility of this important tool for corporate and municipal finance. These funds are the result of creation and financial innovation over 40 years ago to fulfill a need in the capital markets. We implore you to not act without first conducting a thorough analysis to fully understand the operational and economic

impact of any changes on international and American businesses as well as the broader capital markets.

The CCMC is very concerned that several of the suggested options to "reform" money market mutual funds will be detrimental to American businesses' cash management efficiencies and significantly impair businesses' ability to secure affordable short-term financing. Such results will have both direct and indirect implications for the global economy. These possible changes to money funds will also come at the same time that American companies will be confronted by the effects of the Volcker Rule, Basel III capital requirements, and expanded derivatives regulation—all of which will impair companies' ability to hedge risk and obtain capital necessary to grow and create jobs.

It is also important to note that any proposed changes will be made closely on the heels of sweeping money market mutual fund reforms that were implemented by the U.S. Securities and Exchange Commission ("SEC") in 2010. The 2010 reforms, which substantially bolstered liquidity and credit safeguards, have proven to withstand market turbulence since their implementation. The efficacy of these reforms must be thoroughly studied and understood by both U.S. and international regulators before undertaking more sweeping changes like those discussed in the Report. If IOSCO is compelled to make recommendations for money market fund reform, we believe that you should recommend the international community adopt standards to bring them in line with the SEC's current Rule 2a-7—rather than any of the policy options discussed in the Report that could have far reaching implications.

Although a formal proposal to modify money market mutual fund regulation has yet to be released by U.S. or international regulators, public discussion of options under consideration by regulators has already incited businesses to take steps in finding alternative investments options. This advance reaction underscores the importance of money market mutual funds to the corporate treasury function. Corporate treasurers cannot afford to wait until a final rule is in place, and it is likely that when the SEC issues a proposal, many U.S. companies will move cash out of money market mutual funds and into other, potentially less favorable or less well-regulated instruments. Instead of preventing any anticipated runs, financial regulators will spark a methodical walk out of these funds, leaving the industry in the dust. Thus, we cannot agree more with the Report's assessment that a "…transition to a VNAV paradigm may itself be systemically risky, by potentially generating pre-emptive runs by investors seeking to avoid potential losses or by the outflow of

institutional investor who transfer assets to less regulated or unregulated cash management vehicles that hold similar or substantially similar vehicles, but which are not subject to the protections of the Investment Company Act."[1]

Background

Money market mutual funds play a critical role in the U.S. economy because they work well to serve the investment, cash management, and short-term funding needs of businesses across America. Corporate treasurers rely on money market mutual funds to efficiently and affordably manage cash. Cash balances for companies fluctuate on a daily basis, and depending on the nature of the business, some companies' cash levels can swing widely—from hundreds of dollars to hundreds of millions of dollars.

Corporate treasurers' main priority is to ensure liquidity. As such, money market mutual funds' stable price per share and easy investment and redemption features make them the preferred investment choice. Investments can be made and redeemed on a daily basis without fees or penalty. Moreover, money market mutual funds offer corporate treasurers diversified and expertly-managed short-term investment of their cash. Quite simply, it is more economical to pay the management fee for a money market mutual fund than to hire internal staff to manage the investment of cash.

It is important to note that corporate treasurers understand the risk of investing in money market mutual funds. They and their staff are professional stewards of their companies' monies and take their responsibility seriously. Because U.S. money market mutual funds include significant disclosures in their prospectuses and other investor resources, corporate treasurers are able to easily ascertain what investments are in each money market mutual fund and the degree of risk associated with each of the funds.

As documented in the Report, money market mutual funds also represent a major source of funding to the corporate commercial paper market in the U.S., purchasing approximately one-third of all outstanding commercial paper. In April

[1]IOSCO Technical Committee Consultation Report on Money Market Fund Systemic Risk Analysis and Reform Options, dated 27 April 2012, page 14.

2012, U.S. money market mutual funds held $379.5 billion in commercial paper, according to iMoneyNet. This source of financing is vital to companies across America as commercial paper is an easy, affordable way to quickly obtain affordable short-term financing.

In general, corporate treasurers receive a daily cash report indicating the anticipated cash inflow and cash outflows for that day. If there is an anticipated cash shortfall, a company can issue commercial paper and have the funds available later that same day. This "just in time" financing not only affords corporate treasurers the flexibility to borrow cash when needed, it also grants them the flexibility to borrow for the duration needed—and at much lower, more affordable rates. For example, currently in the United States, a company rated A2/P2 can issue commercial paper at approximately 41 basis points[2]. In contrast, drawing on a bank line of credit with same day notice for a short duration will cost prime plus 100 basis points, which is approximately 425 basis point—a 10 times increase in costs.

Comments on Policy Options

Recent Reforms to SEC Rule 2a-7

Before discussing possible further changes in the regulation of money market mutual funds, it is important to emphasize that such changes will not occur in a vacuum. A mere two years ago, the U.S. Securities and Exchange Commission made enhancements to money market mutual fund regulation through Rule 2a-7. These changes did a number of things, but most importantly, increased the liquidity requirements of money market mutual funds. Funds are now required to meet a daily liquidity requirement such that 10 percent of the assets turn into cash in one day and 30 percent within one week. This large liquidity buffer makes it unlikely that large redemption requests—even at the rate seen in the 2008 financial crisis—will force a fund to sell assets at a loss prior to their maturity. During the recent jitters over the European sovereign debt crisis, substantial concerns arose over the exposure of U.S. money market mutual funds to European banks. Additionally, the U.S. Government debt ceiling crisis coupled with the downgrade of the U.S. Government securities by Standard & Poor's put pressure on money market funds that are predominantly

[2] Based on the 2012 annual average 15 day CP rate published by the Federal Reserve on May 22, 2012 at http://www.federalreserve.gov/releases/CP/rates.htm.

invested in these securities. Yet, investor confidence in money market funds and the enhanced liquidity requirements permitted funds to meet all redemption requests without a problem.

By increasing the daily and weekly liquidity requirements for money market mutual funds, the reforms have substantially reduced the likelihood that a wave of redemptions would cause distressed selling of assets. The normal cash flows from maturing assets can cover redemptions even in extreme situations. Even in a situation where there is a loss of confidence in prime funds, there would be no panic selling. The worst that can happen is that the prime funds shrink as investors move their assets at a "walk" into presumably safer U.S. government funds. Some issuers of commercial paper may be shut out of the commercial paper market, but they would then utilize their backup lines of credit from banks. Credit rating agencies effectively require such backup letters of credit, so the companies would still be able to get funding in such emergencies, even though the price would be higher than with commercial paper. Since these issuers are of the highest quality, the banks would experience an increase in the credit quality and profitability of their loan portfolios at a time of economic stress, which should please both the banks and their regulators.

Variable NAV

The stable price per share feature of money market mutual funds is the hallmark that makes these funds an attractive investment option for corporate investors in the U.S. If financial regulators implement a floating or variable NAV, an exodus of investments by corporate investors is certain to occur. Preservation of principal is equally important to a corporate treasurer who is responsible for ensuring that daily working capital needs are met, and therefore, a variable NAV would present significant challenges that will no longer make these funds a viable option. Additionally, some corporate investment guidelines preclude the investment of cash in anything other than a stable value product.

A variable NAV would also present significant tax and accounting issues for corporate investors. From a tax perspective, a capital gain or loss would have to be recorded each time redemptions are made. Many companies invest and redeem several times daily, so with a variable NAV, accounting becomes an excessively complex process. Moreover, corporate treasury and accounting systems are not programmed to handle variable NAVs. Given the complexity of such systems, they

would not be upgraded quickly or cheaply. Early indications from discussions with third party vendors experienced in such upgrades suggest that a 6 to 18 month implementation and testing timeframe would be required. Accordingly, upgrade costs would be significant. Few corporations have the flexibility or desire to deal with this complexity, and instead would transition cash to other alternative investment options.

Capital Buffers

Some of the proposed reform options call for various capital buffers or parent company guarantees. As documented in the Report, parent companies of money market funds have stepped in many times over the years to purchase securities from their money market funds to prevent losses to those funds. Often, however, these securities were only temporarily impaired due to liquidity concerns, and there was no permanent decrease in value. The securities eventually paid off at par and on schedule. Parent companies have a strong incentive to step in and stabilize their funds in order to protect their reputations: fund investors can only lose money if the fund managers err and purchase risky securities that go bad.

One problem with requiring funds to hold capital buffers is that such buffers would cost far more than the expected value of any losses. In order to make a fund truly bulletproof, the buffer would have to be able to withstand the default of the largest holding in the fund. The opportunity cost of letting capital sit idle is likely to outweigh any management fees that the investment advisor can earn for its efforts.

By mandating some form of capital buffer, financial regulators are attempting to provide protection for investors against potential losses. If the capital buffer is funded by the parent company, it will drive some fund companies out of the industry, leaving fewer choices for investors. If the capital buffer is built up over time by allocating some of the yield to the buffer, it will take too long to build the necessary buffer to protect against losses or virtually eliminate any return on investments for investors. Thus, increasing fees or reducing yields, particularly during a time of near zero interest rates, will inevitably drive investors out of the marketplace.

Redemption Restrictions

The Report also outlines several options that would impact shareholders' redemption rights, including liquidity fees and minimum balance requirements.

Implementation of either of these two options will generate a pre-emptive run among corporate investors. As stated earlier, both liquidity and preservation of principal are two key elements of the corporate treasury function. Imposing a liquidity fee is akin to implementing a variable NAV, and as such, would preclude a number of companies from investing in money market mutual funds. Although the liquidity fee may not be imposed until the fund's portfolio falls below a specified threshold or when there is a high volume of redemptions, corporate treasurers have an obligation to ensure that "a dollar in will be a dollar out" and therefore, will not risk investing cash in an investment product that may not return 100 cents on the dollar. Given that there is limited transparency into when high volumes of redemptions may occur, instead of second guessing other investors' redemption activities, companies will simply not invest.

The minimum balance requirement option not only presents operational challenges for corporate treasurers, it also substantially increases the company's borrowing costs. Like any prudent investor, corporate treasurers "don't put all their eggs in one basket" but rather spread cash throughout a multitude of money market mutual funds. Some larger companies may maintain investments in several dozen funds at any given time. If a minimum balance is required for each fund, there will be pockets of "minimum balances" in each account, complicating cash forecasting and accounting. Furthermore, restricted access to theoretically liquid investments may force companies to draw on their lines of credit to meet working capital needs, thereby needlessly increasing borrowing costs. Hence, it would be illogical and imprudent for corporate treasurers to invest in funds with a minimum balance requirement.

Marked-to-Market Valuations

Determining a true "market" price to calculate NAV presents many problems. Money market instruments are traded over the counter. Many issues are intended to be held until maturity and not traded, so there may not be any actual trades for exactly the same instrument. Pricing services may generate a model-based price based on other instruments, but then the number is just an estimate, not a real market price. If dealer quotes are available, should the bid or the ask price be used? Bid-ask bounce injects noise into market-based prices. This noise is only a minor nuisance for most investment products, but it could cause serious problems for customers that require a stable asset value.

Furthermore, many academics will argue that accurate prices are not always reflected during times of financial distress. Market quotations do not always reflect true value. The proposal to force money market mutual funds to use "market" prices rather than amortized cost is based on the mistaken belief that such prices are always more accurate than amortized cost. The recent financial panic demonstrated that the over-the-counter market for many fixed income securities dried up during the panic. Money market mutual funds should be permitted to use amortized cost accounting for those unimpaired short-term securities that they can hold to maturity unless the value of those assets is clearly impaired. Unless a credit event has occurred, the assets will turn into cash at par value within a few days, justifying the use of amortized cost.

Conclusion

In summary, the money market mutual funds are an extremely important part of the global economy. Businesses in particular rely on these funds for their investment, cash management and financing needs. Recent reforms have strengthened the industry. Proceeding with additional changes to money market mutual fund regulation so soon after earlier reforms that have proven to work may lead to significant disruption in the capital markets that will result in dire consequences for end users of these funds and the overall global economy. Before IOSCO moves forward with proposing any of the options outlined in the Report, we urge you to thoroughly assess all the comments provided and conduct an economic impact analysis to ensure that any regulatory changes made will not exacerbate efficiency in the capital markets or concentrate risk in certain sectors of the financial system.

Sincerely,

David Hirschmann