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Mr. Mohammed Ben Salem,
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By post and via e-mail to: moneymarket@iosco.org

28 June 2012

Dear Mr. Ben Salem,

Public Comment on

Money Market Fund Systemic Risk Analysis and Reform Options

Thank you for the opportunity to comment on the International Organization of Securities Commission's ("IOSCO") 27th April 2012 Money Market Fund Systemic Risk Analysis and Reform Options Consultation Report (the "Consultation Report"). Legg Mason, Inc. ("Legg Mason") is pleased in this letter to provide IOSCO with our views and comments to its Consultation Paper.

About Legg Mason

Legg Mason was founded in 1899 and today is one of the largest asset management firms in the world with assets under management of US$639 billion (as of 30th April 2012), serving individual and institutional investors on five continents. Legg Mason is a global asset management firm that includes a diversified group of asset management firms ("affiliates") who are recognized for their independent investment expertise. The principal investment affiliates of Legg Mason are among the industry leaders in their respective areas of specialization- equity, fixed income, liquidity and alternatives solutions- with unique investment approaches that have been developed over decades.

Western Asset, a Legg Mason affiliate, is one of the world's leading fixed income managers. From offices in Pasadena, Hong Kong, London, Melbourne, New York, São Paulo, Singapore, Tokyo and Dubai, Western Asset provides investment services for a wide variety of global clients, across an equally wide variety of mandates. As part of these fixed income services, Western Asset manages money market funds and other cash investment vehicles domiciled and regulated in accordance with the laws of in the United States, Canada, the Cayman Islands, Hong Kong, Australia, Ireland and Luxembourg. As May 30, 2012, Western Asset had assets under management of approximately US$ 446,253,000,000 of which approximately US$111,247,744,676 were U.S. registered money market funds operated under Rule 2a-7 of the Investment Company Act of 1940 ("Rule 2a-7"), approximately US$6.87 billion were Irish domiciled money market funds authorized under and operated under the European Union's Directive on Undertakings for Collective Investment in Transferable Securities (the "UCITS Directive") and approximately US$331 million were Canadian domiciled money market fund assets.

Money market funds play a vital economic role as a source of credit and short-term financing to consumers, corporations, financial institutions and government entities around the world. Money market funds have gained widespread acceptance because of their ease of use, compelling investment benefits and conservative risk profile. They provide investors with cost-effective access to investment

expertise, including credit risk analysis, and enable broad diversification away from the banking system and across individual issuers. In addition, money market funds have emerged as a simple, stable and important source of short-term funding for a broad range of issuers. This includes financial, corporate, municipal and other government entities. As such, money market funds play a key role in support of economic activity.

As a major sponsor of money market funds, we strongly support efforts to strengthen their resiliency and the overall goals of policymakers to reduce the vulnerability of the financial system, including money market funds, to systemic risk. We share this aim and have, along with other industry participants, worked actively over the years with both policymakers and industry associations around the world, such as the Investment Company Institute ("ICI"), the Institutional Money Market Funds Associations ("IMMFA") and the Irish Funds Industry Association ("IFIA"), toward this shared goal of strengthening the resiliency of money market funds. This cooperative effort between regulators and the fund industry has already resulted in number of significant regulatory reforms in the United States and Europe to money market funds and the wider financial industry. As discussed below, there is clear evidence that these measures have greatly strengthened the resiliency of money market funds by enhancing protections for investors, improving transparency for market participants and further strengthening the ability of money market funds to withstand periods of severe market stress. As a direct consequence of these enhancements, the industry is better positioned today than at any time previously to protect investors from the extreme redemption pressures potentially associated with periods of extreme market volatility. We therefore believe it is vital for IOSCO and other policymakers to conduct a rigorous and comprehensive cost benefit analysis, taking into account the full impact of changes that have already been implemented and the risks associated with taking further action, prior to proposing any additional money market fund reforms.

We remained committed to working with regulators and industry associations on this important issue, but echo the point raised by ICI in its recent response to the Consultation Report that the starting point for any further/future money market fund reform should be guided by the following two principles:

- We should preserve those key features of money market funds, including a constant/stable NAV ("CNAV") and ready liquidity, that have made them so valuable and attractive to investors; and
- We should preserve choice for investors and competition by ensuring a continued robust and competitive global money market fund industry.

With that said, the remainder of our comment letter focuses on certain key aspects of Consultation Paper, including namely (1) the progress and success that recent regulatory reforms already enacted since the financial crisis have had on the resiliency of money market funds, (2) the preservation of the CNAV for money market funds, and (3) flaws of certain of the policy options identified in the Consultation Report including requiring money market funds to let their share prices fluctuate or "float," requiring money market funds or their advisers to maintain capital buffers against money market fund assets, and imposing permanent redemption restrictions. As previously discussed, Legg Mason has worked very closely with ICI, IFIA and IMMFA on these money market fund issues and is generally supportive of the responses, thoughts and ideas expressed by those industry associations in their respective responses to IOSCO on its Consultation Paper.

I. Thorough consideration should first be given to the significant regulatory reforms enacted since the global financial crisis before proposing additional changes to money market funds

Money market funds in the United States and Europe are already subject to an extensive, well-defined and rigorous regulatory framework. In the United States, money market funds are subject to extensive oversight and regulation by the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940, together with the rules promulgated thereunder, including namely Rule 2a-7,

which has provided U.S. money market funds with a solid foundation of safety, liquidity, investment diversification, and a market-based rate of return.[1] In Europe, EU domiciled money market funds are authorized as UCITS funds and are subject to regulation at the European level by the EU's UCITS Directive.

In the wake of the global financial crisis, there was widespread acknowledgement of the need to strengthen the regulatory framework governing money market funds. The industry worked very closely with regulators to improve money market fund regulation. Most significantly, in January 2010, the SEC, following a period of public comment that included extensive discussions with industry representatives, adopted comprehensive amendments to Rule 2a-7 that further enhanced the already strict regime of money market fund regulations in the United States.[2] The amended rules make U.S. money market funds more resilient by, among other things, imposing new credit quality, maturity, and liquidity standards and increasing the transparency of these funds. In the event a money market fund proves unable to maintain a stable $1.00 net asset value. ("NAV") per share, the fund's board of directors is empowered to take prompt action to assure an orderly liquidation of the fund and equitable treatment for all shareholders.

Similarly, in Europe the European Commission moved promptly in 2009 to enhance the regulation of UCITS funds generally through revision of the UCITS Directive (i.e., UCITS IV). This was followed in May 2010 by the adoption by the Committee of European Securities Regulators (now European Securities and Markets Authority) of Guidelines on European money market funds which went into effect in 2011. Like in the United States, the regulatory initiatives undertaken by the European regulators focused on enhancing liquidity, maturity, credit, issuer diversification and disclosure requirements designed to promote stability and investor protection.

In addition to specific improvements to money market fund regulations, regulators around the world have undertaken numerous broader financial reform efforts designed to prevent a recurrence of the events of 2008 and address other perceived gaps in financial regulation. Many aspects of these efforts benefit money market funds, which, like other financial market participants, have a strong interest in a well-functioning global financial system that can withstand periodic shocks. When evaluating the need for further reforms specific to money market funds, it is important to take into account not only the changes already made to strengthen money market fund regulation but also other financial market reforms designed to reduce the likelihood of, and provide better regulatory tools to cope with, any future financial crisis.

While the Consultation Paper references the 2010 amendments to Rule 2a-7, it essentially relegates to a footnote the important discussion of how these changes have helped money market funds successfully weather the recent periods of severe market stress following their implementation. As set out in more detail in the ICI response letter, there is clear and substantial evidence that money market funds today are more resilient products due to these changes and are better equipped to handle severe market stresses than they were back in 2008. For example, from June through August of 2011, money market funds successfully weathered two financial market shocks caused by the deteriorating condition of the debt markets in Europe and the downgrade of U.S. sovereign debt. During this period, investors withdrew US$213 billion out of prime money market funds in the United States.[3] Notwithstanding these major events, prime money market funds were able to accommodate these sizable outflows in an orderly manner and no funds reportedly experienced difficulty processing redemptions, maintaining a $1.00 NAV or satisfying the 10% daily and 30% weekly liquidity requirements mandated by the amended Rule 2a-7.[4] It is also instructive to examine the liquidity

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[1] In addition, mutual fund investors in the United States are afforded protections under state law and other federal statutes, such as the Investment Advisers Act of 1940, the Securities Act of 1933 and the Securities and Exchange Act of 1934.

[2] See the section II of the ICI's response to Consultation Paper for a more detailed discussion on the 2010 amendments to Rule 2a-7 and their effectiveness in bolstering the regulatory framework for money market funds in the United States.

[3] See ICI response letter to Consultation Paper at page 12.

[4] See page 14 of ICI response letter for more details on mark-to-market values of prime money market funds during this period.

strains experienced by money market funds during the peak of the global financial crisis in the week following the collapse of Lehman Brothers and the significant effects that the new liquidity fund requirements under Rule 2a-7 would have had during this period. As ICI noted in its response to the Consultation Paper that, "in December 2011, prime money market funds held daily and weekly liquid assets more than twice the level of outflows they experienced during the worst week in money market fund history."[5] As of December 2011, the ICI reported that, in accordance with the revised Rule 2a-7 liquidity requirements, prime money market funds held over $1.43 trillion in assets and a minimum of $416 billion in daily liquidity and $660 billion in weekly liquidity.

We therefore urge IOSCO to not fall into the trap of considering reform options for money market funds through the lens of only 2008, but to recognize that money market funds in the United States and Europe, and the financial markets in which they operate, are meaningfully different today. It is critical for policymakers to assess the combined effect of significant regulatory reforms that have been enacted, many of which have not yet been fully implemented, before deciding whether additional, untested regulation is desirable. SEC Commissioner Daniel Gallagher expressed this view unequivocally recently when he observed that:

> "Without an adequate understanding of the current state of play, we are handicapped in our effort to define existing risks and measure their magnitude. Nor can we simply hand-wave and speak vaguely of addressing "systemic risk" or some other kind of protean problem. The risks and issues justifying a rulemaking must be specifically and thoughtfully defined in relation to the Commission's mission."[6]

In the same speech Commissioner Gallagher noted:

> "We cannot know what risks money market funds pose unless...we have a clearer understanding of the effects of the Commission's 2010 money market reforms. For some reason, much of the discussion surrounding the current need for money market reform sweeps aside the fact that the Commission has already responded to the 2008 crisis by making significant changes to Rule 2a-7. Notably, those amendments only became effective in May 2010... If the Commission moves forward with a proposal, the option of doing nothing until we have seriously analyzed the impact of last year's reforms must be given serious consideration. By pre-judging the outcome of this rulemaking - that something, anything must be done as soon as possible. never mind the consequences - the Commission runs the danger of skewing its analysis of the proposed regulatory changes. Any analysis we undertake will necessarily be flawed if we lack a rigorous sense of the current baseline against which to measure the effects of proposed changes. Moreover, we have a legal obligation to thoroughly consider all reasonable alternatives, and that includes the alternative of doing nothing beyond those significant changes the Commission has undertaken just last year."[7]

We agree strongly and urge policymakers to analyze fully the impact of the substantial reforms already enacted before proposing additional regulations, particularly given that such actions could have significant adverse effects on the continued competitiveness of money market fund industry and a choice for investors.

II. Moving to Floating/variable NAVs will not prevent investor runs and will likely trigger large outflows from money market funds

We do not support a mandatory move from a CNAV to a variable/floating NAV ("VNAV") for money market funds. CNAV has been a defining feature of a majority of money market funds for over four decades. A main reason for the popularity of CNAV money market funds with investors is

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[5] See ICI response letter at page 9.
[6] Speech given by SEC Commissioner Daniel M. Gallagher to U.S. Chamber of Commerce, December 14, 2011.
[7] Id.

the administrative, accounting and tax efficiencies provided by such products. If VNAVs are mandated, investors will need to determine cost basis and relevant gains and losses on each transaction, which adds burdensome tax, accounting and recordkeeping requirements and costs on investors that engage in frequent and sometime daily trading in money market funds for short-term liquidity needs. The introduction of a mandatory VNAV would alter the defining characteristics of money market funds and undermine their ability to respond to well-developed investor expectations of obtaining price stability, daily liquidity and ease of use. Therefore, we share the concerns raised by IOSCO that the mandating VNAV for all money market funds could precipitate a destabilizing flood of preemptive withdrawals by investors seeking to guarantee the return of their principal, an unintended result that the Consultation Paper is looking to prevent in the first place.

Moving to a VNAV would also reduce of the number of investment options available to certain larger investors for their cash management and could direct a greater concentration of assets towards the banking sector or unregulated or less regulated substitute products. VNAV are not eligible investments for many institutional investors in the United States and other parts of the world. For example, municipalities, insurance companies and others types of institutional investors are allowed under a number U.S. state laws and regulations to invest only in CNAV money market funds. Certain retirement plans in the United States and other parts of the world are also not permitted to invest in VNAV money market funds. If policymakers mandate VNAVs for all money market funds, a number of large institutional investors will be driven to investing in less regulated investment products that continue to offer stable pricing or into bank deposits. Driving significant investments currently invested in money market funds into lesser or even unregulated products will actually increase risk and defeats the objectives that policymakers are looking to achieve under the Consultation Paper. Moreover, a significant inflow of investments into bank deposits could put considerable pressure on the banking system by requiring banks to hold additional capital to support these new deposits to continue satisfy more stringent capital requirements recently enacted under the Basel III regime. For larger investors, including corporations and municipalities, these bank deposits would likely be uninsured and would substantially reduce the diversification of their cash management investments. The end result would be to increase systemic risk by concentrating more short-term assets in the banking system.

Furthermore, we concur with the ICI that requiring all money market funds to convert to VNAVs would not reduce the likelihood of investors redeeming shares during periods of market stress. For example, ultra-short bond funds, which have VNAVs, invest in short-dated securities very similar to money market funds. During global financial crisis in 2007 through 2008, ultra-short bond funds experienced an average decline of 2% in their NAVs and declines in net assets of 50% in 2008 and 60% from their peak in 2007. Furthermore, European VNAV cash funds experienced a similar trend.[8] This was foreseeable to some degree since, as the IOSCO Report notes, "shareholders in a VNAV [money market fund] still have an incentive to run due to the limited liquidity in any [money market fund], which creates a higher share price for early redeemers, and thus a first mover advantage.[9] Thus, the sizable redemptions experienced by ultra-short funds and European domiciled VNAV cash funds illustrates the redemption pressures that VNAV money market funds would have likely experienced during this period of market turmoil. Thus, it is very doubtful that a move VNAV for money market funds would reduce the risk of redemptions in any meaningful way. Rather, we believe the steps already taken by the SEC in the United States and the EU in Europe, which have focused on strengthening the natural liquidity of money market funds to meet such redemptions, are the more sensible approach and have already proven to be effective in bolstering money market funds ability to handle redemptions during periods of market stress.

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[8] See Investment Company Institute Report of the Money Market Working Group (March 17, 2009), at 105, which highlights the outflows that European money and bond funds with VNAVs experienced during the period of market turmoil.

[9] IOSCO Consultation Paper at page14.

Finally, we note that the available evidence strongly suggests that investors do not want a VNAV because it would not serve their needs. In discussions with our clients, which are largely institutional investors, we have found virtually no support for the VNAV concept and strong concerns about the many administrative, accounting, and tax issues that it raises that would greatly complicate their short-term investment activities. Other fund complexes that focus on the retail market have advised us that their investors share the same views as ours.

III. Other changes under consideration are not workable

The other changes under consideration by IOSCO are not workable and would render money market funds unattractive to sponsors and investors. For example, the Consultation Paper suggests that, during a financial crisis, a capital buffer would enable a money market fund to sell assets in the secondary market at a loss in order to raise cash to meet redemption payments, without those losses impacting the price of the fund or precipitating further redemptions. However, during the financial meltdown in 2008, secondary fixed income markets essentially closed down, and so the loss absorbing capacity of a capital buffer would have been of limited use in enabling funds to raise cash. As previously mentioned, we believe that the most effective way of ensuring that money market funds are able to meet redemption payments is to reduce their reliance on secondary markets, by focusing on natural liquidity.

Furthermore, the options for funding and structuring a capital buffer give rise to additional issues and concerns. For example, sponsor funded capital buffers or the requirement for sponsors to purchase a "first loss" equity share class from their funds would impose significant additional costs on money market fund sponsors at a time when revenues associated with these funds are at historic lows due to the continuing low interest rate environment. If implemented, this would likely result in a two tier money market fund industry, i.e. a top-tier comprising sponsors who have access to capital, and a bottom-tier comprising sponsors that do not have access to capital and - it has been proposed - whose funds therefore run with more liquidity and lower yields. In that case, the sponsors of bottom-tier money market funds would be at a competitive disadvantage and could lose market share to sponsors of top-tier money market funds. Ultimately, a sponsor funded capital buffer would eventually drive existing sponsors out of the market and to prevent new competitors from entering thus concentrating potential risk further.

We also do not support a move to investor funded capital buffers. This simply results in transfers between different generations of investor (i.e., income retained or accumulated at the expense of today's investors, could be used for the benefit of tomorrow's investors). That is not consistent with basic principles of securities regulation (i.e., equal treatment of investors).

Finally, we believe that a move to impose redemption restrictions on investors in money market funds, especially during normal market conditions, would impair the fundamental utility of money market funds. CNAV money market funds are used today by a wide variety of investors primarily because of the product's liquidity and CNAV per share. As discussed in further detail in the ICI response letter, many financial intermediaries that offer institutional account and sweep services have indicated that they may choose to offer alternative cash products rather than build complex systems to offer a dramatically different money market fund product that would not meet the fundamental needs of their customers. Furthermore, U.S. treasurers have indicated they will scale back or eliminate their use of money market funds if redemption restrictions that restrict daily liquidity are imposed on money market funds.[10] In addition to the unpopularity of these options with investors, there are a

[10] ICI commissioned Treasury Strategies, Inc. to conduct a study to help understand the effects of various SEC reform concepts on money market fund investors. The report, *"Money Market Fund Regulation: The voice of the Treasurer"*, is available on ICI's website at http://www.ici.org ("TSI Survey"). Treasury Strategies surveyed 203 unique corporate, government, and institutional investors between February 13 and March 6, 2012, asking 31 questions regarding their cash pools, investment objectives, and three SEC concepts for money market fund reform, including floating NAVs and redemption fees. Treasurers are significant users of money market funds: institutional share classes account for $1.7 trillion, or 65 percent, of the $2.6 trillion in U.S. money market fund assets.

myriad of operational, legal, regulatory and timing issues posed by these proposals, many of which are discussed in the Consultation Report itself, as well as the ICI response that render them essentially unworkable and too costly to implement.

Conclusion

Legg Mason believes that it is imperative that policymakers conduct a thoughtful and comprehensive analysis of the impact that the significant reforms recently in the United States and Europe concerning regulation of money market funds and the global financial system generally prior to proposing any additional changes to money market fund regulations. Making additional changes prior to completing such an analysis or considering the impact they have had on strengthening money market funds would be premature and could seriously jeopardize the fragile global economic recovery. The analysis must therefore include a rigorous cost-benefit analysis balancing this and other risks against the incremental benefits that might be achieved by further reforms.

As discussed herein, there is clear and substantial evidence that the 2010 amendments to Rule 2a-7 have strengthened the resiliency of money market funds and have enabled them to weather the recent significant stresses placed on the markets since mid-2011. Therefore, we would support an extension of changes adopted in the 2010 amendments to Rule 2a-7 to non-U.S. money market funds. These recent changes focused on such things as liquidity, maturity, credit issuer diversification and disclosure requirements to promote stability and investor protection.

We appreciate the opportunity that we have been given to comment on this important matter and look forward to continuing to work with policymakers and others in the industry to ensure that money market funds remain a useful and important investment alternative for investors seeking a product that offers safety, liquidity and yield.

On behalf of Legg Mason please contact me if you want to discuss anything in this letter in more detail or any other policy options, questions and challenges you have or may be considering. As appropriate Legg Mason would also like to have the further opportunity to comment on IOSCO's final recommendations before they are implemented. My direct telephone number is 001-410-454-4475 or feel free to e-mail me at tplemke@leggmason.com.

Yours sincerely,

Thomas P. Lemke
Executive Vice President and General Counsel