The Road Ahead for Proposed Money Market Reforms
Invesco’s comment letter to the SEC

On Sept. 17, Invesco submitted its comment letter to the Securities and Exchange Commission (SEC) on proposals for additional reforms to regulations governing US money market funds (MMFs). The letter stresses that Invesco believes that it is critical that any additional reforms adopted should aim to preserve the utility and core features of the product. It also conveys support for Alternative 2, which would allow MMFs to continue to transact at a stable share price under normal market conditions, and would allow funds to implement redemption gates and liquidity fees during periods of market stress.

SEC proposals for additional MMF reforms
On June 5, the SEC voted unanimously to propose the following alternatives for reform of regulations governing US MMFs:

- **Alternative 1.** Floating the net asset value (NAV) for institutional prime money market funds instead of using amortized cost to value portfolio securities. Government and retail MMFs would be exempt.
- **Alternative 2.** Providing standby liquidity fees and redemption gates for MMFs during times of stress, while seeking to maintain a stable $1.00 NAV. Government funds would be exempt.
- **Alternative 3.** Merging the floating NAV proposal (alternative 1) and the liquidity fees and redemption gates proposal (alternative 2) into one reform package.

Additional proposals were made to enhance disclosure requirements, improve reporting, enhance stress testing and strengthen diversification.

The stated goals of the SEC in pursuing additional reforms included:

- Addressing the vulnerability of MMFs to heavy redemptions and mitigating the related potential of contagion risk.
- Increasing the transparency of MMF risk and risk management practices.
- Preserving the benefits MMFs currently offer to the extent possible.

It is important to clarify that these are still proposals. There have been no changes to the regulations governing your money market fund at this time. Current requirements under SEC Rule 2a-7 continue to govern and regulate the investments of money market shareholders at more vigorous levels than at any time since the industry’s inception.

Invesco supports Alternative 2 coupled with proposed new disclosure requirements
In our comment letter, Invesco articulated support for Alternative 2, coupled with the proposed new disclosure requirements, because we believe this solution would be more effective at meeting the SEC’s goals with the least disruption to the normal functioning of short-term markets.

Alternative 2, would allow MMFs to continue to transact at a stable share price under normal market conditions, includes the most direct, simple and effective methods to achieve the central goal of regulators to prevent investor runs and contagion risk:
Redemption gates would be an effective means of preventing runs when liquidity is abnormally low by providing a “cooling off” period to help mitigate the effects of short-term investor panic.

Similarly, liquidity fees would provide an appropriate and effective means to ensure that the extra costs associated with raising liquidity to meet fund redemptions during times of market stress are borne by those responsible for them. They would also mitigate the “first-mover” advantage issue, which has been one of the Commission’s concerns since 2008. However, the amount of any liquidity fee should be carefully calibrated in relation to a MMF’s actual cost of liquidity. The fees should be restorative, not punitive, and designed to deter “first movers.”

Alternative 1, would require institutional prime funds to float the NAV, would change the fundamental nature of these funds and impose extremely onerous burdens on their investors, sponsors and distributors, which are unjustified considering that redemptions gates and liquidity fees are a more effective and less costly way of addressing the concerns of regulators.

The floating NAV would not achieve the primary goal of reforms because it would:
- Not stop MMF investor runs.
- Reduce significantly the utility of the affected MMFs for the majority of their investors who have no appetite for floating NAV MMFs.
- Trigger a wide variety of unintended and undesirable consequences.
- Pose significant operational challenges.

Alternative 3, would combine the floating NAV feature of Alternative 1 with the significant liquidity restrictions of Alternative 2, and would create a uniquely undesirable product. If adopted, it would drive investors to seek alternative short-term investment products such as unregistered funds and bank deposits, effectively destroying the MMF business.

**Beyond the alternatives: additional areas of concern**

Regardless of which alternative the SEC chooses, we believe it is imperative for the SEC to address and/or clarify the following issues:

- **Government and municipal funds should be off the table.** Government funds and municipal funds have remained relatively unaffected by investor runs, even during periods of extreme market turmoil. These funds generally carry extremely high levels of liquid assets and carry securities with low default risk. We support the SEC position that no fundamental changes should be applied to government MMFs and believe it should be extended to municipal funds, which would otherwise have to bear the heavy costs of instituting a floating NAV when doing so would not provide any clear benefit.

- **Stable NAV MMFs should continue to use amortized cost pricing.** The SEC proposes that regardless of which alternative is adopted, stable NAV MMFs would use the penny rounding method instead of the amortized cost method of valuing securities. Doing so would severely limit or even eliminate the ability of MMFs to offer same-day settlement, a feature that is critical to the cash management of many investors. Moreover, the SEC should clarify that MMFs can continue to use the amortized cost method for portfolio securities with maturities of 60 days or less, which is standard practice for mutual funds.

- **Government MMFs should continue to be governed by the “names rule.”** We support the proposal that government funds continue to be governed by rule 35d-1 under the Investment Company Act (the “names rule”) requiring these funds to hold at least 80% of their total assets in cash, government securities or repurchase agreements collateralized with government securities. This is consistent with the practice in the broader mutual fund industry, in which funds focus on a particular type of investment or industry and are named accordingly.

- **MMFs should continue to be treated as “cash equivalents.”** We support the continued treatment of investments in MMFs as cash equivalents for accounting and tax purposes, so that they can continue to be an effective cash management tool.

- **Modify the proposed 10% diversification limit on sponsors of asset-backed securities (ABS).** We do not support the SEC’s proposal to include the sponsors of asset-backed securities (ABS) in the definition of guarantor, which would make them subject to the diversification limits of Rule 2a-7, and to limit the maximum exposure of a MMF to any single ABS sponsor to 10%. As noted by the Investment Company Institute (ICI), Rule 2a-7 already counts toward a company’s diversification limit any ABS for which the company actually provides a guarantee or demand
feature. The proposal would change this result by treating a sponsor of an ABS as a guarantor of the entire amount of the security held by the MMF, even if the sponsor’s guarantee or demand feature is limited to a smaller amount or if the sponsor has no legal obligation to support its asset-backed security. Implementation of this rule would further limit credit availability to companies and ultimately individuals.

- **Modify the elimination of the 25% guarantor “basket.”** We do not support the SEC’s proposal to eliminate the 25% guarantor basket, which allows up to 25% of the value of securities held in a portfolio to be subject to guarantees or demand features from a single institution. We believe doing so would severely limit the investment options of municipal MMFs, which have traditionally had a substantial focus on short-term, variable-rate securities issued by municipalities and enhanced by financial institutions and other guarantors. Implementation of this rule would severely limit the availability of short-term financing for state and local governments.

### The industry agrees about the need for caution going forward

Fundamentally, our letter strives to make the point that any further changes to MMFs should be undertaken with extreme caution and only where it can be demonstrated that any changes would effectively address concerns without jeopardizing the utility or fundamental nature of MMFs as an investment product. These are tenets that we have always – and will continue to – uphold, reflecting our commitment to continue strengthening MMFs and to protect the interests of our investors.

This sentiment – as well as the specific comments Invesco provided – were reflected in the comment letter of the ICI as well as other stakeholders in the industry. While individual firms offered comment letters that were nuanced differently, the broad areas of consensus included:

- The detrimental effect the combination of a floating NAV and redemption gates/liquidity fees (Alternative 3) would have on the industry if adopted.
- A general preference for redemption gates/liquidity fees.
- Broad agreement that a floating NAV would not effectively deter runs as envisaged by the regulators.
- The need to preserve the features and benefits that have made MMFs such a valuable and popular investment vehicle for millions of investors.

### In the meantime, it’s wait and see

Now that the comment period has ended, the SEC will begin reviewing and evaluating the comment letters, which as expected were extensive. To date, over 1,300 comment letters have been submitted to the SEC. After what will likely be a months-long process, the SEC will finalize its proposals and submit them for another, final vote by the SEC. To be approved, the proposals would need to receive a majority vote by the five commissioners. Importantly, the SEC itself has recently undergone some significant changes. Two of the five commissioners – Troy Paredes and Elisse Walter – have left. It is unclear how the change in the composition of the SEC commissioners could affect the proceedings going forward.

To give a sense of perspective, the process of approving the proposals for the 2010 reforms, took approximately 4½ months, from August 2009 to January 2010 when the final SEC vote took place. Keep in mind that at the time, there was a greater sense of consensus among all the relevant stakeholders – regulators, industry, investors – regarding the necessary reforms in the aftermath of the great financial crisis.

Invesco pledges to continue to work with policymakers toward a viable solution that meets the needs of all stakeholders. We remain committed to the money market business and the pursuit of helping our clients meet their cash management needs. We are also committed to keeping you updated about ongoing events in this process.

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  We’re committed to giving you the expert insights you need to make informed investing decisions, and we are well-equipped to provide high-quality support for investors and advisors.

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**1** A government MMF would be defined as any MMF that holds at least 80% of its assets in cash, government securities or repurchase agreements collateralized with government securities. A retail MMF would be defined as an MMF that limits each shareholder’s redemptions to no more than $1 million per business day.

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**NOT FDIC INSURED | MAY loose VALUE | NO BANK GUARANTEE**

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of an investment at $1.00 per share, it is possible to lose money by investing in such a fund.

An investor should consider the investment objectives, risks, fees and expenses carefully before investing. Please read the prospectus or other offering documents carefully before investing. For this and other important information, please contact your financial advisor or visit invesco.com/fundprospectus.

All data as of September 2013, unless otherwise noted.

1. Defaulted securities involve the substantial risk that principal will not be repaid and may be subject to restrictions on resale.
2. Amortized Cost: Pursuant to SEC Rule 2a-7, the Funds use the amortized cost method of accounting, rounded to the nearest cent, to value their securities when calculating their net asset value for purposes of all Portfolio share transactions.
3. Contagion: Financial contagion refers to the transmission of a financial shock in one entity to other interdependent entities.
4. Redemption gates: If a prime money market fund’s level of “weekly liquid assets” were to fall below 15 percent of its total assets its board of directors would be able to impose a temporary suspension of redemptions (or “gate”). A money market fund that imposes a gate would need to lift that gate within 30 days, although the board of directors could determine to lift the gate earlier.
5. The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.
6. All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. As with all investments, there are associated inherent risks. Please obtain and review all financial material carefully before investing. This does not constitute a recommendation of the suitability of any investment strategy for a particular investor.