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September 17, 2013

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE, Washington, DC 20549-1090  
via internet: <http://www.regulations.gov>

Re: **Money Market Fund Reform; Amendments to Form PF (File Number S7-03-13)**

Dear Ms. Murphy:

We are writing to share our views on the proposal promulgated by the Securities and Exchange Commission (the "Commission") to amend certain provisions of the Investment Company Act of 1940 (the "1940 Act") relating to money market mutual funds ("MMFs").<sup>1</sup> Invesco Ltd. is a leading independent global investment management firm, with approximately \$720 billion in assets under management as of August 31, 2013. Invesco Advisers, Inc., along with its affiliates, has managed and advised MMF and other cash investment vehicles for over 30 years. As of August 31, 2013, Invesco Advisers had \$64 billion in assets under management in its 12 registered MMFs operated in compliance with Rule 2a-7 of the 1940 Act, as amended ("Rule 2a-7"). As a leading MMF sponsor, Invesco believes that it is important for us to share our views on the proposed reforms, which would directly affect the millions of MMF shareholders whose financial needs we serve.

## **I. Introduction**

The Proposal sets forth three general alternatives for additional MMF regulation. The first proposed alternative ("Alternative 1") would require institutional prime MMFs to move to a variable (or "floating") net asset value ("NAV") from their current stable \$1.00 NAV, which is calculated using the amortized cost method of valuation and the penny-rounding method of pricing permitted by Rule 2a-7. The second alternative ("Alternative 2") would retain the stable NAV for MMFs but impose on MMFs other than government funds a default liquidity fee of 2% (which may be reduced or eliminated at the discretion of the MMF board) if the MMF's weekly liquidity level goes below a 15% threshold; government funds would be permitted but not required to impose these fees. In addition, the MMF Board would have the authority to impose a redemption "gate" for up to 30 days if this threshold is reached. The third alternative

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<sup>1</sup> Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-30551 (June 5, 2013), 78 FR 36834 (June 19, 2013) (the "Proposed Rule").

(“Alternative 3”) represents a combination of Alternative 1 and Alternative 2. In addition to these three alternatives, the Commission has proposed changes to expand the existing disclosure, portfolio diversification and stress testing requirements for MMFs under Rule 2a-7.

In summary, our views on the reforms included in the Proposed Rule are as follows:

- The comprehensive changes to Rule 2a-7 promulgated in 2010 have significantly enhanced the stability and transparency of MMFs. The impact of these changes must be taken into account when considering further MMF reforms.
- Consideration of further reforms to MMFs must begin with a clear understanding of the objectives that the reforms are intended to achieve and the criteria used to evaluate them.
- Policymakers have enunciated the principal goals of additional MMF reforms as:
  - addressing the vulnerability of MMFs to heavy redemptions and mitigating the related potential contagion risk;
  - increasing the transparency of MMF risks and risk management practices;
  - preserving the benefits that MMFs currently offer to investors to the greatest extent possible;
  - preserving MMFs as a key source of funding for state and local governments and as an important cash management tool for investors; and
  - promoting equitable treatment for all MMF investors by, among other things, ensuring that extraordinary liquidity costs for MMFs during periods of market stress are borne by the investors generating them and eliminating information advantages.
- In evaluating potential reform options, it is critical for policymakers to apply criteria designed to ensure that any additional reforms:
  - are effective in accomplishing the goals discussed above;
  - are carefully tailored to address the particular risks policymakers seek to mitigate;
  - preserve the utility and core features of the product valued by those who invest in and distribute MMFs;
  - minimize the significant and potentially destabilizing effects of unintended consequences; and
  - increase transparency regarding MMFs for both investors and regulators.

- We support Alternative 2 which, when coupled with the proposed new disclosure requirements, reflects the most appropriate balance of the cost/benefit elements set forth above.
- The ability to suspend investor redemptions by imposing redemption gates when MMF liquidity is abnormally low provides the most direct, simple and effective method to achieve the central goal of additional MMF reforms: preventing investor runs and contagion risk to other MMFs.
- Redemption gates have been proven to be an effective means of preventing runs and providing a “cooling off” period to mitigate the effects of short-term investor panic.
- 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.
- The implementation of liquidity fees also would mitigate the ‘first-mover’ advantage issue, which has been one of the Commission’s concerns since 2008.
- 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 early redemptions.
- We generally support the enhanced disclosure requirements in the Proposed Rule but believe that the proposed dramatic expansion in stress testing requirements is unwarranted.
- The floating NAV proposal in Alternative 1 would not achieve the stated objectives of MMF reform and is substantially inferior to Alternative 2 from a cost benefit perspective because:
  - it would not deter MMF investor runs;
  - it would reduce significantly the utility of the affected MMFs for the majority of their investors;
  - investors have no appetite for floating NAV MMFs;
  - it would trigger a wide variety of unintended and undesirable consequences;
  - it would pose significant operational challenges; and
  - the proposed distinction between “retail” and “institutional” funds is artificial and difficult to implement.

- If the Commission nevertheless decides to proceed with Alternative 1, the following changes are critical:
  - retail funds should be defined with reference to shareholder social security numbers;
  - municipal MMFs should be exempt from floating their NAVs;
  - amortized cost pricing should be retained for stable NAV MMFs; and
  - NAV calculations for MMFs should remain consistent with those of other mutual funds.
- Alternative 3 effectively would destroy MMFs by combining the undesirable features of Alternative 1 with the significant liquidity restrictions of Alternative 2, thereby to creating a uniquely undesirable product that no rational investor would select.
  - Alternative 3 wholly fails the cost/benefit analysis that must be applied to any proposed reform by imposing the heavy operational and cost burdens of both liquidity fees and redemption gates without the countervailing administrative benefits of a stable NAV.
  - If adopted, it would drive investors to seek less attractive short-term investment products such as unregistered funds and bank deposits.
- The Commission should clarify that MMFs may continue to use amortized cost pricing for portfolio securities with maturities of 60 days and less.
- Government MMFs should continue to be governed by the “names rule.”
- MMFs should continue to be treated as “cash equivalents.”
- The proposed 10% diversification limit on sponsors of asset-backed securities should be modified to avoid adverse impacts on ABS markets and the financial institutions and investors that rely on these securities.
- Elimination of the 25% guarantor “basket” would severely limit municipal MMFs’ investment options.

## **II. Consideration of Further MMF Reforms Must Begin with a Clear Understanding of the Goals that the Reforms are Intended to Achieve and the Appropriate Criteria for Evaluating Them**

Proper evaluation of the MMF reform alternatives contained in the Proposed Rule must begin with a clear understanding of the goals that the proposed reforms are intended to achieve and the appropriate criteria for evaluating them. The Director of the Commission's Division of Investment Management has summarized these goals as follows:

- addressing the vulnerability of MMFs to heavy redemptions and mitigating the related potential contagion risk;
- increasing the transparency of MMF risks and risk management practices; and
- preserving the benefits that MMFs currently offer to investors to the greatest extent possible.<sup>2</sup>

In addition to these aims, policymakers have stressed the importance of:

- preserving MMFs as a key source of funding for state and local governments and as an important cash management tool for investors; and
- ensuring equitable treatment for all MMF investors by, among other things, ensuring that extraordinary liquidity costs for MMFs during periods of market stress are borne by the investors generating them and eliminating information advantages.

However, while policymakers have noted that the central objective of the proposed reforms is to mitigate risks associated with MMFs, they have also recognized that eliminating these risks entirely is not feasible since the changes required to do so would be so drastic as to essentially destroy the product. The Report of the President's Working Group on Financial

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<sup>2</sup> Money Market Mutual Fund Reform: Opening Statement at the SEC Open Meeting, Norm Champ, Director, Division of Investment Management, U.S. Securities and Exchange Commission, June 5, 2013 (hereinafter referred to as "Champ Statement"). The Proposed Rule contains a similar summary, stating that the proposals are focused on "preserving the benefits of stable share price money market funds for the widest range of investors and the availability of short term financing for issuers while enhancing investor protection and risk transparency, making funds more resilient to mass redemptions and improving money market funds' ability to manage and mitigate potential contagion from high levels of redemptions." Proposed Rule, p. 168. It also states that the proposed alternatives are "designed to address money market funds' susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds." *id.*, p. 1. These aims are consistent with those expressed by the President's Working Group on Money Market Fund Reform (the "PWG") in its 2010 report, which states that "In formulating reforms for MMFs, policymakers should aim primarily at mitigating systemic risk and containing the contagious effect that strains at individual MMFs can have on other MMFs and on the broad financial system." Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options, October, 2010, p. 3. (hereinafter, the "PWG Report").

Markets: Money Market Fund Reform Options acknowledges that “Importantly, preventing any individual MMF from ever breaking the buck is not a practical policy objective...”<sup>3</sup>

The critical importance of MMFs to investors and global financial markets demands that any additional reforms be well-balanced, tailored and effective. Given regulators’ stated goal of “mak[ing] the funds more resilient...while preserving, to the extent possible, the benefits of money market funds,”<sup>4</sup> any further MMF reforms must be crafted within the context of a holistic cost-benefit analysis that takes into account their full implications for financial system stability, investor choice, and continued access to short-term financing for governments and businesses, as well as the feasibility of implementing them.<sup>5</sup>

In evaluating the reforms contained in the Proposed Rule it is also important to take into account the significant impact of the reforms implemented by the Commission in 2010, which amounted to a comprehensive overhaul of the regulatory framework governing MMFs. These reforms have already advanced substantially the policy goals outlined above and their effectiveness is evident from the fact that MMFs have experienced only *de minimis* volatility since the reforms were implemented despite several periods of extreme market turbulence triggered by events such as the European sovereign debt crisis and the credit downgrade of U.S. government debt. Indeed, the Commission staff opined in a recent report that “The most important finding from the [statistical models used in the report] is that the probability of breaking the buck declined after the 2010 reform assuming a fund had been at the maximum allowable WAM.”<sup>6</sup>

In addition to the positive effects of the 2010 reforms, evolving industry best practices have resulted in, among other benefits, MMF investors having access to more—and more timely—information than ever before regarding the funds in which they are invested. For example, many MMF sponsors, including Invesco, now voluntarily provide daily public

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<sup>3</sup> PWG Report, pp. 3-4. Commissioner Gallagher has similarly observed “I do not believe that it should be – nor can it be – the goal of the Commission to ensure that securities products are risk-free.” Speech entitled “SEC Reform After Dodd-Frank and the Financial Crisis”, Commissioner Daniel M. Gallagher, U.S. Securities and Exchange Commission, December 14, 2011 (hereinafter referred to as “Gallagher Speech”).

<sup>4</sup> Proposed Rule, p. 14.

<sup>5</sup> This view is shared by the Director of the Division of Investment Management, who noted the “careful consideration of risks, costs, and benefits that characterized the recommendations’ development.” Champ Statement. Commissioner Aguilar has also opined on the importance of striking “a balance between reducing the systemic risk that money market funds may pose as an industry, while protecting the benefits provided by registered money market funds.” Striving to Restructure Money Markets Funds to Address Potential Systemic Risk, Commissioner Luis A. Aguilar, U.S. Securities and Exchange Commission, June 5, 2013 (hereinafter referred to as “Aguilar June 5 Statement”).

<sup>6</sup> The report observes that “Despite heavy redemptions during [the Eurozone sovereign debt crisis in 2011], prime funds were able to meet redemptions without any fund breaking the buck” and goes on to note that “In contrast to the fall of 2008, however, redemptions in 2011 were relatively light, occurred over a much longer period of time, and funds did not have significant unrealized capital losses as indicated by the fact that funds’ shadow NAVs did not deviate significantly from \$1.” Response to Questions Posed by Commissioners Aguilar, Parades and Gallagher, Division of Risk, Strategy and Financial Innovation, U.S. Securities and Exchange Commission, November 30, 2012, Executive Summary. Note that the report does not consider to what degree these lower redemption rates and the lack of capital losses were driven by the impact of the 2010 reforms.

disclosure of their prime funds' market-value (or "shadow") NAVs. This information was previously disclosed only monthly with a 60-day lag.

Given these considerations, we believe that in evaluating potential reform options, it is critical for policymakers to apply criteria designed to ensure that any additional reforms:

- Are effective in accomplishing the goals discussed above

Policymakers should seek to implement only those solutions with a proven track record of advancing their stated policy goals. For example, there is ample evidence of the relative effectiveness—or ineffectiveness—of floating NAVs, redemption gates and liquidity fees in reducing the probability and severity of investor runs. This evidence should be weighed when determining the relative merits of the proposed reform options.

- Are carefully tailored to address the particular risks policymakers seek to mitigate

Commissioner Gallagher has rightly observed that regulators attempting to strengthen MMFs further must ask themselves “for what *specific* problems or risks are we trying to solve?”<sup>7</sup> The solutions that they propose should be tailored to achieve these specific ends. Attempts to craft solutions intended to address broad and ill-defined problems such as “systemic risk” are doomed to failure, in part because, as Federal Reserve Vice-Chair Janet Yellen and others have observed, the nature and definition of systemic risk themselves are far from settled.<sup>8</sup> The issues that the proposed reform alternatives are intended to remedy, such as the risk of MMF investor runs, are specific in nature and arise in particular circumstances—namely, during periods of extreme market stress. Any additional reforms implemented to address these issues should be similarly tailored.

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<sup>7</sup> Gallagher Speech (emphasis in original).

<sup>8</sup> Janet L. Yellen, Vice Chairman, Federal Reserve Board, *Interconnectedness and Systemic Risk: Lessons from the Financial Crisis and Policy Implications*, Speech delivered Jan. 4, 2013. This issue is explored in detail in a paper filed with the Financial Stability Oversight Council (“FSOC”) regarding its own proposals for additional MMF reforms. Comment letter submitted to FSOC by Melanie Fein titled “The Financial Stability Oversight Council’s Proposals for Money Market Fund Reform” dated January 9, 2013. Commissioner Gallagher has enunciated a similar concern, noting that “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. As a reminder, the Commission’s mandate is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. We are not expected to regulate with other goals in mind.” Gallagher Speech.

- Preserve the utility and core features of the product valued by those who invest in and distribute MMFs

The plain fact of the matter is that investors cannot be forced to purchase an investment product that does not appeal to them. The fundamental features of MMFs that investors have embraced for over 40 years—stability of principal, liquidity, administrative ease and a competitive yield—are critical to the product’s appeal, utility and continued viability. Our MMF clients have communicated clearly that they will seek alternative products to address their needs if MMFs are altered in such a way as to impair substantially their usefulness as a cash management tool. Likewise, the distribution partners through whom many MMF sponsors offer their products to investors must be willing and able to support changes required by the proposed reforms, otherwise they will cease to make MMFs available on their platforms. Distributors have limited resources and understandably focus their efforts on those products most likely to appeal to end investors.

- Minimize the significant and potentially destabilizing effects of unintended consequences

The carefully tailored approach to reform discussed above is especially important given the critical role played by MMFs within the financial system and the corresponding potential for serious adverse effects on global markets from overly broad or onerous reforms.<sup>9</sup> In its 2009 report examining the root causes of the financial crisis, the Treasury Department explicitly acknowledged the dangers of these risks, cautioning the Commission and the PWG to “carefully consider ways to mitigate any potential adverse effects of such a stronger regulatory framework for MMFs, such as investor flight from MMFs into unregulated or less regulated money market investment vehicles or reductions in the term of money market liabilities issued by major financial and non-financial firms.”<sup>10</sup>

- Increase transparency regarding MMFs for both investors and regulators.

Greater access to information substantially reduces the likelihood of MMF investors engaging in preemptive runs based on a fear of the unknown. It also promotes equitable treatment of investors by removing information advantages that might otherwise be enjoyed by larger, more sophisticated investors. Finally, as Commissioner Aguilar has noted, “the transparency of

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<sup>9</sup> As Commissioner Aguilar has observed, “Money market funds play an integral role in our economy. Investors, issuers, and intermediaries all utilize these funds. It’s hard to think of another investment product that impacts so many different components of the American capital markets. This reality underscores the need to act in a careful and informed manner.” Aguilar June 5 Statement.

<sup>10</sup> “Financial Regulatory Reform: A New Foundation,” U.S. Department of the Treasury, October 8, 2009, p.39.

regulated money market funds provides a crucial safeguard in monitoring systemic risk.”<sup>11</sup>

### **III. Alternative 2, Coupled with Enhanced Disclosure Requirements, Reflects the Most Appropriate Balance of the Cost/Benefit Elements Set Forth in Section II**

#### *A. Overview of Alternative 2*

Alternative 2, when coupled with the enhanced disclosure requirements proposed in the Proposed Rule, represents the best balance of the cost/benefit factors discussed in Section II above. Alternative 2 would require the board of directors of a MMF (other than a government fund) to impose on redeeming investors a liquidity fee of 2% when the fund’s weekly liquid assets fall below 15% of total assets, unless the board explicitly determines that doing so would not be in the best interest of the fund or that a lesser fee is appropriate. In addition, it would empower the MMF board to suspend for up to 30 days investors’ right to redeem from the fund if weekly liquid assets fall below 15% of total assets. The additional disclosure requirements contained in the Proposed Rule, which would apply regardless of whether Alternative 1 or Alternative 2 is adopted, would enhance transparency by mandating among other things that MMF sponsors make market-value NAV and liquidity information for their funds available publicly on a daily basis; portfolio holdings information would also be disclosed on a more timely basis (using a five-day rather than the current 60-day lag).

As the Proposed Rule recognizes, the possible imposition of liquidity fees and/or redemption restrictions on a MMF, even on a temporary basis, significantly affects one of the fundamental attributes that investors value most highly in MMFs: their liquidity. It is therefore appropriate that these drastic remedies be reserved for circumstances of significant liquidity disruption.<sup>12</sup> This tailored approach is in sharp contrast to the blunt prescription offered by Alternative 1, which would radically change the nature of MMFs even when they are in no real danger of a run. Furthermore, the discretion contemplated in Alternative 2 for a MMF board to determine whether and at what level to impose liquidity fees and redemption gates is appropriate and would provide the flexibility needed for the board, which is intimately familiar with the attributes of the MMFs it oversees and prevailing market conditions, to tailor a response to the particular facts and circumstances of the fund. Finally, we believe that additional education about the purpose and operation of the proposed liquidity fees and redemptions gates and the

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<sup>11</sup> Statement on Money Market Funds as to Recent Developments; Commissioner Luis A. Aguilar, U.S. Securities and Exchange Commission, Dec. 5, 2012. These dangers were also highlighted in a 2006 speech by the Commission’s Chief Economist and Director of the Office of Economic Analysis, who noted that “The introduction of new regulations, if they are perceived as burdensome, can lead to the unintended consequence of transactions substituting towards the less regulated markets and toward investors who themselves are less heavily regulated.” Speech entitled “Financial Regulation: Economic Margins and Unintended Consequences” by Chester S. Spatt, March 17, 2006.

<sup>12</sup> As noted in the Proposed Rule, even during the significant market turmoil caused by the European sovereign debt crisis and U.S. downgrade there were only two months during which any funds dipped below the 15% liquidity threshold (one fund out of 260 in May, 2011 and four funds out of 257 in June 2011). Proposed Rule, pp. 176-7.

circumstances in which they might be implemented would increase greatly MMF investors' willingness to accept them.

### *B. Redemption Gates*

The ability to suspend investor redemptions is the most direct, simple and effective method to achieve the primary goal of additional MMF reforms: preventing investor runs and contagion risk to other MMFs. We concur with Commissioner Gallagher that “[d]iscretionary gating directly responds...to run risk, both as to individual funds and across multiple funds, as well as to potential disparate treatment between retail and institutional investors”<sup>13</sup> and that “the only way to ensure that a run is stopped in its tracks is to permit gating.”<sup>14</sup> Indeed, the Proposed Rule specifically notes that “gates are the one regulatory reform discussed in this Release and the FSOC Proposed Recommendations that definitively stops a run on a fund (by blocking all redemptions).”<sup>15</sup> The ability to impose redemption gates would provide MMF boards with a powerful tool to combat investor panic triggered by short-term market volatility and to prevent the destructive spiral of forced fire sales of portfolio holdings at artificially depressed prices followed by further redemptions as fund MMF NAVs continue to fall. In contrast, the imposition of a floating NAV for prime institutional MMFs would result in investors in those funds immediately experiencing the effects of such abnormal activity.

The effectiveness of redemption gates as a means to stem investor panic was demonstrated amply during the financial crisis, when several non-U.S. short-term investment funds implemented temporary redemption restrictions. These funds were heavily invested in U.S. sub-prime asset-backed securities, the value of which had dropped precipitously despite the fact that they were all rated AAA or AA at the time. In imposing the gates, the funds' sponsor noted that “With no prices and no trading, there was no market to serve as a reference and thus it was impossible to value the three funds. Moreover, disposing of securities at knockdown prices to attract buyers in order to satisfy any sales would not have protected investors and selling other assets would not have respected the principle of investor equality.”<sup>16</sup> The effectiveness of these measures was demonstrated by the fact that the funds' NAVs declined only slightly (0.97%, 1.78% and 1.21%, respectively) when they were reopened for redemptions approximately three weeks later.<sup>17</sup>

The concept of imposing “circuit breakers” during times of extreme volatility is not foreign to financial markets. Trading exchanges routinely impose temporary trading halts to stem potential panicked selling by investors when markets or individual security prices fall precipitously. Moreover, as noted by Commissioner Gallagher, permitting MMF boards of directors to impose temporary redemption restrictions would represent “a change that would build on the 2010 reforms” by extending a MMF board's existing power under Rule 22e-3 of the

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<sup>13</sup> Statement on the Regulation of Money Market Funds, Commissioners Gallagher and Paredes, August 28, 2012 (hereinafter “Gallagher/Paredes Statement”).

<sup>14</sup> Statement at SEC Open Meeting – Proposed Rules Regarding Money Market Funds; Commissioner Daniel M. Gallagher; U.S. Securities and Exchange Commission; SEC Open Meeting, Washington, D.C.; June 5, 2013.

<sup>15</sup> Proposed Rule, p.160.

<sup>16</sup> “Background Information on Suspension and Reopening of ABS Funds in August,” BNP Paribas.

<sup>17</sup> *Id.*

Investment Company Act to impose redemption restrictions once the board has made the irrevocable decision to wind down a MMF because it is on the verge of breaking the buck.<sup>18</sup> Permitting a MMF to restrict redemptions in order to protect the fund also would complement the fund's existing ability to reject new shareholder purchases during periods when accepting additional assets could be detrimental to the fund.

While we believe that redemption gates would provide MMF boards with an effective tool to stem investor panic and prevent investor runs, we recognize that implementing such a change could cause investors to begin redeeming from a MMF before it hits the 15% weekly liquidity threshold in order to avoid liquidity fees and the possible imposition of redemption restrictions. As a practical matter, MMF sponsors will therefore seek to manage the liquidity levels in their funds at some higher level to avoid triggering preemptive redemptions. We believe that this will result in reduced risk within MMFs that might otherwise be managed below the general 30% liquidity restriction currently contained in Rule 2a-7.<sup>19</sup>

Notwithstanding these benefits, the implementation of redemption gates for MMFs would pose numerous operational and administrative challenges, which are addressed in detail in the comment letter submitted by the Investment Company Institute ("ICI").<sup>20</sup> In addition, many MMF investors have expressed substantial opposition to this proposal. We believe, however, that these challenges are surmountable and that investor concerns over the proposal could be addressed in part by greater education regarding the circumstances in which the gates would be imposed.

### *C. Liquidity Fees*

We believe that the liquidity fees contemplated by Alternative 2 would provide an appropriate and effective way of ensuring that the extra costs associated with raising liquidity to meet fund redemptions during times of market stress are borne by those responsible for them. Requiring fund investors to pay a fee when redeeming during periods of limited liquidity could also help to deter preemptive redemptions by investors seeking to gain a "first mover" advantage. These investors might be more inclined to remain in the fund and wait for the markets to stabilize.

The imposition of MMF liquidity fees would be feasible in large part because, like redemption gates, they would be triggered only if a fund were experiencing severe liquidity stress. The Commission has highlighted the targeted nature of this proposed tool, noting that "...liquidity fees only will be imposed when the fund's board of directors considers the fund's liquidity costs to be at a premium and the liquidity fee, if imposed, will apply only to those shareholders and cause the fund to incur that cost. Under normal market conditions, fund

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<sup>18</sup> Gallagher/Paredes Statement. Rule 22e-3 was promulgated as part of the 2010 Reforms.

<sup>19</sup> We note that the general 30% weekly liquid asset restriction contained in Rule 2a-7 does not require a MMF to maintain 30% in weekly liquid assets at all times. Instead, it restricts a MMF that is below this threshold from purchasing any additional assets that are not considered weekly liquid assets. Thus, it would be possible for a fund to operate below the current 30% threshold for some period of time.

<sup>20</sup> Comment letter filed by the ICI on September 17, 2013 (hereinafter, the "ICI Letter").

shareholders will continue to enjoy unfettered liquidity for money market fund shares.”<sup>21</sup> We believe that, with the benefit of additional education, investors ultimately will recognize that extreme measures would be appropriate in these circumstances to protect the fund’s shareholders generally.

While we believe that liquidity fees could provide an effective method of allocating extraordinary liquidity costs equitably and also may help to deter investor runs, we note that our clients have expressed reservations about this proposal and, in particular, the default setting of the fee at 2%. We believe that the amount of any liquidity fee must be carefully calibrated in relation to a MMF’s actual cost of liquidity. In short, the purpose of the fees should be restorative, not punitive. Our experiences during the financial crisis and those of other fund sponsors indicate that the proposed default level of 2% would be excessive since it is far higher than the actual cost of liquidity paid by MMFs even at the height of the financial crisis.<sup>22</sup>

As with redemption gates, the implementation of liquidity fees would raise a number of difficult operational considerations. For example, many MMF investors invest through “omnibus” accounts maintained by third-party intermediaries.<sup>23</sup> In these instances, the MMF sponsor does not have access to the underlying shareholder account records that would be necessary to assess liquidity fees on a per account basis. Other obstacles include the tax treatment of fees paid to a fund and the application of the fee to multiple transactions by shareholders on the same day. We agree with the ICI that these issues could be resolved, unlike the more fundamental problems that would arise if MMFs were required to float their NAVs.

#### *D. Enhanced MMF Disclosure and Stress Testing Requirements*

We note that the enhanced disclosure requirements proposed in the Proposed Rule, which would be implemented in connection with either Alternative 1 or Alternative 2, would provide all MMF investors with ready access (through MMF sponsors’ websites) to daily, market-based NAV and liquidity information, as well as to more timely and comprehensive portfolio holdings information. This would help eliminate the information asymmetry between more and less sophisticated investors. We fully support these proposals and believe that they would accomplish the goals of greater transparency and equal treatment of MMF investors that the Commission seeks to achieve without significant adverse effects.

We do not support, however, the proposed dramatic expansion of MMF stress testing requirements. The 2010 MMF reforms required periodic reporting to MMF boards of detailed,

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<sup>21</sup> Proposed Rule, p. 157

<sup>22</sup> Actual liquidity costs for MMFs during the financial crisis were closer to 0.50% based on general industry data. We acknowledge that under Alternative 2 MMF boards would have the ability to impose a liquidity fee lower than 2% in the event that they determined that a lower fee was more appropriate. However, we do not believe that investors would take much comfort from this given that the 2% fee would be a default and unlikely to be changed by a fund board. As Commission Chair White noted in her remarks regarding the Proposed Rule, “That determination would be subject to the board’s fiduciary duty, and we believe it would be a high hurdle.” Money Market Mutual Fund Reform: Opening Statement at the SEC Open Meeting, Mary Jo White, Chairman, U.S. Securities and Exchange Commission, June 5, 2013.

<sup>23</sup> Institutional omnibus accounts hold approximately 36% of Invesco’s institutional MMF outstanding shares.

comprehensive stress testing results incorporating variables such as hypothetical changes in short-term interest rates, increases in shareholder redemptions, downgrade of or default on portfolio securities, and widening or narrowing spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other securities held. Many MMF complexes, including Invesco, provide additional information to assist their boards in assessing the stability of the MMFs they oversee.

The Proposed Rule would expand the existing stress testing provisions of Rule 2a-7 to require: (i) testing the impact of stresses on a MMF's holdings of weekly liquid assets, (ii) an indefinite number of stress tests, (iii) testing of combinations of stresses, (iv) assumptions as to the potential correlation of stresses and how the portfolio might change in response to stress factors and (v) additional information to help the MMF's board interpret stress testing results. We believe that this additional testing is unnecessary and would create a substantial burden for MMF advisers while producing little valuable information for MMF boards due to the inherently speculative nature of most of the factors. For example, the proposed reforms include testing of scenarios in which a MMF falls below the 15% liquidity threshold. Since MMFs are overwhelmingly buy-to-hold and invest in short-term maturity, high-quality securities, the only reasonable scenario in which liquidity would fall below the threshold would be a significant increase in shareholder redemptions, which is already being tested under the existing rules. Additionally, the suggested proposal for correlation of stress testing would require extensive analysis including multiple arbitrary variations and differing results, which would provide little additional value to the stress testing process.

#### **IV. Alternative 1 is Substantially Inferior to Alternative 2 from a Cost-Benefit Perspective**

##### *A. Overview*

Alternative 1 is substantially inferior to Alternative 2 from a cost-benefit perspective. In contrast to Alternative 2, the requirement for prime institutional MMFs to adopt floating NAVs in Alternative 1 fails to satisfy four of the five evaluative criteria for proposed reform measures outlined in Section II. In sum, it is an overly broad remedy that would fail to address policymakers' primary concern regarding MMFs (the risk of investor runs), eliminate the fundamental feature that makes MMFs useful for a large portion of MMF investors, spark a large-scale exodus of assets from these funds and potentially destabilize global markets.<sup>24</sup> The Proposed Rule states that the floating NAV proposal "is designed to increase transparency, and thus investor awareness, of money market fund risks and dis-incentivize redemption activity that can result from informed investors attempting to exploit the possibility of redeeming shares at their stable share price even if the portfolio has suffered a loss."<sup>25</sup> As discussed above, however, these goals can be achieved fully—with far fewer adverse consequences for the millions

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<sup>24</sup> While the floating NAV proposal would exempt retail and government funds, it would nevertheless have a sweeping impact. As of August 28, 2013, assets in prime institutional MMFs represented approximately \$919 billion, or approximately 35%, of the total \$2.6 trillion invested in MMFs.

<sup>25</sup> Proposed Rule, p.51.

investors and issuers who rely on MMFs—through the measures proposed in Alternative 2 and the additional disclosure requirements contained in the Proposed Rule.

*B. Floating NAVs Would Not Deter MMF Investor Runs*

Perhaps the most significant infirmity of the floating NAV proposal contained in Alternative 1 is that, unlike the redemption gates proposed in Alternative 2, it fails to address the central concern expressed by policymakers with respect to MMFs: the risk of investor runs that could ultimately lead to systemic instability.<sup>26</sup> The Proposed Rule acknowledges this weakness directly, noting that “a floating NAV may not eliminate investors’ incentives to redeem fund shares, particularly when financial markets are under stress and investors are engaging in flights to quality, liquidity, or transparency.”<sup>27</sup> The Commission states that Alternative 1 “is designed primarily to address the incentive of money market fund shareholders to redeem shares in times of fund and market stress based on the fund’s valuation and pricing methods.”<sup>28</sup> However, an approach focused on addressing concerns associated with MMFs’ valuation and pricing methods ignores the reality that investors are likely to flee *any* fund that is experiencing severe liquidity issues.

Substantial historical evidence supports this view. For example, floating NAV ultra-short bond funds in the U.S. experienced severe outflows during the financial crisis and by the end of 2008 assets had dropped to less than 40% of their 2007 peak levels.<sup>29</sup> Floating NAV cash funds outside the U.S. also saw major asset declines during the financial crisis.<sup>30</sup>

*C. Imposing Floating NAVs on Prime Institutional MMFs Would Significantly Reduce the Utility of These Funds for the Majority of Their Investors*

Alternative 1 would significantly reduce the utility of prime institutional MMFs by eliminating one of the features most important to the majority of their investors: the stable NAV. It is important to keep in mind that MMFs serve a fundamentally different purpose for their investors than most investments. Unlike typical investment products, MMFs are generally used as a cash management tool; they are not simply “ultra-short duration” investment funds. This is particularly true for institutional prime MMFs, which are the cash management vehicle of choice

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<sup>26</sup> Commissioner Gallagher has also made this point, observing that “even if there is no stable \$1.00 NAV — i.e., even if, by definition, there is no “buck” to break — investors will still have an incentive to flee from risk during a crisis period such as 2008, because investors who redeem sooner rather than later during a period of financial distress will get out at a higher valuation.” Gallagher/Paredes Statement.

<sup>27</sup> Proposed Rule, p. 56. The FSOC also recognized this fact in its proposed recommendations, noting that “while a floating NAV would remove the ability of a shareholder to redeem shares at \$1.00 when the market value is less than \$1.00, it would not remove a shareholder’s incentive to redeem whenever the shareholder believes that the NAV will decline significantly in the future, consistent with the incentive that exists today for other types of mutual funds.” Proposed Recommendations Regarding Money Market Mutual Fund Reform, Financial Stability Oversight Council, November, 2012. 77 Fed. Reg. 69455, at 69467 (hereinafter, “FSOC Report”).

<sup>28</sup> Proposed Rule, p. 47.

<sup>29</sup> “Report of the Money Market Working Group Submitted to the Board of Governors of the Investment Company Institute,” March 17, 2009.

<sup>30</sup> The ICI has noted that “French floating NAV dynamic money funds lost about 40% of their assets in a three-month time span from July 2007 to September 2007.” Statement of the Investment Company Institute, SEC Open Meeting of the Investor Advisory Committee, May 10, 2010, at 4.

for corporations, government entities, foundations, endowments and other organizations seeking a stable, short-term investment offering a competitive yield to facilitate payroll processing and other day-to-day functions. Policymakers have acknowledged this special role played by MMFs, noting that “MMFs serve an important role in the asset management industry through their investors’ use of MMFs as a cash-like product in asset allocation and as a temporary investment when they choose to divest of riskier investments such as stock or long-term bond mutual funds.”<sup>31</sup> The importance of MMFs’ role as a cash management tool is demonstrated by the fact that they have continued to maintain a substantial asset base—\$2.6 trillion as of the end of August, 2013—despite paying very low yields for several years.

A requirement for prime institutional MMFs to adopt floating NAVs would render these funds unsuitable as a cash management tool for the majority of their current investors due to the formidable and costly administrative burdens that it would create. Furthermore, many governmental and institutional entities are limited by statute or their investment guidelines to investing only in stable-NAV products and would therefore effectively be barred from prime funds. In this regard we note the comment letter submitted by the National Association of State Treasurers.<sup>32</sup>

#### *D. MMF Investors Have No Appetite for Floating NAV Funds*

As stated above, investors cannot be forced to purchase an investment product that does not suit their needs. Numerous industry surveys have demonstrated that there is little market demand for floating NAV MMFs. For example, one recent survey of approximately 900 financial industry professionals found that “Nearly two-thirds of financial professionals indicate their organizations would be less willing to invest in MMFs and/or would reduce /eliminate their current holdings of MMFs in their short-term investment portfolio in response to a floating NAV.”<sup>33</sup> This supplements an earlier survey, which found that 79% of respondents using money funds would decrease or stop using MMFs—with the majority decreasing their usage by at least 50%—if the funds were to implement floating NAVs.<sup>34</sup> Invesco surveyed our own MMF client base in July 2013 regarding the reform proposals contained in the Proposed Rule and 84% of respondents indicated that they would decrease or stop using money market funds if prime institutional funds were to move to a floating NAV. We have also seen an increase in requests recently for separately managed cash mandates by our clients who are concerned by the prospect of a change to floating NAVs for institutional prime MMFs.

The track record of floating NAV funds abroad provides further evidence of this product’s very limited popularity with investors. For example, the chart below demonstrates the dramatic decline of AUM in French floating NAV funds.<sup>35</sup> The French funds’ asset flows were similar to the flows of the U.S. prime funds during periods of stress. However, based on a percent change in monthly flows, the French floating NAV funds saw significantly more

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<sup>31</sup> FSOC Report, p.8.

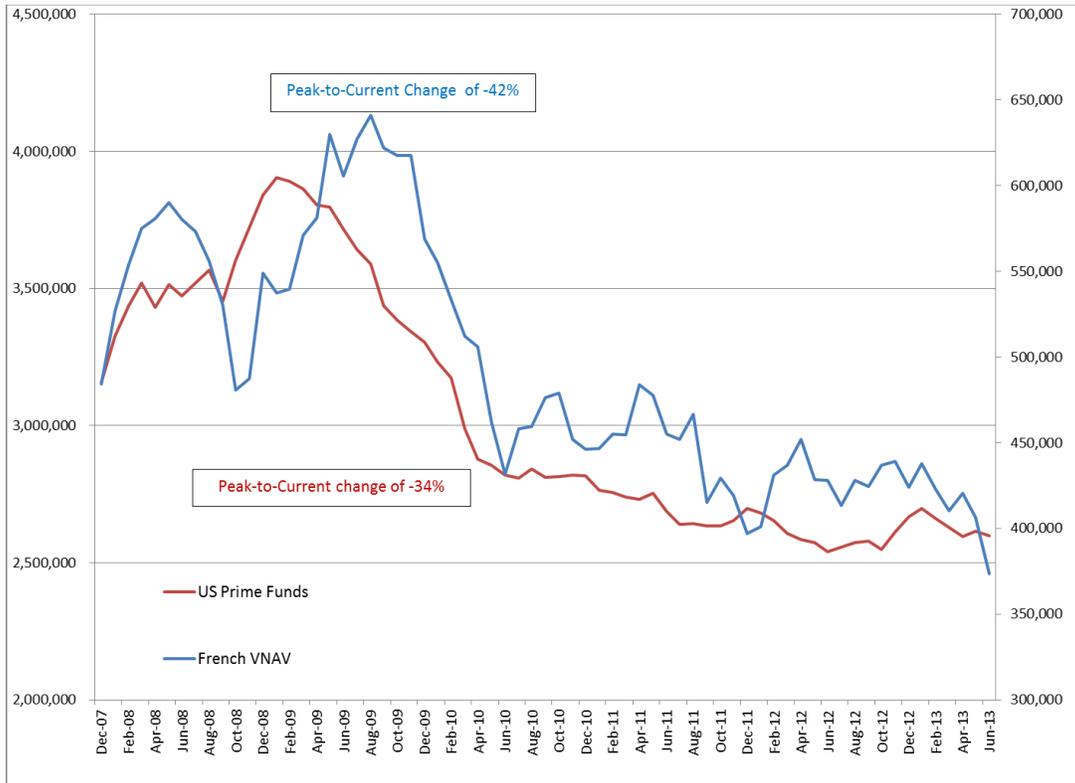
<sup>32</sup> Comment Letter submitted by National Association of State Treasurers, September 17, 2013.

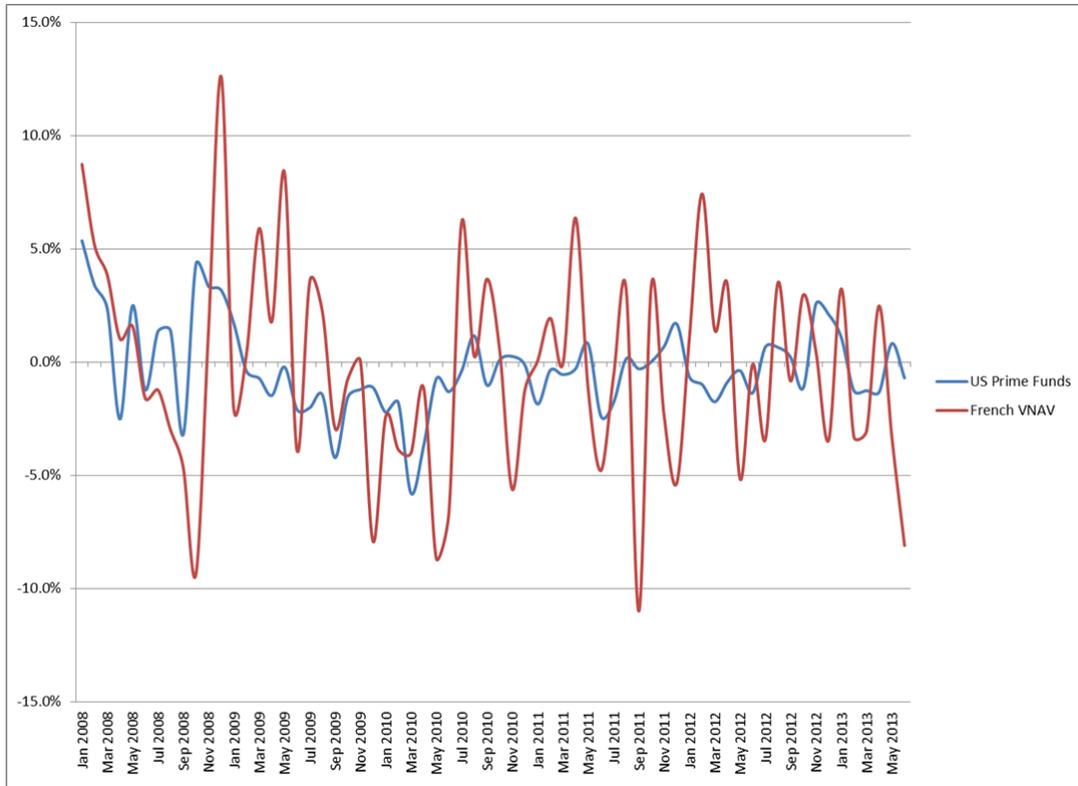
<sup>33</sup> 2013 Liquidity Survey, Association for Financial Professionals, June 2013.

<sup>34</sup> Money Market Fund Regulations: The Voice of the Treasurer, Treasury Strategies, Inc., April 2012, p. 12.

<sup>35</sup> Lipper FundFile.

volatility than the U.S. stable-NAV prime funds. The higher volatility is not easily explained but could be due to stable-NAV fund investors' greater comfort with the shorter duration and more liquid securities held in U.S. prime MMFs. Additionally, it could be due to floating NAV investors being equally disposed to engage in a 'flight to quality' as the stable-NAV investors who moved to government funds during periods of crisis.





The Proposed Rule explicitly acknowledges that “investors may withdraw more assets under the floating NAV proposal than they would under the liquidity fees and gates alternative because *the floating NAV proposal may have a more significant effect on investors’ day-to-day experience with and use of money market funds than the liquidity fees and gates alternative* and because many investors place great value on principal stability in a money market fund.”<sup>36</sup> This comment highlights the problems associated with using the blanket, “always on” approach contemplated by Alternative 1 to address a very specific (and relatively infrequent) problem, in direct contrast to the more tailored approach represented by Alternative 2.

*E. Outflows from Prime Institutional MMFs Triggered by Imposition of a Floating NAV Would Generate Significant Unintended Adverse Consequences*

Our research indicates that a large-scale reallocation of assets from institutional prime funds into government MMFs by investors seeking to retain stable NAVs would lead to a drastic

<sup>36</sup> Proposed Rule, pp. 285-6 (emphasis added). The Proposed Rule goes on to note that the Commission staff “expect[s] that more institutional investors would be unwilling to invest in a floating NAV money market fund than a money market fund that might impose a fee or gate because a floating NAV would have a persistent effect on investors’ experience in a money market fund.” Proposed Rule, 287.

reduction in the supply of government securities. The table below illustrates these effects over a five-year time period.<sup>37</sup>

Migration Rate %	Migrated Prime Assets (\$bn)	Curr. Gov't Assets (\$bn)	Proj Gov't Assets (\$bn)	Year 1 Surplus/Deficit (\$bn)	Year 2 Surplus/Deficit (\$bn)	Year 3 Surplus/Deficit (\$bn)	Year 4 Surplus/Deficit (\$bn)	Year 5 Surplus/Deficit (\$bn)
50%	\$715	\$917	\$1,632	339	311	287	267	254
75%	\$1,073	\$917	\$1,990	-19	-47	-71	-91	-104
100%	\$1,431	\$917	\$2,348	-377	-405	-429	-449	-462

These deficits may be exacerbated by the proposed regulatory changes such as Basel III Liquidity Coverage Ratio (LCR) and Derivative Margining Requirements (OTC). The combination of these factors could push government securities yields to zero, and possibly even negative yields in secondary markets, even when short-term interest rates begin to rise. In addition, if government funds are left as the only stable NAV MMFs available to institutional investors then these funds, which have traditionally been quite stable, will become far more volatile since they will be the sole MMF option for institutional cash management needs.

As noted above, the heavy costs associated with implementing a floating NAV would also cause many fund sponsors and distributors to exit the MMF business, thereby increasing concentration risk within the industry. Large asset flows out of prime institutional MMFs and into bank products would increase bank industry concentration risk further. At June 30, 2013, the top five largest U.S. banks by deposits represented 41.7% of total deposits for all FDIC insured banks, a dramatic increase from 33.8% at December 31, 2007.<sup>38</sup> Additional constraints on the U.S. money fund industry will exacerbate further this “too big to fail” risk with a corresponding increase in overall systemic risk.

Ironically, while the proposed adoption of a floating NAV regime for prime institutional funds is intended to generate greater transparency with respect to the assets invested in these funds (a result already achieved by the enhanced disclosure provisions included in the Proposed Rule), the adoption of Alternative 1 would precipitate a large-scale shift in assets to products not offering the substantial protections of the Investment Company Act. As Commissioner Aguilar has cautioned “The outflow of money fund assets to an unregulated market is a significant systemic risk concern, and can result in harm to our market and investors.”<sup>39</sup>

Finally, to the extent that assets shift out of prime institutional funds and into government products, capital markets funding to the private sector would be reduced. Given that prime institutional money market funds held \$659.3 billion of private sector money market instruments

<sup>37</sup> Source: Crane Data, JPMorgan Securities, U.S. Treasury, ICI, Invesco. The projected rates of government security issuance used for purposes of this table are based upon broad market consensus estimates of future U.S. Treasury securities issuance.

<sup>38</sup> Source: FDIC, Bloomberg

<sup>39</sup> Statement on Money Market Funds as to Recent Developments, Commissioner Luis A. Aguilar, U.S. Securities and Exchange Commission, December 5, 2012.

as of June 2013, the effects could be quite significant.<sup>40</sup> Even if only a portion of outflows from prime institutional funds are invested in private sector money market instruments via other products, the transition itself could be highly disruptive as prime institutional funds may be forced to sell a significant portion of their holdings.

#### *F. The Imposition of a Floating NAVs Would Pose Significant Operational Challenges*

The requirement for institutional prime funds to adopt floating NAVs would raise a variety of significant operational challenges due in large part to the interdependencies of the various users of MMFs. There is a broad array of MMF stakeholders with different roles and needs, including corporations, states, municipalities, universities, government sponsored enterprises, treasury management systems, custodians, fiduciaries, MMF portals and other brokers, fund advisors, fund transfer agents, sweep account providers, and fund accounting departments. Many of these parties interact with one another when purchasing, redeeming, holding or administering MMFs. For example, fund advisors depend on transfer agents to process transactions. Broker-dealers interact with fund advisors and transfer agent systems. Investors are dependent on both cash management system providers and sweep and treasury services systems. While some tasks can be completed concurrently, because of the sequential nature of moving a MMF transaction through multiple systems controlled by multiple organizations not all of the work can be completed in parallel. Large blocks of reprogramming would need to be performed sequentially and then be tested to ensure that the many systems interfaces perform together properly.<sup>41</sup>

#### *G. “Retail v. Institutional” Fund Distinction is Artificial and Would Be Difficult to Implement*

A critical feature of Alternative 1 is the exemption for “retail” MMFs from the floating NAV requirement. However, as acknowledged in the Proposed Rule, the distinction between retail and institutional funds is fraught with difficulties due to the fact that many individual investors access MMFs indirectly through intermediaries that may aggregate trades for tens of thousands of underlying shareholders. Moreover, even investors that may at first glance appear to be institutional, such as company-sponsored 401(k) retirement plan (i.e. plan), would be characterized more properly as retail since they have no single decision maker. They ultimately represent individual retail investors who do not pose a “hot money” risk. Nor do all institutional investors automatically pose a flight risk during crises. For example, the investment behavior of the corporate treasurer of a small business is more likely to mirror that of a typical retail investor than a multi-billion dollar company.

#### *H. Conclusion*

As demonstrated above, the imposition of a floating NAV regime for institutional prime MMFs would change the fundamental nature of these funds and impose extremely onerous burdens on their investors, sponsors and distributors. While these burdens might be justifiable if

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<sup>40</sup> ICI Letter, p. 38.

<sup>41</sup> See “Operational Implications of a Floating NAV across MMF Industry Key Stakeholders,” Center for Capital Markets, Summer 2013.

no feasible alternative existed to address the policy concerns expressed by the Commission, this is clearly not the case. Alternative 2, when paired with the enhanced disclosure proposals contained in the Proposed Rule, would accomplish policymakers' stated goals more effectively without generating the serious problems and associated risks described above.

## **V. If the Commission Nevertheless Decides to Proceed with Alternative 1, Several Changes are Critical**

While we strongly believe that the imposition of a floating NAV envisioned in Alternative 1 is unnecessary and potentially dangerous, if the Commission nevertheless decides to implement this option we believe that several changes to this proposal would be critical in order to make it viable.

### *A. Retail Funds Should be Defined with Reference to Shareholder Social Security Numbers*

We support the Commission's proposal to exempt retail funds from the floating NAV requirement in Alternative 1 given that retail investors are generally less like to run from MMFs during a crisis. As discussed above, however, in many instances it can be difficult to distinguish retail investors from institutional ones.

The Commission proposes to define retail funds as those funds that limit daily redemptions to \$1 million. The Commission states that the definition would be "relatively simple to implement, since it would only require a retail money market fund to establish a one-time, across-the-board redemption policy."<sup>42</sup> However, this ignores the significant complexities and operational challenges necessary to track account activity that could cause a shareholder's total redemption in single day to exceed \$1 million and to aggregate accounts across different MMF platforms. These challenges would drive up funding costs for sponsors, intermediaries, and investors unnecessarily. The Commission's proposed definition also fails to recognize that many individuals in retail MMFs hold relatively high account balances and may trade actively in transactions exceeding \$1 million.

We believe that a simpler and more feasible approach would be to define a MMF as a retail fund only if it were comprised exclusively of accounts most commonly held by individuals or natural persons. These accounts include accounts registered under social security numbers or omnibus accounts held on behalf of underlying accounts registered solely under social security number(s) (subject to certification by the omnibus account owner). This alternative definition for a retail prime MMF would provide a substantially more efficient and less costly method of ensuring that exempt MMFs contained only individual investors by relying on information and attributes readily available for MMF accounts.

### *B. Municipal MMFs Should be Exempt from Floating Their NAVs*

While government funds would be exempt from the requirement to float their NAVs under Alternative 1, tax-exempt municipal MMFs would not benefit from this exception. We

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<sup>42</sup> Proposed Rule, p. 80.

strongly believe that given the characteristics of municipal MMFs and like products such as local government investment pools there is no justification under any circumstances for them to be forced to bear the “significant costs” and administrative burdens of moving to floating NAVs noted in the Proposed Rule.<sup>43</sup> The Proposed Rule implies that the vast majority of municipal MMFs would qualify for the retail fund exception to Alternative 1. However, these funds would nevertheless be obligated to institute complex and costly changes to systems, policies and procedures to ensure compliance with the new rules. Furthermore, as discussed above, depending on the definition chosen, the implementation and administration of the measures required to distinguish between retail and institutional investors could be both extremely onerous and plagued by uncertainty.

Like government funds, municipal MMFs have remained relatively unaffected by investor runs even during periods of extreme market turmoil. We note the extensive data provided in the ICI Letter demonstrating that the overwhelming majority of municipal MMFs retained (or even attracted) assets through the depths of the financial crisis.<sup>44</sup> Thus, they do not implicate the primary risk that the proposed reforms are intended to mitigate. Further, these funds generally carry extremely high levels of liquid assets, well in excess of even the stringent weekly liquidity requirements of the 2010 MMF reforms. The ICI has noted that “the majority of tax-exempt funds have weekly liquidity far in excess of the 30 percent required under Rule 2a-7. As of June 2013, tax-exempt funds had \$203 billion in weekly liquidity, amounting to 79 percent of their total assets. This level of liquidity provides a high degree of protection against shareholder outflows.”<sup>45</sup> In the light of these facts, there is no compelling reason to require municipal MMFs or similar products to bear the heavy costs of instituting a floating NAV when doing so would not provide any clear benefit.

### *C. Retain Amortized Cost for Stable NAV MMFs*

The ability to use amortized cost pricing is essential to the operation of stable NAV MMFs because it enables them to offer investors same-day settlement of portfolio transactions, a critical feature for cash management. Most MMFs utilize proprietary systems that support the same-day settlement transaction processing, including the remittance of redemption proceeds through the Fedwire system throughout the day at various cutoff times. Elimination of the ability to use amortized cost to maintain a stable NAV for money market funds would effectively eliminate this ability due to the difficulty that would be associated with determining intraday market prices for portfolio securities.

The Proposed Rule acknowledges that “the vast majority of money market fund portfolio securities are not valued based on market prices obtained through secondary market trading because the secondary markets for most portfolio securities such as commercial paper, repos, and certificates of deposit are not actively traded. Accordingly, most money market fund portfolio securities are valued largely through “mark-to-model” or “matrix pricing” estimates.”<sup>46</sup>

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<sup>43</sup> The Proposed Rule explicitly acknowledges that “shifting to a floating NAV could impose potentially significant costs on both a fund and its investors.” Proposed Rule, p. 67.

<sup>44</sup> ICI Letter, p. 14.

<sup>45</sup> *id.*, p. 22.

<sup>46</sup> Proposed Rule, p. 15

Therefore, to continue to offer same-day settlement for investors several times a day, MMFs not only would need to obtain intraday data for securities from pricing vendors periodically during the day (which the vendors may not be able or willing to do), but also would need to make significant systems modifications and procedural changes to support a multiple, intraday NAV calculation process. If intraday pricing and processing could not be accommodated, the valuation process generally would occur only at the end of the day and investors' options for same-day settlement would be eliminated or severely limited.

*D. NAV Calculations for MMFs Should Remain Consistent with Those of Other Mutual Funds*

Under Alternative 1, all MMFs, other than government and retail MMFs, would be required to price and transact in their shares at a NAV calculated to the fourth decimal place for shares with a target NAV of \$1.00 (e.g., \$1.0000) ("basis point rounding"). This would be inconsistent with the pricing convention used for all other mutual funds, which round their calculated NAVs to the nearest penny for purposes of processing trades in fund shares. As the ICI correctly points out, "the SEC's proposal would require money market funds to comply with a pricing standard that is 10 times more precise than the standard articulated in ASR 219."<sup>47</sup>

The requirement to price MMFs to the fourth decimal place would also impose significant additional burdens and costs on MMF intermediaries and shareholders. As noted by the ICI, "investors would be reluctant to utilize a cash management product priced at \$100.00. Thus, most money market fund shareholder recordkeeping systems and ancillary systems—used by funds, intermediaries (e.g., banks, broker-dealers, bank trust companies, retirement plan record keepers), and municipal and corporate entities—would require significant modification to comply with basis point pricing (i.e. \$1.0000)."<sup>48</sup> Investment product systems are currently designed to process and record-keep transactions using two decimal points. Changes to a \$100 NAV would require fundamental changes to core record keeping system components used to calculate transactions for all mutual funds. Ancillary investor-facing inquiry and trading systems also would require costly changes to address the storage, delivery and confirmation of new NAV prices.

The impact of a requirement to trade and transact at four decimal places cannot be underestimated. All stakeholders in the industry would be required to implement and program a universal rounding methodology for processing transactions. Further, the new pricing structure would require a converted share balance for every account in every prime MMF which equate to millions of accounts, and would result in every intermediary, broker-dealer, and transfer agent having to process this costly conversion.

Adoption of this new pricing methodology is costly and impacts investors and other industry stakeholders. We believe these costly and unnecessary changes are unjustified given that standardization has been established for all mutual funds.

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<sup>47</sup> ICI Letter, p. 41.

<sup>48</sup> *id.*

## **VI. Alternative 3 Would Effectively Destroy MMFs by Creating a Uniquely Undesirable Product That Would be Unacceptable to MMF Investors, Sponsors and Distributors**

We strongly oppose Alternative 3 because it wholly fails the cost/benefit analysis described in Section II. It would impose the exorbitant costs and onerous operational burdens associated with Alternative 1 and Alternative 2 without the countervailing benefits of retaining a stable NAV.<sup>49</sup> Simply put, there is little reason why a rational investor would choose to invest in such a uniquely undesirable investment product when many other short term investments (including bank deposits) are available without potentially significant restrictions on liquidity.

Industry surveys, corroborated by our own client feedback, clearly indicate that investors would have no tolerance for a floating NAV MMF that included redemption gates and/or liquidity fees. Invesco's recent client survey found that 100% of our MMF distribution partners surveyed believed that their clients would decrease or stop using prime institutional MMFs if these funds moved to a floating NAV combined with fees and gates in times of liquidity stress. As indicated above there is no need to saddle the tailored, effective measures contained in Alternative 2 (combined with the proposed additional disclosure requirements) with the overbroad and onerous features of Alternative 1 when the former option by itself achieves fully the reform goals stated by policymakers. Doing so would effectively sound the death knell for this critically important product and trigger serious disruptions in global short-term markets.

## **VII. Clarification is Needed in Several Areas to Avoid Potential Confusion for MMF Investors and Sponsors**

### *A. The Commission Should Clarify That MMFs May Continue to Use Amortized Cost Pricing for Portfolio Securities with Maturities of 60 Days and Less*

When valuing portfolio securities with a remaining maturity of 60 days or less, MMFs, like all mutual funds, are permitted to deem the amortized cost of these securities to be their fair value so long as circumstances do not dictate otherwise.<sup>50</sup> The Proposed Rule explicitly recognizes this, stating that “money market funds would continue to be permitted to use amortized cost to value portfolio securities with a remaining maturity of 60 days or less.”<sup>51</sup> This

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<sup>49</sup> The projected costs associated with Alternative 3 are staggering. The ICI has estimated, based upon data compiled by the Commission, that “Funds and their transfer agent service providers would incur *one-time costs* ranging from approximately \$400 to \$712 million, and *annual ongoing costs* of approximately \$40 to \$137 million to implement both proposals. These estimates *do not include* one-time and ongoing costs for intermediaries, institutional investors, or others affected by the proposed changes. The industry (including funds, transfer agents, intermediaries, institutional investors, and service providers) would incur 2 to 2 1/2 times the estimated costs for funds, with total *one-time costs* ranging from approximately \$800 million to \$1.75 billion, and *annual ongoing costs* of approximately \$80 to \$350 million.” ICI Letter, 58.

<sup>50</sup> Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977).

<sup>51</sup> Proposed Rule p. 113, footnote 253.

guidance is repeated several times elsewhere in the Proposed Rule.<sup>52</sup> However, one of the footnotes to the Proposed Rule could be read to cast some doubt on this since it refers to amortized cost pricing being available when it is “the same as valuation based on market factors,” implying that MMF could be barred from using amortized cost pricing if it differs even minutely from the market value of the securities.<sup>53</sup> While we believe this implication to have been unintentional, we nevertheless request the Commission to reaffirm clearly that MMFs, as all other mutual funds, can continue to use amortized cost pricing for securities with maturities of 60 days and less.

### *B. Government MMFs Should Continue to Be Governed By the “Names Rule”*

We believe that it is appropriate, as contemplated by the Proposed Rule, that government funds continue to be governed by rule 35d-1 under the Investment Company Act (commonly known as the “names rule”). This rule requires government MMFs 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 approach taken for other mutual funds that focus their investments on a particular type of investment or in investments in a particular industry and are named accordingly. We see no reason that government MMFs should be subject to a different standard in this regard.

### *C. Maintain Cash Equivalent Status for MMFs*

It is critically important that further reforms to MMFs not jeopardize in any way their existing cash equivalent accounting or tax treatment, which is essential to their continued utility as a cash management tool. If investments in MMFs were no longer considered cash equivalents, they would be considered investments held for trading purposes, which would create costly and complicated tax and accounting problems for their investors. The tax implications would include the potential recognition of capital gains and losses and the calculation of the “wash sales” as required under the Internal Revenue Code. Accounting implications would include, among other things, that MMFs would no longer be eligible for use to maintain required levels of cash and cash equivalents under investors’ debt covenants, as well as placing additional burdens on investors to track realized and unrealized gains and losses for financial reporting. The ICI Letter further outlines these difficulties and complexities.

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<sup>52</sup> “The Commission...has stated that it would not object if a mutual fund board of directors determines, in good faith, that the value of debt securities with remaining maturities of 60 days or less is their amortized cost, unless the particular circumstances warrant otherwise.” Proposed Rule p. 8, footnote 10. “Money market funds would only be able to use amortized cost valuation to the extent other mutual funds are able to do so—where the fund’s board of directors determines, in good faith, that the fair value of debt securities with remaining maturities of 60 days or less is their amortized cost, unless the particular circumstances warrant otherwise.” Proposed Rule p. 48, footnote 136. “As discussed above, money market funds, like other mutual funds, would be able to use amortized cost to value securities with maturities of 60 days or less provided the fund’s board determines that the security’s fair value is its amortized cost and the circumstances do not suggest otherwise.” Proposed Rule, p.374, footnote 744.

<sup>53</sup> Proposed Rule, p. 48, footnote 136

## **VIII. The Proposed 10% Diversification Limit on Sponsors of Asset-Backed Securities Should be Modified to Avoid Adverse Impacts on ABS Markets and the Financial Institutions and Investors that Rely on These Securities**

The Proposed Rule proposes to extend the universe of “guarantors,” for purposes of the diversification provisions of Rule 2a-7, to include the sponsors of asset-backed securities (“ABS”) and to limit to 10% the maximum exposure of a MMF to any single ABS sponsor. The proposal contains an exception permitting a MMF board to exclude an ABS sponsor from this treatment if the board or its delegate determines that the fund “is not relying on the ABS sponsor’s financial strength or its ability or willingness to provide liquidity, credit or other support to determine the ABS’s quality or liquidity.”<sup>54</sup> However, this exemption would be of little practical use since MMF advisers routinely include a credit analysis of the program sponsor as one of the many factors assessed in considering an ABS investment. Accordingly, the 10% restriction would effectively apply to all ABS. The Proposed Rule asks whether this exemption should be revised to apply to ABS “if the fund’s board of directors (or its delegate) determines that the sponsor’s financial strength or its ability or willingness to provide liquidity, credit, or other support did not play a *substantial role* in the fund’s assessment of the ABS’s quality or liquidity.”<sup>55</sup> We strongly support such an approach since without it we believe that this provision threatens to deal a critical blow to those who rely on these securities as a funding source or investment.

As of July, 2013, there were over 70 asset-backed commercial paper programs (“ABCP”) totaling \$95 billion held by the 2a-7 money funds representing approximately 4% of all taxable money market fund assets.<sup>56</sup> While the size of this market has declined markedly from its peak in July 2007, ABCP programs continue to represent a critical source of funding for banks and their clients as well as an important investment option for MMFs (particularly in the light of the reduction in permissible investments brought about by the 2010 MMF reforms). Generally, this funding provides working capital financing to the bank’s corporate clients by purchasing or advancing against receivables.

Asset classes financed by ABCP proceeds include trade receivables, auto loans and leases and credit card receivables. Each of these forms of financing is critical to making credit widely available in the U.S. economy. ABCP programs are backed by asset pools that exhibit intrinsic creditworthiness due in part to multiple levels of structural protection. The programs also provide transparency to investors through detailed monthly reporting of performance of the collateral portfolios supporting the structure. ABCP investors are exposed primarily to the risks inherent in the program’s asset pools rather than the credit risk of a single financial institution or other issuer. Over the last several years, the credit quality and asset performance in these programs has been very stable.

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<sup>54</sup> Proposed Rule, p.445.

<sup>55</sup> Proposed Rule, p. 446.

<sup>56</sup> Crane Data. The Proposed Rule notes that “Analysis of Form N-MFP data from November 2010 through March 2013 indicates that financial company commercial paper and asset-backed commercial paper comprise most of money market funds’ commercial paper holdings.” Proposed Rule, p. 308.

In the wake of the financial crisis, regulators around the globe have imposed a raft of new prudential restrictions on banks that have had a significant and adverse impact on the ABS market. For example, regulations aimed at forcing banks to report the risk of formerly off-balance sheet investment vehicles on bank balance sheets have significantly undermined the incentive for a bank to operate ABCP programs since it now must hold capital against these on-balance sheet financing conduits. In addition, the Basel III liquidity coverage ratio and net stable funding ratio requirements obligate banks to hold higher quality liquid assets and to term out their funding positions.<sup>57</sup> Proposed regulations affecting the securitization market also have placed pressure on program sponsors. The changes in the Proposed Rule thus would require MMFs to expand the diversification of the ABS sponsors represented in their portfolios at the same time that many of these sponsors are exiting the market.

### **IX. Elimination of the 25% Guarantor “Basket” Would Severely Limit Municipal MMFs’ Investment Options**

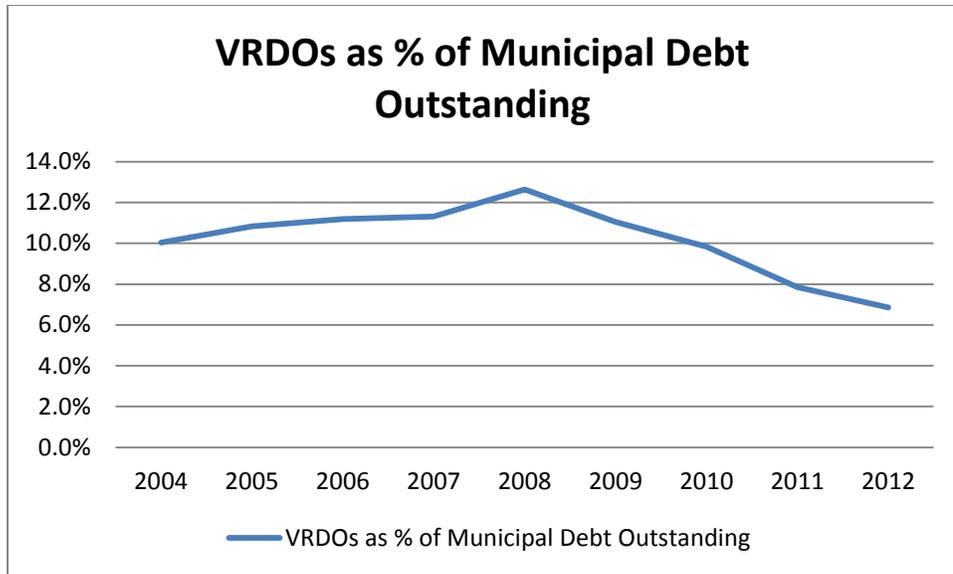
The proposed elimination of the 25% guarantor “basket,” under which as much as 25% of the value of securities held in a MMF’s portfolio may be subject to guarantees or demand features from a single institution, would have a significant adverse effect on tax-exempt MMFs. Municipal MMFs traditionally have had a substantial focus on short-term, variable-rate securities issued by municipalities and subsequently enhanced by financial institutions or other guarantors. In late 2012, tax-exempt MMFs had an average of 83% of total assets invested in variable rate demand obligations (“VRDOs”).<sup>58</sup> With the majority of VRDOs offering one- and seven-day demand features, these securities provide a vital source of liquidity for both tax-exempt and taxable MMFs. However, many taxable prime MMFs use VRDOs as a reliable option for daily and weekly liquidity. The combination of regulatory requirements for banks to hold more capital, the dwindling number of financial guaranty companies and the decrease in highly-rated banks has significantly reduced the number of entities offering credit support for VRDOs.

Since 2008, there has been a significant decline in the issuance of VRDOs. As illustrated in the chart below, the issuance of short-put variable rate debt has fallen from 12.6% of total municipal market issuance in 2008 to only 6.9% in 2012. While total municipal market debt outstanding has held stable for the past five years at about \$3.7 trillion, VRDO outstandings have declined steadily from \$444.9 billion in December 2008 to only \$246.8 billion in June 2013.

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<sup>57</sup> The Proposed Rule notes that “The Basel III liquidity framework also proposes requirements aimed at limiting banks’ reliance on short-term wholesale funding.” Proposed Rule, p. 308, footnote 599.

<sup>58</sup> Fitch – Callable CP: Short-Term Credit Market Primer (May, 2013)



*Sources:*

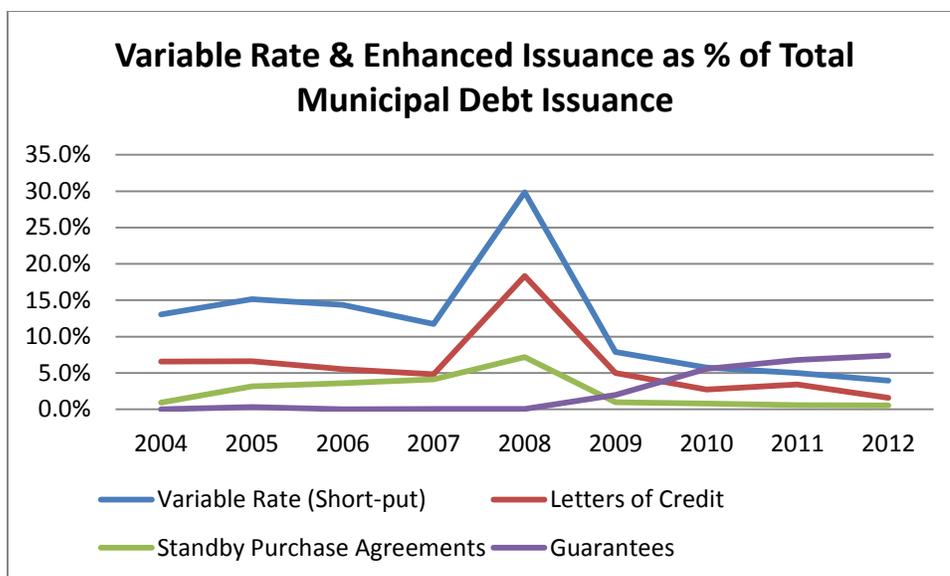
*Bond Buyer Municipal Marketplace Directory – Spring 2010, 2011, 2012, 2013*

*Bond Buyer Online (Thomson Reuters)*

*SIFMA.org (US Municipal VRDO Update 2013 & US Municipal VRDO Historicals 2012)*

There has also been a marked decline in the issuance of credit enhanced securities. Securities issued with a letter of credit (“LOC”), standby purchase agreement or guarantee comprised 25.6% of total municipal market issuance in 2008. In 2012, these securities made up only 9.5% of total issuance. This contraction in the availability of credit enhanced securities hinders the level of diversification that managers can achieve in tax-exempt MMF portfolios.

Municipal issuers with debt supported by credit enhancement are exposed to both the bank’s credit risk and to overall remarketing risk. Uncertainty with regard to financial institutions can lead to failed remarketing of securities with bank enhancement. Failed remarketing often results in accelerated amortization and increased interest costs for municipal issuers, making the issuance of fixed-rate debt somewhat more attractive in the current low interest rate environment. To avoid these risks, many issuers have also resorted to direct loans with banks, further limiting the availability of enhanced short-put variable rate debt in the market.



Sources:

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*Bon-d Buyer Online (Thomson Reuters)*

*SIFMA.org (US Municipal VRDO Update 2013 & US Municipal VRDO Historicals 2012)*

The number of LOC providers supporting new issuance has fallen along with the decline in VRDOs and other credit enhanced securities. In 2008, there were at least 76 different LOC providers supporting new issues in the market. In 2012, that number had dwindled to only 31 providers. Increased regulatory capital requirements may make the provision of support facilities less advantageous for financial institutions.

Many of the LOC providers that were active in the market in 2008 have since been downgraded to ratings levels inconsistent with MMF guidelines. In the current market, there are significantly fewer institutions with ratings appropriate to provide LOCs for municipal issuers. In June 2012, Moody's downgraded a number of popular LOC providers to tier-2, prompting many municipal issuers to seek credit facilities from higher-rated banks and further consolidating the pool of available LOC providers.

## X. Conclusion

As a leading MMF provider, Invesco strongly supports the Commission's efforts to strengthen this critically important product in a manner that enhances its stability while retaining its fundamental characteristics and continued utility for investors. Any such efforts must begin with a clear understanding of the policy goals they are intended to achieve and an appropriate set of evaluative criteria to be applied in the context of a rigorous cost-benefit analysis. We believe that the proposed combination of liquidity fees, redemption gates and enhanced disclosure is the most effective and feasible method of achieving policymakers' stated goals. On the other hand, requiring MMFs to float their NAVs would fail to achieve the Proposed Rule's aim of preventing and mitigating investor runs. Furthermore, it would generate significant costs and administrative burdens that would cause large numbers of MMF investors, sponsors and service providers to reconsider their willingness to use this product. Worse still, the proposal to require MMFs to implement floating NAVs with liquidity fees and redemption gates would wholly fail the

required cost/benefit analysis and would devastate the industry by creating an essentially unmarketable product that would lead investors to abandon MMFs en masse. We respectfully request the Commission to consider carefully our views on this matter and to pursue only those reforms that advance its expressed policy goals while preserving the viability of MMFs, which have served investors' cash management needs ably for over 40 years.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Lu Ann S. Katz". The signature is fluid and cursive, with the first letters of each name being capitalized and prominent.

Lu Ann S. Katz

Head of Global Liquidity