THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

August 26, 2011

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets
and Government Sponsored Enterprises
U.S. House of Representatives
2244 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Garrett:

Thank you for your letter dated August 12, 2011, regarding the Commission's continuing review of the regulation of money market funds, including the Commission's consideration of whether to require money market funds to use "floating" net asset values ("NAVs").

The severe problems experienced by money market funds in 2007 and 2008 prompted the Commission to review our regulation of money market funds and to adopt a number of reforms in 2010 intended to make money market funds more resilient in order to prevent another run by fund shareholders. The run on institutional money market funds in September 2008 was stopped only as a result of an unprecedented intervention into the short-term markets by the Department of the Treasury and Federal Reserve Board.

When we adopted the 2010 money market reforms we noted that they were only a first step to addressing our concerns and that the Commission would continue to consider more fundamental changes to the structure of money market funds to prevent a future run, which could harm investors, and potentially damage or destabilize the short-term markets. Subsequently, a number of policy options were explored in detail in a report prepared by the President's Working Group on Financial Markets ("PWG Report"), a copy of which can be located at http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf.

The PWG Report identified the stable net asset value feature of money market funds as a characteristic that contributed to the susceptibility of money market funds to runs. It suggested requiring money market funds to operate with a floating NAV as one of several possible reforms that the Commission could consider.

The Commission subsequently requested public comment on the recommendations set forth in the PWG Report and received a number of helpful suggestions, including additional options for reform. In addition, in May the Commission hosted a Financial Stability Oversight Council roundtable on money market funds and systemic risk. At that public roundtable, financial regulators, money market fund managers, investors, academics and others debated the merits of various reform options, including a floating NAV.

I want to assure you that the Commission is taking a deliberative approach and reviewing the potential advantages and disadvantages of various policy options including a floating NAV. We know that there are also substantial risks in failing to address the risks that came to light in the financial crisis and are identified in the PWG Report. We are committed to carefully exploring all of the options available to us before moving forward and will consider carefully all of the comments we receive.

As always, I welcome the opportunity to share our views with you and your colleagues. I have asked the staff of the Division of Investment Management to prepare responses to your specific questions, which are attached to this letter. Please call me at (202) 551-2100 or have your staff call Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2100 if you have any questions.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
Chairman

Attachment

Responses from Staff in the Division of Investment Management related to Money Market Mutual Funds

1. **Do all investors understand that money market mutual funds pose some risks and are not insured deposits? If not, could the SEC enhance existing disclosures which explain money market mutual fund risks?**
2. **Do all investors know that a money market mutual fund's net asset value has the ability to fall below one dollar? Are there ways to increase transparency around a fund's net asset value without floating the NAV?**

All money market funds are required to disclose that they are not insured or guaranteed by the FDIC or any other government agency and that, despite the funds' efforts to maintain a stable NAV, investors may lose money. The PWG Report states that, notwithstanding these disclosures, (i) investors have come to view money market funds as extremely safe, and in some cases as risk-free cash equivalents, in part because of the funds' stable NAVs and their sponsors' longstanding practice of supporting funds that might otherwise lose value, and (ii) the federal government's unprecedented support of money market funds in 2008 and 2009 may have left investors with the impression that the government stands ready to support money market funds again with the same tools employed at the height of the financial crisis.

3. **Do all money market mutual funds pose the same risk to the U.S. financial system?**

Some money market funds likely pose more risks to the U.S. financial system than others. For example, a small institutional money market fund "broke the buck"—that is, it was unable to maintain its stable NAV—in 1994 without causing significant repercussions. In contrast, the Reserve Primary Fund's inability to maintain its stable NAV in September 2008 contributed to a run on institutional money market funds, which impaired access to credit in short-term private debt markets and prompted unprecedented market interventions by the federal government to stabilize and provide liquidity to these markets. It is difficult, however, to identify in advance which money market funds are likely to pose more risks than others. For example, notwithstanding the experience in 1994, a small fund's breaking the buck under financial conditions extant in 2008 could pose a serious risk to the U.S. financial system if it led to a broader run on money market funds.

4. **What has been the success or failure of the SEC's 2010 reforms to the money market fund Rule 2a-7? Do investors and the capital markets have better information about the product as a result of the changes?**

As reflected in the PWG Report, the Commission's 2010 reforms made money market funds more resilient and less risky and therefore reduced the likelihood of runs on money market funds, increased the size of runs that money market funds can withstand, and mitigated the systemic risks they pose. As discussed in more detail below, the Commission's 2010 reforms also enhanced the information available to investors and the capital markets by requiring money market funds to disclose additional information about their portfolios.

5. **Have the Rule 2a-7 reforms changed the behavior of money market mutual fund providers, boards and investors?**

Money market funds and their boards and advisers must comply with the recent amendments to rule 2a-7, which among other things require money market funds to maintain a larger proportion of liquid assets to allow them to meet redemption requests, reduce the maximum weighted average maturity of their portfolio holdings, and improve the quality of their portfolio securities. The amendments also require money market funds' advisers periodically to stress test the funds' ability to maintain a stable NAV per share based on certain hypothetical events and to report the results of these tests to the funds' boards. Money market funds' boards thus are now better informed about the risks facing their funds, but given the short period of time during which these new requirements have been in effect, it remains to be seen how boards will use this new information.

Money market fund investors also are now better informed as a result of the recent amendments, which require money market funds to provide investors additional information about the funds' portfolio holdings. This additional information is intended to permit investors to make more informed investment decisions and to strengthen their ability to exert influence on risk-taking by their funds' advisers. It similarly remains to be seen how investors will use this new information and, particularly in the current low rate environment, it may be difficult to discern which aspects of investor behavior are motivated by new information about the money market fund's risk profile as opposed to other factors.

6. **What would happen to the long-term viability of money market mutual funds if the Commission required the net asset value to float?**

It is difficult to assess how a floating NAV would affect the long-term viability of money market funds. The PWG Report, however, does identify a number of potential concerns raised by a switch to a floating NAV, including that this change could reduce investor demand for money market funds and cause investors to shift assets to other vehicles or products, including to bank deposits or to stable NAV substitutes that may be subject to less regulation than money market funds. Investors' acceptance of floating rate money market funds likely would be based on a number of factors, including consideration of available substitutes and, in the case of institutional investors, the investment guidelines and operational constraints applicable to each investor.

7. **Would requiring money market mutual funds to float their net asset values have negative consequences on the ability of both the public and private sectors to meet their short-term funding needs?**

The PWG Report identifies the possibility that requiring money market funds to use a floating NAV could reduce investor demand for money market funds and thereby reduce the extent to which money market funds lend in the short-term markets. The PWG Report does note the possibility that a reduction in demand for money market funds could adversely affect the availability of some types of short-term credit which today are provided predominantly by money market funds. Whether this would negatively affect the public and private sectors' ability to meet their short-term funding needs would depend on the extent to which any investors' substitutes for money market funds engage in similar short-term lending.

8. **What empirical evidence does the Commission have to support a floating net asset value for money market mutual funds?**

The Commission continues to gather empirical evidence relevant to all aspects of money market fund reform, including evidence related to the Commission's consideration of a floating NAV. For any policy option the Commission pursues, it would seek public comment on it and other options, and would carefully consider the empirical evidence it received together with the evidence independently identified by its staff.

9. **Could the Commission prevent future stress on money market mutual funds with enhanced oversight by using its authority to require a fund provider to de-leverage certain assets, or is the floating net asset value the Commission's only option to prevent a run on one or more funds?**

The Commission is considering a number of potential further money market fund reforms. A floating NAV is just one of the options under consideration. For example, the Commission recently sought public comment on a number of possible reforms identified in the PWG Report. These reforms include, in addition to a floating NAV, private emergency liquidity facilities, insurance for money market funds, the regulation of money market funds as special purpose banks, and other options. Commenters on this report also identified additional possible regulatory reforms, including various forms of capital buffers for money market funds. The Commission continues to consider the comments it has received on these and other possible reforms.