April 11, 2022

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: *File Number S7-22-21—Proposed Rule—Money Market Fund Reforms*

Dear Ms. Countryman:

The Committee on Capital Markets Regulation (the "**Committee**") appreciates the opportunity to comment on the proposed rule of the Securities and Exchange Commission (the "**SEC**") on money market fund reforms (the "**Proposed Rule**").*

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-eight leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Proposed Rule[1] would make extensive changes to the rules governing money market funds ("**MMFs**") under the Investment Company Act of 1940 (the "**Act**"), including by: (i) increasing minimum portfolio liquidity requirements; (ii) removing MMFs' ability to impose liquidity fees and redemption gates when they drop below certain liquidity thresholds; (iii) prohibiting "reverse distributions," and (iv) requiring swing pricing for institutional prime and municipal MMFs. The Proposed Rule is issued in response to the events of March 2020, when certain MMFs (particularly institutional prime funds) experienced significant outflows at the onset of the COVID-19 pandemic. According to the SEC, the proposed amendments would improve MMFs' resilience and transparency.[2]

* National Economic Research Associates (a part of the Oliver Wyman Group) consulted on the CBA analysis in the Committee's letter.

[1] 87 Fed. Reg. 6652 (Feb. 8, 2022), *available at* https://www.federalregister.gov/documents/2022/02/08/2021-27532/money-market-fund-reforms [henceforth, the "**Proposing Release**"].

[2] *See* Proposing Release at 7248; U.S. SEC. & EXCH. COMM'N, *Fact Sheet: Money Market Fund Reforms* (Dec. 15, 2021).

As stated in our May 2021 report,[3] *Money Market Funds and the COVID Crisis* (the "**Committee Report**"), the Committee supports reforms that would enhance the resilience of prime MMFs, including enhancing portfolio liquidity requirements and eliminating liquidity fees and redemption gates that are linked to liquidity thresholds. However, we do not support the implementation of a swing pricing requirement for MMFs, as doing so is impracticable and would not enhance MMF resilience.

Our letter proceeds in two parts. First, we describe the Proposed Rule and then we assess the Proposed Rule's removal of liquidity fees and gates that are linked to liquidity thresholds and proposal for enhanced portfolio liquidity requirements and implementation of a swing pricing regime. In doing so, we focus on the cost-benefit analysis conducted by the SEC. We find that the SEC's cost-benefit analysis fails to substantiate several purported benefits, and to consider or quantify several principal costs, of the proposal.

I. PROPOSED RULE

If adopted, the Proposed Rule would make several key revisions to the principal rule governing MMFs, Rule 2a-7 under the Act.[4] These changes include: (i) increasing minimum portfolio liquidity requirements; (ii) removing MMFs' ability to impose liquidity fees and redemption gates when they drop below certain liquidity thresholds; (iii) prohibiting "reverse distributions," and (iv) requiring swing pricing for institutional prime MMFs.

A. Amendments to Portfolio Liquidity Requirements

The Proposed Rule would revise both the daily liquid asset requirements and weekly liquid asset requirements that apply to MMFs. Currently, MMFs are required to invest at least 10% of their portfolios in "daily liquid assets," including cash, U.S. government securities, and other securities that provide the holder the right to demand payment within one business day.[5] All MMFs are also required to hold 30% of their portfolios in "weekly liquid assets," which include daily liquid assets, U.S. government agency discount notes maturing in 60 days or less, and other private debt securities maturing within five business days.[6] These portfolio liquidity requirements are intended to support MMFs' ability to meet redemptions even in stressed market conditions.[7]

The Proposed Rule would revise MMFs' portfolio liquidity requirements by increasing daily and weekly liquid asset requirements to 25% and 50%, respectively.[8] A fund whose portfolio

[3] COMMITTEE ON CAPITAL MARKETS REGULATION, *Money Market Funds and the 2020 COVID Crisis* (May 2021), https://www.capmktsreg.org/wp-content/uploads/2021/05/CCMR-Prime-MMFs-and-COVID-05.24.2021-.pdf [henceforth, the "**Committee Report**"].
[4] 17 CFR 270.2a-7.
[5] 17 C.F.R. § 270.2a-7(a)(8), (d)(4)(ii).
[6] 17 C.F.R. § 270.2a-7(a)(28), (d)(4)(iii).
[7] *See* Proposing Release at 7272; U.S. SEC. & EXCH. COMM'N, *Money Market Fund Reform*, 75 Fed. Reg. 10059, 10062 (March 4, 2010), *available at* https://www.federalregister.gov/documents/2010/03/04/2010-4059/money-market-fund-reform.
[8] *See* Proposing Release at 7272; proposed rule 2a-7(d)(4)(ii) and (iii).

did not meet the daily or weekly liquid asset threshold would be prohibited from acquiring any assets other than daily or weekly liquid assets, as applicable, until it met the minimum thresholds. According to the SEC, the "increased thresholds will provide a more substantial buffer that would better equip [MMFs] to manage significant and rapid investor redemptions, like those experienced in March 2020, while maintaining funds' flexibility to invest in diverse assets during normal market conditions."[9]

B. Removal of Liquidity Fee and Redemption Gate Provisions

The Proposed Rule would also remove liquidity fee and redemption gate provisions. Under the current rule, a MMF may impose a fee of up to 2% or suspend redemptions for up to 10 business days in a 90-day period, if the fund's weekly liquid assets fall below 30% of its total assets and the fund board determines that such a fee or gate is in the fund's best interests.[10] Fees and gates are intended to restrict redemptions in order to mitigate the effects of investor panic and preserve liquidity during market stress.[11] The SEC proposes these changes because they "recognize that the current fee and gate provisions did not have their intended effect in March 2020"—instead, as described in Section II, the possible imposition of a fee or gate tied to a fund's weekly liquid assets appears to have accelerated redemptions.[12]

C. Prohibition of Reverse Distributions

The Proposed Rule would prohibit MMFs from employing "reverse distribution" mechanisms, whereby a government or other stable-NAV MMF seeks to maintain its stable share price, despite a decline in the value of its assets, by reducing the number of its shares outstanding.[13] As discussed in Section II below, this prohibition would effectively require a stable-NAV government MMF to switch to a floating NAV in a negative interest rate environment.

D. Swing Pricing Requirement

The Proposed Rule would require institutional prime MMFs to use "swing pricing" when the fund experiences net redemptions (i.e., when the value of share redemption orders exceeds the value of share subscriptions for a given pricing period).[14] Swing pricing is a process whereby a fund's net asset value ("**NAV**") per share is adjusted down to allocate the costs of redemption activity to the redeeming shareholders. Currently, the costs associated with redemptions are borne by non-redeeming shareholders, which can dilute their interests.[15] The SEC states that the new

[9] Proposing Release at 7272.
[10] 17 C.F.R. § 270.2a-7(c)(2).
[11] *See* Proposing Release at 7256; U.S. SEC. & EXCH. COMM'N, *Money Market Fund Reform; Amendments to Form PF*, 79 Fed. Reg. 47735 (Aug. 14, 2014), *available at* https://www.federalregister.gov/documents/2014/08/14/2014-17747/money-market-fund-reform- amendments-to-form-pf.
[12] *See* Proposing Release at 7256; 7257.
[13] Proposing Release at 7279.
[14] Proposing Release at 7260-61.
[15] Proposing Release at 7261.

swing pricing requirement is intended to ensure that the costs from net redemptions are fairly allocated and do not give rise to a first-mover advantage or dilution.[16]

Under the Proposed Rule, a covered MMF is required to adjust its NAV by a "swing factor" when it experiences net redemptions.[17] The swing factor is the amount by which a fund must reduce its NAV per share, expressed as a percentage of the fund's NAV, for a redeeming investor.[18] The swing factor is determined by calculating bid-ask spread costs and other transaction costs, as applicable, to meet the net redemptions.[19] Critically, the swing factor must be calculated before a MMF can provide a redeeming investor with cash settlement. However, as discussed in Section II below, MMFs generally satisfy redemptions with their cash and do not have to sell assets with a transaction cost to meet redemptions. Therefore, in most circumstances the actual transaction costs associated with such a redemption will be zero.

Furthermore, if net redemptions on a given day exceed 4% of total assets, the swing factor must also include an additional "market impact" cost. The market impact (or price impact) cost is an estimate of the percent change in the price of an asset per dollar sold[20] and refers to the fact that the offering for sale of an asset often reduces the prevailing market price of the asset and in turn reduces the seller's realized proceeds.[21] The market impact cost is additive to the direct transaction costs (e.g., bid-ask spread) and would further reduce the proceeds received by a redeeming shareholder by increasing the swing factor. Notably, even if a MMF satisfies redemptions with cash on hand when net redemptions exceed 4%, the "market impact" cost would continue to require MMFs to assume that other assets (such as commercial paper) were sold to satisfy investor redemptions and impose the estimated cost of selling such assets (that were not sold) on the redeeming investor.

To estimate market impact cost, a fund would need to determine how a sale of its assets would affect the market prices for the assets constituting that portfolio. The Proposed Rule acknowledges that a fund may be required to exercise meaningful discretion in estimating such effects. In this regard, funds will be guided by the principle of "good faith."[22]

The proposed swing fee pricing regime is best described with an example. If a fund with a portfolio of $1 billion[23] receives on a given day with net redemptions a specific redemption request with respect to 1% of its outstanding shares, the fund must calculate the direct transaction costs

[16] Proposing Release at 7261.
[17] Proposing Release at 7261. For a fund that computes its NAV once per day, there is one pricing period per day, whereas for a fund that computes its NAV multiple times per day, there are multiple pricing periods per day. *Id*.
[18] *See* proposed rule 2a-7(c)(2)(iii); Proposing Release at Note 114.
[19] Proposing Release at 7261.
[20] Proposing Release at 7306.
[21] *See, e.g.*, J. Doyne Farmer et al., *The market impact of large trading orders: Correlated order flow, asymmetric liquidity and efficient prices* (preliminary draft), *available at* https://haas.berkeley.edu/wp-content/uploads/hiddenImpact13.pdf.
[22] Proposing Release at 7262.
[23] The example assumes that the fund's gross assets (the value of its investment portfolio) and its NAV are exactly equal.

associated with liquidating a pro rata slice of its portfolio worth $10 million. If the fund estimates the cost of such transactions at $200,000 or 2% based on prevailing bid-ask spreads, then the fund must adjust its NAV per share for purposes of the redemption from $1.00/share to $0.98/share and reduce the shareholder's redemption proceeds accordingly. Thus, whereas the shareholder would otherwise receive $10 million, with swing pricing the shareholder receives $9.8 million ($10 million less the $200,000 in estimated transaction costs).

If the fund has experienced more than 4% in net redemptions on that day, then there would be an additional "market impact" cost further reducing the proceeds for the redeeming shareholder. For example, assume a good faith estimate finds that the withdrawal of $10 million would reduce the price of assets by 0.5% or $50,000. The redeeming shareholder would therefore receive $9.75 million ($10 million less the $200,000 in estimated transaction cost and $50,000 in estimated market impact).

II. ANALYSIS

In this section, we assess the Proposed Rule's elimination of fees and gates that are tied to liquidity thresholds. We also evaluate the Proposed Rule's portfolio liquidity requirements and swing pricing regime. In doing so, we focus on the Proposed Rule's cost-benefit analysis ("**CBA**"), finding that with respect to portfolio liquidity requirements and swing pricing the CBA fails to consider or quantify several principal benefits and costs of these proposals.

Shortcomings in the CBA are a serious concern because under the National Securities Markets Improvement Act of 1996, the SEC is required "to promote efficiency and capital formation in the financial markets," and "[w]henever . . . the [SEC] is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[24]

The U.S. Court of Appeals for the District of Columbia Circuit (the "**D.C. Circuit**") has held that the statutory language of the Administrative Procedure Act ("**APA**") imposes an obligation on the SEC to weigh the costs and benefits of proposed regulation, and to quantify those costs and benefits where possible.[25] In *Chamber of Commerce v. SEC (2005)*, the D.C. Circuit considered the validity of an SEC rule requiring that mutual fund boards be composed of no less than 75% independent directors and be chaired by an independent director. The court found that the proposed rule violated the APA because the SEC had failed to "adequately consider the costs mutual funds would incur in order to comply with the [proposed rule]"[26] and rejected the SEC's

[24] National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.).
[25] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); *see also* Paul Rose & Christopher Walker, *The Importance of Cost-Benefit Analysis in Financial Regulation*, CTR. FOR CAPITAL MKTS. COMPETITIVENESS 24–33 (2013), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf.
[26] *Chamber of Commerce*, 412 F.3d at 136.

contention that such costs were not practically quantifiable.[27] Similarly, in *Business Roundtable v. SEC (2011),* the D.C. Circuit remanded an SEC rulemaking on shareholder proxy access due to inadequate economic analysis, including a failure to quantify the costs of the rulemaking.[28] The court found that the SEC "inconsistently and opportunistically framed the costs and benefits of the rule" and "failed adequately to quantify the certain costs of its proposed rule or to explain why the those costs could not be quantified."[29] For these and other reasons, the court found that the proposed rule violated the APA.

A. The Elimination of Fees and Gates Tied to a Weekly Liquid Asset Threshold Will Enhance MMFs' Resilience

The Committee supports the proposed removal of fee and gate provisions from Rule 2a-7—we agree that fees and gates tied to the weekly liquid asset threshold failed to achieve their objectives during the March 2020 market stress, instead appearing to exacerbate investor withdrawals.[30] For example, as summarized in the Committee Report, empirical research by Avalos and Xia (2021), Cipriana and La Spada (2020), and Li et. al (2020) finds that institutional investors withdrew from prime MMFs to avoid liquidity fees and gates that could be triggered by a fund's board once its 30% weekly liquid asset threshold was breached.[31] Investment Company Institute ("**ICI**") surveys show that the primary factor in motivating withdrawals from institutional prime funds was the avoidance of liquidity gates tied to a fund's weekly liquid asset threshold,[32] since gates deny a shareholder access to the entirety of its investment whereas fees only reduce the shareholder's investment by a small percentage.[33]

These March 2020 findings are consistent with the Committee's 2013 observation that the threat of liquidity gates could "accelerate redemptions as investors scramble to redeem their shares before the gates are lowered."[34] The current rule also allows a MMF's board the discretion to select the amount of the fee up to 2%, which introduces an added element of uncertainty that may well be undesirable to investors. Removing fee and gate provisions tied to a weekly liquid asset

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[27] *Id*. at 143.
[28] *Bus. Roundtable v. SEC*, 647 F.3d, 1144 (D.C. Cir. 2011).
[29] *Id*. at 1148-49.
[30] *See* Proposing Release at 27-28.
[31] Fernando Avalos and Dora Xia, *Investor size, liquidity and prime money market fund stress*, BANK FOR INT'L SETTLEMENTS (Mar. 2021), https://www.bis.org/publ/qtrpdf/r_qt2103b.pdf; Marco Cipriani and Gabriele La Spada, *Sophisticated and Unsophisticated Runs*, FED. RESERVE BANK OF NEW YORK (Dec. 2020), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr956.pdf; Lei Li et al., *Liquidity Restrictions, Runs, and Central Bank Interventions: Evidence from Money Market Funds* (Dec. 30, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3607593.
[32] INVESTMENT COMPANY INSTITUTE, *Letter to the SEC re: Report of the President's Working Group on Financial Markets*, 11-12 (April 12, 2021), https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf.
[33] *Id*. at 15, 38.
[34] COMMITTEE ON CAPITAL MARKETS REGULATION, *Letter to the SEC re: Money Market Fun Reform Proposal*, 5 (Sept. 17, 2013), https://www.capmktsreg.org/wp-content/uploads/2013/09/CCMR-comment-letter-on-SEC-MMF1.pdf

threshold will therefore bolster MMF resilience by reducing investors' incentives to redeem during periods of stress.

B. Capital Buffers

The Committee supports the SEC's decision not to impose capital buffers as part of the Proposed Rule. As previously reported by the Committee, evidence shows that even modestly sized capital buffers would substantially increase the cost of operating prime MMFs, to an extent that would likely prevent sponsors from offering such funds.[35] For example, a 2013 study by the SEC's Division of Economic Research and Analysis found that a capital buffer of 0.6% would reduce investor returns from prime MMFs to levels at or below the returns of government MMFs.[36] It is also unclear that capital buffers would meaningfully reduce the incentive of investors to withdraw in a crisis. For example, a capital buffer of 1-3% of total AUM for prime MMFs would likely not suffice to absorb losses from a major credit event, such as the failure of Lehman Brothers, or the costs associated with a fire sale of assets from a widespread run on short-term funding markets generally.[37] As the Proposed Rule notes, capital buffers may also not have prevented the liquidity stresses that arose in March 2020.[38]

C. Portfolio Liquidity Requirements

As noted earlier, the Proposed Rule would increase the minimum percentages of daily and weekly assets that MMFs must hold from 10% and 30% to 25% and 50% of total assets, respectively.

According to the proposal, MMFs with higher liquidity buffers will be better able to withstand large redemptions. However, the CBA does not explain how it was determined that 25% and 50% represent the appropriate thresholds for daily and weekly liquid assets. Although the Committee generally supports the enhancement of MMFs' liquid assets as a means to bolster their resilience, we caution that increasing the minimum quantity of liquid assets, as the Proposed Rule does, must be weighed both qualitatively and quantitatively against the potential for outflows of investor capital from MMFs to non-MMF alternatives, including more opaque or less regulated investment products or bank deposits and government MMFs, in response to reduced prime MMF yields.

Indeed, the Proposed Rule acknowledges that heightened liquidity thresholds may reduce the yield of prime MMFs' investment portfolios, and thus make government MMFs and non-MMF

[35] Committee Report at 2.
[36] Craig Lewis, *The Economic Implications of Money Market Fund Capital Buffers*, U.S. SEC. & EXCH. COMM'N (Nov. 2013), https://www.sec.gov/files/rsfi-wp2014-01.pdf.
[37] COMMITTEE ON CAPITAL MARKETS REGULATION, *What to Do About Contagion? A Call by the Committee on Capital Markets Regulation for a Public Debate*, 25-26 (Sept. 2014), https://www.capmktsreg.org/wp-content/uploads/2018/10/What-to-do-About- Contagion.pdf.
[38] Proposing Release at 7323.

alternatives more attractive to investors relative to prime MMFs.[39] However, the CBA does not seek to quantify the expected extent of such reductions in yield or investor capital flows out of prime MMFs and the potential consequences, or the extent to which smaller increases in liquidity thresholds would mitigate these effects.

D. Government MMFs, Negative Interest Rates and Floating NAV

We are also concerned that the Proposed Rule would effectively require government MMFs to shift from a stable NAV to a floating NAV in the event that interest rates in the United States were to become negative by prohibiting "reverse distribution" mechanisms.

Presently, if interest rates were negative, MMF sponsors could intervene to avoid this outcome with what is called a "reverse distribution" whereby the MMF reduces *the number* of shares outstanding, rather than *the price* or NAV of the shares outstanding, thereby maintaining a stable NAV price of $1.00.[40] However, the Proposed Rule would prohibit MMF sponsors from engaging in reverse distributions or similar actions that would maintain a stable NAV in the event of negative rates.[41] As a result, negative interest rates would require government MMFs to "break the buck" and shift to a floating NAV since the assets held by government MMFs would decline in value at regular intervals to reflect negative interest payments.

According to the Proposed Rule, a prohibition on reverse distributions is necessary because investors in government MMFs could be confused by a stable share price of $1.00 when in fact their investment has declined in value due to negative nominal interest rates.[42] However, this rationale is not persuasive. Investors in government MMFs can simply monitor the total dollar value of their investment so they would not be confused by the $1.00 share price. For example, assume nominal negative interest rates resulted in a loss of 1% on the value of an investor's $1,000,000 investment in a government MMF that maintained a stable NAV of $1.00. The investor in the government MMF would see that the total value of their investment had declined to $990,000 by simply checking the value of their account, so the $1.00 stable NAV would not confuse them about the actual value of their investment.

Furthermore, requiring government MMFs to shift to a floating NAV in the event of negative rates would impose significant costs on government MMFs and their investors. Most prominently, a floating NAV would create accounting and tax complexities and costs for investors, particularly institutional investors. MMF sponsors would also incur costs in redesigning their operations and agreements with broker-dealer intermediaries to process floating NAV transactions. The proposal fails to identify or quantify these costs.

[39] Proposing Release at 7301.
[40] Proposing Release at 7279.
[41] *Id.*
[42] *Id.*

We therefore do not support the Proposed Rule's prohibition on reverse distributions for government MMFs in the event of negative rates as doing so is unnecessary and potentially costly for investors.

E. The CBA does not adequately consider or quantify the benefits or costs of swing pricing.

The Committee strongly opposes the proposed swing pricing regime for institutional prime MMFs, which poses extraordinary operational challenges and may undermine, rather than promote, MMF resilience. A quantification of the costs and benefits of a requirement that is intended to reduce the risk of an investor "run" event is critical, because the benefits of such a regime must be discounted by the relative infrequency of crises that are sufficiently severe to provoke such an event, whereas the costs imposed by a swing pricing regime, including in the form of compliance costs, reduced trading activity, and pricing distortions, each as described more fully below, would be incurred on an ongoing basis. The CBA however fails to substantiate several purported benefits, and to consider or quantify several costs, of the proposed swing pricing regime, as we now describe.

1. The swing pricing regime does not reflect how MMFs meet redemption requests

The swing pricing regime seeks to approximate a redeeming shareholder's proportionate share of the transaction costs associated with its redemption. However, it does so in a fundamentally flawed way. To calculate the swing factor, a MMF is required to assume that it must sell its holdings such as commercial paper to meet redemption requests. However, MMFs very rarely, if ever, sell assets such as commercial paper to generate the cash necessary to redeem shares, and instead use the substantial cash they hold to meet such requests. The proposal and the CBA completely ignore this market reality. The swing pricing regime would therefore impose costs on redeeming investors for assets that are not in fact sold by an MMF.

2. The CBA does not adequately consider or quantify the extent to which swing pricing is costly and impracticable for institutional prime MMFs and may result in consolidation of prime MMF investment capital in the largest funds.

The proposed swing pricing regime poses operational complexities and costs that would render certain of the key features of institutional prime MMFs no longer viable. The CBA does not adequately consider or quantify each of these costs and risks and fails to evaluate the extent to which they could render institutional prime MMFs unviable.

Many institutional prime MMFs price their shares multiple times per day and provide same-day T+0 settlement, such that investors can sell their shares and receive redemption proceeds

on the same day.[43] These are critical and unique features of such funds for the institutions that rely on them for their cash management needs.

Integrating the SEC's complex swing pricing requirements into this framework is not feasible, because there would not be sufficient time for price discovery to calculate the correct swing factor to apply to a redeeming investor before the end of the day.[44] Determining the swing factor requires timely and accurate data on redemptions, the value of portfolio securities, and the transaction costs associated with the sale thereof. This data must then be used to calculate, apply, and potentially correct the swing factor multiple times per day.[45]

Requiring the calculation of a swing factor would also likely require the application of forward-looking models and assumptions for determining the "market impact" of asset sales. Among other things, the implementation of swing pricing would require substantial reconfiguration of existing distribution and order-processing practices and the creation and calibration of reliable models to price liquidity. The proposal's CBA does not evaluate these implementation costs.

The CBA also does not consider the limitations of modeling and pricing liquidity and attendant uncertainty. Determining the market impact of asset sales (i.e., pricing liquidity) is an enormous challenge even under the best of circumstances with sufficient historical data and time to perform the relevant calculations. It may be a virtual impossibility in the midst of market stress, when the liquidity of assets that MMFs hold may be substantially reduced.[46] As noted above, the Proposed Rule does not provide guidance on how to estimate "market impact" costs, other than directing MMFs to be guided by the principle of "good faith."[47]

Fund sponsors widely report that the implementation of the swing pricing requirement would therefore be impractical and that MMFs would likely no longer be able to offer intraday pricing and same-day settlement. Indeed, none of the foreign funds that we have identified as having implemented swing pricing are MMFs.[48] The proposal's CBA does not acknowledge nor evaluate why MMFs have not voluntarily adopted swing pricing in any jurisdiction.

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[43] *See, e.g.*, FEDERATED HERMES, INC., *Comment Letter of Federated Hermes on President's Working Group Report on Money Market Mutual Funds*, 6 (Sept. 13, 2021), *available at* https://www.sec.gov/comments/s7-01-21/s70121-9232417-250529.pdf; BLACKROCK, *Letter to the SEC re: S7-01-21: Comments on the Report of the President's Working Group on Financial Markets*, 8 (Apr. 12, 2021), *available at* https://www.sec.gov/comments/s7-01-21/s70121-8662484-235306.pdf; *see also* BLACKROCK, *Operational guide to cash investing: BlackRock U.S. Money Market Funds* (2020), https://www.blackrock.com/cash/literature/investment-guide/operational-guide-to-cash-investing.pdf.

[44] *See* BLACKROCK, *supra* note 39, at 8.

[45] *See, e.g.*, INVESTMENT COMPANY INSTITUTE, *supra* note 31, at 21.

[46] Proposing Release at 7306.

[47] Proposing Release at 7262.

[48] *See, e.g.*, J.P. MORGAN, *Swing pricing: The J.P. Morgan Asset Management approach in the Luxembourg domiciled SICAVs JPMorgan Funds and JPMorgan Investment Funds* (Sept. 23, 2020).

Moreover, the proposed swing pricing regime could cause prime MMF investors seeking to minimize the potential impact of swing pricing on their investment to migrate from smaller to larger prime MMFs, as they might reasonably believe that net redemptions for larger funds are less likely to exceed the 4% market impact threshold.[49] Concentration of investment in a smaller number of prime MMF issuers could reduce competition among funds, which may in turn result in higher fees or lower yields, to the detriment of investors. The CBA does not consider this risk.

3. The CBA does not adequately consider or quantify the potential effects of swing pricing on pricing efficiency and trading activity.

By increasing the cost for a MMF investor to withdraw from a fund, swing fee pricing would result in reduced trading activity by MMF investors that could result in reduced trading activity by MMFs in the underlying market for MMF assets. Swing pricing would thereby negatively affect pricing efficiency for MMF shares and underlying money market assets held by MMFs. The CBA, however, ignores the effects of swing fee pricing on pricing efficiency.

Furthermore, the swing factor (i.e., the fee imposed by swing pricing) is generally higher during market stress due to the fact that transaction costs are higher when markets are illiquid. Therefore, the reduced incentive to trade (from higher costs) and the attendant negative effect on price efficiency would be particularly strong during times of market stress. The CBA again fails to consider or quantify this risk.

The proposal and CBA also fail to consider the complexities of implementing any modeling necessary to estimate "market impact" for swing fee pricing. For example, the complexity of estimating market impact introduces the possibility that there would be errors that would negatively affect the accuracy of the pricing for redemptions received by investors. Similarly, the CBA does not consider the potential implications for investors and pricing efficiency of different MMF sponsors implementing different swing fee pricing models and formulas that result in different swing fees being charged on the same day by different MMFs.

4. The CBA does not fully consider how swing pricing may limit or eliminate the marketplace for institutional prime MMFs and increase borrowing costs for issuers of short-term paper.

As the Proposed Rule acknowledges, the compliance costs associated with the proposed swing pricing requirement may be passed on wholly or partly to investors that are "already earning low [or] zero net yields in a low interest rate environment," which in turn may reduce demand for institutional prime MMFs.[50] The CBA does not however attempt to quantify these costs or estimate the extent to which those costs may cause investors to seek non-MMF alternatives, some of which

[49] There is evidence that smaller investment funds experience larger net redemptions in a crisis environment. *See, e.g.*, Jean-Francois Carpantier, *The Impact of COVID-19 on Large Redemptions in the Luxembourg Investment Fund Market*, CSSF Working Paper (2021), *available at* https://www.cssf.lu/en/2021/10/publication-of-cssf-working-paper-the-impact-of-covid-19-on-large-redemptions-in-the-luxembourg-investment-fund-market/.
[50] Proposing Release at 7300-01.

may be less well-regulated.[51] The potential for such outflows is a major potential cost of the swing pricing requirement and should therefore be weighed qualitatively and quantitatively against the expected benefits of this requirement.

There is indeed evidence that the proposed swing pricing requirement could zero out the yields of many prime MMFs or otherwise negatively affect their performance. From January 2021 through February 2022, the net yields of prime MMFs were consistently at or below 10 basis points and frequently dropped to just a few basis points.[52] Swing pricing has also been demonstrated to increase tracking error.[53] Tracking errors are particularly consequential when targeting low yields, since a small difference in absolute return (1-2 bps) can be a large difference in relative return (20-25%).

Given the costs associated with the implementation of swing pricing, prime MMFs may find themselves unable to offer positive yields to investors or to offer sufficiently low tracking error, depending on the precise extent of the costs associated with swing pricing, such that investors migrate away from prime MMFs. Because prime MMFs are significant holders of short-term paper, any further reduction in the size of prime MMFs could also indirectly increase the cost of borrowing for issuers of short-term paper. For example, JPMorgan Research estimates that a $100 billion reduction in aggregate prime MMF assets, would increase the cost of borrowing for non-government issuers of short-term paper by 3 basis points (0.03%).[54] It is therefore essential that the costs associated with swing pricing be quantified in order to understand the likely effect of the swing pricing requirement on the market for prime MMFs as a whole. The CBA could have based an estimate of such costs on publicly available data with respect to the expense ratios of European non-MMF investment funds that implemented swing pricing regimes compared to such funds that did not implement swing pricing, or by comparing expense ratios of the same fund before and after it implemented swing pricing, but the CBA does not do so.

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[51] *See* Committee Report at 2.

[52] *See* U.S. SEC. & EXCH. COMM'N, Money Market Fund Statistics (filings through Mar. 10, 2022), https://www.sec.gov/files/mmf-statistics-2022-02.pdf.

[53] *See, e.g.*, J.P. MORGAN, *Swing pricing: The J.P. Morgan Asset Management approach in the Luxembourg domiciled SICAVs JPMorgan Funds and JPMorgan Investment Funds*, (Sept. 23, 2020), https://am.jpmorgan.com/content/dam/jpm-am-aem/emea/lu/en/communications/lux-communication/swing-pricing-ce-en.pdf ("Investors should be aware that swinging the NAV per share is likely to increase the tracking error . . . and may introduce volatility into the daily prices"); VANGUARD, *Letter to UK investors*, (Mar. 19, 2019), https://global.vanguard.com/portal/site/loadPDF?country=global&docId=11417 (explaining that following an Vanguard intended to roll back the "full" swing pricing regime it introduced to certain of its European mutual funds to a "partial" regime following an analysis of the effect of swing pricing on fund performance, including tracking error).

[54] As measured by the 3-month LIBOR/Treasury bill spread. *See* J.P. MORGAN, *Short-Term Market Outlook and Strategy* (Dec. 17, 2021).

5. The CBA does not fully consider or quantify the costs and benefits of swing pricing with respect to MMF resilience and systemic stability.

The CBA does not fully identify or quantify the extent to which the introduction of swing pricing for institutional prime MMFs would be expected to reduce investor outflows under potential stress scenarios or consider the potential for significant limitations of these benefits. In fact, given the typical role of prime MMFs in investors' portfolios, swing pricing is unlikely to dissuade significant redemptions from prime MMFs in financial crises, as discussed in what follows. In our view, the swing pricing proposal would not only fail to staunch outflow but would also, and as highlighted in the Committee Report, *exacerbate* investor withdrawals during market stress. The CBA also fails to consider the full extent of the empirical evidence on the effect of swing pricing on fund resilience.

i) The CBA misidentifies the motives for investor withdrawals from MMFs and fails to consider or quantify the likely impact of swing pricing on MMF resilience and overall systemic stability.

A fundamental flaw with the proposal's CBA is that it compares non-swing pricing redemption conditions to swing pricing redemption conditions in evaluating the effectiveness of the proposal in deterring withdrawals. However, in practice, if the proposal is implemented, then investors will be comparing current and future redemption conditions, both under swing pricing, when determining whether to withdraw. For instance, an investor would compare redemption conditions at t=0 and t=1 and if an investor concludes that redemption conditions at t=0 are more favorable than expected redemption conditions at t=1 then they would withdraw at t=0. In other words, despite the existence of swing fee pricing, it remains possible that future redemption conditions could be worse than existing conditions and investors would thus still be incentivized to withdraw *now* to avoid such future conditions. Swing pricing would not address this fundamental issue motivating investor withdrawals.

Furthermore, the spreads on the assets sold by MMFs will be wider during periods of significant market stress and illiquidity—and such increased transaction costs will result in a higher swing factor as market stress worsens. Similarly, the proposed requirement to include "market impact costs" in the swing factor calculation only when net redemptions exceed 4% could also drive anticipatory withdrawals during stress episodes: If investors believe that a fund's net redemptions are at risk of exceeding the 4% "market impact threshold" in the near future, it may incentivize investors to redeem shares earlier, before the threshold is exceeded, such that any swing pricing to which the redeeming shareholders are subject takes account only of "direct" transaction costs (e.g., bid-ask spread) and not market impact costs, while investor who delay their redemptions risk bearing this additive, and unpredictable, cost. The absence of any upper limit on the total swing factor that may be applied under the Proposed Rule only compounds this effect.[55]

[55] *See, e.g.*, Proposing Release at 7259, citing *Investment Company Swing Pricing, Investment Company Release No. 32316* (Oct. 13, 2016) [81 FR 82084 (Nov. 18, 2016)].

The CBA also fails to consider the potential signaling role of swing pricing. A MMF that imposes strict swing pricing terms on withdrawing investors may signal to other investors and the market more broadly that the fund has pessimistic expectations about the future values of its illiquid assets. Such signals can increase market-wide demand for redemptions.

Finally, as the Proposed Rule acknowledges, institutional prime MMFs represent only 6% of the MMF industry. Any enhanced resilience that were to accrue to such MMFs from the imposition of swing pricing would represent only a minor contribution to the stability of the MMF industry as a whole or short-term funding markets in general, and this is not factored into the CBA.

ii) The CBA fails to consider evidence that swing pricing would have been ineffective in preventing outflows in prior crises.

Because MMF assets (such as commercial paper) are illiquid in a crisis and often do not have a well-established market price, MMF investors prefer cash in a crisis, which incents MMF redemptions. As Diamond and Dybvig observed with respect to bank runs: "Illiquidity of assets provides the rationale both for the existence of banks and for their vulnerability to runs."[56] It is therefore unlikely that the swing pricing requirement would have been effective in staunching significant institutional prime MMF outflows in either the 2008 financial crisis or the market turbulence that occurred in March 2020, because the demand for cash in a crisis remains despite the existence of swing fee pricing.

For example, in early August 2007 and into early 2008, the marketplace for many instruments typically held by institutional prime MMFs was affected by the distress and various failures impacting the financial sector. The proposed swing pricing requirements would not have been effective in "unfreezing" these markets and restoring liquidity to the marketplace. It would thus have not been effective in preventing any of the disruptions experienced by prime MMFs that were driven by the broader credit and liquidity crisis in 2007 and 2008.

In March 2020, the U.S. capital markets experienced severe turbulence. The economic circumstances had a substantial impact on the need for cash and liquidity amongst investors that led to significant redemption pressures on MMFs during the second half of March. Given that large MMF shareholders look to MMFs to provide liquidity in a crisis, the proposed swing pricing requirements would have been unlikely to staunch MMF outflows – that is, where shareholders are facing heightened liquidity needs, and MMF shares are one of their sources of emergency liquidity, increasing the marginal cost of a MMF redemption is unlikely to dissuade a redemption.

[56] Douglas Diamond and Philip Dybvig, *Bank runs, deposit insurance and liquidity*, JOURNAL OF POLITICAL ECONOMY 91(3), 403 (1983), *available at* http://www.bu.edu/econ/files/2012/01/DD83jpe.pdf.

iii) The CBA does not adequately consider the empirical evidence on the costs and benefits of swing pricing with respect to fund resilience.

Empirical support for the efficacy of swing pricing in enhancing fund resilience is limited, and there is meaningful empirical evidence that swing pricing in fact erodes fund resilience.

The Proposed Rule cites one study (Jin et al. (2022))[57] concluding that swing pricing reduced outflows during market stress where it was implemented by corporate bonds funds in the United Kingdom.[58] However, corporate bond funds serve as vehicles for longer-term investment as compared to MMFs, which are more typically sources of short-term liquidity. Investors with a short-term horizon are generally more likely to withdraw during market stress, so even if swing pricing deters long-term investors from withdrawing from corporate bond funds, it is not clear swing pricing would have the same effect on short-term investors seeking to withdraw from MMFs during market stress.[59] Indeed, Jin et al. (2022) finds that corporate bond fund investors with shorter investment horizons redeem more often after a fund adopts swing pricing compared to investors with longer investment horizons.[60] The proposal's CBA ignores this key finding of Jin et al. (2022).

Moreover, the CBA does not discuss the finding of the ESMA/ESRB report (2020) that in February and March of 2020, European non-MMF funds that activated swing pricing actually experienced higher outflows that those that did not.[61] Nor does it discuss the findings of the Bank of England (2021), which found only very weak or inconclusive evidence of the efficacy of swing pricing on reducing outflows from U.K.-domiciled non-MMF funds during the first quarter of 2020.[62] The study also found that the implementation of swing pricing decreased such funds' incentives to hold lower-yielding high-quality liquid assets and cash, meaning that funds with swing pricing were less liquid.[63]

There is also empirical evidence against the efficacy of swing pricing in reducing withdrawals from bond funds. For example, Lewrick & Schanz (2017) compared bond mutual funds domiciled in Luxembourg (where swing pricing is permitted) to funds domiciled in the US (where it was not permitted at the time) and found that swing pricing failed to offset investor first-

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[57] *See* Jin et al., *Swing Pricing and Fragility in Open-End Mutual Funds*, REVIEW OF FINANCIAL STUDIES 35 (2022), *available at* https://academic.oup.com/rfs/article/35/1/1/6162183.
[58] Proposing Release at 7303.
[59] *See* U.S. TREASURY DEPT., *Report of the President's Working Group on Financial Markets – Overview of Recent Events and Potential Reform Options for Money Market Funds*, 3 (Dec. 2020).
[60] Jin et al. *Swing Pricing and Fragility in Open-End Mutual Funds*, at 5, 35.
[61] *See* EUROPEAN SECURITIES AND MARKETS AUTHORITY, *Recommendations of the European Systemic Risk Board (ESRB) on liquidity risk in investment funds*, 31 (Nov. 2020), *available at* https://www.esma.europa.eu/sites/default/files/library/esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf.
[62] BANK OF ENGLAND AND THE FINANCIAL CONDUCT AUTHORITY, *Liquidity Management in UK Open-Ended Funds* (Mar. 26, 2021), *available at* https://www.bankofengland.co.uk/report/2021/liquidity-management-in-uk-open-ended-funds.
[63] *Id.*

mover advantages and does not enhance fund stability during stress episodes.[64] In fact, the study concludes that Luxembourg funds that had committed to swing their NAVs were less incented to hold cash as insurance against redemptions, and thus maintained lower cash buffers and experienced higher daily volatility. The CBA does not consider or quantify these risks and more generally does not examine the findings of the studies of the implementation of swing pricing in European jurisdictions.

6. The CBA fails to consider the extent to which partial redemptions affect the purported benefits of swing pricing or render it unnecessary.

The CBA also appears to assume that the redeeming investor liquidates its entire position in the MMF, which will not always be the case. If the redeeming investor liquidates only part of its position, the redeeming investor would, through its remaining interest in the MMF, internalize part of the transaction costs associated with its partial redemption. Thus, the marginal benefits of swing pricing in terms of requiring redeeming investors to internalize the costs of their redemptions may be lessened to the extent that investors are only redeeming portions of their positions in a given MMF. If partial redemptions are the norm in a non-stressed environment, it may obviate the application of swing pricing in a non-stressed environment. Indeed, even in a crisis environment, investors may only partially redeem their investment from an MMF. The CBA does not consider any historical transaction data on whether partial redemptions for MMF investors are common in non-stress and stressed market environments.

7. The CBA fails to fully consider or quantify the interaction of swing pricing with other elements of the Proposed Rule, the costs and benefits of a mandatory regime relative to a voluntary regime, or relevant comparisons to the banking industry.

The CBA does not consider how the costs and benefits of the swing pricing requirement may change depending on which of the other rule changes in the Proposed Rule are implemented. It also does not consider the costs and benefits of a mandatory swing pricing regime relative to an alternative in which MMFs have the choice to "opt in" to swing pricing. Finally, though the CBA relies predominantly on studies of banks to support its analysis, it does not provide an example of a bank adopting swing pricing as a mechanism to reduce the likelihood of runs on deposits. Whereas for other aspects of the proposal (e.g., liquidity requirements) there are regulatory analogs to the banking industry, the absence of such an analog with respect to swing pricing raises concerns about the CBA's reliance on banking research and the role of swing pricing in mitigating run risk.

[64] Ulf Lewrick & Jochen Schanz, *Is the price right? Swing pricing and investor redemptions* BANK FOR INT'L SETTLEMENTS, BIS Working Papers No 664 (Oct. 2017), *available at* https://www.bis.org/publ/work664.pdf.

8. Conclusion

In summary, the CBA does not quantitatively or qualitatively assess the significant limitations to the purported benefits of the swing pricing proposal and fails to either consider or quantify the major potential costs of the proposal, including in the form of outflows of investor capital from institutional prime MMFs and into non-MMF alternatives, higher operational costs and complexity, and reduced price efficiency. In regard to the goal of enhancing resiliency, it does not quantify the purported enhancements to the stability of prime MMFs from the swing pricing proposal and determine that it outweighs the risk that swing pricing may in fact undermine MMF stability, among other potential costs. Given these significant negative consequences for the resilience and viability of impacted MMFs, the Committee urges the SEC not to adopt its proposed swing pricing regime.

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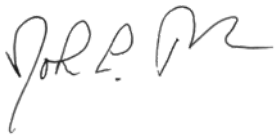
Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott (hscott@law.harvard.edu), or its Executive Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,



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