Treasury Strategies

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January 11, 2013

Financial Stability Oversight Council
Attention: The Honorable Timothy Geithner
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

By Internet: http://www.regulations.gov

Re: Proposed Recommendations Regarding Money Market Mutual Fund Reform (Docket Number FSOC-2012-0003) – An Overview of Treasury Strategies Comments.

Members of the Financial Stability Oversight Council:

We are writing in response to the Financial Stability Oversight Council's recommendations on money market mutual fund ("MMF") reform, *"Proposed Recommendations Regarding Money Market Mutual Fund Reform" ("*the Proposal(s)"). Treasury Strategies, Inc. has prepared detailed opinions on each of the three alternatives and submitted them under separate cover to the Council. In them, we present evidence to discourage regulators from pursuing flawed and potentially devastating regulation.

We appreciate the opportunity, as the leading corporate treasury and liquidity management consulting firm, to participate in this process and sincerely hope that you refrain from any actions that impair the deepest, broadest, most efficient and most transparent capital markets in the world.

Overview

Treasury Strategies believes this entire process is seriously flawed. Many statements in your Proposal background purported to be "facts" are not facts at all. Rather, they are unfounded assertions that have been repeated so often by senior officials they have now become lore. But, we repeat, they are not facts.

For four years, the regulatory process has been highly and publicly focused on placing new constraints and requirements on MMFs. Your Proposal asserts this is because MMFs were a pernicious source of trouble during the 2008 – 2009 financial crisis, and need to be reined and tamed so that does not happen again. We disagree.

- First, the groundwork for the financial crisis had nothing whatsoever to do with MMFs. The responsibility for that, in the form of utterly shameless public policies that supported "a mortgage in every pot", and which spiraled completely out of regulatory and supervisory control, rests squarely in Washington.

Treasury Strategies, Inc.
309 W. Washington Street
13th Floor
Chicago, Illinois 60606
t 312.443.0840
f 312.443.0847
61 Broadway
Suite 905
New York, New York 10006
t 212.292.0856
f 212.292.0863
1 Northumberland Avenue
Trafalgar Square
London
WC2 N5BW
Great Britain
t +44 207 872 5551
f +44 207 872 5611
www.TreasuryStrategies.com

- Second, MMFs were the victims of financial trauma, not the cause. They were the Twin Towers of the financial crisis. An over-extended mortgage market, Lehman Brothers, AIG, and ratings failures were the planes that crashed into them. The buildings themselves were not at fault; it makes no sense to try to prevent a recurrence by changing building construction codes.

- Third, should events similar to the precipitating events of the financial crisis ever be repeated, *investors will still behave the same way*. They will panic. They will run from every non-insured financial instrument, again. Period. That's the human emotion, not a financial decision. No amount of regulation will ever change that.

- Fourth, MMFs withstood the unprecedented events of the financial crisis remarkably well. Planes did indeed crash into them. The Lehman Brothers bankruptcy, the massive and unexpected AIG bailout, and the complete failure of the U.S. securities rating system were gargantuan financial issues of previously unimaginable proportion. MMFs experienced problems, yet they did NOT crumble and burn. Regulators argue they would have without the temporary guarantee program; fund advisors argue that the program was unnecessary. Whichever conclusion is more reasonable, it is a fact that the industry survived a horrific onslaught of double black swan proportions better than every other segment of the financial system.

- Fifth, regulators have been entirely too sanguine about what will happen to investment dollars if they eviscerate MMFs. The assets will find other homes, most likely increasing systemic risk and decreasing transparency. Capital will flow into mega banks in the United States that will become even larger, a consequence that is inexplicably palatable to regulators. Treasurers will move capital into unregistered investment pools or private accounts, outside the view of regulators. Treasurers with global access will move money offshore with ease.

- Sixth, investors are responsible and informed, and understand risk-reward tradeoffs. Several independent research programs confirm that. Policies that coddle investors or reward uninformed investors at the expense of informed investors destroy capital markets. Policies that fail to recognize the first mover advantage as a cornerstone of capitalism ultimately impair the entire financial system. The moral hazard created by such policies will bring about even greater, unforeseen risks.

It seems obvious to us that FSOC's suggested reforms are aimed at an imaginary problem. Regulators have specified a target that, while plausibly connected to the problem, is in actuality not a problem at all.

Nonetheless, we have commented on the Proposals, and a summary of our comments is detailed in the remainder of this letter.

Alternative One: Floating Net Asset Value (NAV)

FSOC's first Proposal is to require all non-Treasury MMFs to adopt a floating NAV in combination with an initial price reset to $100. FSOC assumes such a requirement would limit the likelihood of a run by making investors more aware of investment risk and tolerant of suffering a loss. We believe this is a flawed proposition with likely devastating effects for MMF utility and market appeal. This is evidenced by the fact that 79% of Corporate Treasurers, which make up a majority of institutional investors, would abandon or decrease the use of MMFs if a floating NAV were implemented.

Furthermore, regulators have not provided quantitative evidence to support their claims that floating NAV funds will not be subject to runs. We present numerous examples contradicting their claims and reinforcing the U.S. MMF market's continued strength and resiliency in the face of seemingly constant market turmoil.

We demonstrate that moving to a floating NAV will:

- Increase the likelihood of each of the three types of runs: credit-driven, liquidity-driven, and speculative
- Make MMFs more susceptible to runs, as proven by the historical performance of ultra-short bond funds, which lost nearly 90% of assets under management early in the financial crisis
- Increase the likelihood of runs caused by changing interest rates
- Impose additional costs on investors, significantly hampering the appeal of MMFs
- Preclude MMFs from being an effective liquidity tool, as floating NAV funds will not easily allow for intraday settlement, a critical characteristic for corporate investors
- Lead to assets leaving MMFs, impairing credit markets that depend on MMFs for short-term financing
- Exacerbate the "too big to fail" problem
- Layer unnecessary regulation on top of current MMF regulations, which are already sufficient to prevent runs

Alternative Two: NAV Buffer and Minimum Balance at Risk (MBR)

FSOC proposes a NAV buffer combined with a subordinated holdback, the MBR, to limit the likelihood of a run by providing a disincentive for investors to redeem their positions. Every MBR would be in a subordinated position; aggregate MBRs would be the first to absorb losses if the fund breaks the buck beyond the NAV buffer within the 30-day period following redemption. As with the floating NAV recommendation, FSOC proposes this requirement only for non-Treasury MMFs.

We believe the NAV buffer with an MBR requirement is a misguided and operationally infeasible approach that will lead to institutional investors abandoning MMFs en masse.

Furthermore, in our response we demonstrate that the NAV buffer with MBR requirement:

- Introduces bias among MMF asset classes
- Will not stop a run
- Will *create* investor incentives that may precipitate a run
- Flies in the face of investment logic by trying to eliminate the first mover advantage
- Introduces numerous investment, accounting and operating difficulties
- Punishes the prudent investor
- Will cripple MMFs' ability to attract assets and thereby remove a source of credit for corporate and municipal borrowers
- Will not treat all investors equally, particularly disadvantaging large corporate investors that use MMFs as a cash management tool

Alternative Three: NAV Buffer

FSOC's third Proposal is to require MMFs to incorporate a risk-based NAV buffer of three percent to provide explicit loss absorption capacity. Similar to the first two Proposals, this requirement would only apply to non-Treasury MMFs.

In our detailed response, we identify and explain the three types of financial runs: credit-driven, liquidity-driven, and speculative. We believe the modifications to Rule 2a-7 instituted in early 2010 adequately deal with each type of run. Furthermore, the negative effects of the NAV buffer Proposal, listed below, will roll back the benefits already achieved.

The NAV buffer Proposal will not only ***fail*** to achieve regulators' objectives of preventing a run, but may in fact ***stimulate*** such undesirable events.

Key dangers of the Proposal include:

- Introduction of bias which places Prime MMFs at a competitive disadvantage
- Reduced transparency for investors
- Confusion leading to more risk averse/panic-prone investors
- Increased moral hazard for fund companies and investors
- Increased volatility
- Increased concentration of assets into the largest banks
- Exit of both monoline and bank advisors from the business
- Creation of new AIG-like risks

Conclusion

Successful regulation requires a delicate balance between too much and too little. We believe the SEC has found the proper balance in its existing regulations and encourage the Council to maintain this balance by **rejecting the destabilizing impact inherent in the three Proposals.**

We recognize the good intentions and sincere concern of FSOC members in administering their regulatory responsibilities. We acknowledge the enormous amount of work by SEC and FSOC staff in researching and drafting these Proposals for public comment. We appreciate the opportunity to comment on these Proposals and hope our comments are useful in your decision making.

Sincerely,

Anthony J. Carfang, Partner

Cathryn R. Gregg, Partner

Treasury Strategies, Inc.
309 W Washington Street, 13th Floor
Chicago, Illinois 60606

cc: The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
U.S. Department of the Treasury

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau

The Honorable Mary L. Schapiro
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National Credit Union Administration

S. Roy Woodall
Independent Member
Financial Stability Oversight Council

Richard Berner
Counselor to the Secretary
U.S. Department of the Treasury

Michael McRaith
Director
Federal Insurance Office
U.S. Department of the Treasury

John Huff
Director
Department of Insurance, Financial Institutions, and Professional Registration
State of Missouri

John P. Ducrest
Commissioner
Office of Financial Institutions
State of Louisiana

David Massey
Deputy Securities Administrator
Securities Division
Department of the Secretary of the State
State of North Carolina

The Honorable Elisse B. Walter
Commissioner
Securities and Exchange Commission

The Honorable Luis A. Aguilar
Commissioner
Securities and Exchange Commission

The Honorable Troy A. Paredes
Commissioner
Securities and Exchange Commission

The Honorable Daniel M. Gallagher
Commissioner
Securities and Exchange Commission