Written Statement of Marie Chandoha
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Before the US House of Representatives Committee on Financial Services,
Subcommittee on Capital Markets and Government-Sponsored Enterprises

"Examining the SEC's Money Market Fund Rule Proposal"

September 18, 2013

Chairman Garrett, Ranking Member Maloney, and members of the Subcommittee, my name is Marie Chandoha, and I am the president and chief executive officer of Charles Schwab Investment Management, Inc., the asset management business of the Charles Schwab Corporation. Thank you very much for the opportunity to be here today to discuss Schwab's perspective on the SEC's money market fund proposal.

Schwab is one of the largest managers of money market fund assets in the United States, with 3 million money market fund accounts and $168 billion in assets under management as of June 30, 2013. The overwhelming majority of Schwab's fund offerings are used by retail investors who use money market funds to manage their cash. Approximately 88% of Schwab's money market fund assets are in sweep funds, with the balance in purchased funds. Sweep accounts automatically invest idle cash balances while providing investors with convenience, liquidity and yield. These sweep accounts facilitate trading in brokerage accounts, allowing individuals to seamlessly buy and sell stocks, bonds, and mutual funds. Individuals also can write checks, pay bills electronically and use debit cards on these accounts. Even in the current environment, with historically-low yields on money market funds, our retail clients continue to value the convenience of this product.

Overview of Our Position

We generally support the SEC's reform proposal because it strikes the right balance between reducing the likelihood of runs while also preserving money market funds as an extremely important cash management tool for individual investors. At the same time, we believe the proposed rule has a number of significant areas that need resolution before the rule is finalized. We believe a careful cost benefit analysis regarding the cost of implementation and the impact on the larger financial system, should be undertaken.

To maximize the impact of the proposal, Schwab recommends that the final rule combine the two alternatives proposed, subject to the recommended changes outlined below, for maximum effectiveness: requiring institutional prime funds to have a floating net asset value (NAV), and allowing a fund's board to impose liquidity fees and gating of all prime, municipal and government money market funds whenever the board believes doing so is in the best interest of the fund.

In our comment letter to the SEC[1], we offer a number of recommendations in an attempt to strengthen the proposal. An overview of our key recommendations follows:

1. We recommend that the daily redemption limit for retail investors, which serves as the dividing line between "institutional investors" and "retail investors," be increased from $1 million to $5 million per business day. We also recommend that the Commission create a "Large Trade Order Notification" system that would allow retail investors to redeem more than the maximum daily redemption amount provided they have requested and received approval from the fund for such a transaction at least three days in advance.

2. We recommend that municipal (tax-exempt) money market funds be exempted from the floating NAV proposal.

3. We request that the rule confirm the treatment of registered investment advisers in the context of the definition of "retail" and "institutional" investor.

4. We recommend that retirement accounts (Individual Retirement Accounts and employer-sponsored 401(k) and similar plans) and educational accounts such as 529 plans be exempted from the rule.

5. We recommend that the tax issues identified by the Commission in its proposal be resolved by the appropriate regulator prior to the rule taking effect.

6. While generally supporting the Commission's proposed enhancements to disclosure, Schwab has a number of recommendations for changes.

Alternative One – Floating NAV for Institutional Prime Funds

In its proposal, the Commission calls for requiring certain institutional prime money market funds to move from a stable NAV to a floating NAV, while permitting retail prime money market funds, Treasury money market funds and Government money market funds to retain their stable $1-per-share price. Schwab has long opposed a broad floating NAV for all money market funds as a lethal blow to the product. We believe that what limited risk there is of a run in a money market fund lies with institutional investors. Chairman White articulated this view concisely in her opening statement at the Commission's Open Meeting at which it voted unanimously to propose the rule: "This floating NAV proposal specifically targets the funds where the problems during the financial crisis occurred: institutional, prime money market funds."[2]

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[1] Comment letter from Marie A. Chandoha, Charles Schwab Investment Management, Inc. (the "Schwab comment letter"), to SEC proposed rule, "Money Market Fund Reform: Amendments to Form PF," File No. S7-03-13, 78 Federal Register at 36834, June 19, 2013. Available at: http://www.sec.gov/comments/s7-03-13/s70313-109.pdf.
[2] White, Mary Jo, "Opening Statement at the SEC Open Meeting," June 5, 2013. Available at: http://www.sec.gov/News/Speech/Detail/Speech/1365171575546#.UhFnBz_ZPDY.

While we continue to oppose a broadly-applied floating NAV for the entire money market fund industry, we believe a targeted solution such as the one put forward by the Commission would make the product less susceptible to destabilizing runs yet preserve this critically important product for retail investors. A floating NAV would reduce the "first-mover advantage." Runs in money market funds can be triggered when institutional investors who have the ability to redeem large amounts of shares believe that a fund may be in danger of seeing its share price fall below $1 per share and they redeem their shares. There is an incentive to be first to redeem because investors who are slower to redeem have a higher chance of getting less than $1 per share return on their investment if the fund's share price does "break the buck." We agree with the Commission's assessment that a floating NAV would reduce the incentive to redeem shares and would result in greater appreciation of the risks in money market funds by making gains and losses more apparent to investors.

Where the Commission once appeared to have an unrealistic goal in mind for money market fund reform – namely, eliminating any possibility of a run – there is now an acknowledgement that such a goal is impossible. No regulatory solution short of banning an entire product can eliminate the risk of a run, and the floating NAV is no perfect panacea. If a crisis is bad enough, investors in a floating NAV fund will run, even at the risk of getting less than $1 per share return. But the targeted floating NAV proposal the Commission has put forward accomplishes the critical goals: reducing the risk of a run and reducing the impact such a run would have on retail investors.

Distinguishing Between "Retail" and "Institutional" Investors

We believe the proposed $1 million Redemption Limit for distinguishing between "retail" and "institutional" investors is too low and we recommend that the limit be increased to $5 million. Our concern is for operational complexities and the negative client experience that will result if the limit is set too low. If the client experience is poor or has complexities, clients will move out of retail prime funds in large numbers. Prime retail money market funds with a daily redemption limit need to maintain most of the value proposition of today's money fund or clients will abandon the product. At a threshold of $5 million, this value proposition for retail investors can be better maintained, yet this threshold is still low enough that it would not include institutional investors.

There are numerous circumstances in which a retail investor might find himself needing to move more than $1 million out of money market fund in a single day. The Commission's proposal notes some: "a retail investor may make large redemption requests when closing out their account, rebalancing their investment portfolio, paying their tax bills, or making a large purchase such as the down payment on a house."[3] To that list, we would add other examples, including the sale or purchase of a small business and the transfer of assets from one firm to another.

The example of transferring assets from one firm to another is a useful illustration of how cumbersome the rule could be for clients. A client with a $50 million portfolio, including $5 million in a prime money market fund, decides to transfer that portfolio from Financial Services Company X to Schwab. Under the current proposal, the client could only sell out of his position

[3] 78 Fed. Reg. at 36859.

in the prime money market fund in $1 million increments, a process that would take 5 business days. That cash would then be transferred to Schwab, where we would sweep that cash into a money market fund that night. If the cash was swept into a prime fund, the new client would not be able to diversify right away; rather, he would again be limited to $1 million daily redemptions in order to then purchase shares of a stock, bond, mutual fund or other investment product. This kind of client experience is simply untenable. To avoid such a scenario, Schwab would undoubtedly prohibit the incoming cash from being swept into a prime money market fund and would instead sweep the cash into a Treasury or government money market fund, potentially at a lower yield.

Schwab's heavy use of money market funds as the sweep vehicle presents a host of other challenges. Given that a client can use a variety of mechanisms to access the funds in his sweep account, including writing a check, withdrawing cash at an automatic teller machine, and using a debit card to make a purchase, it is not clear how a client whose aggregated activities exceed the redemption limit during a given day should be treated. For example, if a client with $1.5 million in prime money market fund assets makes an online purchase of $995,000 worth of shares in a stock, and on the same day his $10,000 donation check to his alma mater clears, he pays three bills totaling $750 via electronic bill payment, and withdraws $100 in cash at an ATM, he has exceeded the daily redemption limit by $5,850. Schwab will be required to reject certain of these client transactions to ensure compliance with the daily dollar threshold, resulting in an unsatisfactory client experience and likely negative external impacts to the client that derive from the canceled cash transactions. Moreover, a client will have to self-monitor his cumulative money fund withdrawals for a given day, which could be overwhelmingly complicated as it could include pending withdrawals from previous days' activity, the clearing of previously written checks, and the settlement of executed trades across all of the shareholder's accounts.

Need for a "Large Trade Order Notification" System

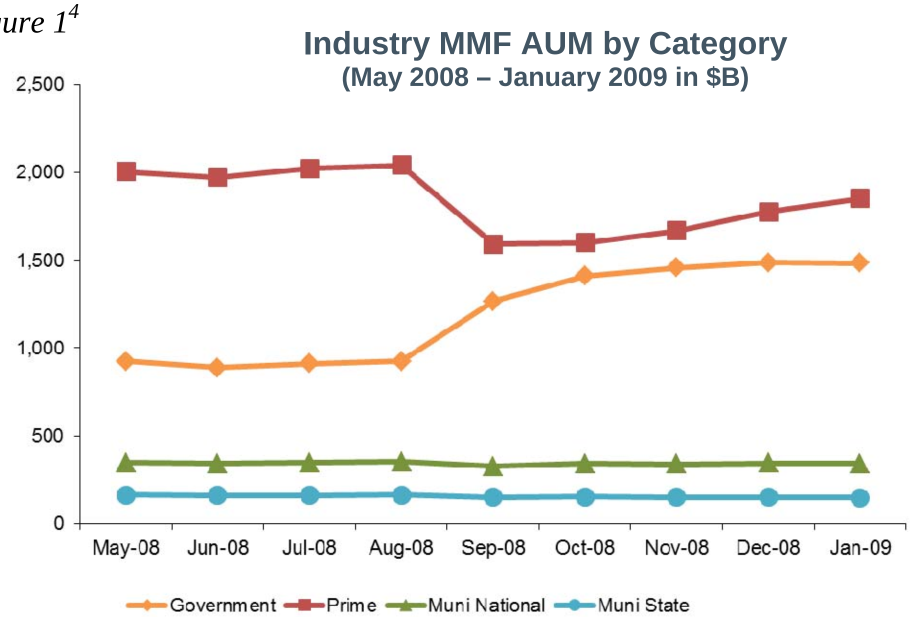
Schwab strongly supports the addition of a mechanism for retail investors to redeem more than $1 million (or more than whatever daily redemption limit the Commission ultimately settles upon in the final rule) in a single day, provided the investor gives advance notice of their intent to do so. We call this a "Large Trade Order Notification" system, or LTON. We believe this is an important addition to the rule because it benefits retail investors and will help alleviate investor anxiety when an unusual circumstance arises – a house sale, a small business sale, a transfer of assets from one firm to another, or other event that warrants a significant movement of cash in and out of a money market fund – while also allowing the fund manager enough time to prepare for the larger-than-usual redemption without affecting the fund or other investors.

We recommend that the Commission adopt an LTON that requires the investor to provide the fund with information about his or her intention to redeem in excess of the daily redemption limit, including the amount of the redemption and the date of the redemption, with a minimum of three business days advance notice. We believe that there should be no limit on the amount of the redemption, but that the fund manager should be granted the discretion to reject all or part of the redemption request if the request is so large as to potentially put the fund at an inappropriate level of risk. For example, a fund manager could decide to decline a redemption request if it would cause the fund to fall below the required 30% weekly liquidity level under Rule 2a-7 or otherwise have an adverse impact on the fund. We suggest giving the fund manager broad discretion on this point.

Exception for Municipal (Tax-Exempt) Money Market Funds

Schwab believes strongly that municipal (tax-exempt) money market funds should be exempted from the floating NAV requirement. A key reason to exempt tax-exempt money market funds from the proposal is that these funds are much more liquid than prime funds and are significantly less susceptible to runs. An examination of the performance of municipal money market funds during the 2008 financial crisis underscores this point. As seen in Figure 1, municipal money market funds – both national funds and state-specific funds – were remarkably stable during the financial crisis, particularly when compared with prime funds.

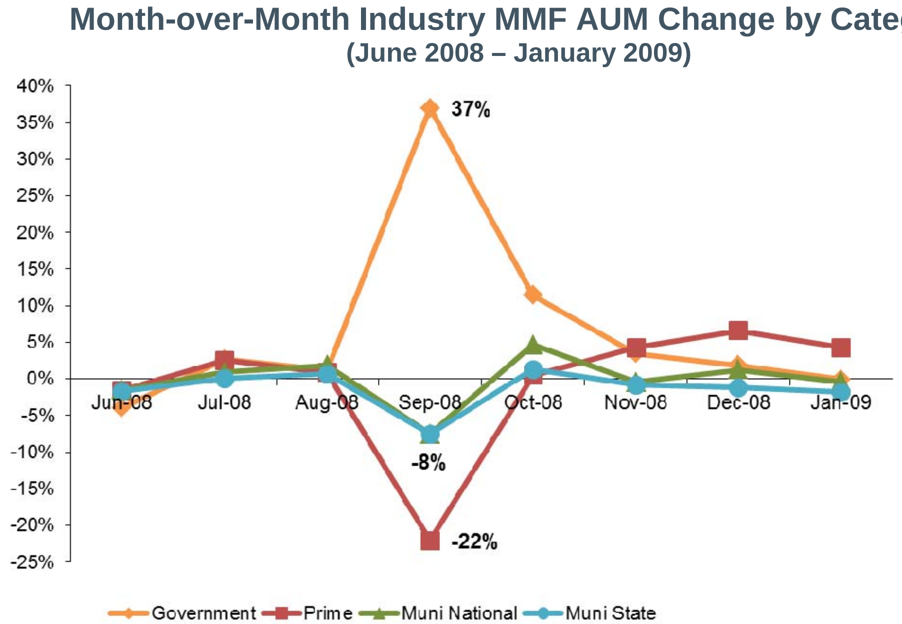
Figure 1[4]



In Figure 2, which shows the month-over-month change in assets under management in different types of funds from June 2008 through January 2009, we can see that during the worst month of the crisis – September 2008 – municipal money market funds dropped only 8% industrywide, as compared to a 22% drop in assets in prime funds.

[4] Data for Figures 1 and 2 compiled using end-of-month assets under management data from iMoneyNet (www.iMoneyNet.com)

Figure 2



The experience with Schwab's proprietary municipal money market funds during the crisis shows that these funds are particularly resilient. Schwab's largest tax-exempt fund is the nationally-diversified Schwab Municipal Money Fund Portfolio, which in August 2008 accounted for nearly half of all municipal money market fund assets under management at Schwab. Between August 2008 and December 2008, the largest weekly outflow the fund experienced was 5.1% of assets – far below the minimum weekly liquidity requirement of 30%. Only one of Schwab's eight municipal money market funds experienced an outflow of greater than 10% in any week during the crisis, still well below the weekly liquidity requirement. Indeed, Schwab's municipal money market funds typically hold much more than the required 30% in weekly liquidity; for the first seven months of 2013, Schwab's Municipal Money Fund (SWXXX) held weekly liquid assets ranging from 68% to 72% of total assets.

Another compelling reason to exempt tax-exempt money market funds from the proposed reforms is that the product as a whole does not pose a systemic risk. Municipal money market funds comprise just over 10% of total money market fund assets -- $267.06 billion out of a total of $2.622 trillion as of August 14, 2013.[5] Despite its relatively small size, the municipal money market is critically important to the financing of state and local governments because the money fund industry is the largest investor in short-term municipal securities. We do not believe that a product of this size, yet with outsized importance to the economy, warrants the complex and costly operational challenges that would be presented by trying to comply with the daily redemption limit envisioned by the Commission's proposal. We urge the Commission not to rely on the current rule proposal's assumption that most tax-exempt funds would qualify for the retail money market fund exception to the floating NAV, and instead specifically exempt municipal money market funds from the proposal.

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[5] "Money Market Mutual Fund Assets," a weekly report compiled by the Investment Company Institute, August 15, 2013. Available at: http://www.ici.org/research/stats/mmf/mm_08_15_13.

Treatment of Registered Investment Advisers (RIAs)

The Charles Schwab Corporation's Advisor Services business provides trading, custody, technology, practice management and other support services to nearly 7,000 registered investment advisers. Registered investment advisors are not shareholders of record, and thus, by the terms of the proposed rule the Redemption Limit would not and should not apply; rather, the proposed rule would require that the Redemption Limit be applied to the investment adviser's underlying clients, either by the financial intermediary that custodies the underlying clients' assets or the investment adviser itself. Registered investment advisers typically bundle the transactions of their many retail clients into a single transaction, much in the same way that a financial intermediary holding an omnibus account bundles trades of its underlying customers. A registered investment advisor, however, is not an "omnibus account holder" as defined under the proposed rule.

We do not believe it is or should be the Commission's intent to apply the Redemption Limit to registered investment advisers. Retail investors who choose to engage the services of a registered investment adviser should not be excluded from retail funds in which they otherwise would be permitted to invest. Indeed, if registered investment advisers are subject to the redemption limit, it would be penalizing the retail client who has elected to outsource their investment management to a professional rather than handle it themselves. We are concerned, however, that because the proposed rule does not expressly consider the treatment of registered investment advisers, there could be a lack of clarity as to its application relative to these advisers. As such, we respectfully ask that the Commission confirm our understanding of the proposed rule as it relates to registered investment advisers.

Tax Treatment of Floating NAV Money Market Funds

We share the widely-held view that the tax implications of moving to a floating NAV are significant and need to be resolved *before* the rule takes effect. Shareholders in a floating NAV fund would experience small gains or losses on the sale of their shares and would be required to track those gains and losses for determining their tax burden. Given that clients may make hundreds of transactions within a money market fund every year, the burden on tracking this information seems wildly out of proportion with the potential revenue gain for the Treasury.

We applaud the efforts of the Commission to work with the Department of the Treasury and the Internal Revenue Service on this issue. Earlier this year, the Treasury Department issued a proposed Revenue Procedure[6] that addresses one aspect of the tax implications for a floating NAV fund – the wash sale rule. The proposal includes a *de minimis* exception from the loss disallowance rule if the loss is less than 0.5% of the taxpayer's basis. While we support this proposal, we note that it does not eliminate the requirement to track compliance with the wash sale rule. We recommend that the IRS simply exempt floating NAV money market funds from the wash sales reporting rules.

With regard to the reporting of gains and losses, some of the issues could be ameliorated if the

[6] "Application of Wash Sale Rules to Money Market Fund Shares," Internal Revenue Service Notice 2013-48. Available at: http://www.irs.gov/pub/irs-drop/n-13-48.pdf.

IRS were to issue guidance allowing net information reporting by funds and summary income reporting by shareholders. But, again, these steps do not relieve funds of the burden of tracking literally hundreds of thousands of transactions per day and reporting gains and losses to investors. At Schwab, between March 16, 2013, and June 25, 2013, we conducted an average of 365,000 sweep transactions per day, with a peak day of 1.1 million sweep transactions. The burden of tracking and reporting the gains and losses within each of those transactions presents a systems issue that would be prohibitively expensive to develop and implement.

To illustrate the *de minimis* gains and losses at stake, we analyzed our largest money market fund, the Cash Reserves Fund (SWSXX) to estimate the net gain or loss realized by shareholders who redeemed during a particular period. Since Schwab began calculating daily mark-to-market NAV of the fund in March 2013, there has been little price fluctuation. Between March 25, 2013, and July 23, 2013, the range of the daily NAV of this fund spanned $1.000132 to $1.000179. With that narrow of a fluctuation, the daily gains and losses offset one another, resulting in a negligible gain over the time period. As of July 23, 2013, the fund had more than $37 billion in assets and more than 700,000 investors. That infinitesimal gain is spread out among each of those investors. In other words, on a per-investor basis, the net gain was a fraction of a penny – an amount that could not be remitted to the Treasury anyway.

Given the operational burdens of tracking and reporting this information and the negligible impact to the Treasury in terms of revenue, we urge the Commission to continue working with the IRS to eliminate this tracking altogether unless the gain or loss on any transaction exceeds 50 basis points.

Alternative Two – Standby Liquidity Fees and Gates

The Commission proposes, as an alternative to the floating NAV for institutional prime money market funds, imposing two provisions for money market funds that encounter distress. Funds would be allowed to continue to transact at a stable, $1-per-share price under normal conditions, but when the weekly liquid assets of a non-government money market fund drop below 15% of the total assets, the fund would be *required* to institute a liquidity fee and would be *permitted* to impose a redemption gate.

Schwab's recommendation is that the Commission should permit the fund's board to impose either a liquidity fee or redemption gates whenever it determines that doing so is in the best interest of the fund and its shareholders. Instead of having the 15% weekly liquidity level as the trigger for an imposition of fees and/or gates, the proposal should require the fund's board to meet when the fund's weekly liquidity hits 15%, if it has not already done so. The fund must then issue a public statement from the board indicating that it has met as required, that it has determined that redemption gates and/or liquidity fees are to be imposed or not imposed, and its reasons for the decision it has made.

We believe that gating and redemption fees can be a powerful tool if a fund is under serious stress and heading towards liquidation. In such a scenario, these tools would help facilitate an orderly liquidation and ensure that shareholders are treated fairly, as there would be less opportunity for first mover advantage. We believe that this is the only circumstance in which it would be reasonable to impose gates and/or fees, as we have a hard time seeing how any fund that actually imposed fees and or redemption gates would ever be able to recover and be a viable fund again. Investor trust in that fund would be lost. We see the fees and gating proposal, then, as an interim step toward orderly liquidation of a fund.

We also believe that the board should have more discretion over when to impose gates and/or fees, rather than having a mandatory trigger of reaching 15% weekly liquidity. There are situations in which a fund could be under stress without reaching the proposed trigger point. For instance, the liquidity of a fund could be high, but a default of a creditor in the portfolio could put the fund in a highly-stressed scenario. In such a situation, the board might believe it is in the best interest of the shareholders to gate the fund and impose liquidity fees. It should have the ability to do so.

Moreover, a hard trigger could lead to "pre-emptive" runs on funds as they approach the weekly liquidity threshold. With the increased transparency of money market funds, investors can keep close track of a fund's weekly liquidity levels. Sophisticated investors will likely redeem from the fund as it approaches the 15% weekly liquidity trigger, though it is not clear at what point they will begin redeeming – it could be 20%, or 18%, or some other number. The result could be a run that sends the fund more rapidly below the trigger point, from which we have already asserted the likelihood of recovery is minimal. By giving the board discretion to impose fees and/or gates at any time, this risk is mitigated. Moreover, since there is no certain point at which fees or gates must be imposed, it lessens the likelihood of a run.

We agree with the Commission that liquidity fees would add an important disincentive to early redeemers. As discussed earlier, a key concern of the Commission is that early redeemers have an advantage over other investors when a fund is under stress, since they will get a full return on their investment and later redeemers may not. A liquidity fee would force early redeemers to pay for the costs of their redemption, without knowing whether the fund was actually going to experience losses or not. This is a powerful disincentive.

While we agree that the proposed liquidity fee of 2% would be a strong disincentive to redeem during a crisis, we also support the provision in the rule proposal to allow the fund board to increase or decrease this fee if it determines that circumstances warrant such action. The latter provision gives the board needed flexibility.

We also note that there are several operational challenges, particularly for sweep funds, that arise with the possibility of fees and/or gating, which further supports providing the board discretion to impose fees and gates rather than subjecting funds to a hard trigger. As envisioned by the Commission, once a fund imposes a liquidity fee, that fee would be taken out of each client transaction. However, at Schwab, our money market fund sweep clients are able to use debit cards, make withdrawals of cash at automatic teller machines, write checks, and use electronic bill pay to access their money market fund assets.

If a mandated liquidity fee is imposed on a fund during the course of the day, and the client makes a series of transactions that day, we would have to impose the liquidity fee on each transaction retroactively. For example, if the client writes a check tied to his or her sweep fund holdings to make a $100 purchase at the grocery store and uses a debit card to buy a $4 cup of coffee at Starbucks, at the end of the day Schwab would have to impose a $2.08 liquidity fee on those transactions. The funds could be withdrawn from the client's remaining balance in the fund and the client notified of the fee, but this would be a cumbersome and time-consuming process. Alternatively, Schwab could bounce the check, which could potentially trigger additional fees, not to mention frustrate the client.

The Commission notes in its proposal that it chose to require the fee, rather than make it fully discretionary, because of concerns that "a purely discretionary trigger creates the risk that a fund board may be reluctant to impose restrictions, even when they would benefit the fund and the short-term financing markets."[7] We believe that this view does not take into account that fund boards have a fiduciary duty to act in the best interest of the fund's shareholders. As noted above, imposing fees or gates is, in our view, tantamount to commencing an orderly liquidation of the fund. But not every instance of a drop in weekly liquidity will warrant such drastic action. We urge the Commission to empower fund boards to impose liquidity fees and/or redemption gates whenever it believes doing so is in the best interest of the fund, and to require the board to meet and determine whether or not fees and/or gates are warranted if the fund hits 15% weekly liquidity and the board has not already taken any action.

Exemption for Retirement and Education Accounts

We believe that retirement and education accounts should either be allowed unlimited redemptions, or, perhaps more simply, exempted entirely from both alternatives in the proposal. Accounts such as Individual Retirement Accounts ("IRAs"), employer-sponsored defined contribution retirement plans (such as 401(k) plans and 403(b) plans), and 529 college savings plans are designed for individuals and serve no purpose for institutional investors. We believe the risks in these types of accounts are minimal.

Defined contribution plan sponsors often select money market funds as a capital preservation fund investment alternative. In virtually all plans, this is the only stable NAV investment option. Some plans even <u>require</u> a stable NAV investment option within the capital preservation category. A floating NAV money market fund is likely to be unworkable as an investment option in a defined contribution plan.

The major issues for these accounts, however, arise with the Commission's Alternative Two, which contemplates imposing liquidity fees and redemption gates in certain circumstances. The proposal has a number of unintended consequences for retirement plan participants and sponsors. For example, the proposal may inadvertently cause a plan participant to violate the Minimum Required Distribution rules. Participants in qualified retirement plans and Individual Retirement Accounts generally must begin receiving distributions by April 1 following the year in which the participant or IRA holder reaches age 70 ½. Failure to make the distribution may result in disqualification for the retirement plan or IRA and excise taxes for the participant or IRA holder. The imposition of a redemption gate may cause the plan or the IRA to fail to make a timely distribution if all or some of the assets from which the distribution needs to be taken are held in a money market fund that has a gate in place.

[7] 78 Fed. Reg. at 36884.

In our comment letter to the SEC, we outline several other common situations in which potential unintended consequences could impact a plan participant. Similar complexities arise in education accounts, such as 529 plans. We believe that many plan sponsors would avoid these issues by simply declining to use any money market fund that has even the potential of being subject to liquidity fees and/or redemption gates. A movement by retirement plans away from prime money market funds and into money market funds not subject to the proposed rules, such as Treasury or government funds, would further exacerbate the concentration within those types of funds. If plan sponsors did not believe that such funds were adequate for the plan's needs, it could increase desire for other types of stable-value products, in an environment where the supply of such funds is diminishing. In addition, a plan sponsor's selection of a government money market fund as the cash sweep vehicle for a plan would not necessarily be the most appropriate vehicle for retirement plan assets that are already tax-exempt while held in the plan's trust.

As a result of the complexities that arise in the context of an employer-sponsored plan, IRA or an education account, we recommend that these types of accounts be exempted from both alternatives in the Commission's proposed reforms.

Combining Alternative One and Two

Schwab supports combining the two alternatives proposed by the Commission – with the recommended changes outlined in this letter – into a single final rule because the two alternatives together provide a larger set of tools to deter runs in money market funds. The first alternative applies only to institutional prime money market funds. The second alternative, the liquidity and gating proposal, would be available as an option, should the fund board determine it is necessary, to prime, municipal and government money market funds. Together, we believe the two alternatives cover a broader array of products and could prove effective at deterring destabilizing runs.

Enhanced Disclosure Requirements

Generally, Schwab believes that more disclosure and transparency is better for individual investors. Of course, all regulators struggle with achieving an appropriate balance between providing the right amount of information to investors to help them make informed investing decisions and overwhelming investors with so much disclosure that they do not read or absorb any of it. It is Schwab's view that the Commission's call for enhanced disclosure has, for the most part, achieved the proper balance, with the exception of some elements of the rule proposal where we believe that the cost and complexity of producing the information far outweighs the benefits to investors or to the Commission. Proposed disclosures around instances of sponsor support would provide investors with useful context for analyzing the stability of the fund, though we would note that not all instances of sponsor support are indicative of a fund under even mild stress, let alone nearing the point of breaking the buck. Requiring daily disclosure of a fund's current net asset value, which Schwab began voluntarily making available in February 2013, would be a very valuable tool for investors.

There are elements of the proposed disclosure requirements, however, that we believe are <u>not</u> appropriate. In our comment letter, we recommend that the SEC eliminate the requirement to provide new, detailed information with respect to every portfolio holding – a costly process that we do not believe would result in useful information for investors. We also believe that disclosing the total percentage of shares held by the 20 largest shareholders of record could lead to misperceptions of the concentration risk in a fund, since a financial intermediary could be reported as a significant holder of fund shares despite the fact that no one underlying investor has any meaningful number of shares. There are also several examples of disclosure requirements in which the proposed time period for making the information available is simply unrealistic.

Cost Analysis of Complying with the Proposed Rule

As required by law, the Commission has included in its proposed reforms an analysis of the costs of compliance. We find the Commission's conclusions to significantly underestimate those costs. In some areas, the Commission's estimates are low by multiple orders of magnitude. We cite below some representative examples of the anticipated costs of the proposed reforms.

One area in which we believe the Commission has not adequately considered the cost of its proposal is in the development of a floating NAV institutional prime money market fund. The Commission staff's estimate for the systems modifications necessary to support a floating NAV money market fund in the proposal ranges from $1.2 million to $2.3 million.[8] By contrast, given the complexities of developing the operational capability to support our sweep features, we estimate that the one-time cost will exceed $10 million.

We also believe that the Commission has not adequately considered the costs of educating and training employees to understand the new rules, or the costs of communicating the rule changes to clients. We estimate these costs to be in a range of at least $4 million in advance of the new rules taking effect, and at least $500,000 in annual costs thereafter. The Commission's proposal does not include a specific estimate of education, training and client communication costs. Rather, the proposal embeds these costs as part of its estimates of the costs of developing the systems to support floating NAV funds, daily redemption limits, gates and fees, and other aspects of the proposal. We believe this leads to a serious underestimation of the communications and education challenges that funds will face if these rules were to be approved.

Potential Repercussions of Money Market Fund Reform

While Schwab generally supports the SEC's reform efforts, especially in the context of other proposals that have been considered, the reforms being proposed would bring about fundamental changes to money market funds, at significant cost. Those changes have potentially significant repercussions on the larger financial system that warrant careful consideration by the Commission. Among the most significant is the degree to which the proposal would reduce the number and size of prime money market funds by driving those assets elsewhere.

The question then becomes what is the impact on other products if prime money market funds experience a sharp decline in assets. In particular, we believe the impact on government money

[8] 78 Fed. Reg. at 36871.

market funds will be significant. Government money market funds would undoubtedly absorb the majority of the assets that move out of prime money market funds if a daily redemption limit were to be imposed on the latter. But it is not clear that government money market funds have the capacity to handle this amount of inflows. Portfolio managers of government money market funds would likely find themselves in a frantic competition to purchase a dwindling supply of securities. The combination of tight supply, high demand and low interest rates will continue to put pressure on government funds. It will become increasingly challenging for these funds to maintain a positive rate of return for investors.

Alternatively, assets could flow to other types of products, such as bank products or ultra-short funds and exchanged-traded funds. None of these products are regulated by Rule 2a-7. Many of the largest banks are likely to be reluctant to absorb these dollars because of the impact on their capital ratios, the lack of short-term investment options, and the fact that they must pay deposit insurance based on their assets.

Another potential concern is that the transition to a new regulatory regime for money market funds could itself spark a destabilizing run of the very kind the rules are intended to prevent. We expect that, if the Commission finalizes a rule calling for institutional prime funds to have a floating NAV, there will be a quick exodus by institutional investors from prime funds to government funds or other products that do not have the new restrictions. This could lead to worry by other investors that the large redemptions are either indicative of a problem in the fund or will lead to liquidity concerns within the fund as it seeks to meet those redemptions – and those investors could then also seek to redeem.

We believe it is incumbent upon the Commission to carefully weigh these potential impacts on the broader financial system as it considers a final rule.

Conclusion

The SEC has proposed a serious set of reforms that will have enormous ramifications on the money market fund industry. They will be costly for Schwab and other firms to implement, and they represent a fundamental overhaul of a product investors of all types have relied upon for four decades. But we support the proposed reforms because they target the reform where the risk exists and reform will have its greatest impact: institutional prime funds. By exempting retail investors from the floating NAV, the Commission is acknowledging both that the product is of critical importance to retail investors and that these investors are not likely to cause a run. We believe that this proposal, when combined with increasing the ability of fund boards to impose redemption gates and/or liquidity fees to facilitate orderly liquidation of a distressed fund, will produce a stronger, more robust money market fund industry. Other regulators have called for a one-size-fits-all approach that would destroy the product for individual investors. We believe the SEC has found a tough yet pragmatic solution that will boost investor confidence, deter destabilizing runs, and ensure that individual investors can rely on this critically important product for generations to come.

Thank you very much for the opportunity to offer Schwab's perspective on this important issue. I would be happy to respond to any questions.