



AMERICAN BENEFITS  
COUNCIL

February 1, 2013

*Submitted electronically via e-mail*

Amias Gerety  
Deputy Assistant Secretary for the Financial Stability Oversight Counsel  
Department of Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

**RE: Proposed Recommendations Regarding Money Market Mutual Fund Reform,  
Docket # FSOC-2012-0003**

Dear Mr. Gerety:

I am writing on behalf of the American Benefits Council (the “Council”) to express concerns of the Council’s members about the Financial Stability Oversight Counsel’s (“FSOC’s”) proposed recommendations to alter, in fundamental ways, the regulation of money market funds. The recommendations that FSOC proposed could have a significant and adverse impact on retirement plans that employers offer their workers, and thus on Americans’ preparedness for retirement.

We outline in this letter some unintended consequences for retirement plans that regulators should consider before moving forward. It is critical we have a fulsome dialogue on the effect these recommendations – and any others regulators may be considering – to avoid harming plans and their participants.

The Council is a public policy organization principally representing Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

## THE CURRENT ROLE MONEY MARKET FUNDS PLAY IN RETIREMENT PLANS

Sponsors of defined contribution and defined benefit plans, such as 401(k) and pension plans, use money market funds in a number of important ways. In particular, sponsors use these funds because they seek to maintain a stable net asset value (“NAV”) while providing liquidity. Americans saving for their retirement through these plans at work, in turn, value these funds for their stability, low volatility, and diversified, low-cost access to commercial paper, government securities, and other money market instruments. Money market funds fit well into the legal and regulatory structure established by the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).

Defined benefit pension plans – like other institutional investors – use money market funds for their stable pricing and full liquidity. A plan fiduciary, to comply with ERISA, must manage the plan’s assets consistent with the purposes and needs of the plan, which typically means some portion of the plan’s trust must be available for short-term cash needs. Pension plans, like many other institutional investors, have ongoing and critical liquidity needs. Each month they send benefit checks to retirees and hold funds in a liquid form for investment purposes. Holding those assets in more volatile, less liquid investments would introduce additional uncertainty for defined benefit plans, and would make investment planning and plan funding strategy less predictable. In a defined benefit plan, plan sponsors are ultimately responsible for ensuring that sufficient assets are available to pay plan benefits when due under the terms of the plan.

Department of Labor (“DOL”) regulations require participant-directed defined contribution plans that want to satisfy section 404(c) of ERISA to make available investments with a range of risk/reward characteristics. Under these regulations, the plan must offer a low risk investment. Money market funds serve this role in many plans – surveys of plan sponsors suggest more than half of plans include them in their investment menus. While most 401(k) savers focus their savings in long-term investments like equities, money market funds play important diversification and capital preservation roles, particularly as a worker nears retirement and prepares to withdraw money from the plan. According to Investment Company Institute data, as of the end of third quarter 2012, Americans held \$369 billion in money market funds through 401(k) and similar defined contribution plans and IRAs. Therefore, regulatory action that would hinder the ability of plans to use these funds could have unintended consequences on many Americans’ retirement savings.

Both defined contribution and defined benefit plans use money market accounts to ease administration, as well. For example, plans with vesting schedules generally hold

forfeitures in a forfeiture account, often invested in a money market fund.<sup>1</sup> Internal Revenue Service guidance requires these forfeiture accounts to be used fully for plan expenses or plan benefits, or allocated to individual accounts of participants. In addition, a money market fund may be the plan's "sweep" investment, holding participant contributions temporarily until they can be invested based on participants' asset allocations.

Money market investments are also often used to provide liquidity in unitized funds. For example, a plan offering investments in employer securities may unitize that investment to ease transactions between those investments and mutual fund investments, where investment transactions settle at different times. The money market component in a unitized fund allows for daily processing of transactions. Holding a portion of a unitized fund in money market investments can also ease volatility in unitized funds due to investment and redemption requests.

#### **POTENTIAL IMPLICATIONS OF FSOC'S PROPOSED MONEY MARKET MUTUAL FUND REFORM RECOMMENDATIONS**

In 2010, the Securities and Exchange Commission (the "SEC") enhanced the rules for money market funds to improve their liquidity and transparency. These reforms were generally viewed as helpful and positive. In June 2012, the Council commented on other reforms to money market fund regulation that the SEC was considering.<sup>2</sup> In our letter, we expressed concern that the changes would alter the fundamental characteristics of money market funds. The proposed recommendations by FSOC (which resemble, to a degree, some of the proposals considered by the SEC) are the imposition of (1) a floating NAV, (2) a capital buffer and minimum balance at risk, and (3) a larger capital buffer and other measures.

The Council is concerned that FSOC's proposed recommendations, if implemented, would alter the fundamental characteristics of money market funds, namely their stable pricing and full liquidity. This could have unexpected adverse effects on plans that use these important investment vehicles. The special rules and considerations that apply to retirement plans must be considered by regulators before implementing any reforms as sweeping as those FSOC is considering.

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<sup>1</sup> Forfeitures arise when plan participants cease plan participation before becoming fully vested in their retirement plan accounts.

<sup>2</sup> Letter to Mary L. Schapiro, Chairman, SEC, June 19, 2012; *see also* Letter to Elizabeth Murphy, Secretary, SEC, August 21, 2012 (joint letter with a number of other organizations that represent the retirement plan community).

## Continuing to Use Money Market Funds

Retirement plans governed by ERISA are managed by fiduciaries that owe strict duties to the plans and their participants. If the proposed reforms were implemented, plan fiduciaries, like all investors, would need to reevaluate whether a money market fund continues to be prudent to use or offer to participants in light of the role the fund plays in the overall portfolio of the plan. Some defined benefit plan fiduciaries may exit money market funds because they no longer meet the plan's needs for ready liquidity. Some fiduciaries of participant-directed plans may decide that a money market fund no longer is appropriate to offer on the plan's menu because the fund no longer meets participants' desire for a stable value product. All money market fund investors would need to decide whether to exit the product; what is unique about plan fiduciaries is that ERISA imposes strict duties of care and prudence in making these decisions.<sup>3</sup>

Retirement plans may be restricted in moving to alternative investments in ways that other investors are not. For example, section 403(b) plans – which are used by educational institutions and non-profits – may only invest in annuity contracts or registered mutual funds. While some institutional investors could move their commercial paper investing off-shore, ERISA plans are limited in their ability to invest assets outside the United States because ERISA requires that the indicia of ownership of all plan assets be maintained in the United States.<sup>4</sup>

## Operational Challenges

Because money market funds are liquid and provide for a stable NAV, they are used throughout the retirement system, and the reforms FSOC has proposed could pose significant operational problems. For example, plans may use money market funds to receive employee contributions for a short period before investing in the investment options that participants have elected. Participants' contributions would be at risk of reduction because of a daily fluctuation in the NAV of the plan's sweep investment. This result would not be welcomed by participants. In addition, if participants cannot redeem their full investment immediately, then those participants taking distributions from money market investments would need to receive another check, with attendant processing, mailing and tax reporting associated with a plan distribution. Administrative uses of money market funds in unitized funds and other contexts where predictability and liquidity are sought would also be hampered, if not eliminated.

Retirement plans operate under a variety of rules that require events to occur by a particular deadline. It is precisely for this reason that money market funds are effective holding investments. Here are a few examples. The Code requires that distributions

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<sup>3</sup> See ERISA § 404(a); 29 C.F.R. § 2550.404a-1.

<sup>4</sup> See ERISA § 404(b).

under plans begin no later than an individual's required beginning date.<sup>5</sup> Failure to pay minimum distributions by the deadline disqualifies a plan and results in an excise tax to the individual.<sup>6</sup> Similarly, the Code imposes limits on contributions that may be made to defined contribution plans, and Treasury regulations generally require that plans return excess contributions by April 15 of the year following the year the excess contribution was made.<sup>7</sup> If the terms of a plan require that a distribution be made by a deadline, the plan administrator must comply with that deadline. Failure to comply could be viewed as a breach of ERISA's requirement that a fiduciary follow the terms of the plan as well as a failure to operate the plan in accordance with its terms, a violation of which jeopardizes the tax-qualified status of the plan.<sup>8</sup> Reforms that significantly impact a plan's ability to redeem its investment or delay that redemption could cause operational problems where a plan must meet a fixed deadline.

### **Use as a Default Investment**

It is possible that the proposed recommendations, if implemented, would make a money market fund ineligible to serve as a qualified default investment alternative ("QDIA"). Section 404(c)(5) of ERISA provides that a participant may be treated as having exercised control over his or her account even if the participant is defaulted into the investment, if the participant's account is invested in accordance with regulations prescribed by DOL.<sup>9</sup> Under current rules, a money market fund may qualify as a temporary QDIA for up to 120 days.<sup>10</sup> (After that point, the participant must be invested in one of three other types of investments). The advantage of using a money market fund as a temporary QDIA is that a participant, who by definition did not affirmatively elect the investment, is not at risk of significant losses. A fund can be a temporary QDIA only if it is a product that is "designed to preserve principal and provide a reasonable rate of return" and "[s]eeks to maintain, over the term of the investment, the dollar value that is equal to the amount invested."<sup>11</sup>

If money market funds were required to use a floating NAV, it does not appear that the fund would continue to meet this requirement. DOL either would need to amend

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<sup>5</sup> See Code §§ 401(a)(9), 403(b)(1), and 457(d)(2).

<sup>6</sup> See Code § 4974.

<sup>7</sup> Treas. Reg. § 1.402(g)-1(e)(2).

<sup>8</sup> See ERISA § 404(a)(1)(D); see also Rev. Proc. 2008-50, 2008-35 I.R.B. 464 (treating a failure to operate a plan in accordance with plan terms as a qualification failure).

<sup>9</sup> See 29 C.F.R. § 2550.404c-5 (setting forth the requirements for an investment to be treated as a QDIA).

<sup>10</sup> See 29 C.F.R. § 2550.404c-5(e)(4)(iv).

<sup>11</sup> See *id.*

the regulation or issue guidance that interprets the regulation to mean that a floating NAV money market fund qualifies as a temporary QDIA.<sup>12</sup>

Further, the regulations provide that an investment may not qualify as a QDIA if it imposes fees, like redemption fees, or withdrawal restrictions, in connection with a decision to sell the investment during the 90-day period beginning when the participant is first invested in the investment.<sup>13</sup> Because some of the proposed recommendations, if implemented, would subject a participant to a restriction or fee based on a participant's decision to sell a money market fund, money market funds would be at risk of being ineligible to qualify as QDIAs.

### **Other Rules Contemplating Money Market Fund Use**

Because money market funds are viewed as stable and liquid investments, DOL has often written into its rules and exemptions criteria that contemplate the use of money market funds as holding investments. In some circumstances, retirement assets must be moved because of mandatory rollover requirements or because a plan has been abandoned. Certain safe harbor regulations and prohibited transaction class exemptions effectively require that funds be placed in an investment that seeks to maintain the dollar value that is equal to the amount invested, generally is liquid and does not impose "substantial restrictions" on redemptions.<sup>14</sup> If the proposed recommendation imposing a floating NAV is implemented, it appears that money market funds may not continue to meet these safe harbors or exemptions because the fund may no longer be viewed as seeking to maintain a value equal to the amount invested. Further, any proposed recommendation that imposes a restriction on liquidity could be viewed as placing a substantial restriction on a participant's access to the fund assets.

### **Participant-level Account Challenges**

Under the FSOC's second proposal, the capital buffer would be protected by a "holdback," also described as a "minimum balance at risk" or MBR. The holdback is a requirement that 3 percent of any shareholder's highest account value in excess of \$100,000 during the previous 30 days (the shareholder's MBR) be available for redemption only with a 30-day delay. Investors could immediately redeem the difference between the account balance and the MBR. An investor's MBR is then

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<sup>12</sup> Plan fiduciaries may still feel uncomfortable using a floating NAV fund as a temporary QDIA because of the possibility that the participant will experience losses prior to deciding to make an affirmative election to another investment or make a withdrawal.

<sup>13</sup> See 29 C.F.R. § 2550.404c-5(c)(5)(ii).

<sup>14</sup> See 29 C.F.R. § 2550.404a-2; PTE 2004-16, 69 Fed. Reg. 57,964 (Sept. 28, 2004); PTE 2006-06, 73 Fed. Reg. 58,629 (Oct. 7, 2008).

subordinated, or put in a “first loss” position, if the fund suffers losses in excess of its capital buffer.

In a defined contribution plan, like a 401(k), the plan owns the beneficial interest of an investment, and then establishes individual accounts for each participant. The FSOC report does not explain whether the minimum balance at risk requirement would be imposed at the participant or plan level, or both. In either case, plans face significant challenges.

This can be illustrated by an example. Assume that the holdback and MBR treatment is applied at the plan level, but not at the participant level. Assume further that a plan has \$10,000,000 invested in a money market fund, and a participant with \$500,000 held in that fund in his account decides to redeem his entire holdings. The money market fund would permit the complete redemption because more than 3% of the plan’s investment in excess of \$100,000 continues to be held with the fund. With the participant’s investment completely redeemed, part of the plan’s remaining investment in the money market fund is put in a “first loss,” or subordinated position. If that subordinated amount incurs losses, the departing participant does not suffer any of the losses, but the remaining participants would. This could be viewed as unfair.

On the other hand, if the holdback requirement and MBR treatment is imposed on the departing participant, this problem of unequal treatment of participants is not presented. But this imposes significant recordkeeping challenges for the plan because it must monitor and impose the holdback and MBR treatment on each and every participant account (and unnecessarily so, since the plan continues to be sufficiently invested in the fund), significantly raising the cost of offering a 401(k) plan that includes a money market fund investment.<sup>15</sup>

Because the effects of the holdback in either case have not been addressed by FSOC, there should be careful consideration of the issue before implementation of this recommendation.

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While we share the goal of ensuring that the regulation of money market funds adequately protects plans and other investors, we are concerned about changes that would remove those features of money market funds most valued by retirement

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<sup>15</sup> According to a report by the Investment Company Institute, the complex systems that process and implement participant instructions are not equipped to implement a redemption restriction without costly systems changes. See Investment Company Institute, *Operational Impacts of Proposed Redemption Restrictions on Money Market Funds* (2012), [http://www.ici.org/pdf/ppr\\_12\\_operational\\_mmf.pdf](http://www.ici.org/pdf/ppr_12_operational_mmf.pdf). This is because most investment instructions in participant-directed plans are processed through one or more layers of intermediaries, each of whom may be sending trade information on an “omnibus” basis to the mutual fund company.

savers – liquidity and stability. We ask that FSOC and other regulators take into consideration the effect any proposal will have on employers who sponsor retirement plans, and on workers who depend on these plans for a safe and secure retirement. In addition, any other ideas under consideration should be the subject of a public dialogue that considers any unintended effects on Americans’ retirement savings. We very much appreciate your consideration of our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Lynn D. Dudley". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Lynn D. Dudley  
Senior Council, Retirement Policy

cc: Luis A. Aguilar, SEC Commissioner  
Norm Champ, SEC Director, Division of Investment Management  
Daniel M. Gallagher, SEC Commissioner  
Troy A. Paredes, SEC Commissioner  
Elisse B. Walter, SEC Commissioner