Cynthia Lo Bessette
Chief Legal Officer
Fidelity Management & Research Company LLC
245 Summer Street V13E, Boston, MA 02210
617.392.2211 cynthia.lo.bessette@fmr.com

April 11, 2022

Submitted electronically through: https://www.sec.gov/rules/submitcomments.htm

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

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

Dear Ms. Countryman,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposed rule and form amendments relating to money market funds (the "Proposal" or "Proposed Rule").[2]

The stresses in the money market fund industry that occurred at the onset of the COVID-19 pandemic in the United States have been well documented.[3] These stresses highlighted certain vulnerabilities in segments of the money market fund industry as well as the need to reconsider certain aspects of Rule 2a-7.[4] Fidelity is encouraged that the SEC has sought to solve for these vulnerabilities in the Proposal by bolstering liquidity requirements and by reevaluating its prior support for temporary suspensions of redemptions (commonly referred to as "gates"). Fidelity is also encouraged that the SEC did not propose other, more pernicious, reform options that would significantly disrupt the money market fund industry and, in turn, the smooth functioning of the capital markets. It is evident that the SEC, at least in portions of the Proposing Release, accounted for the feedback provided by the industry in response to the report of the President's Working Group on Financial Markets (the "PWG") on potential reform options for money market funds.[5]

[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 40 million individuals and institutions, as well as through 13,500 financial intermediary firms. Fidelity submits this letter on behalf of Fidelity Management & Research Company LLC, the investment adviser to the Fidelity family of mutual funds.
[2] *See* Money Market Fund Reforms, Release No. IC-34441, RIN 3235-AM80 (December 15, 2021) ("Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.
[3] *See, e.g.,* Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report, Release No. IC-34188 (February 4, 2021), *available at* https://www.sec.gov/rules/other/2021/ic-34188.pdf (the "PWG Report") and Policy Proposals to Enhance Money Market Fund Resilience, Financial Stability Board Consultation Report (June 30, 2021), *available at* https://www.fsb.org/wp-content/uploads/P300621.pdf (the "FSB Report").
[4] 17 CFR 270.2a-7 ("Rule 2a-7") under the Investment Company Act of 1940 (the "Act").
[5] *Supra* note 3.

In our view, the Commission can best carry out its mission to protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation when it implements policies after adequately considering the insights and feedback received through the public comment process. In the case of money market funds, commenters with a long history of managing funds on behalf of investors can provide unique and valuable insights into the markets in which they operate, the behaviors and motivations of investors and the potential consequences of rule proposals.

Fidelity has long served as a leading provider of money market funds and has extensive experience managing funds in both normal and stressed market conditions. With an ethos focused on meeting our customers' needs and delivering a superior customer experience, we view our money market fund business as an important component of delivering better outcomes for our customers. Fidelity first began managing and offering money market funds in 1974 and remains the largest provider of money market funds with approximately $940 billion in assets under management as of March 31, 2022, representing approximately 19 percent of the U.S. money market fund industry. Fidelity currently offers an extensive suite of money market funds, including government, prime and tax-exempt funds,[6] to both retail and institutional investors.[7] In addition, as a diversified provider of financial services, Fidelity witnesses firsthand and in real time the starkly divergent investment behaviors of different types of money market fund investors such as retail brokerage customers, individuals saving for retirement through employer-sponsored and individual retirement accounts, and corporate treasurers seeking short-term investment options for operating cash, among others.

Based on this experience, we believe much of the Proposal, including increasing liquidity requirements and the SEC reevaluating its prior support for redemption gates, solves for the vulnerabilities in money market funds that surfaced in March 2020 and, in this regard, is an appropriate and positive regulatory response from the SEC. That said, we are equally concerned that other recommendations in the Proposal do not address the events of March 2020 and are inconsistent with the practical realities of managing and distributing money market funds. In particular, Fidelity believes that neither swing pricing nor the SEC's proposed requirements relating to negative yields are necessary or suitable tools to protect investors.

I. EXECUTIVE SUMMARY

In the remainder of our letter, Fidelity evaluates each of the primary components of the Proposal, discussing in detail the points summarized below. In addition, we are encouraged that the SEC did not propose several of the other reform options described in the PWG Report, which

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[6] Tax-exempt funds are often referred to as "municipal funds" and invest in municipal securities that are normally free from federal income tax, federal alternative minimum tax (AMT) and/or state income tax. Municipal securities serve as an important source of funding for states and municipalities and can help fund hospitals, educational systems, utilities and other public works projects.

[7] Fidelity liquidated its two publicly offered institutional prime funds in August 2020 in response to our experience with rapid, significant investor redemptions from these funds during periods of market stress, as well as evolving institutional investor preferences (as evidenced by the decline in institutional prime fund assets since 2016). We believe we can better meet institutional investor needs with other products and we continue to offer a broad array of money market funds across all other categories.

would have severely and negatively impacted shareholders in money market funds, including capital buffers, insurance programs, a minimum balance at risk and a floating NAV for all funds. Our views are informed by our long-standing commitment to meeting the needs of our customers as their circumstances change and as markets evolve.

- ***Fidelity Supports the Removal of Gates***: In our view, the key vulnerability that led to instability in the money market fund industry in March 2020 was the fear among shareholders in publicly offered institutional prime funds that they could lose access to their money from the potential imposition of a gate. As this fear took hold, redemptions in institutional prime funds accelerated, putting downward pressure on liquidity levels, which, in turn, further amplified the likelihood that a gate could be imposed. These events also highlighted the degree to which institutional prime funds are unable in practice to access and deploy the sizable amounts of weekly liquidity that Rule 2a-7 requires funds to maintain.

  By removing the gate provisions from Rule 2a-7, the SEC's proposal would eliminate the concerns that shareholders in publicly offered institutional prime funds have with potentially losing access to their money in times of market stress.

- ***Fidelity Supports Higher Liquidity Requirements***: Fidelity continues to believe that the most effective combination of reforms to solve for the weaknesses exposed in March 2020 is to couple the removal of gates with higher liquidity requirements. Higher amounts of liquidity make money market funds more resilient overall, allow funds to manage through periods of higher redemptions with little or no concern and delay (in most cases permanently) the point at which funds must access the secondary market to generate liquidity.

  Compared to most competitor funds, Fidelity maintained higher percentages of weekly liquid assets (approaching 50 percent) in the two publicly offered institutional prime funds we managed in March 2020. This higher liquidity allowed our funds to withstand market pressures more effectively and allowed the funds to satisfy redemptions without accessing the secondary market. Based on this experience, we support the proposed 50 percent weekly liquid asset requirement for these funds. We believe, however, that retail prime funds, due to their stable investor base and less volatile redemptions, could be made sufficiently resilient with 40 percent in weekly liquid assets.

- ***Fidelity Remains Strongly Opposed to Swing Pricing***: Fidelity is deeply concerned that regulators have rushed to the conclusion that swing pricing would be an effective tool, despite the overwhelming evidence to the contrary. In particular:

  - **The SEC has failed to justify a need for swing pricing**. The SEC acknowledges a lack of data quantifying the amount of trading costs or dilution that can arise from redemptions in institutional prime and institutional municipal funds, but nonetheless concludes that swing pricing would solve for "significant, unfair adverse consequences to remaining investors in a fund"[8] caused by other shareholders' redemptions. To the

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[8] Proposing Release at 45.

contrary and based on our experience managing a broad array of money market funds for many years, shareholders are not motivated to redeem based on the potential for dilutive trading costs. Money market funds maintain ample short-term liquidity allowing the funds to satisfy redemptions with liquidity on hand, resulting in no trading costs and no dilution imposed on other shareholders from redemptions. As a result, there exists no problem that swing pricing would solve.

- **The proposed removal of gates and higher liquidity requirements make swing pricing even less necessary**. While the SEC is correct that some institutional prime funds accessed the secondary market to generate liquidity in March 2020, this was a function of the inability of funds to deploy the 30 percent in weekly liquid assets because of the gate provisions in Rule 2a-7. By eliminating gates and by requiring funds to maintain even higher percentages of liquidity, any small justification that may have existed for swing pricing is rendered moot.

- **Even with the introduction of a market impact factor, NAVs would never move sufficiently to affect shareholders' decisions to redeem**. Fidelity conducted an analysis of the changes in fund NAVs that would occur from applying market impact factors of various sizes. Even with market impact factors that would be considered historically large and unprecedented, the NAVs of institutional prime and institutional municipal funds would only move by minute fractions of a percent. In our experience, these nearly imperceptible adjustments to a fund's NAV are unlikely to affect a shareholder's decision to redeem.

- **Operational impediments in the U.S. market remain**. The obstacles to implementing swing pricing in the U.S. mutual fund market have been well documented since the SEC first introduced the concept in 2015. These obstacles center on the inability of fund companies to know flows in sufficient time to decide whether a NAV must be swung. Significant changes to the distribution of money market funds and a massive investment of shareholder resources would be required to enable the implementation of swing pricing. In the absence of any benefits from swing pricing, these operational impediments further underscore why swing pricing is an inappropriate regulatory tool.

- ***The SEC Should Not Move Forward with its Proposal Relating to Negative Yields***: The SEC's Proposal, which would require funds and broker-dealers to enact permanent solutions that have the potential to impact government money market funds that serve as daily investment vehicles for cash in retail brokerage accounts (or "brokerage sweep vehicles"), is premature. A host of complexities to this issue exist and Fidelity encourages the SEC to undertake a concerted and thorough review (which the current environment of higher-than-normal inflation and rising interest rates affords), with input from the industry, of the many issues at play prior to mandating such a radical change.

  In addition, because the Proposal as currently drafted could drive assets away from government money market funds, the Proposal could negatively impact both the Treasury

Department's exercise of fiscal policy (with government funds holding close to 30 percent of outstanding Treasury debt) and the Federal Reserve's conduct of monetary policy.

If the SEC proceeds with including requirements relating to negative yields in the final rule, we encourage the SEC to modify the requirements to not require that fund companies discontinue distributing funds through broker-dealers that cannot support a floating NAV now, but instead require that fund companies working with their intermediaries to have in place a reasonably adequate plan for how they would respond to a negative rate environment should one arise.

- ***The SEC Should Extend the Compliance Deadlines***: The SEC should extend each of the compliance deadlines for the following portions of the Proposal: swing pricing and the related disclosure from 12 months to two years, requirements relating to negative yields from 12 months to two years, and the new Form N-CR and Form N-MFP disclosure requirements from six months to 18 months. These requirements all entail significant challenges to implement and likely will be occurring at a time when fund companies and administrators are implementing multiple other rule changes currently on the SEC's rulemaking agenda.

II. GATES AND FEES

Fidelity supports the SEC's proposed removal of redemption gates from Rule 2a-7 because the mere possibility that gates could be imposed was the key factor that contributed significantly to the stresses experienced by publicly offered institutional prime funds in March 2020. Before evaluating the SEC's proposed removal of redemption gates in further detail, it is important to first summarize the key events of March 2020.[9]

Events of March 2020

Volatility in the equity markets increased significantly in late February 2020 as investors began to recognize that the United States would not be spared from the COVID-19 pandemic. Assets in government money market funds began to increase significantly at this time as investors sought the safety and liquidity that these funds provide. Inflows into government funds were attributable to a few different types of investors, including retail brokerage customers reducing their equity exposure and, most importantly, institutional investors redeeming from institutional prime funds.

As redemptions from institutional prime funds began accelerating, Fidelity and other fund managers took prudent steps to maintain or increase their funds' liquidity in anticipation of needing to satisfy further redemptions, such as discontinuing making investments in securities that do not qualify as weekly liquid assets under Rule 2a-7.[10] Beginning on March 11th, some

[9] Fidelity discussed these events in further detail in its comment letter in response to the PWG Report (the "Fidelity PWG Letter"). The letter is available at https://www.sec.gov/comments/s7-01-21/s70121-8662947-235324.pdf.
[10] Rule 2a-7(a)(28) defines weekly liquid assets as (i) Cash; (ii) Direct obligations of the U.S. Government; (iii) Government securities that are issued by a person controlled or supervised by and acting as an instrumentality of the

fund managers (though not Fidelity) also began actively selling securities with longer maturities (i.e., non-government securities that do not qualify as weekly liquid assets such as commercial paper). By Monday, March 16th, attempts by managers to sell more of these assets were no longer successful because the broker-dealers that had been purchasing these assets the prior week discontinued doing so, likely because of the low margins that broker-dealers make in buying commercial paper. At the same time that institutional prime funds were no longer able to build liquidity by accessing the secondary market, redemptions from these funds accelerated even further. This combination of accelerating redemptions and fewer options for building liquidity resulted in declines in the weekly liquid asset percentages for institutional prime funds.

As redemptions in institutional prime funds began, the fear of a redemption gate, which, under Rule 2a-7 as currently in effect, boards of institutional prime funds must consider when weekly liquid assets fall below 30 percent, took hold among these investors, resulting in accelerating redemptions. As the pace of redemptions increased, declining levels of weekly liquid assets (the percentages of which are disclosed daily on fund websites) then fed even further the fear among institutional prime investors that a gate would be imposed. The weekly liquid asset percentages among the largest institutional prime funds fell from between 35 and 40 percent to percentages in the low 30s, with one competitor fund in particular falling from 35 percent to 27 percent in one day on March 19th.[11]

The fear of a redemption gate and the resulting increase in redemptions is both understandable and predictable in light of the reasons for which institutional investors use institutional prime funds. These investors (mostly businesses) invest corporate assets in institutional prime funds as a temporary investment until such time as the assets are needed to fund business operations (payroll, rent, etc.). As a result, the investor base tends to be more sensitive to changes in fund characteristics, including liquidity levels, which are published daily on fund websites.[12] Furthermore, because these investors redeem their money market fund assets when cash is needed to fund business operations, they prioritize unfettered access to their cash over all else. When even a remote risk of a redemption gate arises, many of these investors prefer to forego the slight yield advantage of an institutional prime fund in favor of ensuring immediate access to cash by switching their investments to a government money market fund.

The redemption patterns in institutional prime funds in March 2020 also exposed an inherent problem with the current 30 percent threshold for a fund board's consideration of

government of the United States pursuant to authority granted by Congress of the United States that: (A) Are issued at a discount to the principal amount to be repaid at maturity without provision for the payment of interest; and (B) Have a remaining maturity date of 60 days or less; (iv) Securities that will mature, as determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments, or are subject to a demand feature that is exercisable and payable, within five business days; or (v) Amounts receivable and due unconditionally within five business days on pending sales of portfolio securities.

[11] Even though the weekly liquid asset percentages for Fidelity's two institutional prime funds began the month significantly higher than those of competitor funds, the contagion effect was apparent. For example, the weekly liquid asset percentages for one of our institutional prime funds declined from 49 percent to a low of 42 percent, though remained well above the 30 percent threshold that would have obligated the fund's Board of Trustees to consider the imposition of a liquidity fee or gate.

[12] Rule 2a-7(h)(10)(ii).

whether to impose a gate. As the SEC notes in the Proposing Release, institutional prime funds are unable to deploy the liquidity built into the fund by virtue of the 30 percent weekly liquid asset requirement in Rule 2a-7.[13] Instead, because institutional shareholders redeem from prime funds when liquidity levels begin to approach the 30 percent threshold out of concerns that a gate could be imposed, funds effectively are unable to use the 30 percent of the portfolio held in weekly liquid assets as a source of liquidity.

Fidelity Supports Removing Gate Provisions

In response to the foregoing events, Fidelity and many others in the industry publicly supported removing the tie between a weekly liquid asset percentage and the board's consideration of imposing a gate.[14] This proposal, which the industry commonly referred to as "delinking," was designed to reduce the propensity for institutional investors in prime funds to redeem preemptively out of concerns they could lose access to their capital through gates as well as enable funds to deploy more effectively the 30 percent in weekly liquid assets that funds must maintain.

In the Proposal, the SEC went further and eliminated the gate provisions from Rule 2a-7 entirely citing not only the feedback the SEC received on delinking but also the practical difficulties of developing a workable replacement to the 30 percent threshold for the board's consideration of a gate that does not itself contribute to preemptive redemptions in times of stress.[15]

Fidelity supports removing the gate provisions from Rule 2a-7 for the reasons cited by the Commission. By eliminating the provisions entirely, the SEC has eliminated any risk that an institutional investor will redeem preemptively from a prime fund at the first sign of stress because of fears that a gate could be imposed. The Proposal would also allow fund managers to deploy more effectively the 30 percent in weekly liquid assets in a manner that fund managers cannot deploy in practice under Rule 2a-7 as it is currently written. Fidelity is also encouraged by the SEC's willingness to revisit and eliminate a regulatory requirement it imposed less than ten years ago once events demonstrated that the requirement was not only ineffective but contributed to the very stresses the requirement was originally designed to prevent.

Consideration of Fee Provisions

The SEC has also proposed eliminating the fee provisions in Rule 2a-7 entirely.[16] We agree with the SEC's contention that investors are less sensitive to the possibility of fees than to the possibility of redemption gates.[17] We nonetheless support efforts to reconsider the current

[13] Proposing Release at 28.
[14] *See* Fidelity PWG Letter. *See also* comment letters of the Investment Company Institute, *available at* https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf, and the Asset Management Group of the Securities Industry and Financial Markets Association, *available at* https://www.sec.gov/comments/s7-01-21/s70121-8664048-235345.pdf.
[15] Proposing Release at 30; 33-34.
[16] Proposing Release at 36.
[17] Proposing Release at 36.

formulation in Rule 2a-7 in which the minimum weekly liquid asset requirement also serves as the trigger point for the consideration of a liquidity fee.[18] This formulation has the potential to spur institutional prime shareholders to redeem in a manner similar to the incentives created by the gate provisions in March 2020 and, as a result, could preclude investment managers from accessing weekly liquidity when needed. The SEC's removal of liquidity fees from Rule 2a-7 will have the effect of eliminating these concerns. That said, we support the efforts of the Investment Company Institute to identify and propose an alternative to swing pricing that would involve a form of a liquidity fee and believe that, if properly constructed, such a fee potentially could serve as a more effective alternative than swing pricing.

III. LIQUIDITY REQUIREMENTS

Fidelity Supports the Proposed Liquidity Requirements for Institutional Prime Funds

In our comment letter on the PWG Report, Fidelity advocated that the most effective combination of reforms to solve for the vulnerabilities in institutional prime funds would be to couple the removal of the set threshold for imposition of a gate with higher liquidity requirements. As noted above, Fidelity supports the SEC's proposal to remove the gate provisions from Rule 2a-7 entirely. We also continue to support coupling such a solution to the problems created by the gate provisions with higher liquidity requirements.

As described in further detail above, the stresses experienced by money market funds in March 2020 were focused on liquidity pressures in publicly offered institutional prime funds resulting from substantial institutional investor redemptions. In addition, some fund managers were unable to bolster the liquidity positions of the funds they managed by accessing the secondary markets once broker-dealers discontinued buying commercial paper during the week of March 16, 2020. Fidelity, however, had no need to engage in such transactions because the percentages of weekly liquid assets in the two institutional prime funds we managed at the time were higher than that of other institutional prime funds. At the beginning of March 2020, many of the largest institutional prime funds held weekly liquid assets between 35 percent and 40 percent of their total assets.[19] Fidelity consistently managed its two publicly offered institutional prime funds at weekly liquidity levels well above many of its competitors' funds. At the beginning of March 2020, Fidelity's funds held 49 percent and 47 percent of their total assets in weekly liquid assets. In light of our experiences managing institutional prime funds through the events of March 2020 with weekly liquid assets that began at levels approaching 50 percent, we support the SEC's proposal to require this percentage for institutional prime funds going forward.[20] Furthermore, we agree with the SEC's statement that such a requirement would be sufficiently high to allow a fund to manage its liquidity risk in a market crisis.[21]

Beginning the month with higher weekly liquid asset percentages allowed Fidelity's two institutional prime funds to navigate the turbulent market events more effectively than other

[18] Rule 2a-7(c)(2)(i).
[19] iMoneyNet daily data as of March 2, 2020.
[20] While our discussion in this section focuses on the SEC's proposed *weekly* liquidity requirements, Fidelity is not opposed to the SEC's proposed daily liquidity requirements for institutional funds.
[21] Proposing Release at 93.

funds. While our funds experienced redemptions and declines in weekly liquid asset percentages, the funds remained well above the 30 percent threshold and well above many competitor funds. Maintaining higher percentages of liquid assets makes a fund more resilient overall and allows the fund to withstand redemptions, particularly in times of stress when liquidity in the secondary market may be unavailable. Rather than attempting to increase liquidity once a crisis starts when the tools to do so may become unavailable, maintaining a healthier percentage of liquid assets prior to a crisis will prevent, or at the very least lessen, stresses on the fund if that crisis ensues.

The following table includes data on the mathematical impact of redemptions on weekly liquid asset percentages at various starting points ranging from 30 percent to 50 percent. The table includes data assuming immediate (i.e., same day) redemptions ranging from zero percent to 40 percent. For example, a fund with 30 percent in weekly liquid assets would see a decline in its weekly liquidity percentage to 13 percent (i.e., a decline of 17 percentage points) if the fund experienced 20 percent redemptions on a single day. This is in contrast to a fund with 50 percent in weekly liquidity, which would experience a smaller decline to 38 percent (i.e., 12 percentage points) from the same 20 percent redemption. The reason for the difference is not due to anything unique about a particular fund or the adviser's investment management practices and is solely a consequence of the math – all else equal, redemptions lower a fund's assets, which in turn lowers both the numerator and denominator in the calculation of the weekly liquidity percentages.

TABLE 1: WEEKLY LIQUIDITY POST REDEMPTIONS

	Percentage of Redemptions from Fund on a Single Day				
Starting Weekly Liquidity	**0**	**10**	**20**	**30**	**40**
30%	30%	22%	13%	0%	0%
40%	40%	33%	25%	14%	0%
50%	50%	44%	38%	29%	17%

During the March 2020 crisis, redemptions in publicly offered institutional prime funds averaged approximately 30 percent but these redemptions extended over a period of two weeks.[22] Depending on the weighted average maturity of the fund, the data points in the table likely would be higher if the same percentage redemption occurs over a period of days or weeks instead of on a single day because the fund's weekly liquidity would be replenished at least in part by securities approaching their maturity dates during the period that the redemptions occur.

<u>Fidelity Supports Different Liquidity Requirements for Retail Prime Funds</u>

[22] PWG Report at 14.

While Fidelity supports a 50 percent weekly liquid asset requirement for institutional prime funds, we believe that retail prime funds could be subject to a requirement of 40 percent and still be sufficiently resilient. It is appropriate to subject retail and institutional prime funds to separate liquidity requirements primarily because of the differences in investor behavior over time in the two types of funds.

As noted above, institutional investors in prime funds are primarily businesses who invest cash in prime funds until such time as the cash is needed to fund business operations. As a result, the investments tend to be short-term, and redemptions can be significant even in normal market conditions. Retail investors, on the other hand, display more stable and predictable redemption behaviors than institutional investors in all market conditions. Retail investors normally invest in prime funds for the same reasons that cause individuals to invest in other asset classes – to seek exposure to a particular asset class as one of several investment positions they may hold. As such, the investments tend to be less transitory (i.e., 'stickier') than investments by institutional investors in a prime fund.

The distinctions between a retail investor's motivation for investing in a prime fund versus an institutional investor's motivation for investing in a prime fund are evident in the redemption patterns for these funds over time. Even in periods of crisis, redemptions from prime funds by retail investors have been lower than redemptions by institutional shareholders. In both 2008 and 2020, retail prime funds were inherently more stable than institutional prime funds. As the PWG Report notes, redemptions from retail prime funds totaled approximately nine percent during the critical period from March 13 to March 26, 2020 and totaled approximately five percent during the heaviest two-week period of redemptions during the 2008 crisis. This contrasts with redemptions from institutional prime funds totaling approximately 30 percent over two weeks in March 2020.[23]

In light of the contrasting motivations for investment in a prime fund and the resulting differences in a shareholder's propensity to redeem, Fidelity believes that retail prime funds could be subject to a weekly liquid asset requirement of 40 percent and still be able to manage its liquidity risk sufficiently in a market crisis. Setting the minimum liquidity percentage at 40 percent would allow retail prime funds to offer slightly more yield to shareholders while at the same time remaining sufficiently resilient should another crisis ensue. Accordingly, Fidelity also believes that the daily liquidity percentage for a retail prime fund could be set at 20 percent in order to maintain the same proportionality of daily to weekly liquidity across both types of funds.

<u>Other Liquidity Matters</u>

The Proposed Rule would obligate a fund to notify its board and file Form N-CR with the Commission when the fund's daily liquidity falls below 12.5 percent or the fund's weekly liquidity falls below 25 percent. In other words, funds would have reporting obligations if liquidity were to fall below 50 percent of either of the required percentages. If the SEC agrees with our position that retail prime funds should be subject to lower percentages, we encourage the SEC to adjust the reporting thresholds for retail prime funds accordingly. For example, if

[23] PWG Report at 14-15.

retail prime funds were required to maintain at least 40 percent in weekly liquid assets and 20 percent in daily liquid assets, then the fund should be obligated to notify its board and file Form N-CR when its weekly liquid assets fall below 20 percent or its daily liquid assets fall below 10 percent.

In our view, a 50 percent shortfall in liquidity is a reasonable threshold for the SEC to select when structuring the reporting obligations. A decline of this scale would be a significant enough event signaling likely liquidity pressures in the fund that it is reasonable to expect a fund board to be notified so that the board can exercise its oversight duties. In addition, we do not expect shortfalls of this magnitude to be a common occurrence and, thus, the reporting obligations should not impose an undue burden on funds or advisors.

Consistent with the current requirements of Rule 2a-7,[24] the Proposed Rule would obligate funds that fall below either of the liquidity requirements to only purchase qualifying assets until the fund meets the minimum thresholds. For example, if a fund were to fall below 25 percent in daily liquidity, the fund could only purchase assets that qualify as daily liquid until the fund is back in compliance with the 25 percent requirement.[25] As we noted in our comment letter on the PWG Report, this self-correcting mechanism is a simple, effective regulatory tool for ensuring compliance.

We do not believe it is appropriate to impose penalties or to require funds to over-correct by meeting an even higher liquidity percentage following a shortfall.[26] As noted above, one of the primary advantages of removing the gate provisions from Rule 2a-7 is to allow funds to access its daily and weekly liquid assets to fund redemptions when necessary, even if doing so entails falling below either or both of the minimum thresholds for a short period of time. We agree with the SEC that the possibility of facing penalties or an obligation to over-correct with a higher liquidity requirement would create incentives for fund managers to avoid falling below the threshold at all costs.[27] Similar to the manner in which funds are currently unable to deploy the 30 percent in weekly liquidity, the specter of punitive measures in the event of a liquidity shortfall could lead fund managers to view the fund's daily and weekly liquidity as per se off limits.

IV. <u>OTHER REFORM OPTIONS</u>

We are pleased that the SEC did not propose a number of the other reform options discussed in the PWG Report. In particular, we believe the following options proposed in the PWG Report could have most significantly threatened the viability of the money market fund industry with substantial consequences for the capital markets and would not have addressed the events of 2020, which involved concerns about liquidity rather than asset quality.[28] The SEC's decision not to advance these proposals, citing in the Proposing Release many of the same

[24] *See* Rule 2a-7(d)(4)(ii) and (iii).
[25] Proposing Release at 101.
[26] *See* Question 77 in Proposing Release at 104.
[27] Proposing Release at 102.
[28] Fidelity discussed its views on each of these options in further detail in the Fidelity PWG Letter.

concerns that the industry advanced in their feedback, was an appropriate exercise of its duties as the primary regulator of the capital markets.

- *Capital Buffers*: As the Proposing Release acknowledged, capital buffers would not have addressed the liquidity pressures (and, thus, investors' redemption patterns) faced by institutional prime funds in March 2020 because buffers pertain to asset quality rather than liquidity.[29] In addition, institutional prime funds already operate with a floating NAV, which effectively addresses asset quality in a manner analogous to capital buffers. Other segments of the industry such as government funds or retail prime funds, have never experienced asset quality pressures to a degree that would justify such a radical change to the product. Furthermore, if buffers are funded by retaining rather than distributing income, the buffers would take a significant amount of time to accumulate and, if funded by fund sponsors, managing money market funds would no longer be economically feasible.

- *Floating NAV for All Funds*: We fail to see how adopting a floating NAV for all prime and tax-exempt funds, or even worse for government funds, would address liquidity in these funds or improve the resiliency of the products in any way. Because the floating NAV did not prevent outflows in institutional prime funds in March 2020, there would be no plausible justification for now requiring a floating NAV for government, retail prime or retail tax-exempt funds. As the Proposing Release also acknowledges, adopting a floating NAV for all funds may reduce the attractiveness of money market funds and cause investors to reallocate capital into cash accounts subject to deposit insurance, which in turn would adversely impact the availability of wholesale funding liquidity and access to capital for issuers.[30]

- *Liquidity Exchange Bank Membership*: Requiring fund sponsors to be members of a private liquidity exchange bank or other forms of broader, industrywide insurance programs, is complex, economically unworkable, and would be ineffective at preventing future runs or potential government intervention; rather these approaches could create moral hazard[31] by forcing responsible funds to insure less responsible funds. The liquidity exchange bank also would be an unnecessarily complex and costly means to provide additional liquidity to funds in which each fund's success in handling liquidity challenges in times of stress could be dependent on the behavior and liquidity characteristics of other funds as well as the amount of capital available at the bank at the time such capital needs to be deployed.

- *Minimum Balance at Risk*: Application of a minimum balance at risk to money market funds would alter money market funds significantly and drive investors and intermediaries away from the product to unregulated or less-regulated investment

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[29] Proposing Release at 257.
[30] Proposing Release at 237.
[31] Proposing Release at 264 ("Membership in the LEB has the potential to create moral hazard and encourage excessive risk-taking by money market funds, given the difficulties and costs involved in creating effective risk-based pricing for insurance and additional regulatory structure to offset this incentive.").

options, causing disruption to the short-term financing markets. In addition, there are serious operational and legal challenges to implementing such a mechanism that extend beyond the control of money market funds to intermediaries and service providers who would need to undertake intricate, and costly system changes to be able to calculate, restrict, and hold back the portion of an investor's shares to comply with the minimum balance at risk. We further agree with the Proposing Release that this alternative would not have addressed liquidity stresses that occurred in March 2020.[32]

V. SWING PRICING

In our comment letters in response to the PWG and FSB Reports, Fidelity opposed consideration of swing pricing for money market funds.[33] We are encouraged the Proposal narrows the application of swing pricing to a small segment of the money market fund industry (i.e., institutional prime and institutional municipal funds),[34] acknowledges the impact of bid-side pricing on the routine application of swing pricing[35] and properly recognizes that daily and weekly liquid assets are sufficiently liquid such that there is no market impact from selling these securities.[36] That said, we remain strongly opposed to swing pricing in any form.

In the Proposing Release, the SEC has failed to state its case sufficiently for the adoption of such a drastic change to the mutual fund operating model that has served investors and the capital markets so well for so many years. Based on unsupported assertions of "significant, unfair adverse consequences" and "material dilution,"[37] the SEC has proposed requiring that funds apply the speculative concept of a market impact factor in a manner that bears no resemblance to how investment advisors manage funds. In addition, Fidelity's analyses continue to demonstrate that swing pricing will not achieve the results that the SEC claims because the NAV movements will be immaterial. Given the lack of any benefits to shareholders from the adoption of swing pricing, it is unreasonable for the SEC to expect the industry to undertake lengthy and expensive efforts to solve for the significant operational impediments to swing pricing.

The SEC has Failed to Make the Case for Swing Pricing

Fidelity has actively participated in the industry dialog on swing pricing since it began, including submitting comment letters on the SEC's suite of liquidity risk management rules in 2015 and to the PWG and FSB Reports proposing money market fund reform options. Fidelity has also engaged in direct discussions with regulators and participated in trade association working groups on swing pricing. Based on those efforts, we continue to be concerned about the seeming inevitability of its adoption without first evaluating in detail and supported with facts and data the questions that must form the basis of any regulation; namely, does a problem exist,

[32] Proposing Release at 261.
[33] Fidelity's comment letter in response to the FSB Report is available at https://www.fsb.org/wp-content/uploads/Fidelity.pdf.
[34] Proposing Release at 44.
[35] Proposing Release at 49.
[36] Proposing Release at 51.
[37] Proposing Release at 45.

is that problem significant enough to warrant a regulatory response and can that problem be solved by swing pricing. We recognize the simple, intuitive logic of swing pricing *in theory*. All other considerations aside, it is hard to argue with the general notion that a redeeming shareholder should bear the cost of his or her redemption. That alone, however, is not a sufficient basis to impose swing pricing on the industry, especially when the facts and data demonstrate that neither a problem exists nor that swing pricing would achieve the SEC's goals.

The SEC asserts in the Proposing Release that trading activity associated with redemptions "may impose costs" that "can dilute the interests of non-redeeming shareholders."[38] In the same paragraph, the SEC claims that there can be "significant, unfair adverse consequences to remaining investors in a fund… including material dilution."[39] The SEC does not include data in this section on the amount of costs imposed on a fund from redeeming shareholders and, thus, on the scale of dilution. Furthermore, the sections of the Proposing Release containing the economic baseline and the costs and benefits of swing pricing contain similar conclusions without supporting data.[40] Nowhere in the Proposing Release does the SEC include data quantifying the amount of trading costs or the amount of dilution. Without such data, the SEC's basis for adopting swing pricing is built on conclusory statements rather than sufficient evidence of a problem in need of a solution.

It is understandable that the SEC has been unable to quantify the amount of costs imposed on other shareholders, and, thus, the extent of the dilution created from redemptions, because money market funds are designed and constructed to provide nearly immediate liquidity to shareholders. Rule 2a-7's already extensive liquidity requirements, which the Proposal would further bolster, provide the very reason why dilution is not an issue in money market funds. In normal market conditions, funds can easily satisfy redemptions with liquidity on hand, even the relatively large redemptions that can occur in institutional prime funds. While there were liquidity pressures in publicly offered institutional prime funds in March 2020, as discussed above, those pressures were a direct consequence of the fear among institutional shareholders of losing access to their money from the possibility of redemption gates. Even the most illiquid institutional prime fund on its worst day still had 27 percent in weekly liquid assets, which, in the absence of the gate provisions, would have been sufficient to meet redemptions. When funds can satisfy redemptions with liquidity on hand and are not obligated to access the secondary market to generate liquidity, there are no trading costs and there is no dilution imposed on the remaining investors in a fund.

Nonetheless, in addition to positing that material dilution exists, the SEC also claims that this dilution creates a first-mover advantage among investors. Without knowing the significance or materiality of the dilution based on data, the SEC claims that a shareholder is motivated to redeem quickly in times of market stress in order to avoid bearing the costs that others' redemptions may impose.[41] In our view, without knowing the scale of dilution, attributing such

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[38] Proposing Release at 45.
[39] Proposing Release at 45.
[40] Proposing Release at 154-158; 182-192.
[41] Proposing Release at 45.

a motivation to a shareholder is pure conjecture. Even the SEC acknowledges the "dearth of academic research" on the causal link between dilution costs and runs in money market funds.[42]

In our view, this notion of a first-mover advantage is inherently flawed because it is based on a misunderstanding of the motivations that drive investor behavior and because, as noted above, the dilutive costs of investor behavior are not an issue in money market funds. In our experience managing a wide array of money market funds for more than 45 years and interacting directly with investors through our broad and extensive distribution businesses, investors in money market funds are not motivated to redeem by the potential for bearing a portion of the costs that others' redemption behavior may impose on the fund. This is simply not an impetus that drives investors' redemption behavior. Instead, investors redeem for a variety of other reasons, such as needing to deploy their assets for other uses or adjusting their investment portfolios based on changes in circumstances or risk tolerances. As discussed above and in further detail in our response to the PWG Report, in the stressed conditions of March 2020, investors in institutional prime funds redeemed in order to protect access to their assets rather than face the prospect of a redemption gate.

NAVs Will Not Move Sufficiently to Achieve the Outcomes the SEC Claims

The insurmountable problem with swing pricing is that the theoretical concept is not borne out in the data and in the actual motivations that drive shareholder redemptions. In our view, the data and analysis described below demonstrates that a theoretical market impact factor would not result in a NAV movement sufficient to change a shareholder's calculus when deciding whether or not to redeem. For this reason, swing pricing would not achieve the outcomes the SEC claims.

In our comment letter in response to the FSB Report, Fidelity included an analysis of hypothetical swing factors for three Fidelity money market funds in March 2020. In the Proposing Release, the SEC acknowledged our analysis but noted that the current Proposal is different because of the introduction of the market impact factor.[43] We acknowledge that the proposed market impact factor is a variation from the analysis we discussed in our FSB letter. It is also a variation from the SEC's current, optional swing pricing rule for non-money market mutual funds because the SEC specifically rejected the notion of market impact when adopting that rule.[44]

Should the SEC proceed with requiring swing pricing, Fidelity believes the industry would benefit from additional clarity on how swing pricing administrators should estimate market impact factors. That said, to evaluate the potential effects that swing pricing would have on fund NAVs, we analyzed the impact to NAVs from applying different-sized market impact factors. Based on the guidance in the Proposing Release that securities qualifying as daily or weekly liquid assets have a market impact factor of zero,[45] we limited the application of the

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[42] Proposing Release at 158.
[43] Proposing Release at 184-185.
[44] *See* Investment Company Swing Pricing, Release Nos. 33-10234; IC-32316, RIN 3235-AL61 (October 13, 2016), *available at* https://www.sec.gov/rules/final/2016/33-10234.pdf at pp. 74-75.
[45] Proposing Release at 51.

factor to the portion of a fund's portfolio that does not qualify as daily or weekly liquid. In addition, we calculated the changes in NAV assuming weekly liquidity requirements of 30 percent, 40 percent, and the proposed 50 percent.

The results of our analysis focus on the changes in NAV from the application of market impact factors of various sizes. We considered the market impact factor as a change in a security's yield. If a fund owns a security with a market yield of 1.00% and the swing pricing administrator determines that the market impact of selling the fund's position would move that yield to 2.00%, this would result in a 100-bps market impact factor because these securities trade on yield. For simplicity's sake, we applied the same market impact factor to each security in the fund that does not qualify as daily or weekly liquid and then recalculated the bid prices for each security. We then aggregated the results to determine the overall change in the fund's NAV.

The changes in the fund's four-digit NAV for the various market impact factors are shown in the table below.

TABLE 2: CHANGES IN NAV ($)

	Market Impact Factor (bps) [46]			
Weekly Liquidity	**25**	**50**	**100**	**150**
30%	-0.0002	-0.0005	-0.0009	-0.0014
40%	-0.0002	-0.0004	-0.0008	-0.0012
50%	-0.0002	-0.0003	-0.0007	-0.0010

According to our analysis, if the swing pricing administrator were to apply a 100-basis point upward move in all of the market yields for non-daily and non-weekly liquid securities in a portfolio subject to a 50 percent weekly liquid asset requirement, the fund's NAV would only move down by $0.0007. Furthermore, a move of 100 basis points in a single day would be a historically large move. We analyzed three-month LIBOR rates from 2007 to the present. These rates are suitable proxies for the movement in spreads and, thus, bid prices in prime funds. The table below includes the largest one-day and one-week moves in LIBOR during this period. It is important to note that this period covers the three most significant events to affect prime funds in the last 15 years – the 2008 financial crisis, the Eurozone crisis in 2011 and the events of March 2020 at the onset of the COVID-19 pandemic.

[46] The changes in NAV for a 25-bps market impact factor are shown with four decimals in line with how investors in institutional prime and institutional municipal funds transact. Due to rounding conventions, the results appear to be identical. Carrying the results out a few additional decimal points allows one to see the differences across the three weekly liquidity percentages. In order from 30% to 50% in weekly liquidity, those results are -$0.0002279, -$0.0001953 and -$0.0001628.

TABLE 3: LARGEST RATE MOVES SINCE 2007

Rate[47]	Change in Rate	Date(s)
Three-Month LIBOR: One Day Change	29 bps	September 25, 2008
Three-Month LIBOR: Weekly Change	84 bps	September 23, 2008 – September 30, 2008

This analysis is similar to the tests that Fidelity already conducts for each of the money market funds it manages on a quarterly basis in compliance with the stress testing requirements of Rule 2a-7.[48] Among other matters, Rule 2a-7 requires that a fund maintain written procedures providing for periodic testing of a fund's ability to minimize principal volatility or maintain the stable NAV (as applicable) from various events including a "…widening of spreads compared to the indexes to which portfolio securities are tied" coupled with increases in shareholder redemptions.[49] These stress tests are an important tool for ongoing oversight by fund boards and an important mechanism by which investment advisers can evaluate risk trends in the funds they manage. The analysis we conducted to examine the effect of various market impact factors on a fund's NAV is similar to the stress tests we have conducted since the requirements went into effect in 2010.

The SEC claims in the Proposing Release that swing pricing would eliminate the "significant, unfair adverse consequences" and the supposed first-mover advantage that arise because of the potential for dilution caused by the redemption patterns of other shareholders.[50] By adjusting the NAV downward on days with net redemptions, so the theory goes, a shareholder would feel less compelled to exit the fund when the shareholder suspects that others may be redeeming. In our view, NAV changes on the order of those shown in Table 2 would never influence an institutional shareholder's decision of whether or not to redeem. Institutional prime fund shareholders would continue to be motivated by other, more significant factors such as needing to deploy their money for other uses or changing the risk profile of their investments. These shareholders will not pause to consider whether they could run the risk of foregoing an immaterial amount from a NAV potentially swinging on the day they choose to redeem.

As noted above, institutional shareholders invest in prime funds on a temporary basis until such time as they need to deploy their money for other uses. An institutional shareholder seeking access to an investment in order to fund payroll for its employees will not be influenced by small NAV adjustments. For example, if the market impact factor were 50-basis points, which, in light of the data in Table 3, would be a large and extremely rare factor to be applied, the fund's NAV would move down by $0.0003 and a shareholder who redeems $10,000 from the

[47] Bloomberg.
[48] Rule 2a-7(g)(8).
[49] Rule 2a-7(g)(8)(i)(C).
[50] Proposing Release at 45.

fund would receive $9,997. In our view, such a move of three one-hundredths of one percent would never affect the shareholder's decision to redeem.

Removal of Gates and Higher Liquidity Requirements Render Swing Pricing Unnecessary

The foregoing analysis also underscores the degree to which swing pricing is unnecessary in light of the other changes the SEC has proposed. As discussed in Section III above, by solving for the liquidity concerns that arose in March 2020 through a combination of the removal of the gate provisions coupled with higher liquidity requirements, the SEC has solved for the remaining vulnerabilities in money market funds. Removing the gate provisions would eliminate an institutional shareholder's propensity to redeem at the first sign of distress out of concerns of losing access to its money. Increasing the liquidity requirements would bolster the resilience of money market funds and would extend sufficiently the length of time before a fund would need to seek liquidity in the secondary market. While we question the utility of swing pricing even in the absence of these other changes, these changes eliminate any small justification for swing pricing that may have otherwise existed.

We agree with the SEC's conclusion in the Proposing Release that the proposed higher liquidity requirements "…would be sufficiently high to allow most money market funds to manage their liquidity risk in a market crisis."[51] This conclusion, when coupled with the fact that institutional prime funds do not incur trading costs to satisfy redemptions given the high liquidity in institutional prime funds (all of which will now be available to deploy with the proposed removal of the gate provisions) renders swing pricing unnecessary.

As discussed above, the Proposal would require the consideration of a market impact factor in a manner that the SEC's current swing pricing rule does not. The SEC notes in the Proposing Release that most institutional money market funds value securities at the bid price and that the NAVs of these funds would not swing on days when a market impact factor is not applied.[52] (In addition, as the analysis above demonstrates, even large market impact factors would result in only immaterial NAV adjustments.) The SEC proposes to require that funds apply the market impact factor when redemptions exceed four percent.[53] Assuming a fund is fully in compliance with the proposed liquidity requirements, on a day with four percent redemptions, the fund would have on hand more than six times that amount in daily liquidity and 12.5 times that amount in weekly liquidity to satisfy the redemptions. As a result of these significant buffers, redemptions do not result in "material dilution" or "significant, unfair adverse consequences." Given that the facts and data demonstrate that neither a problem exists nor that swing pricing would achieve the intended outcomes, Fidelity believes that swing pricing would have no practical benefit for money market funds or their shareholders.

Operational Impediments Remain to Implement Swing Pricing for All Mutual Funds

[51] Proposing Release at 93.
[52] Proposing Release at 49.
[53] Proposing Release at 51-52.

In comment letters over the last several years, the industry has described in detail the many operational challenges with implementing swing pricing in the United States.[54] Fidelity discussed these challenges in our comment letter in response to the proposed liquidity risk management rule in 2015 as well as our comment letters on the PWG and FSB reports.[55] These impediments remain and preclude the effective adoption of swing pricing for both money market funds and other types of mutual funds.

As detailed in our prior comment letters, the process for calculating a fund's NAV is a complicated, multifaceted process that requires fund complexes to receive and review daily investor flow information in a short period of time, from various sources, in order to determine whether the fund's NAV should be swung. This issue is not unique to Fidelity and exists across the mutual fund industry in the United States predominately due to:

- *Timing considerations*, as most mutual funds (excluding publicly offered institutional prime money market funds) typically cut off investor subscription and redemption orders, value portfolio securities and calculate their NAVs as of the close of the New York Stock Exchange, normally 4 p.m. Eastern Time (ET). Once calculated, fund NAVs are then disseminated through a variety of methods to the fund's transfer agent, intermediary distribution partners, media outlets, and investors, ordinarily between 6:00 p.m. and 8:00 p.m. ET. Fidelity generally strives to finalize fund NAV calculations by the 6:05 p.m. ET media deadline in order to enable prompt and complete publication in newspapers and on financial websites. To adopt swing pricing a fund would need to obtain timely and reasonably accurate daily investor subscription and redemption information in order to determine if a NAV adjustment is to be made.

- *The widespread use of intermediaries, such as broker-dealers, retirement plan keepers, fund supermarkets, and financial advisers, in the United States* that serve as the mechanism by which most retail investors buy and sell funds. In the United States, intermediaries are not required to provide the fund's transfer agent with their net/gross activity by the time the fund's NAV is calculated, but rather are allowed to transmit this information to the transfer agent until as late as 8:30 p.m. ET. Retirement recordkeeping systems are not currently configured to create fund orders until they receive a fund's NAV. This sequence of events creates a problematic circular dependency given that funds who adopt swing pricing will require the investor orders (or reliable estimates) to determine their NAV. In current practice, this retirement account activity is executed overnight through DTCC's Defined Contribution Clearance & Settlement service and communicated to the funds' transfer agents thereafter. For these reasons, in today's operating environment, a significant portion of the fund's actual investor orders cannot be known within the timeframe that a fund's swing pricing operation would be conducted. In addition, we are concerned with the potential impacts to mutual fund investors,

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[54] *See, e.g.,* the Investment Company Institute's comment letter on the PWG Report, *available at* https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf, and the Investment Company Institute's comment letter on the FSB Report, *available at* https://www.fsb.org/wp-content/uploads/ICI-1.pdf.

[55] Fidelity's comment letter in response to the proposed liquidity risk management rules is available at https://www.sec.gov/comments/s7-16-15/s71615-45.pdf.

particularly retirement plan participants, from disruptions in intermediaries' processes in order to implement swing pricing.

The SEC notes in the Proposing Release that commenters have discussed the distinctions between fund operations in the European and U.S. markets and that these differences account for Europe's ability to support swing pricing in a manner that is not possible in the United States.[56] The order cutoff times in Europe are earlier in the day than times at which the markets close and much earlier in the day than NAV strike times. Fidelity does not support the widespread adoption in the United States of trade order cutoff times that are earlier than NAV strike times, either as a matter of industry practice or through SEC mandate. NAV strike and cutoff times are generally designed to coincide with the close of primary exchanges to allow shareholders to make investment decisions throughout the trading day. An earlier cutoff to a fund's orders likely would disadvantage shareholders by restricting their ability to transact in money market funds and by removing the flexibility to make investment decisions until the time that trading on the primary exchanges closes. As a result, the change effectively would limit investor choice in the products available for investment.

These operational impediments are important in their own right and are matters that the SEC must consider seriously before adopting such a significant change to the operational structure of mutual funds. In addition, since swing pricing will not achieve the aims the SEC intends (as discussed above), the operational impediments further underscore why swing pricing is inappropriate. Regulatory policy that leads to significant implementation costs for the industry and for shareholders may be appropriate when that policy will also lead to significant benefits. In the case of swing pricing, however, the costs are significant with no offsetting benefits.

Operational Impediments for Institutional Prime Funds

The SEC acknowledges these challenges in the Proposing Release but notes that institutional prime funds often have order cutoff times earlier than 4 p.m. ET. The SEC attributes this earlier cutoff time to a desire by fund companies to "…receive flow data prior to striking their NAV." [57] As a result, the SEC notes that these funds "…would not be subject to significant operational impediments with respect to having timely flow information."[58]

As discussed above, Fidelity liquidated its two publicly offered institutional prime funds in 2020. One of the two funds offered same-day settlement and calculated its NAV at 9:00 a.m. ET, 12:00 p.m. ET and 3:00 p.m. ET. The fund imposed order cutoff times that corresponded to its calculation of NAV at these three intervals, but this was not because Fidelity was seeking to receive flow data prior to striking the NAV. Instead, the order cutoff and NAV strike times were the same in order to allow the fund to calculate its NAV and wire redemption proceeds as quickly as possible to meet shareholder expectations and cash needs. Because the fund's NAV strike time was the same as the order cutoff time, the fund did not have flow information

[56] Proposing Release at 74.
[57] Proposing Release at 75.
[58] Proposing Release at 75.

available in a manner that would have allowed it to implement swing pricing. Instead, this fund would be subject to the same impediments as other mutual funds.

Concerns with Market Impact Factor

Fidelity has three primary concerns with the SEC's proposed market impact factor. Firstly, the concept of the market impact factor bears no resemblance to the manner in which investment advisors manage money market funds on a daily basis. Secondly, the proposed four percent trigger for the application of the factor is too low. Lastly, if the SEC decides to adopt swing pricing, we strongly encourage the SEC to provide additional guidance on how swing pricing administrators should estimate the market impact factor.

The SEC starts with the premise (albeit one that is unquantified) that there are *real* costs imposed on a fund by virtue of redemptions, which in turn translate into "material dilution" for other shareholders.[59] As discussed at length above, we do not believe this to be the case considering the large amounts of liquidity built into money market funds. That said, assuming for the moment that these costs do exist, the SEC's solution is to force funds to deploy a *theoretical* cost estimation based on a *hypothetical* sale of a vertical slice of the portfolio. Fidelity is concerned with such a mechanism because fund managers would never sell a vertical slice of an entire portfolio (money market fund or otherwise) into the secondary market to fund redemptions.

If adopted as proposed, swing pricing administrators would be obligated to generate an estimate of the market impact from a practice (i.e., the sale of a vertical slice of the portfolio) that a fund manager would never engage in and then impose that estimate on redeeming shareholders, notwithstanding that the shareholder's redemption was satisfied without cost to the fund and its other shareholders. The SEC's attempt to marry the faulty premise that money market fund redemptions can impose costs on other shareholders with a solution that involves estimates divorced from the actual trading patterns of mutual funds is not sound regulatory policy.

If the SEC nonetheless adopts swing pricing for institutional prime and institutional municipal funds that includes the notion of a market impact factor, Fidelity believes that a four percent shareholder redemption trigger is too low. According to the Proposing Release, the SEC settled on a four percent trigger because their data indicates that four percent redemptions occur on average once every 20 days.[60] In our view, there is nothing notable about an institutional prime fund experiencing four percent redemptions five percent of the time. Fidelity's publicly offered institutional prime funds experienced four percent redemptions often and the funds were able to meet these redemptions (and more) without incurring costs to the funds and their other shareholders.[61] As a liquidity vehicle, money market funds are managed with an understanding that redemptions on a scale larger than that of other mutual funds can and do regularly occur. In

[59] Proposing Release at 45.
[60] Proposing Release at 52.
[61] As noted above, Fidelity discontinued managing publicly offered institutional prime funds in 2020. Fidelity continues to manage several institutional prime funds that are available only to other Fidelity-managed mutual funds.

fact, large redemptions are typically known well in advance of the redemption date as institutional investors plan for specific liquidity needs. This notion of serving as a liquidity vehicle is a key distinguishing feature of money market funds from other types of mutual funds.

As noted above, a fund that is compliant with the proposed liquidity requirements would have daily liquidity on hand of over six times the amount necessary, and weekly liquidity of 12.5 times, to satisfy a four percent redemption. The stability and resilience generated by the higher liquidity requirements provides the SEC the flexibility to raise the threshold for application of the market impact factor above four percent. While we continue to believe that swing pricing is an unnecessary requirement for money market funds, at the very least, we believe that the threshold for application of a market impact factor should be much higher.

In addition to a higher trigger amount, the money market fund industry will require greater clarity and guidance from the SEC on the proposed market impact factor if the SEC adopts swing pricing as proposed. The SEC's current description of the factor is insufficient to allow fund companies to implement the mechanism effectively and consistently across industry participants. The Proposed Rule defines the factor as, "…an estimate of the percentage change in the value of the security if it were sold…under current market conditions."[62] This raises a number of open questions, including but not limited to:

- Over what time period? Should the swing pricing administrator estimate the market impact factor assuming the full vertical slice of the portfolio is sold on the current trading day? In exercising their fiduciary duties to funds and shareholders, advisors often determine that it is optimal to sell securities in tranches over several days.

- If the swing pricing administrator should account for multiple trading days in estimating the factor, should the administrator base its estimate on its expectations of what the market price for a security may be on subsequent days if that is when a portion of a security is most likely to be sold?

- Should the swing pricing administrator's estimation of the factor assume that the act of selling the securities does not itself drive price changes for the securities? Or, alternatively, should the estimate of the factor include a determination of the extent to which the sales by the fund will themselves drive changes in market value?

Other Swing Pricing Matters

If the SEC proceeds with swing pricing, we encourage the SEC to take two additional steps in the final rule. First, we agree with the guidance in the Proposing Release that the market impact factor for daily liquid assets and weekly liquid assets can be set at zero and encourage the SEC to reiterate this guidance in the final rule release. We agree with the SEC's statement that,

[62] Proposing Release at 290.

"…a fund could reasonably expect such assets to convert to cash without a market impact to fulfill redemptions (e.g., because the assets are maturing shortly)."[63]

Rule 2a-7 defines daily liquid assets as cash, direct obligations of the U.S. government, securities that will mature within one business day, and receivables on prior sales of securities that are due within one business day.[64] Similarly, the rule defines weekly liquid assets as cash, direct obligations of the U.S. government, securities issued by a government agency (with certain conditions), securities that will mature within five business days, and receivables on prior sales of securities that are due within five business days.[65] There are two characteristics to these definitions, both of which lead to the conclusion that the market impact factor should be zero. First, securities with a short duration until the cash due at maturity or from a prior sale will be in the fund's possession – either one business day or five business days – are included. With such a short duration, there is unlikely to be volatility in the assets even in the face of market distress. Second, government securities are included. Government securities are inherently stable and are generally perceived to have the lowest credit risk and the greatest liquidity among all securities traded in U.S. debt markets. Because of the lack of volatility in these various instruments even in stressed conditions (including 2008 and March 2020), we agree with the SEC that the market impact factor for daily liquid and weekly liquid assets should be set to zero and, to avoid any confusion, we request that the SEC restate this guidance in the final rule release.

Second, we encourage the SEC to exclude institutional prime and institutional municipal funds that are offered for investment solely to mutual funds or accounts managed in the same fund complex. In the Proposing Release, the SEC asks whether it should provide exclusions of this sort from the swing pricing requirements.[66] We encourage the SEC to exclude from the swing pricing requirements institutional prime and institutional municipal funds that are not sold to the public. This exclusion should include funds that are used by other funds and accounts in the same fund complex for managing cash, for investing collateral from securities lending transactions or for providing an efficient means for other funds and accounts to gain targeted access to certain market sectors.

Fidelity believes such an exclusion is appropriate because the adviser knows the shareholders and has significantly greater visibility into upcoming redemptions. This allows the adviser to closely manage to the appropriate liquidity for the fund and virtually eliminates the prospect of unexpected redemptions. In addition, many of these funds are designed for specific purposes and, as such, are not as susceptible to redemptions based on unexpected market volatility. For example, institutional prime money market funds managed as a cash position for other mutual funds in the same complex have not experienced the sizeable outflows that publicly offered institutional prime funds have. In the critical period of March 2020, the Proposing Release notes that privately offered institutional prime funds faced redemptions of approximately six percent compared to approximately 30 percent for publicly offered institutional prime

[63] Proposing Release at 51.
[64] Rule 2a-7(a)(8).
[65] Rule 2a-7(a)(28).
[66] *See* Question 40 in the Proposing Release at 71-72.

funds.[67] Furthermore, money market funds that are used as investment vehicles for securities lending cash collateral have seasonal flows based on the demand for the underlying securities being lent and have little correlation to any volatility in the short-term markets.

VI. NEGATIVE YIELDS

Fidelity shares the concerns of many in the industry with the SEC's proposals relating to the potential for negative interest rates, which would require funds and broker-dealers to enact a permanent solution *now* even though the threat of negative interest rates has passed and may *never* return. We are concerned that the Proposal demonstrates a lack of appreciation on the part of the SEC of the scale and breadth of the issues that the Proposal creates as well as the potential negative consequences on government money market funds. In light of the complexities of this issue, we encourage the SEC to undertake significantly more review in consultation with the industry before adopting a final rule. Rushing forward with the Proposal as currently constructed without adequately studying the myriad of issues it creates could significantly damage the government money market fund industry and could significantly alter the customer experience for retail shareholders investing through broker-dealer accounts.

Proposal Could Lead Broker-Dealers to Shift Away from Government Money Market Funds

Brokerage Sweep Vehicles

The core issue with the Proposal that the SEC should study in greater detail centers on the potential impact on government money market funds that serve as a daily investment vehicle for cash in a brokerage account. Until such time as this cash is ready to be deployed, the cash is invested in a fund chosen by the customer as a temporary vehicle, or what is commonly known as a 'brokerage sweep vehicle.' These sweep vehicles serve as temporary investments until the money is deployed for other uses. For example, a retail customer may be funding other security purchases, paying for a child's tuition or funding the down payment on a home. To do so, the individual moves money out of other sources perhaps by redeeming from other mutual funds or selling individual securities held in the brokerage account. The proceeds of those transactions are then invested in the money market fund on a temporary basis until the customer is ready to make the payment.

On days when the aggregation of (i) a customer's cash credits from other investment activity (e.g., the receipt of proceeds of sales of other investments, wiring of money into the brokerage account, etc.) minus (ii) the amount of cash to be paid by the broker-dealer on the customer's behalf to fund other activities (e.g., to fund security purchases, to honor a check written from the account, to wire money out of the account for other uses, etc.) is *positive*, the broker-dealer will automatically invest the net amount into the sweep vehicle chosen by the customer. On days when the net amount is *negative*, the broker-dealer will redeem that amount from the sweep vehicle.

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[67] Proposing Release at 15.

Broker-dealers offer options for sweep vehicles, but the two most prevalent are government money market funds and bank deposits. Prior to the 2014 reforms, broker-dealers also offered prime money market funds as brokerage sweep vehicles but discontinued doing so once the redemption gate provisions in Rule 2a-7 went effective. The majority of Fidelity's broker-dealer customers have elected one of eight Fidelity government money market funds as the sweep vehicle. In the two most popular Fidelity funds, over $450 billion, or approximately 90% of the funds' assets, represent investments made from the operation of the brokerage sweep.

Customer Preferences

Offering a stable NAV fund as the sweep vehicle creates a simple, intuitive experience for retail brokerage customers. There are a number of reasons why a stable NAV fund is an attractive option for a sweep vehicle, including a straightforward customer experience in which the customer knows with confidence the amount available to spend, as well as the liquidity provided by a government money market fund. Because these investments are temporary and in anticipation of funding other activity, customers value knowing that the amount invested will not change. With our focus on ensuring we are meeting the needs of our customers and delivering better outcomes, Fidelity has engaged with retail customers frequently over the years through our extensive broker-dealer business. Based on these interactions, we know the value that customers place on the stability and predictability of government money market funds, including a stable NAV.

It is possible that shareholders would not elect a government money market fund as the sweep vehicle if the fund were to transition from a stable to a floating NAV. While a negative rate environment would be an extraordinary event for the financial system, we cannot know with certainty that customers would continue to choose government money market funds as sweep vehicles if faced with the prospect of experiencing a decline in their assets. In fact, we suspect that they would not choose these funds in light of the strong sentiment that brokerage customers have expressed over the years for a stable NAV.

Brokerage Systems

Brokerage systems can process subscriptions and redemptions in floating NAV funds. Those systems handle the processing of transactions for non-money market mutual funds (equity funds, bond funds, target date funds, etc.) every day with no concerns. Many of the systems, however, cannot currently handle the processing of transactions in a floating NAV fund when those transactions involve a government money market fund serving as the sweep vehicle. Over the years, broker-dealers have developed customer offerings (e.g., check writing, ATM withdrawals, etc.) and systems built on the premise that the sweep vehicle will not decline in value.

Modifying the product offerings and brokerage systems to accommodate a floating NAV fund would be a lengthy, difficult and expensive undertaking. As noted above, customers' preferences for a stable NAV suggest that customers would transition away from a government money market fund as the sweep vehicle if the fund were to transact with a floating NAV. In light of these two factors, if the SEC's expectation is that financial intermediaries such as broker-dealers will expend the resources to support the floating NAV *now* for an eventuality (i.e., a negative rate environment) that may never occur, it is possible that broker-dealers will elect not to expend the resources and instead will seek alternatives to government money market funds as sweep vehicles. If broker-dealers believe that their retail customers would shift away from government money market funds in a negative rate environment, then a broker-dealer's decision not to undertake costly implementation efforts to support a floating NAV sweep vehicle would be prudent.

Consequences

As noted above, government money market funds are a common investment option for brokerage sweep vehicles. If bank deposits become the preferred alternative to government funds, the transition of these assets would represent a massive influx into the banking system. In addition, there is no guarantee that banks would even accept such a significant increase in deposits from brokerage customers. In today's environment at least, banks already are leery of accepting more demand deposits, which are inherently short-term and, thus, do not offer banks the opportunity to earn the stable, higher returns that they can earn from longer-dated assets. In a true negative rate environment, banks are likely to lose money on short-term deposits unless they are able to make up the shortfall by imposing high fees on customers. In addition, while the banking system is subject to a complex and multifaceted regulatory regime, this would represent a significant transition of assets away from the SEC's purview.

Such a substantial move away from government money market funds could significantly disrupt the smooth operation of the Treasury market, make deficit financing more difficult for the Treasury Department and negatively impact the Federal Reserve's exercise of monetary policy. Government money market funds are significant purchasers of Treasury debt. In total, government money market funds currently hold approximately 29% percent or $1.159 trillion of outstanding Treasury debt.[68] In addition, government money market funds are the primary participants in the Federal Reserve's Reverse Repurchase Agreement Facility, which has become an important tool for the central bank in managing the federal funds rate in an abundant reserve environment. Recently participation in this facility has exceeded $1.5 trillion.

<u>Inherently Complex Issue Requiring Additional Consideration</u>

Sampling of Complexities

The efforts required to allow broker-dealers to support floating NAV funds as sweep vehicles is not as simple as just making a change to a system or two. The transition to a floating NAV introduces a host of complexities that we suspect the SEC has not adequately considered. Below is a sampling of a few of these complexities, which we believe underscores the need for the SEC to analyze this matter in greater detail rather than rushing forward with the Proposal as currently drafted.

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[68] Crane Data and Bloomberg: February 28, 2022.

- Currently, shareholders have access to their money at various times throughout the day. Introducing a floating NAV would restrict the frequency of this access and may require multiple intraday NAV calculations.

- By floating the NAV, fund companies would need to introduce gain/loss tax reporting for shareholders, and shareholders would have potential tax consequences associated with their brokerage sweep activities.

- The SEC has not specified in its proposal when a fund would be required to convert to a floating share price, which potentially creates an arbitrage opportunity as the impacts of the adoption of a negative interest rate policy by the Federal Reserve are slowly felt in the fund.

- Some brokerage systems do not distinguish between share quantities and dollars because of the assumption that the NAV would always be $1.00.

- Introducing a floating NAV would cause the number of transactions in brokerage platforms to increase significantly, putting pressure on nightly cycles and deadlines, and would require new solutions for price corrections and trade confirmations.

- It is unclear how a fund would transition back to a stable NAV fund once interest rates turn positive. The SEC would need to provide additional guidance on the mechanisms by which this would occur.

- Depending on these mechanisms (e.g., retaining income, reverse stock split), IRS guidance also may be needed.

In addition, if the SEC moves forward now with the Proposal as currently constructed, broker-dealers could be faced with the prospect of implementing complicated, expensive systems and process changes to transact in floating NAV funds while at the same time implementing the SEC's proposed move from T+2 to T+1 settlement.[69] It is unreasonable to expect the broker-dealer community to engage in multiple, large-scale platform changes at the same time. In addition, there are no synergies or economies of scale with the two efforts. While the technology personnel needed to implement both would be the same, the two projects would otherwise be entirely distinct.

Current Rate Environment Affords SEC Time for Additional Review

The sampling of complexities noted above underscore the need for the SEC to undertake significantly more review, in consultation with the industry, before moving ahead with the Proposal. The SEC has proposed a blunt instrument in which financial intermediaries are forced to make decisions now with potentially long-term ramifications on customers, on the broader financial system and on the effective functioning of fiscal and monetary policy for a state of

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[69] *See* Shortening the Securities Transaction Settlement Cycle, Release Nos. 34-94196, IA-5957; RIN 3235-AN02 (February 9, 2022), *available at* https://www.sec.gov/rules/proposed/2022/34-94196.pdf.

affairs (i.e., a negative interest rate environment) that may never occur. By moving forward in haste without proper consideration of the full range of issues with the current Proposal, the SEC runs the risk of inflicting significantly more harm than any good that could come from their attempts to encourage adequate preparation for a negative rate environment. As a result, we strongly encourage the SEC to engage in a concerted review with industry participants and others that takes full account of the breadth of issues at play.

Fidelity believes the current interest rate environment affords the SEC the opportunity to approach these issues with the careful attention and thoughtfulness required. We recognize that the financial sector faced the possibility of negative interest rates in 2008 and again in 2020 and we understand the SEC's goal of considering regulatory action in case the threat of negative interest rates returns.[70] That said, the threat of negative interest rates has passed. With U.S. inflation at levels not seen in more than 35 years, the Federal Reserve recently raised its target interest rate in the Federal Open Market Committee meeting held on March 16, 2022 and has signaled that additional increases are likely.[71] In light of these moves, the SEC can afford to take the time needed to develop a solution that is workable for investors, fund companies and broker-dealers and that does not unnecessarily disrupt the government fund industry.

If the SEC insists on moving forward at this time, at the least, we encourage the SEC to modify the requirements of the Proposal. Rather than the draconian condition that fund companies discontinue distributing through intermediaries that cannot support a floating NAV now, the SEC should, at a bare minimum, modify the Proposal so that financial intermediaries must have in place a reasonably adequate plan for how they would respond to a negative rate environment should one arise. It is unnecessary for financial intermediaries to be able to support a floating NAV for a brokerage sweep vehicle *now* for a rate environment that could be decades away, if at all.

The SEC could achieve its aims of requiring adequate preparation for a negative rate environment by requiring fund companies working with their intermediaries to develop a playbook that contemplates this type of remote event and considers how they would respond. The contingency actions in the playbook could be triggered by Federal Reserve's adoption of a negative interest rate policy, which would allow time for necessary changes to be made by the fund before the effects of the policy caused negative net income in the fund. In addition, if this modification to the Proposal were made, we believe the SEC's proposed compliance deadline of one year, while still aggressive, could be met.

VII. COMPLIANCE DEADLINES

The SEC has included unrealistic deadlines for compliance with various aspects of the Proposal. While Fidelity is comfortable with the SEC's proposal to allow funds six months to comply with the new liquidity requirements and supports the immediate removal of the gate provisions and related disclosure, funds, advisors and fund administrators require more time to

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[70] Proposing Release at 107-108.
[71] *See* Federal Reserve issues FOMC Statement (March 16, 2022), *available at* https://www.federalreserve.gov/newsevents/pressreleases/monetary20220316a.htm.

implement the other aspects of the Proposal. The table below includes the current and Fidelity's proposed deadlines for each of the remaining components of the Proposal.

SEC Requirement	Current SEC Proposal	Fidelity Proposal
Swing Pricing	12 months	2 years
Negative Yields – Determinations regarding financial intermediaries	12 months	2 years
Disclosure: Swing Pricing	12 months	2 years
Disclosure: Form N-CR	6 months	18 months
Disclosure: Form N-MFP	6 months	18 months

By September 2022, mutual funds, their advisors and the administrators that provide back-office functions will have recently implemented the SEC's new fair value rule, the new fund of funds rule and the new derivatives rule.[72] On the horizon are a host of additional rules that either have already been proposed or that are on the SEC's short-term agenda across a wide spectrum of topics such as cybersecurity requirements for funds and advisors, shortening the settlement cycle, accelerated beneficial ownership reporting requirements, expected new disclosure requirements concerning ESG investments, potential changes to liquidity risk management programs, securities lending, and changes to prospectuses and shareholder reports.[73] Many of these proposals likely would impact both the investment advisors managing mutual funds on a day-to-day basis as well as fund administrators who are responsible for handling a range of responsibilities, most notably disclosure.

Implementing a new SEC rule or changes to existing rules requires time, attention and resources. The SEC should not underestimate the degree to which even changes to just one of its existing rules can demand significant technology modifications, new or revised policies and procedures and related changes to operating models, and changes to how funds are managed. Implementing changes to even one rule diverts valuable resources away from the important work of managing and servicing mutual funds and from efforts to expand product offerings to meet changing business dynamics and shareholder preferences. The diversion of resources is compounded when funds, advisors and administrators are forced to implement multiple rules in succession or concurrently.

As a result, Fidelity requests that the SEC provide ample time for the industry to implement the final rule. To do so effectively, each of the categories noted in the table above will require significantly more time than what is included in the Proposal. For example, some financial intermediaries will require more than 12 months to make modifications to their systems

[72] 17 CFR 270.2a-5, 17 CFR 270.12d1-4 and 17 CFR 270.18f-4, respectively.
[73] For a complete list, see the SEC's short-term rulemaking agenda most recently published in Fall 2021, *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&Image58.x=29&Image58.y=15&Image58=Submit.

to support the floating NAV. Similarly, implementing swing pricing will take significantly longer than 12 months given the lack of sufficient flow information at the time that NAVs are calculated and the other operational issues detailed above.

Fidelity requests that the SEC adopt a compliance deadline of eighteen months for the proposed amendments related to Form N-MFP and Form N-CR. These changes will require industry participants, including Fidelity, to work with service providers to obtain the new information in a systematic manner that can be filed with the SEC within the five-business day deadline for Form N-MFP. A number of the new requirements will result in the volume of information provided on Form N-MFP to increase exponentially, such as security level detail on repurchase agreement transactions[74] and lot level trade information.[75] It is not an exaggeration to suggest that the new requirements will result in some fund complexes reporting *thousands* of new data points each month. In addition, to comply with the disclosure requirements of Form N-1A, funds currently obtain information on shareholder concentration on an annual basis with a required filing deadline of 120 days after the fund's fiscal year end.[76] The Proposal would require that funds obtain this information every month and file it with the SEC within just five business days.[77]

The only feasible way that industry participants can provide such an extensive amount of new data within such a short window is for the data collection and reporting processes to be automated. Fidelity and likely many other industry participants will need to make significant technology enhancements (both internally and with third party service providers) to ensure that the data provided to the Commission under the new requirements is accurate. Doing so takes more time than the current six-month compliance deadline would allow and, thus, Fidelity proposes that the SEC adopt a compliance deadline of eighteen months.

While Fidelity would have to automate the data collection and reporting processes, once the draft filing is prepared, fund companies such as Fidelity complete review processes prior to submitting the filing with the SEC. Given the significant amount of data proposed to be gathered and included, Fidelity requests that the SEC modify its filing deadline for Form N-MFP of five business days to seven business days to allow for completion of the preparation and review processes. Extending the filing deadline to seven business days would provide the SEC with an additional level of assurance that fund companies have had sufficient time to prepare and review the filings.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

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[74] Proposing Release at 134.
[75] Proposing Release at 133.
[76] *See* Item 18 of Form N-1A.
[77] Proposing Release at 128.

Sincerely,

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner

William Birdthistle, Director, Division of Investment Management

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