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April 30, 2012

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Proposed Rule: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies; RIN 7100–AD–86 / Docket No. 1438

Dear Ms. Johnson:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), and on behalf of money market mutual funds ("Federated Money Funds") for which a Federated subsidiary serves as investment adviser and distributor, to provide comments in response to the above-referenced notice of proposed rulemaking ("NPR") by the Board of Governors of the Federal Reserve System ("Board").[1] Federated has served since 1974 as an investment adviser to money market mutual funds ("Money Funds").[2] We appreciate this opportunity to provide you with our comments.

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[1] *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, 77 Fed. Reg. 594 (Jan. 5, 2012).

[2] Federated has over thirty-eight years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

Federated, as a participant in the money markets and a sponsor of the Federated Money Funds, and the Federated Money Funds themselves, are interested in many of the details of the NPR and related rulemakings. We are concerned that certain aspects of Titles I and II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA" or "Act"),[3] the implementing rules, and the way they will be interpreted and applied, will increase uncertainty, risk and volatility in the money markets and other fixed income markets, particularly in times of crisis. For instance, as we have stated in prior comment letters, we believe the process for designation of firms for Board oversight by the Financial Stability Oversight Council ("Council"), should include formal consideration of the effects of a particular designation throughout the economy and the financial system. This would help to ensure that efforts to constrain risks in one firm do not simply shift risk to other parts of the financial system where the exposure of taxpayers and the financial system may be larger and more direct. Similarly, we are concerned that certain proposed rules and guidelines may be used inappropriately to designate Money Funds under Title I, which would harm not only Money Funds but the persons who use them, with many unintended consequences across the economy.[4]

Here, while the NPR recognizes that the rules the Board must apply to designated non-banking firms must be tailored to the types of business activities in which such firms engage, it nonetheless proposes to apply bank-type regulations to any company that is designated for supervision by the FSOC, whether or not the company is a bank, and regardless of its business, structure, regulatory oversight, or the types of services that it offers. But shoehorning different types of financial firms into a single regulatory model will have negative consequences. As applied to a Money Fund, these would include

[3] Pub. L. No. 111-203, 124 Stat. 1376 (2010). These rulemakings also include: Financial Stability Oversight Council ("FSOC"), *Final Rule Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2011); Board of Governors of the Federal Reserve System and FDIC, *Final Rule: Resolution Plans Required,* 76 Fed. Reg. 67323 (Nov. 1, 2011); Board of Governors of the Federal Reserve System and FDIC, *Notice of Proposed Rulemaking and Request for Comment Regarding Resolution Plans and Credit Exposure Reports Required*, 12 C.F.R. pt. 381, 76 Fed. Reg. 22648 (Apr. 22, 2011); FDIC, *Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 C.F.R. pt. 380, 76 Fed. Reg. 16324-02 (Mar. 23, 2011), FDIC, *Notice of Interim Final Rulemaking Regarding Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 4207 (to be codified at 12 C.F.R. pt. 380) (Jan. 25, 2011), and Board, P*roposed Rule: Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company*, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

[4] Letter to FSOC *Re: Rulemaking Proposal "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies"* (Dec. 15, 2011) (attached hereto as Appendix A). The comments that we expressed in that letter are incorporated herein by reference.

potentially weakening a crucial source of short-term funding, disrupting capital markets operations, and actually increasing systemic risk, all in contravention of Congressional intent.

Money Funds are subject to robust regulation by the SEC, which has an excellent record in its oversight of Money Funds and a superior track record in this area in comparison to bank-type regulation or receivership by the Federal Deposit Insurance Corporation ("FDIC"). Further, the receivership process created by Title II of the DFA is inappropriate for Money Funds, which rely on equity, rather than debt financing, are essentially self liquidating by the nature of their assets, and are already covered by existing regulatory and judicial protocols when necessary for a prompt and efficient wind-down. Thus, FDIC wind-down procedures and banking supervision are inappropriate for Money Funds. As the Board is aware, Section 170 of the DFA dictates that in connection with Council rules implementing Title I, the Board "***shall*** promulgate regulations in consultation with and on behalf of the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies… from supervision by the" Board. Contrary to a recent statement by the FSOC,[5] Section 170 is not merely a grant of authority, it is a specific rulemaking requirement that the exemptive rules ***shall*** be promulgated. The Section 170 exemption criteria the Board must adopt should make clear to investors and the public that Money Funds will ***not*** be designated for Board supervision under Title I of DFA or FDIC receivership under Title II.

In fact, it is doubtful that *any* open-end investment company (*e.g.* a mutual fund), including a Money Fund, is within the definition of a "nonbank financial company" that is subject to designation under Title I or Title II of the DFA.[6] The Board has consistently

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[5] FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Release Accompanying Final Rule and Interpretive Guidance*, 77 Fed. Reg. 21637, 21638, n. 6 (Apr. 11, 2012).

[6] Section 102 of the D.F.A. defines the universe of "nonbank financial companies," that potentially are subject to designation under Title I, by reference to the financial powers of Section 4(k) of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. 1843(k). Section 4(k) in turn has its own list of activities, including those permitted under Section 4(c)(8) of the BHC Act and Regulation K, 12 C.F.R. § 211. Other parts of the BHC Act (Sections 4(c)(5), 4(c)(6) and 4(c)(7) of that Act) authorize investing in securities and in investment companies, and 4(c)(8) and Regulation K have been interpreted by the Board to include sponsoring, advising, administering and providing other services to open-end and closed end investment companies, as well as dealing and underwriting in securities (as contrasted to investing, reinvesting and trading in securities). But the Board has gone out of its way *not* to determine that being, or controlling, an open-end investment company is a permitted Section 4(c)(8) or 4(k) activity. Petition of the United States in *Board of Governors of the Federal Reserve System v Investment Company Institute* (in U.S. Supreme Court Docket No. 79-927, October Term, 1979), 450 U.S. 46 (1981).

refused to interpret the provisions of Section 4 of the Bank Holding Company Act of 1956 ("BHC Act") that are incorporated into the DFA definition of a "nonbank financial company" to permit bank holding companies to control, be affiliated with, or be open-end investment companies (i.e. mutual funds), and has taken actions to prevent that from occurring.[7] Because the Board has not determined that being or controlling an open-end investment company or mutual funds is an eligible activity under those provisions, the activity of being an open end investment company is not a "financial" activity under the applicable definition. Thus, mutual funds are not "nonbank financial companies" for purposes of Title I of Dodd Frank. The Board cannot have it both ways.[8] If Sections 4(c)(8) and 4(k) do not authorize a bank holding company to engage in the activity of being or controlling a mutual fund, then a mutual fund cannot be a nonbank financial company within the meaning of Title I.

Moreover, a primary purpose of designation of a nonbank financial company under Title I is to prepare it, and place it in line, for a potential FDIC receivership under Title II. Because the text, purpose and structure of Title II (and of Sections 165(d) & (g) of the Act) clearly establish that Title II receiverships are to address defaults by a nonbank financial company on its obligations, and Money Funds are financed entirely by shareholder equity and do not borrow or otherwise use leverage, they do not have the ability to default on obligations in a way contemplated by the statute. If Money Funds do not have the kinds of debts and counterparty obligations that Titles I and II were intended to address, it makes no sense within the structure and purposes of Titles I and II to treat Money Funds as nonbank financial companies that are subject to designation under those Titles. We note in this regard that the final rule and interpretation recently adopted by the FSOC to establish a three-stage process and criteria for screening nonbank companies for potential designation under Title I rely primarily on measures of leverage and derivatives, and debt ratios, that are consistent with excluding Money Funds from designation at an

[7] *See* 12 C.F.R. §§ 211.10(a)(11), 225.28(b)(6), 225.86(b)(3), 225.125. Suggestions, such as those contained in the FSOC's April 2 rulemaking release (77 Fed. Reg. 21637, at 21639), and a recent supplemental proposal by the Board (*Definition of "Predominantly Engaged in Financial Activities*," 77 Fed. Reg. 21494 (Apr. 2, 2011)), that prior Board orders permitted a bank holding company to be or control a mutual fund, but merely imposed a condition requiring that they not be or control a mutual fund, is neither an accurate reflection of prior Board positions nor a permissible construction of the language of the DFA. Such suggestions also beg the question as to whether the FSOC and Board, consistent with legislative intent, may alter the definition of such a fundamental term after passage of the DFA.

[8] *Cf. Citicorp v Bd. of Governors*, 936 F.2d 66 (2d Cir. 1991), *cert. denied* 502 U.S. 1031 (1992) (Federal Reserve Board cannot simultaneously interpret the BHC Act in two different, conflicting ways).

early stage in the screening process.[9] To the extent there is any doubt on this question, it would be appropriate and in the public interest for the Board, acting in consultation with the FDIC and the Council, to exercise the mandatory exemptive authority in Section 170 of the DFA to exclude Money Funds from coverage under Titles I and II.

To the extent that the Council and the Board were to consider applying Titles I and II to them, Money Funds should be excluded from designation because they are already subject to rules and regulations that address the concerns that underlie each of the rules that the NPR proposes. Thus, even if the FSOC designates any Money Funds for supervision by the Board, the regulations proposed by the NPR would be ill-suited to Money Fund supervision, and at the least, duplicative. In this regard, the NPR does not demonstrate adequate consideration of the collateral consequences of applying duplicative rules to entities that are already subject to regulations that address their stability. Nor does its scanty discussion of compliance burdens differentiate among types of financial service companies – again reflecting a one-size-fits-all approach toward regulation.

Finally, and aside from the issues associated with their application to Money Funds, the proposed rules should be revised to permit designated firms to meet asset liquidity standards with additional types of instruments. Specifically, owing to their long history of stability and the fact that they are a pass-through for U.S. government securities, and because they are "a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity is impaired,"[10] we suggest that government money market funds (money market funds that invest exclusively in securities issued by the United States, including those subject to repurchase agreements), be added to the definition of "highly liquid asset" in each of the proposed rules where that term is defined.

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[9] FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Release Accompanying Final Rule and Interpretive Guidance*, 77 Fed. Reg. at 21661 (Apr. 11, 2012).

[10] 77 Fed. Reg. 646. *See e.g.* 77 Fed. Reg. 594, 609 (Jan. 5, 2012).

I. Bank Regulatory Models Are Not Appropriate For Money Market Funds.

The NPR is part of a series of rulemakings by the Council, Board and FDIC, to implement Titles I and II of the Act.[11] In particular, the NPR would implement Sections 165 and 166 of DFA, which require the Board to establish enhanced prudential standards for "Covered Companies," *i.e.*, certain large bank holding companies (BHCs)[12] and nonbank financial companies that have been designated for Board oversight by the Council.[13] The prudential standards to be adopted under Section 165 must include (i) risk-based capital requirements (ii) leverage limits; (iii) liquidity requirements; (iv) overall risk management requirements; (v) resolution plan and credit exposure report requirements; and (vi) concentration limits. Section 166 requires the Board to adopt rules to provide for the early remediation of financial distress at a Covered Company.

Section 165 requires the new regulations to differentiate among financial companies. As the NPR notes, Congress did not simply direct the Board to issue new prudential regulations, but "[i]n prescribing prudential standards under section 165(b)(1) to covered companies, the Board is required to take into account differences among bank holding companies covered by the rule and nonbank financial companies supervised by

[11] Pub. L. No. 111-203, 124 Stat. 1376 (2010). These rulemakings include: Board of Governors of the Federal Reserve System, *Supplemental Notice of Proposed Rulemaking, Definition of "Predominantly Engaged in Financial Activities,"* 77 Fed. Reg.21494 (Apr. 10, 2012) Board of Governors of the Federal Reserve System and FDIC, *Final Rule: Resolution Plans Required,* 76 Fed. Reg. 67323 (Nov. 1, 2011); Board of Governors of the Federal Reserve System and FDIC, *Notice of Proposed Rulemaking and Request for Comment Regarding Resolution Plans and Credit Exposure Reports Required*, 76 Fed. Reg. 22648 (Apr. 22, 2011); FSOC, *Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 4555 (Jan. 26, 2011); FSOC, *Final Rule: Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2012); FDIC, *Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 C.F.R. pt. 380, 76 Fed. Reg. 16324-02 (Mar. 23, 2011), FDIC, *Notice of Interim Final Rulemaking Regarding Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 4207 (to be codified at 12 C.F.R. pt. 380) (Jan. 25, 2011), and Board, *Proposed Rule: Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company*, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

[12] Specifically, BHCs with over $50 billion in total consolidated assets. As of March 31, 2012, there were thirty-four such BHCs. *See* FFIEC, *Top 50 Bank Holding Companies* (available at http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx).

[13] Section 113 of the DFA authorizes the FSOC to designate a U.S. nonbank financial company for supervision by the Board if the FSOC determines, pursuant to certain factors set forth in the DFA, that the company could pose a threat to the financial stability of the United States.

the Board … ."[14] In doing so, the Board must consider the factors considered by the Council in determining whether the company should be designated in the first place.[15] Further, Section 165(b)(1)(A)(i) acknowledges that risk-based capital and leverage requirements are not appropriate for certain business activities "such as investment company activities or assets under management."[16] In such cases, the Board and Council must consult in order to determine whether risk-based capital and leverage requirements would be appropriate for a designated company. If not, the Board must apply other "similarly stringent" risk controls.[17]

Notwithstanding these directives, the NPR proposes to require all Covered Companies, regardless of their businesses, to comply with banking regulations. For example, the NPR would require any nonbank designated company to comply with the Board's capital standards rules for BHCs, and to "[c]alculate its minimum risk-based and leverage capital requirements as if it were a bank holding company."[18] Nonbank designated financial companies would also have to comply with the Board's Capital Plan Rule, which was recently adopted for BHCs after the 2011 Comprehensive Capital Analysis and Review ("CCAR") – a review of capital strength and structures at nineteen BHCs.[19] The CCAR may well provide a basis for the development of sound capital structures at banking entities. However, it did not encompass non-banks, and the NPR fails to examine whether its results have any application to other types of firms.

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[14] *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, 77 Fed. Reg. 594, 596 (Jan. 5, 2012) *citing* 12 U.S.C. 5365(b)(3), DFA Section 165(b)(3).

[15] *I.e.*, the factors described in Section 113 of the DFA: (a) the extent of the leverage of the company; (b) the extent and nature of its off-balance-sheet exposures; (c) the extent and nature of the company's transactions and relations with other significant nonbank financial companies and significant BHCs; (d) its importance as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the U.S. financial system; (e) it importance as a source of credit for low-income, minority, or underserved communities, and the impact its failure would have on availability of credit in such communities; (f) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse; (g) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company; (h) the degree to which the company is already regulated by one or more primary financial regulators; (i) the amount and nature of the company's financial assets; (j) the amount and types of liabilities of the company, including the degree of reliance on short-term funding; and (k) other risk-related factors the Council deems appropriate.

[16] DFA § 165(b)(1)(A)(i).

[17] DFA § 165(b)(1)(A)(i).

[18] 77 Fed. Reg. 603.

[19] 12 C.F.R. § 225.8; *Capital Plans*, 76 Fed. Reg. 74631 (Dec. 30, 2011).

Banking standards are not suited for other types of firms. Unlike Money Funds, banks are complex and highly leveraged, with a range of risks such as those stemming from the mismatch of long-term liabilities with short-term assets, interest rate risks and illiquid assets. Banks also use amortized cost accounting to value assets but, unlike Money Funds, they do not "shadow price" their assets to test whether valuations are appropriate. The regulation of banks involves four (formerly five) federal regulators and over fifty regulators in states and other districts. The federal agencies alone require over 26,000 full-time employees.[20] The federal banking code – Title 12 of the United States Code and Title 12 of the Code of Federal Regulations – totals fourteen volumes and many thousands of pages of requirements and prohibitions. Yet, during the 40 years since the launch of the first Money Fund – a period during which the Money Fund industry experienced exactly two instances in which shareholders did not receive 100 cents on the dollar – some 2,913 depository institutions have failed, and an additional 592 were the subject of "assistance transactions" in which the government injected capital to keep them afloat.[21] From 1971 through 2011, total estimated FDIC losses incurred in connection with failed banks or assistance transactions amount to $188.5 billion.[22] Since January 2008, as a result of the financial crisis that followed the burst of the housing bubble and the collapse of mortgage-backed securities investments, at least 430 banks have failed,[23] and even more would have failed but for dozens of federal programs that infused banks with cash. The Board, Department of the Treasury, and FDIC spent approximately $2 trillion on an array of programs to infuse cash into the banking system.[24] In addition, the Board has kept interest rates close to zero, allowing banks to borrow at almost no cost and to lend at higher rates so as to practically guarantee risk-free profits. This is estimated to cost savers $350 billion each year as banks do not have to compete for depositors' funds, and therefore may offer only low interest rates on

[20] FDIC 2009 Annual Report; FRB 2009 Annual Report; OCC 2009 Annual Report; OTS 2009 Annual Report.

[21] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[22] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[23] FDIC Failed Bank List, *available at* http://www.fdic.gov/bank/individual/failed/banklist.html.

[24] Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of Its Expiration*, at 145-46 (Sept. 16, 2010).

deposits.[25] Certainly, expanding bank-type regulation to other industries is not the intent of the DFA.

The NPR's broad-brushed approach is particularly troubling with respect to the implementation of capital and leverage standards. As noted above, the Act states that risk-based capital and leverage requirements are not appropriate for firms engaged in investment company activities or where assets are under management and not owned.[26] The Act even provides a procedure for the Board and Council to consult in order to ascertain how best to approach the regulation of such firms, should any receive designation.[27] Nonetheless, the proposed rules do not make any exceptions from the proposed capital and leverage requirements for investment companies or asset managers, nor do they establish or even refer to any procedures for consultation between the Board and the Council, which the statute plainly contemplates.

Moreover, Section 165(B)(3)(A)(i) of the Act requires the Board to take the factors described in Section 113(a) into account when creating new prudential standards. The existence of another scheme of prudential regulation and oversight by another federal financial regulator is one of the factors described in Section 113(a).[28] One such scheme of prudential regulation is SEC's comprehensive regulation of investment companies under the Investment Company Act of 1940 ("Investment Company Act"), including Money Funds, which are subject to additional risk-limiting rules adopted by the SEC under the Investment Company Act. Yet the proposed rules do not refer to existing regulations of agencies other than the Board itself.

These are only a few examples of the bank-centric thinking that underlies the NPR. We note that the Board acknowledges that "this proposal was largely developed with large, complex bank holding companies in mind," and that the Board has requested that commenters address the effects that the proposed rules would have on non-bank

[25] Yalman Onaran and Alexis Leondis, *Bank Bailout Returns 8.2% Beating Treasury Yields*, Bloomberg (Oct. 20, 2010), *available at* http://www.bloomberg.com/news/2010-10-20/bailout-of-wall-street-returns-8-2-profit-to-taxpayers-beating-treasuries.html. *See also* Michael Mackenzie, *Double-Edged Sword Of Fed's Interest Rate Policy*, Financial Times (Jan. 27, 2012); *Retirement (In)security: Examining the Retirement Savings Deficit*, Written Statement of James Rickards Senior Managing Director, Tangent Capital Partners LLC, Before the Senate Subcommittee on Economic Policy Committee on Banking, Housing & Urban Affairs, (Mar. 28, 2012).

[26] DFA § 165(b)(1)(A)(i).

[27] DFA § 165(b)(1)(A)(i).

[28] DFA § 113(a)(2)(H).

financial firms.[29] The Board's focus on banking firms is certainly understandable. Large, complex, leveraged banking entities are the most likely sources of financial turmoil, as shown by the collapse of firms like IndyMac, Bear Stearns and Lehman Brothers. In fact, the phrase "too big to fail" was first coined in relationship to the crisis involving Continental Illinois National Bank in 1984.

Yet, we must note that the proposed rules do not include any provisions that differentiate among types of financial service companies: there are no exceptions or exemptions, special standards or unique requirements for any type of firm. The description of the proposed rule change in the NPR does not analyze other federal regulatory systems, or examine how those systems may overlap with, or better fulfill the purposes of the proposed rules. Nor do the Board's estimates of compliance burdens include any discussion as to how different types of companies may incur different expenses and labor in order to implement compliance.[30] As to Money Funds in particular, the only discussion that appears in the NPR is in an open-ended query as to whether to aggregate credit exposures of funds and sponsors for purposes of single-party concentration limits.[31]

It is not sufficient for the NPR to announce the Board's intent to "determine, on its own or in response to a recommendation by the Council, to tailor the application of the enhanced standards to different companies on an individual basis or by category."[32] Under Section 165, "in prescribing" the rules that would apply to designated non-bank companies, "the Board is required to take into account differences among bank holding companies covered by the rule and nonbank financial companies."[33] Thus, merely deferring consideration of the matter is not sufficient. The statute mandates that the differences between banks and non-banks must be taken into account when the regulations are written.

Further, such vague pronouncements of future intent do not assist companies with planning. Financial firms and their customers need clearly defined regulations so that

[29] 77 Fed. Reg. 597.

[30] 77 Fed. Reg. 642-643.

[31] 77 Fed. Reg. 614.

[32] 77 Fed. Reg. 597.

[33] DFA § 165(b)(3).

they can make appropriate decisions. The Board's approach appears to place heavy reliance on case-by-case decision-making, and the NPR provides no guidance as to the factors that the Board would consider when determining whether and how to "tailor" the application of its rules. This can lead to variation in results, as decision-makers' opinions and interpretations tend to vary. Indeed, past oversight techniques employed by the Board have often relied on extensive interaction between regulators and regulated entities, sometimes requiring that regulatory personnel establish workplaces in the offices of a banking entity. This model has a foundation in complex, multi-faceted systems that require judgment and interpretation of what constitutes "sound banking practices." However, where a company is only allowed to invest in short-term securities that have specifically defined characteristics, the utility of such measures as embedded or dedicated regulatory staff is diminished.

The U.S. economic system demands stability and a clear regulatory framework. Indeed, Presidential Executive Order 13563 directs that regulations "must promote predictability and reduce uncertainty."[34] A proposal that only announces that some rules may or may not apply to a company, or that some rules' application may be tailored after the company is made subject to them, provides no certainty for financial companies and their customers. Accordingly, we urge the Council to defer action on the rules as applied to Money Funds unless they can be tailored, refined and justified with further precision.

In any event, as discussed further below, application of banking standards to a Money Fund would have serious negative implications. Money Funds, which are financed entirely by common equity capital, have no leverage, have a high degree of liquidity, and are under comprehensive regulatory scrutiny, are already much less vulnerable to financial distress than other institutions. Placing duplicative burdens on them would only increase costs, and in an industry that already operates on thin margins, this could well be the factor that would cause a fund sponsor to exit the business. Imposing bank-type rules on Money Funds (e.g., risk-based capital requirements and liquidity buffers beyond or different from the SEC's current liquidity requirements for Money Funds), would undermine their vitally important role in providing highly liquid investments for individuals and institutions and critical short-term funding for issuers and others who rely upon them.

[34] *Improving Regulation and Regulatory Review*, Executive Order 13563 (Jan. 18, 2011).

II. Money Funds Are Already Subject To Prudential Regulations That Mitigate Systemic Risk And Better Serve The Purposes Of The Proposed Rules.

The regulations proposed in the Notice address seven primary areas: risk-based capital and leverage, liquidity, single-counterparty credit limits, overall risk management and risk committees, stress tests, debt-to-equity limits, and early remediation requirements. Each of these areas is already addressed in a comprehensive manner by federal securities laws and regulations that apply to Money Funds, or is otherwise not applicable to Money Fund regulation. These securities laws and regulations reflect sound principles of investment management: invest only in very short-term, high quality, marketable debt instruments in a diversified manner, and do not use any leverage. Their application has resulted in an unparalleled record of stability and solvency for Money Funds.

A. Risk-Based Capital Requirements and Leverage Limits

Under the proposed rules, designated nonbank financial companies would be required to comply with the Board's capital regulations for BHCs. Thus, they would have to hold capital sufficient to meet (i) a tier 1 risk-based capital ratio of 4 percent and a total risk-based capital ratio of 8 percent,[35] and (ii) a tier 1 leverage ratio of 4 percent.[36] Designated firms would have to calculate these ratios as if they were BHCs, regardless of the nature of their business or capital structure.[37] They would also have to report their capital and leverage ratios to the Board on a quarterly basis, and to notify the Board immediately of any failure to meet the standards.[38]

Further, under the proposed rules, the Board would apply its recently adopted Capital Plan Rule[39] to all designated nonbank financial companies. Thus, these firms would have to submit annual capital plans to the Board and to the appropriate Reserve Bank.[40] Plans must be reviewed and approved by the company's board of directors or a

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[35] *See* 12 C.F.R. part 225, Appendix A and G.

[36] *See* 12 C.F.R. part 225, Appendix D, section II.

[37] Proposed 12 C.F.R. § 252.13(b); 77 Fed. Reg. 645.

[38] Proposed 12 C.F.R. § 252.14; 77 Fed. Reg. 645.

[39] 12 C.F.R. § 225.8. *See* 76 Fed. Reg. 74631 (Dec. 1, 2011).

[40] 12 C.F.R. § 225.8(d)(ii).

committee thereof. Among other things, the capital plan must address how the company will maintain capital in excess of prescribed ratios under expected and stressed conditions over a minimum of nine quarters. If the Board or Reserve Bank objected to a company's Capital Plans, it would be prohibited from making any capital distributions until it provides a satisfactory one, or the Board or Reserve Bank otherwise approve. Even where a capital plan has received a non-objection, a designated company would have to obtain prior approval from the Board before making a capital distribution in cases where its capital levels fall below Board requirements or where a distribution would result in a material adverse change to the company's capital, liquidity, or earnings structure.

It is hard to see how such capital ratios, leverage ratios and capital planning requirements might apply to Money Funds. Money Funds rely entirely on equity financing. Unlike banks, Money Funds do not accept deposits or make loans or use other forms of debt financing. The assets of Money Funds are comprised only of the investments permitted by SEC Rule 2a-7, rather than the riskier assets held by banks. These assets are financed entirely by the equity capital of the shareholders of the Money Fund. If a capital requirement were to be imposed, whether through some type of "buffer" or otherwise, it would lead to higher costs and reduced yields for investors as the fund's manager built up capital levels. This would destroy the economic utility of the fund, and result in capital withdrawals.[41] Similarly, in contrast to banks, Money Funds do not leverage their assets, securitize them, hold assets off-balance sheet, or engage in any of the other risky activities in which banks engage. Therefore, leverage limits are similarly not appropriately applied to Money Funds.

Capital Plans, as proposed to be applied, would be redundant for Money Funds. The capital planning process is relatively simple for money funds. They hold only cash, from the sale of equity shares, and investment assets. The range of potential investments is pre-determined by Rule 2a-7, which restricts the investments that Money Funds may hold by maturity, quality, liquidity and diversification. Other aspects of the proposed rules are also inappropriate for Money Funds. For example, requiring Capital Plans that extend for nine quarters has little relevance when the longest maturity of an instrument in a Money Fund's portfolio is 397 days. Additionally, within the constraints of Rule 2a-7, the Investment Company Act and SEC rules require a Money Fund's board to oversee the

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[41] *See* Treasury Strategies, Inc., *Proposed Capital Requirements for Money Market Mutual Funds: A Disaster On All Fronts,* pp. 3-5 (Feb. 2012) (filed in SEC Comment File No. 4-619: President's Working Group Report on Money Market Fund Reform) (*available at* http://www.sec.gov/comments/4-619/4619-154.pdf).

Fund's affairs and operations, including its relationships with its distributor and investment adviser, its risk controls, its valuation of portfolio securities and the pricing of its shares.[42]

B. Liquidity Requirements

In order to protect a designated company's liquidity, the proposal would impose specific corporate governance practices on designated companies.[43] Starting from the top, the board of directors would have to oversee the company's overall liquidity risk management policies and procedures, establish an "overall liquidity risk tolerance" (i.e., the acceptable level of liquidity risk the firm may assume) at least annually and review compliance with that level at least semi-annually. The board will also have to approve a Contingency Funding Plan at least annually.

A designated firm's risk committee (which must be composed of members of the board) will be required to review and approve the liquidity costs, benefits, and risk of each significant new business line and product prior to implementation. On at least a quarterly basis, the risk committee would have to review the company's comprehensive cash flow projections, liquidity stress testing, liquidity buffer, limits on liquidity risk, and independent validation of liquidity stress tests, all as outlined below. Finally, senior management will be responsible for implementing the liquidity risk strategies, policies, and procedures and for reporting regularly to the risk committee on the company's liquidity risk profile.

On a more substantive level, the proposal would require designated companies to:

- Produce comprehensive projections of short- and long-term cash flow arising from assets, liabilities, off-balance sheet exposures, contractual maturities, new business, funding renewals, and other potential events that may impact liquidity. Mismatches of cash flow would have to be

[42] 17 C.F.R. §§ 270.2a-4, 2a-7.

[43] The NPR notes that the Board is considering adopting additional quantitative liquidity requirements, including a Liquidity Coverage Ratio and a Net Stable Funding Ratio, consistent with the Basel III standards. 77 Fed. Reg. 599-600.

identified. Short-term projections would have to be updated every day, and long-term projections would have to be updated each month.[44]

- Conduct monthly and *ad hoc* stress tests of cash flow and liquidity that address the company's activities, risks and exposures, including off-balance sheet exposures. Stress tests would have to include, as an assumption, that for the first 30 days of a liquidity stress scenario, the company could only use unencumbered "highly liquid" assets (described below) as cash flow sources to meet projected funding needs.[45]
- Maintain a buffer of unencumbered, diversified, "highly liquid" assets sufficient to meet projected net cash outflows and the projected loss or impairment of existing funding sources for 30 days over a range of scenarios.[46]
- Maintain and update at least annually a detailed "Contingency Funding Plan" describing the firm's strategy, policies, procedures, and action plans for managing times of liquidity stress, including identification of alternative funding sources.[47] For banks, the NPR provides the comforting note that "[d]iscount window credit may be incorporated into CFPs as a potential source of funds in a manner consistent with the terms provided by the Federal Reserve Banks."[48]
- Establish and maintain limits on potential sources of liquidity risk, including limits on (i) concentrations of funding in particular instruments, counterparties, counterparty types, secured and unsecured funding, or other liquidity risk identifiers, (ii) the amount of specified liabilities that mature within various time horizons, and (iii) off-balance sheet exposures and other exposures that could create funding needs during times of liquidity stress; [49] and

[44] 77 Fed. Reg. 607.

[45] 77 Fed. Reg. 608.

[46] 77 Fed. Reg. 609.

[47] 77 Fed. Reg. 610, 648

[48] 77 Fed. Reg. 610.

[49] 77 Fed. Reg. 611.

- Monitor the liquidity risk of collateral positions, liquidity risks across the enterprise, and intraday liquidity risks. [50]

Finally, the proposed rule requires that each designated firm conduct a review of the company's liquidity risk management at least annually. The review would have to be "independent of management functions that execute funding."[51]

The NPR inquires whether there are other possible approaches that would serve the same purposes.[52] We submit that adherence to limits on short term debt, diversification, and insistence on high asset quality ultimately provide the best assurance of liquidity. In this regard, Money Funds are subject to specific SEC regulations that require them to maintain more liquidity than any other type of financial service provider. Their liquidity is dictated by SEC rules, including Rule 2a-7.[53] Under Rule 2a-7, Money Funds are allowed to invest only in short-term, high-quality debt and must keep their portfolios diversified and liquid. Rule 2a-7 fosters Money Fund liquidity by imposing requirements in the following areas:

Liquidity Matching of Portfolio Maturities to Cash Needs for Redemptions. Under amendments to Rule 2a-7 that were adopted in 2010 – promulgated in large part in response to the financial crisis – a Money Fund must have a minimum amount of its assets in highly liquid securities so that it can meet reasonably foreseeable shareholder redemptions.[54] Under new minimum daily liquidity requirements applicable to all taxable Money Funds, at least 10 percent of the assets in the fund must be in cash, U.S. Treasury securities, or securities that convert into cash (*e.g.*, mature) within one business day. In addition, under a new weekly requirement applicable to all Money Funds, at least 30 percent of assets must be in cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, or securities that convert into cash within five business days. No more than 5 percent of a fund's portfolio may be "illiquid" (*i.e.*, cannot be sold or disposed of within seven days at carrying value).

[50] 77 Fed. Reg. 611.

[51] 77 Fed. Reg. 647.

[52] 77 Fed. Reg. 605.

[53] 17 C.F.R. § 270.2a-7.

[54] Thus, depending upon the volatility of the fund's cash flows (in particular shareholder redemptions), a fund may be required to maintain greater liquidity than would be required by the Rule's daily and weekly minimum liquidity requirements, discussed herein. *See* SEC, *Money Market Fund Reform*, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

Redemptions / Know Your Customer. Under a new requirement added to Rule 2a-7 in 2010, Money Funds must hold securities that are sufficiently liquid to meet reasonably foreseeable redemptions. To satisfy this requirement, a Money Fund must adopt policies and procedures to identify the risk characteristics of large shareholders and anticipate the likelihood of large redemptions.[55] Depending upon the volatility of its cash flows, and in particular shareholder redemptions, this may require a fund to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements discussed above.[56]

High Credit Quality. Rule 2a-7 limits a Money Fund to investing in securities that are, at the time of their acquisition, "Eligible Securities." "Eligible Securities" include a security with a remaining maturity of 397 calendar days or less, that meet stringent credit quality standards dictated by the rule.[57] Under the 2010 amendments, 97% of a Money Fund's assets must be invested in "First Tier Securities."[58] Only 3 percent of its assets may be held in "Second Tier Securities."[59] In addition, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer (rather than the previous limit of the greater of 1 percent or $1

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[55] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10075, n.198 and accompanying text (Mar. 4, 2010).

[56] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

[57] Under Rule 2a-7(a)(12), if only one designated NRSRO has rated a security, it will be considered a rated security if it is rated within one of the rating agency's two highest short-term rating categories. Under certain conditions, a security that is subject to a guarantee or that has a demand feature that enhances its credit quality may also be deemed an "Eligible Security." In addition, an unrated security that is of comparable quality to a rated security also may qualify as an "Eligible Security."

[58] A "First Tier Security" means any Eligible Security that:

(i) is a Rated Security (as defined in Rule 2a-7) that has received a short-term rating from the requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);

(ii) is an unrated security that is of comparable quality to a security meeting the requirements for a rated security in (i) above, as determined by the fund's board of directors;

(iii) is a security issued by a registered investment company that is a Money Fund; or

(iv) is a Government Security.

The term "requisite NRSROs" is defined in Rule 2a-7(a)(23) to mean "(i) Any two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) If only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO."

[59] Second Tier Securities are any Eligible Securities that are not First Tier Securities.

million). Under the 2010 amendments, a Money Fund also is prohibited from purchasing "Second Tier Securities" that mature in more than 45 days (rather than the previous limit of 397 days). As a result of these and other provisions of Rule 2a-7, Money Funds may invest in debt instruments in which banks may invest, including prime commercial paper, bank deposits, short-term U.S. government securities, and short-term municipal government securities.[60] However, they may not invest in many of the higher risk, less liquid and longer-term investments that national banks may own, such as medium and long-term government or corporate debt and most types of loans (*e.g.*, mortgages and consumer loans). These quality requirements help to ensure that Money Fund investment portfolios are highly liquid.

Short Maturity Limits. Rule 2a-7 limits the exposure of Money Funds to risks like sudden interest rate movements by restricting the average maturity of portfolio investments. Under the 2010 amendments, the "weighted average maturity" of a Money Fund's portfolio is restricted to 60 days. In addition, the 2010 amendments introduced limits to the maximum "weighted average life" maturity of a fund's portfolio to 120 days.[61] This restriction limits Money Funds' investment in long-term floating rate securities. In practice, 93% of "prime" Money Funds at year-end 2010 had a weighted average life of 90 days or less, and 80% had a weighted average maturity of 50 days or less.[62]

Diversification. In order to limit the exposure of a Money Fund to any one issuer or guarantor, Rule 2a-7 requires the fund's portfolio to be diversified with regard to both issuers of securities it acquires and guarantors of those securities.[63] Money Funds generally must limit their investments in the securities of any one issuer (other than Government securities) to no more than five percent of fund assets.[64] Money Funds also

[60] 12 U.S.C. 24 (Seventh), 12 C.F.R. Part 1.

[61] The "weighted average maturity" of a Money Fund's portfolio is usually shorter than its "weighted average life" because the former is measured at the earlier of repayment or reset of interest rates, while the latter is tied to the contractual repayment date on the fixed income instrument.

[62] Money Fund Regulatory Changes Post Financial Crisis, 2011 Investment Company Institute ("ICI") Money Market Funds Summit (May 16, 2011) (slides available on ICI website).

[63] 17 C.F.R. § 270.2a-7(c)(4)(i).

[64] Rule 2a-7(c)(4)(i)(A). Rule 2a-7 includes a safe harbor that permits a taxable and national tax exempt fund to invest up to 25 percent of its assets in the first tier securities of a single issuer for a period of up to three business days after acquisition (but a fund may use this exception for only one issuer at a time). Rule 2a-7(c)(4)(i)(A).

must generally limit their investments in securities subject to a demand feature or a guarantee to no more than ten percent of fund assets from any one provider.[65] Under the 2010 amendments to Rule 2a-7, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer.

Periodic Stress Tests. Under the 2010 amendments to Rule 2a-7, the board of directors of each Money Fund must adopt procedures providing for periodic stress testing of the funds' portfolio. Fund managers are required to examine a fund's ability to maintain a stable NAV per share based upon certain hypothetical events. These include a change in short-term interest rates, higher redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.

Corporate Governance. Proposed Regulation YY places great reliance on a covered entity's governance and management procedures. Money Funds, in addition to the specific quantitative and qualitative standards discussed above, are subject to SEC regulations that place obligations on directors and managers with respect to liquidity management. The above standards are the responsibility of management and the board, and Money Funds must have policies and procedures that ensure compliance. Further, as detailed below, Money Fund boards must adopt written procedures for the management of risks that protect fund liquidity. For example, risk management programs must include written procedures that relate to periodic reviews of decisions not to rely on demand features or guarantees in the determination of a portfolio security's liquidity.[66]

These requirements of Rule 2a-7 foster liquidity, and they have proven effective. In 2011, at a time of extreme volatility in world markets caused by fear of major sovereign defaults and the potential for related contagion, Money Funds experienced dramatic shareholder redemptions in June and again in late July/early August. As of June 22, 2011, "prime" money market money funds held about $1.6 trillion in assets, requiring daily liquid assets under Rule 2a-7 of at least $160 billion and weekly liquid assets of at least $480 billion. From June 22 to June 29, 2011, following reports of exposures to

[65] Rule 2a-7(c)(4)(iii). With respect to 25 percent of total assets, holdings of a demand feature or guarantee provider may exceed the 10 percent limit subject to certain conditions. *See* Rule 2a-7(c)(4)(iii)(A), (B), and (C). *See also* Rule 2a-7(a)(9) (definition of "demand feature") and (a)(15) (definition of "guarantee").

[66] Rule 2a-7(c)(10)(ii).

European banks and Greek debt, about $48 billion was redeemed from prime Money Funds.[67] Under Rule 2a-7's minimum standards, prime Money Funds had about ten times the weekly liquidity needed to cover actual withdrawals in this period. Consistent with Rule 2a-7's requirement for Money Funds to assess foreseeable redemptions and hold assets sufficiently liquid to meet them, actual amounts of daily and weekly liquid assets held by money funds exceeded these requirements.

As of late July, 2011, taxable Money Funds (Money Funds other than municipal securities Money Funds) held approximately $2.3 trillion in assets.[68] In the last week of July, 2011, when negotiations over the federal debt-ceiling reached an impasse, almost $120 billion in share value was redeemed from taxable Money Funds.[69] In the week ending August 3, net outflows from taxable Money Funds totaled $69 billion, apparently due to concerns about the U.S. debt ceiling negotiations and Eurozone debt.[70] Thus, under Rule 2a-7's minimum requirements, taxable Money Funds held weekly liquid assets of at least 5.7 times the amounts redeemed in late July and 10 times the amounts redeemed in early August. In fact, the minimum daily liquid asset requirement would have been more than sufficient to cover the heaviest week of withdrawals.

From the end of May until August 3, 2011, investors redeemed over 10% of their prime (taxable non-government) Money Fund investments, totaling over $169 billion in redemptions.[71] Some prime Money Funds experienced redemptions of between 20% and 45% of their assets.[72] Much of the redemption activity was in short bursts around the key events of each financial episode. Yet no Money Fund "broke the buck," faltered or was unable to meet redemption requests. Finally, Money Funds currently hold 7-day cash liquidity of approximately $1.1 trillion, an amount *seven times* the largest outstanding

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[67] Investment Company Institute, *Historical Weekly Money Market Data (available at* http://www.ici.org/research/stats).

[68] *Id*.

[69] Mark Jewell, *With Risk of Debt Default Allayed, Money Funds Remain Safe Bet*, Associated Press (Aug. 7, 2011) *available at* http://articles.boston.com/2011-08-07/business/29862085_1_money-finds-crane-data-money-market; *see* Appendix B: Daily Change In Money Market Fund Assets (July 22 - August 4, 2011) (Source: Crane Data).

[70] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[71] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[72] Based on analyses by Federated Investors using data derived from IMoneyNet (Sept. 30, 2011).

borrowing by banks from the Federal Reserve under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility in 2008, and multiples of the amounts needed to meet redemptions in September 2008.[73]

Note further that Rule 2a-7's requirements are quite specific, in contrast to the largely procedural and managerial rules proposed in the NPR. While Money Fund directors and management have duties to monitor liquidity and oversight responsibilities, their powers are constrained by hard limits set in the Rule. In this fashion, Rule 2a-7 takes the judgment calls that the NPR's proposed rules would require directors and managers of Covered Companies to make out of the hands of a Money Fund's management. Rule 2a-7's requirement to hold enough liquidity to redeem foreseeable redemption requests, coupled with its specific quantitative standards, provided sufficient liquidity to withstand two crises in the summer of 2011. These clear, hard standards protect liquidity better than the imprecise measures that proposal contemplates, such as requirements to have liquidity policies and procedures, or requirements to estimate net cash outflows. Accordingly, imposing the proposed rules on a Money Fund would serve little or no purpose.

Finally, it is not clear how the proposed rules relating to "liquidity buffers" might apply to a Money Fund that is designated for Board supervision. The proposed rules would require a covered company to maintain a liquidity buffer of unencumbered highly liquid assets that would be "sufficient to meet projected net cash outflows and the projected loss or impairment of existing funding sources for 30 days over a range of liquidity stress scenarios."[74] In this regard, "highly liquid assets" would be limited to cash, U.S. government and agency securities, and any other assets acceptable to the Board.[75]

Yet, as noted above, all Money Funds are already subject to rules that require them to hold securities that are sufficiently liquid to meet reasonably foreseeable redemptions. Further, under Rule 2a-7, all Money Funds are subject to a Weekly

[73] Further demonstrating how Rule 2a-7 fosters liquidity and stability, an analysis of shadow NAVs for each third year since 2002 shows that the average week-end shadow NAVs were $1.0000033 and $0.999958 – truly minuscule differences from the $1.00 stable NAV price – for two of Federated's largest institutional prime funds. (*See* Appendix C: Analysis of Shadow NAVs for Prime Obligations and Prime Cash Obligations Funds).

[74] Proposed Rule 252.57, 77 Fed. Reg. 648.

[75] Proposed Rule 252.51(g), 77 Fed. Reg. 646. As discussed further below, this list of "highly liquid assets" should be expanded to include government money market funds.

Liquidity Requirement whereby at least 30 percent of assets must be in cash, U.S. Treasury securities, and certain other government securities with remaining maturities of 60 days or less, or securities that convert into cash within five business days.[76] No more than 5 percent of a fund's portfolio may be "illiquid" (i.e., cannot be sold or disposed of within seven days at carrying value).[77] In addition, taxable Money Funds (including "prime" funds) must maintain at least 10 percent of their assets in cash, U.S. Treasury securities, or securities that convert into cash (mature) within one business day.[78]

The NPR does not describe how the "liquidity buffer" would correspond to these requirements of Rule 2a-7. For example, the NPR does not specify whether the required buffer would have to be held in addition to the assets that are counted toward Rule 2a-7's different liquidity standards or otherwise. If so, superimposing a liquidity buffer on any designated Money Fund would only place an additional cost and compliance burden on the Fund and may actually lead to financial instability. In order to build a buffer, a Money Fund would have to reduce the yield to its shareholders, making it a less attractive investment option. Once the buffer is created, however, it may actually increase the likelihood of a "run," because investors will perceive an advance warning to redeem their shares as soon as possible once the buffer is approached or breached. For these reasons, we perceive little utility in any proposal to apply a liquidity buffer to any Money Fund.

C. Single-Counterparty Exposure Limits

Under Section 165(e) of the DFA, the Board must set concentration limits to forbid designated nonbank financial companies and large BHCs from having credit exposure to any unaffiliated company that exceeds 25% of the capital stock and surplus of the company, or a lower percentage that the Board deems necessary. The Board's proposal would implement the 25 percent standard, but would also limit the aggregate net credit exposure of a "major covered company" (defined as a BHC with $500 billion or more in total consolidated assets or a designated nonbank financial company) to any unaffiliated "major counterparty" (defined as a "major covered company" or foreign banking organization that is or is treated as a BHC and has total consolidated assets of

[76] Rule 2a-7(c)(5)(iii).

[77] Rule 2a-7(c)(5)(i).

[78] Rule 2a-7(c)(5)(ii).

$500 billion or more) to 10% of the capital stock and surplus of the "major covered company."[79]

While these standards are fairly clear as general principles, the methods proposed for calculation of credit exposures represent a true challenge. The NPR would have companies begin the calculation process by first determining the gross amounts of credit that they have extended to another company via almost any conceivable means, including through loans and leases, investments in debt and equity securities, repurchase and reverse repurchase agreements, securities borrowing or lending transactions, committed credit lines, guarantees and letters of credit, and credit or equity derivative transactions where the company is the protection provider. The value of each type of instrument or transaction would have to be calculated as specified under detailed requirements in the proposed rules.[80]

To arrive at net credit exposure, gross credit exposure would be adjusted by reference to bilateral netting agreements (as to repurchase and reverse repurchase transactions and securities lending and borrowing transactions), the value of any eligible collateral for a credit transaction, the unused portion of a credit extension (under certain enumerated circumstances), certain guarantees, short sales of the counterparty's debt or equity securities, and the notional amount of certain credit or equity derivatives from an eligible protection provider (such as a bank, a securities broker-dealer, or a sovereign entity) that references the counterparty.[81]

These calculations would have to be performed every day, because the proposed rules would require designated firms to comply with credit exposure limits on a daily basis, as of the end of each business day, and to submit a monthly report to the Board demonstrating their compliance.

We have five observations on this aspect of the NPR.

First, Money Funds are already subject to diversification requirements that prevent any undue concentration, even exceeding the standards proposed by the NPR. As stated above, Rule 2a-7 requires Money Funds' portfolios to be diversified with regard to

[79] 77 Fed. Reg. 652.

[80] 77 Fed. Reg. 652.

[81] Proposed Rule 252.92(u), 77 Fed. Reg. 651.

both issuers of securities it acquires and guarantors of those securities. They generally must limit their investments in the securities of any one issuer (other than Government securities) to no more than five percent of fund assets. In addition, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer, thus preventing substantial exposure to issuers whose credit is strong, though not as strong as the highest quality.

Second, it will not be possible for Covered Companies to comply with the rules as proposed with any substantial degree of confidence because they would require creditors to trace the proceeds of a credit transaction.[82] Read literally, under proposed Rule 252.94(b), in order to calculate gross credit exposure to a counterparty, if the proceeds of a credit transaction between a Covered Company and any person are used for the benefit of, or transferred to, a company, the Covered Company must treat the credit transaction as one with that company. Thus, for example, if a Money Fund were to buy a bank's commercial paper, and the bank were to lend the funds to a third party, the Money Fund would have to determine the identity of that third party and the amount of funds that were transferred to it. The NPR rightly recognizes that this rule, which corresponds to the language of DFA Section 165(e)(4), may "lead to inappropriate results and would create a daunting tracking exercise … ."[83] The Board could interpolate a reasonableness standard into this "attribution" requirement, and require attribution to the extent that a creditor reasonably knows that the funds are or will be transferred. However, to be frank, and notwithstanding Section 165(e)(4), there is, of course, no way for any financial participant to trace loan proceeds in this manner. Realistically, the Board may have to exercise its authority to grant exemptive relief from the Rule under DFA Section 165(e)(6), or defer its application until the law is amended.

Third, even setting aside attribution, the compliance burden imposed by this rule would be substantial. In general, money funds will be able to quickly determine their overall credit exposure to other companies. (In fact, any person can determine a Money Fund's overall credit exposure to any particular company because Money Funds publicly disclose all of their portfolio holdings). However, ascertaining which counterparties are affiliated with one another, and therefore must be consolidated, would be difficult, especially when the determination would have to be made on a daily basis. Therefore, the proposed rules should adopt a "policies and procedures" approach. Thus, a firm that

[82] The proposal thereby reflects the "attribution rule" in Section 165(e)(4) of the DFA.

[83] 77 Fed. Reg. 618.

implemented policies and procedures reasonably designed to calculate net exposures to counterparties would be in compliance, notwithstanding an inadvertent, reasonable failure to link two affiliated companies to whom the company has extended credit.

Fourth, although the proposed rules would exempt certain categories of credit transactions from the limits on credit exposure (such as U.S. government securities and intraday credit exposure to a counterparty), the list of exempt categories should be expanded by adding transactions with state and local government entities. Tax-exempt Money Funds hold substantial amounts of short-term debt issued by state and local government entities. Many such funds hold short-term debt issued by government entities of a single state in order to maximize tax benefits. State and local government entities are strong in terms of creditworthiness, and the municipal bond market is deep and robust. Moreover, SEC Rule 2a-7 already imposes diversification requirements on such funds. Specifically, under Rule 2a-7(c)(4)(B) a "single state fund," with respect to seventy-five percent of its total assets, may not invest more than five percent of its total assets in securities issued by the same issuer. Accordingly, we submit that credit transactions with state and local governments, and the subdivisions thereof, should be exempted from the single counter-party credit limits in any case where the designated firm is subject to Rule 2a-7.

Fifth, the NPR queries whether certain investment vehicles, including Money Funds that are advised or sponsored by a Covered Company, should be counted as part of the Covered Company for purposes of calculating the Covered Company's credit exposure. The basis for doing so would be that the Covered Company "may have strong incentives to provide support" for such vehicles.[84] Possible incentives, however, are not sufficient grounds to ignore legal realities. Money Funds, their advisers and their sponsors are separate legal entities. The instruments of a Money Fund are held by that Fund alone. The liabilities (if any) and shareholder interests of one Money Fund do not have a claim on the assets of another Money Fund or on the Fund's sponsors or advisers. Moreover, as noted above, the portfolio of each Money Fund is diversified by issuer and maturity so that a default by any one (or several) issuers of underlying investments does not mean that either or both Money Funds will collapse. Sponsors and advisers of Money Funds have provided liquidity support, but this is the exception rather than the rule. In fact, sponsors and advisers are not obliged to provide support, and this fact is clearly disclosed to investors and potential investors.

[84] 77 Fed. Reg. 614.

D. Risk Management

Pursuant to Section 165, the NPR proposes to require Covered Companies to establish a risk committee of the board of directors to oversee enterprise-wide risk-management. The proposed rules would require that risk committees report only to the board, have an independent chair, and have at least one member with risk management expertise. Additionally, covered companies, including designated nonbank financial companies, would be required to appoint a Chief Risk Officer, with appropriate expertise and compensation, to implement and maintain the overall risk management framework and practices approved by the risk committee.

Here again, Money Funds are already subject to analogous requirements that are more appropriate for their structure. Money Funds have robust risk management requirements, beginning with Rule 2a-7's requirements that they limit holdings to the safest, most liquid and short-term investments and strict diversification requirements. Moreover, boards of Money Funds have substantial, detailed, and ongoing risk management responsibilities. For example, Money Fund boards must adopt written procedures regarding:

- Stabilization of NAV (which must take current market conditions, shadow pricing and consideration of material dilution and unfair results into account);
- Ongoing review of credit risks and demand features of portfolio holdings;
- Periodic review of decisions not to rely on demand features or guarantees in the determination of a portfolio security's quality, maturity or liquidity; and
- Periodic review of interest rate formulas for variable and floating rate securities in order to determine whether adjustments will reasonably value a security.

In order to ensure that boards are diligent and act in good faith, funds must also keep records of board consideration and actions taken in the discharge of their responsibilities. Management's decision-making processes must also be reflected in records such as whenever a security is determined to present a minimal credit risk, or when it makes a determination regarding deviations in amortized value and market value of securities.

Delegations of responsibilities by the board must be pursuant to written guidelines and procedures, and the Board must oversee the exercise of responsibilities. Even then, boards may not delegate certain functions, such as any decisions as to whether to continue to hold securities that are subject to default, or that are no longer eligible securities, or that no longer present minimal credit risk, or whose issuers have experienced an event of insolvency, or that have been downgraded under certain circumstances Nor may boards delegate their responsibility to consider action when shadow pricing results in a deviation of 1/2 of 1%, or to determine whether such deviations could result in dilution or unfairness to investors.

Rule 2a-7 also provides that if a "First Tier Security" is downgraded to a "Second Tier Security" or the fund's adviser becomes aware that any unrated security or Second Tier Security has been downgraded, the board must reassess promptly whether the security continues to present minimal credit risks and must cause the fund to take actions that the board determines is in the best interests of the fund and its shareholders.[85] A reassessment is not required if the fund disposes of the security (or it matures) within five business days of the event.[86]

If securities accounting for 1/2 of 1% or more of a Money Fund's total assets default (other than an immaterial default unrelated to the issuer's financial condition) or become subject to certain events of insolvency, the fund must promptly notify the SEC and state the actions the Money Fund intends to take in response to such event.[87] If an affiliate of the fund purchases a security from the fund in reliance on Rule 17a-9, the SEC must be notified of the identity of the security, its amortized cost, the sale price, and the reasons for such purchase.[88]

[85] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(A).

[86] Where a Money Fund's investment adviser becomes aware that any unrated security or "Second Tier Security" held by the fund has, since the security was acquired by the fund, been given a rating by a Designated NRSRO below the Designated NRSRO's second highest short-term rating category, the board must be subsequently notified of the adviser's actions. *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(B).

[87] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(A).

[88] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(B).

In the event that after giving effect to a rating downgrade, more than 2.5% of the Money Fund's total assets are invested in securities issued by or subject to demand features from a single institution that are "Second Tier Securities," the fund must reduce its investments in such securities to 2.5% or less of its total assets by exercising the demand features at the next exercise date(s), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[89]

When a portfolio security defaults (other than an immaterial default unrelated to the financial condition of the issuer), ceases to be an Eligible Security, has been determined to no longer present minimal credit risks, or certain events of insolvency occur with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee of a portfolio security, the Money Fund is required to dispose of the security as soon as practicable consistent with achieving an orderly disposition of the security (by sale, exercise of a demand feature, or otherwise), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[90]

The risk management requirements the Board has proposed would not appreciably improve on these standards. Existing requirements for Money Fund Boards are precise, specific, and have no wriggle room. Superimposing the proposed risk management standards over them would provide no meaningful benefits.

E. Stress Tests.

The proposed rules implement Section 165's requirement that the Board conduct annual stress tests of Covered Companies assuming baseline, adverse, and severely adverse scenarios over a planning horizon of at least 9 quarters. The Board would publish a summary of the results of its analyses of Covered Companies.[91] The summary would be on a company specific level and would include estimates of losses, pre-provision net revenue, allowance for loan and lease losses and pro forma regulatory and other capital ratios for each quarter-end over the specified horizons. In addition, pursuant to Section 165(i)(2) of the Act, the proposed rules would require each covered company to conduct its own semi-annual stress tests.[92] For these semi-annual tests, a Covered

[89] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(C).

[90] *See* 17 C.F.R. § 270.2a-7(c)(7)(ii).

[91] 77 Fed. Reg. 657.

[92] 77 Fed. Reg. 658.

Company would be required to create its own scenarios reflecting a minimum of baseline, adverse, and severely adverse conditions. The company must then report the results of the stress tests to the Board, and publish a summary of the results, which would be required to include, at a minimum:

> (i) A description of the types of risks included in the stress test;
>
> (ii) A high level description of the scenarios for the stress test, including key variables (such as GDP, unemployment rate, housing prices);
>
> (iii) A general description of the methodologies employed to estimate losses, revenues, allowance for loan losses, and changes in capital positions over the planning horizon; and
>
> (iv) Aggregate losses, pre-provision net revenue, allowance for loan losses, net income, and pro forma capital levels and capital ratios (including regulatory and any other capital ratios specified by the Board) over the planning horizon under each scenario.

Money Funds are already subject to stress testing rules that are specifically adapted to their unique characteristics. Under the 2010 amendments to Rule 2a-7, the board of directors of each Money Fund must adopt procedures providing for periodic stress testing of the funds' portfolio. Fund managers are required to examine a fund's ability to maintain a stable NAV per share based upon certain hypothetical events. These include a change in short-term interest rates, higher redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.

Again we note that the NPR's standards are not a good fit for Money Funds. Money Funds are primarily short term investments and their outlook is correspondingly short (requiring a stress test of 9 quarters is overkill for an entity whose longest duration asset will cash out in 397 days). As to the disclosure of results, Money Funds are already the most transparent financial entities. Detailed information as to each of a Money Fund's portfolio securities must be posted monthly on their websites, including the name of the issuer, type of investment, principal amount, maturity dates, yields, and amortized cost value. From this data, investors and markets can readily see how a Money Fund would fare over time, and in a far more detailed fashion than via the summaries that would be published under the proposed rules. Money Funds must also file monthly reports with the SEC, in electronic, sortable format, enabling the SEC to review and analyze portfolio holdings, on a micro and macro level. SEC staff monitor this data and can identify, for example, each Money Fund that holds particular issuers' commercial paper, contact managers with questions about market trends, and identify funds that have had sudden asset growth or high yields – which can signal the need for further inquiry. In sum, the stress test proposal, as applied to a designated Money Fund, would have little value.

F. Early Remediation

Section 166 of the DFA requires the Board to create regulations for the early remediation of financial distress at a Covered Company, including a designated nonbank financial company. Here, the statue explicitly states its purpose: to "minimize the probability that the company will become insolvent and the potential harm of such insolvency … ." The new rules must "define measures of the financial condition of the company, including regulatory capital, liquidity measures, and other forward-looking indicators," and must become more stringent as the financial condition of the company worsens. Restrictions would include, in the initial stages of financial decline, limits on capital distributions, acquisitions, and asset growth. At later stages of financial decline, the requirements must include a capital restoration plan and capital-raising requirements, limits on transactions with affiliates, management changes, and asset sales.

To implement this requirement, the Board's rules would identify certain "triggering events" defined by reference to capital and leverage standards, stress test results, risk management weaknesses, liquidity and, for the initial "Level One" remediation level, certain publicly identified and publicly available market indicators, such as credit default swap pricing. Depending on the severity of the triggering circumstances, there would be four levels of remediation.

> Level One: Heightened supervisory review. The Board would review the Covered Company to determine if it is experiencing financial distress or material risk management weaknesses and should be moved to Level Two.
>
> Level Two: Initial remediation. The company's growth and capital distributions would be restricted.
>
> Level Three: Recovery. In addition to the Level Two restrictions, the company would face capital raising requirements and potential limits on executive

compensation, forced divestitures, or requirements to hold new elections for directors, among other things.

Level Four: Recommended resolution. The Board would determine whether to recommend that the firm be resolved under the DFA's orderly liquidation provisions.

The proposal is troubling in several ways. Most importantly, it is likely to have a destabilizing effect on financial markets. Under the proposed rules, it would be very easy to determine which companies are subject to the remediation provisions from public filings, the published results of stress tests, and (for Level One remediation), the publicly identified and available "market indicators." Once the markets are aware that a covered company is subject to any level of remediation (or the fact is even rumored), the dynamics will change quickly. In all likelihood, it will trigger a rush for the doors. In this fashion, the proposed rules may result in the very opposite of Section 166's express purpose: to "minimize the probability that the company will become insolvent."

As to Money Funds in particular, the remediation provisions would have little utility. Again, it appears that the proposed rules are designed for application to banks and investment banks (as they should be). With respect to Money Funds, regulatory concerns center on the potential for a "run," most likely following the downgrade or default of an issuer in which the Fund is invested, and a drop in the Fund's NAV below $1.00. But the hallmark of a run is speed, and it is not clear how the remedial steps outlined above would apply if one were to occur. Nor is it clear how they would apply in the context of the effective remedial and resolution regime that already exists for Money Funds.

Under the existing system, as noted above (pp. 20-21) Rule 2a-7 establishes procedures that a Money Fund must follow if a portfolio instrument is downgraded or a default or other event occurs with respect thereto. In some cases, a fund may be required to dispose of, or reduce its investments in, the issuers of such instruments.

Further, to reduce the chance of a material deviation between the amortized cost value of a portfolio and its market-based value, Rule 2a-7 requires Money Funds to "shadow price" the amortized cost net asset value of the fund's portfolio against its mark-to-market net asset value. If there is a deviation of more than ½ of 1 percent, the fund's board of directors must promptly consider what action, if any, it should take,[93] including

[93] 17 C.F.R. § 270.2a-7(c)(8)(ii)(B) (2010).

whether the fund should discontinue using the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share.[94] Regardless of the extent of the deviation, Rule 2a–7 obligates the board of a Money Fund to take action whenever it believes any deviation may result in material dilution or other unfair results to investors.[95]

Moreover, due to the liquidity required to be held at Money Funds, under amended SEC Rule 2a-7 (as noted above the amount currently is approximately $1.1 trillion in 7-day liquid assets on $2.6 trillion in total assets) it is extremely unlikely that Money Funds will not have sufficient liquidity to satisfy redemption requests out of ordinary cash flow. As a result, it is highly doubtful that a Money Fund would be required to sell portfolio assets to meet redemption requests and be forced to recognize a loss or sale of liquid assets or assets for which the market-to-market NAV is less than amortized cost. This very strong liquidity position is precisely what is needed to stop or prevent runs.[96]

Rule 2a-7 also includes a regulatory scheme that effectively makes Money Funds self-liquidating, and mandates a resolution plan and liquidation procedure for Money Funds, including reporting to the SEC under certain circumstances. The Rule requires Money Funds to invest predominantly in securities that can be sold at book value in short order and have a weighted average maturity of 60 days or less. Due to the liquidity and maturity limitations described above, a Money Fund can self-liquidate in a short period of time merely by ceasing to reinvest the proceeds of investments as they come due. In the event of stresses, Money Funds are also permitted to defer redemption requests for seven days to address liquidity needs. In addition, SEC Rule 22e-3 permits a Money Fund's board of directors to suspend redemptions and postpone payment of redemption proceeds if the fund is about to "break the buck" and the board decides to liquidate it. This facilitates an orderly liquidation of fund assets in the event of a threatened run by ensuring that no one is advantaged by redeeming early. In addition, the reports that Money Funds must file with the SEC enable the SEC to be aware of any developments at

[94] *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

[95] 17 C.F.R. § 270.2a-7(c)(8)(ii)(C).

[96] A 2006 Paper in the FDIC Working Paper Series confirms that liquidity issues, rather than credit issues are the triggers behind banking runs and panics. Kathleen McDill and Kevin Sheehan, *Sources of Historical Banking Panics: A Markov Switching Approach*, Working Paper 2006–01 (Nov. 2006), *available at* www.fdic.gov/bank/analytical/working/wp2006.../wp2006_01.pdf.

a Money Fund that suggest the need for the SEC staff to communicate with its Board and management, and to take prompt oversight action as necessary.

G. Reservation of Authority.

Finally, the proposed rules include a provision – proposed Rule 252.1(d) – that would permit the Board to require a designated firm to hold additional capital, or to comply with additional liquidity requirements, limits on counterparty exposures, risk management requirements, stress test requirements, or any other additional restrictions that the Board, in its sole opinion, deems necessary to mitigate systemic risk – even if the designated company is in complete compliance with all of the requirements of the new rules.[97]

This is an excessively broad, open-ended and undefined proposed rule. Section 113 of the DFA authorizes the FSOC to subject a financial firm to prudential “standards” that are to be adopted by the Board, and not simply oversight by the Board. Section 165 of the DFA also authorizes the Board to “establish prudential standards” for this purpose. The statute thus requires that the measures imposed by the Board on any designated company must be “standards” that are “established” in rulemakings and not created after a designation. Congress did not simply authorize the Board to impose post-designation, un-codified requirements on a designated firm as a matter of its own discretion. To permit otherwise would raise issues of due process, regulatory transparency and fundamental fairness.

In any event, the proposed rule is so broad and undefined that we are not able to provide comments (other than to say that no regulator should possess such undefined and sweeping powers). The description of the proposed rule change does not include any significant discussion of this provision.[98] There is no way to tell when the Board would invoke Rule 252.1(d), or the sorts of companies that might be subject to it. The proposed rule and NPR do not describe the factors, tests or circumstances that the Board would consider in determining whether to apply it. There is no description of the additional capital, liquidity and other unspecified requirements that might be imposed. Nor is there

[97] 77 Fed. Reg. 601-602, 644.

[98] 77 Fed. Reg. 601-602.

any discussion as to whether the Board will allow a designated company to object to the application of the Rule or to appeal to a higher authority. Such broad, vague rules are contrary to fundamental principles of regulatory policy, are subject to abuse, and may lead to conflicting interpretations, litigation and disastrous results.

These weaknesses, in an event, render the NPR deficient under the Administrative Procedures Act ("APA"). Under, the APA, administrative agencies must provide adequate notices of proposed new rules so that the public has an opportunity to understand and comment. The notice and comment process is intended to improve the quality of a rulemaking, to allow the public an opportunity to be heard, and to allow parties to develop a record of objections for judicial review.[99] Thus, in an NPR, an agency "has an obligation to make its views known to the public in a concrete and focused form so as to make criticism or formulation of alternatives possible."[100] An NPR must describe the proposal and any alternatives being considered with specificity so that interested parties may offer informed criticism and comments.[101] Here, the NPR and proposed rule do not provide sufficient information that would allow commenters to understand how the proposed rule would be applied, or what consequences would result from its application. While the Board may tailor application of standards to individual companies, it cannot create a rule to exempt itself from the requirements of the APA. Accordingly, the proposal does not meet the standards of the APA and may not be adopted.

* * * * *

In sum, Money Funds are already subject to an effective program of regulation and oversight that more effectively serves the purposes of the proposed rules. The SEC has continued to refine and enhance its regulatory program, including with the 2010 amendments to Rule 2a-7 which substantially enhanced the required liquidity and credit quality of money funds and their ability to weather financial crises. These enhancements

[99] *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506 (D.C. Cir. 1983); *United Church Board for World Change v. SEC*, 617 F. Supp. 837 (D.D.C. 1985).

[100] *Home Box Office v. FCC*, 567 F.2d 9, 36 (D.C. Cir. 1977).

[101] *Simmons v. Interstate Commerce Commission*, 757 F.2d 296, 300 (D.C. Cir. 1985); *Ethyl Corporation v. Environmental Protection Agency*, 541 F.2d 1, 48 (D.C. Cir.), *cert. den.* 426 U.S. 941 (1976); *United Church Board for World Change v. SEC*, 617 F. Supp. 837 (D.D.C. 1985).

have already been shown to be effective through major financial crises – involving European government debt and the U.S. budget crisis.

Thus, if a Money Fund were to be designated for Board supervision by the Council, imposing the proposed rules as a second layer of regulation would only impose additional costs and burdens upon the Fund, its customers, persons who do business with it, the government agencies that must devote staff time and resources to conduct the supervision, and upon the economy as a whole through the costs and inefficiencies that ultimately are spread out through the economy, without any corresponding benefit in the form of enhanced stability for the economy, Money Funds or the financial system.

IV. Covered Companies Should Be Permitted To Satisfy Liquidity Standards With Government Money Fund Shares.

As noted above, the proposed rules would require Covered Companies to maintain a liquidity buffer of unencumbered highly liquid assets that would be "sufficient to meet projected net cash outflows and the projected loss or impairment of existing funding sources for 30 days over a range of liquidity stress scenarios."[102] In this regard, "highly liquid assets" would be defined as

> (1) Cash;
>
> (2) Securities issued or guaranteed by the U.S. government, a U.S. government agency, or a U.S. government-sponsored entity; and
>
> (3) Any other asset that the covered company demonstrates to the satisfaction of the Federal Reserve:
>
> (i) Has low credit risk and low market risk;
>
> (ii) Is traded in an active secondary two-way market that has observable market prices, committed market makers, a large number of market participants, and a high trading volume; and

[102] Proposed Rule 252.57, 77 Fed. Reg. 648.

> (iii) Is a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity is impaired.[103]

This definition should be revised to permit designated firms to meet asset liquidity standards with U.S. government Money Funds: those that invest solely in securities issued by the United States or guaranteed by the United States with respect to principal and interest (including those subject to repurchase agreements). This would allow Covered Companies an important operational option through which they would be able to avoid the burdens of actively managing a portfolio of U.S. Treasury securities. Further, it would allow holdings in a high quality security with additional benefits of diversification, liquidity and continuous professional management, which is registered under the 1940 Act and subject to the standards of Rule 2a-7.

There is no policy reason to deprive a Covered Company of the benefits of a U.S Government money market fund that is limited to holding the same securities as those that it would be able to hold directly.[104] In this regard, we note that government money market funds have a long history of stability and they are "a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity is impaired."[105]

A recent action by the Commodity Futures Trading Commission ("CFTC") confirmed that agency's positive view of the liquidity and stability of government Money Funds. In recently adopted amendments to its regulations,[106] the CFTC retained Money Funds as a permitted investment under Regulation 1.25, permitting unlimited investments in Money Funds that invest only in U.S. government securities (subject to limits on investments in smaller Money Funds). Regulation 1.25 is the principal CFTC rule

[103] Proposed Rule 252.51(g), 77 Fed. Reg. 646.

[104] Other financial regulators have taken the similar approach of treating as an eligible asset shares of a mutual fund that holds only assets eligible for the entity to own directly. *See., e.g.,* 12 C.F.R. § 1.3(h) (shares of mutual funds that own only bank-eligible investments are themselves eligible for investment by a national bank).

[105] 77 Fed. Reg. 646. Data maintained by the Investment Company Institute shows that government money market funds experienced an *influx* of funds from September 10, 2008 through October 22, 2008 of approximately $470 billion. *See also* Board, *Monetary Policy Report to the Congress* (Feb. 29, 2012) at 22, noting that "government-only funds faced notable inflows" in 2011 that "reflect[ed] the general tone of increased risk aversion."

[106] *Investment of Customer Funds and Funds Held in an Account for Foreign Futures*, 76 Fed. Reg. 78776 (Dec. 19, 2011).

establishing safeguards for the investment of customer segregated funds by futures commission merchants ("FCMs") and derivatives clearing organizations ("DCOs").[107] As the CFTC has stated, "[C]ustomer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers and DCOs and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk."[108] Regulation 1.25 therefore establishes a general prudential standard that all permitted investments be "consistent with the objectives of preserving principal and maintaining liquidity."[109] The CFTC noted that commenters on its original proposal to amend Regulation 1.25 stressed that Money Funds are safe, liquid investments and that only two funds in the 40-year history of Money Funds have failed to return $1 per share to investors.[110] Commenters also noted how enhancements to Rule 2a-7 have made Money Funds even safer and more prepared to withstand heavy redemption requests and have increased Money Fund transparency.[111] In permitting an FCM or DCO to invest all of its customer segregated funds in Treasury-only Money Funds, subject to limits applicable to smaller funds, the CFTC stated that it "agrees with commenters that since an FCM or DCO may invest all of its funds in Treasuries directly, an FCM or DCO therefore should be able to make the same investments indirectly" via a Money Fund.[112]

A similar endorsement of the efficacy of the SEC's amended Rule 2a-7 comes from the Office of the Comptroller of the Currency's ("OCC's") recent proposal to amend its rules governing bank "short term investment funds" ("STIFs") for fiduciary assets to conform more closely to Rule 2a-7.[113] As the OCC notes, a STIF is a bank-administered collective investment fund that, like Money Funds, "permits a bank to value the STIF's assets on an amortized cost basis, rather than at mark-to-market value,"[114] maintains a stable net asset value, and is deemed "a liquid, low risk investment."[115] The

107 17 C.F.R. § 1.25.

108 76 Fed. Reg. at 78776

109 76 Fed. Reg. at 78776, citing 17 C.F.R. § 1.25(b).

110 76 Fed. Reg. at 78785-.

111 76 Fed. Reg. at 78785-78786.

112 76 Fed. Reg. at 78785-78786.

113 *Short-Term Investment Funds*, 77 Fed. Reg. 21057 (Apr. 9, 2012).

114 77 Fed. Reg. 21058.

115 77 Fed. Reg. 21058.

OCC's proposed amendments are intended to address a risk that STIFs and Money Funds share: "[w]hile fiduciary accounts participating in a STIF have an interest in the fund maintaining a stable [NAV], ultimately the participating interests remain subject to the risk of loss to a STIF's principal."[116] Thus, the OCC has proposed rule changes that correspond to those adopted by the SEC in 2010 for Money Funds.[117] As the bureau of the Department of the Treasury that is charged with the oversight of national banks and thrifts, the OCC's adoption of Rule 2a-7's pattern of Money Fund regulation illustrates how the SEC's approach has fostered the stability and utility of Money Funds as short-term investments.[118] Accordingly, we suggest that government money market funds be added to the definition of "highly liquid asset" in the proposed rules.

V. Costs and Benefits of the Proposed Rules.

The Board's proposed rules cannot fail to have a substantial impact on Covered Companies, their customers and the financial system as a whole. Nonetheless, the NPR's consideration of the burdens associated with the proposal are only cursory and do not include a cost-benefit analysis.

Under the Regulatory Flexibility Act ("RFA"), the Board must conduct a cost-benefit analysis of the effect of its proposal on small entities, unless it would not have a

116 77 Fed. Reg. 21058.

117 77 Fed. Reg. 21059, *citing* SEC, *Money Market Fund Reform,* 75 Fed. Reg. 10060 (Mar. 4, 2010). The OCC's proposal states that the new rules would differ from Rule 2a-7 "in certain respects" 77 Fed. Reg. 21059. In particular, bank STIFs under the proposal are subject to significantly less stringent liquidity requirements than Money Funds and would not be required to maintain overnight liquidity of 10% or more of total assets or 7-day liquidity of 30% or more of assets. Because liquidity is key both to preventing and resolving runs, and to obviating the need to sell portfolio assets before maturity to raise cash to make distributions, which thereby substantiates the appropriateness of the use of amortized cost accounting to value units, this is a particularly significant departure from Rule 2a-7.

118 We note that bank collective investment funds operated under the OCC's Part 9.18 regulations have not previously been subject to risk-limiting standards similar to those contained in SEC Rule 2a-7, which can lead to substantial risks. For example, at the time of the Financial Crisis, a Federal Reserve member bank supervised by the Federal Reserve Bank of Boston operated a bank collective investment fund known as a "Limited Duration Bond Fund," that it marketed as a safe and diversified alternative to a Money Fund. That bank collective fund became "almost entirely invested in subprime residential mortgage-backed securities and derivatives that magnified its exposure to subprime securities," and not the diverse array of safe investments that it represented to its customers. Ultimately, the fund's value plummeted, and the sponsor bank paid $663 million to settle SEC fraud charges and investor claims (notwithstanding the supervisory authority of the Federal Reserve Bank of Boston, the SEC retains authority to pursue fraudulent misrepresentation under the general authority of Section 17 of the Securities Act of 1933). SEC Rel. No. 33-9107 (Feb. 4, 2010) (*available at* http://www.sec.gov/news/press/2010/2010-21.htm).

significant economic impact on a substantial number of them.[119] Similarly, the Board must perform a cost-benefit analysis under the Small Business Regulatory Enforcement Fairness Act of 1996, unless it demonstrates that the proposed rules will not result in (i) an annual effect on the U.S. economy of $100 million or more, (ii) a major increase in the costs or prices for consumers or individual industries, or (iii) significant adverse effects on competition, investment, or innovation.[120] The Board is also required to perform a cost benefit analysis under Executive Order 13579, which directs that agency decisions should be made only after consideration of their costs and benefits (both quantitative and qualitative).[121]

The Board's NPR states that the proposal would not have a significant impact on a substantial number of small entities because it would not directly apply to firms with less than $175 million in assets. However, the proposal would have a significant impact on numerous smaller entities that are customers of Covered Companies. Under the RFA, "smaller entities" include small governmental jurisdictions and small non-profit enterprises, as well as small businesses.[122] If a Money Fund were to be designated as a Covered Company, small businesses, municipal entities and small non-profit organizations that use that Money Fund would face higher costs, whether due to the fact that the fund would pass on its compliance costs, or because they would incur the expenses (such as diligence, reprogramming of systems, etc.) of shifting their business elsewhere. Moreover, any Money Funds that are subject to the proposed rules are likely to be less active in the short term debt markets, leading to less liquid and more expensive markets for small municipal and governmental entities that issue commercial paper. In any event, these same concerns would apply to large entities, including states and large

[119] *See* 5 U.S.C. § 601 *et seq.* It is not enough to for an agency to request comment on economic effects. Rather, an agency must affirmatively reach a conclusion on the economic impact and provide sufficient evidence to support it. *Business Roundtable v. SEC*, 647 F.3d 1144 at 1148 (D.C. Cir. 2011).

[120] 5 U.S.C. § 801, 804.

[121] Executive Order 13579 (Jul. 11, 2011); 76 Fed. Reg. 41587 (Jul. 14, 2011).

[122] 5 U.S.C. § 601(6). In brief, the RFA defines "small governmental jurisdictions" as the governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand. 5 U.S.C. § 601(5). Small non-profit organizations that are independently owned and not "dominant" in their fields are also treated as small entities under the RFA. 5 U.S.C § 601(4), (6). Small governmental jurisdictions and small non-profit organizations are common investors in Money Funds. A listing of some of these types of small entities that would be affected by application of the proposed rules to Money Funds is attached as Appendix D.

cities. As a matter of sound policy, the Board should consider how its proposed rules would impact these entities as well.[123]

In addition, the new regulations are likely to affect competitors to Covered Companies regardless of their size. These effects may be positive, as for example, if customers move assets to non-covered companies in search of lower costs. They may also be negative, as customers may elect to move assets to Covered Companies due to a (misplaced) perception that they will be supported by the government in the event of market turmoil. Furthermore, the constraints on credit concentration will require Covered Companies to redistribute their credit extensions, including credit extended to smaller entities.

The Board, in a one-page RFA analysis, cannot reasonably be said to have adequately considered how many loans will have to be unwound, how many bonds will have to be sold off, and what other forms of credit will have to be re-allocated by Covered Companies in order to comply with the credit concentration limits. Nor could it have possibly considered the disruptive effect that such changes would have on the counterparties to Covered Companies' credit transactions, the effect on financial markets in general as positions are unwound, or the adjustments that companies and other entities will have to make as they are forced to do business with new counterparties.

The RFA applies in cases where a regulation does not "directly" apply to an entity, but only "directly affects" it.[124] Here, small entities will be "directly affected and therefore regulated," even though the proposed rules would not have direct application to them. Many small entities will experience diminished access to credit and investment

[123] *See* Letter from James Lewis, President, National Association of State Treasurers to Elizabeth Murphy, SEC (Dec. 21, 2010) (expressing concerns that proposed changes to the regulation of Money Funds could "reduce or eliminate a market for short-term public and non-profit debt," "lead to a contraction in short-term public financing" and "increase short-term debt costs for states due to the reduction of placement options." (*available at* http://www.sec.gov/comments/4-619/4619-6.pdf).

[124] See *Aeronautical Repair Station Ass'n, Inc. v. FAA*, 494 F.3d 161, 177 (D.C. Cir. 2007). There, the FAA promulgated a regulation mandating that air carriers require drug and alcohol testing of employees. The court rejected arguments that an RFA analysis was unnecessary because contractors of air carriers were not "directly regulated" and were not the "targets" of the regulation. Rather, the court held that contractors were "subject to the proposed regulation" for purposes of the RFA even though the regulation was "immediately addressed" to the air carriers, because the regulations applied to employees of the contractors, just as it applied to employees of the air carriers. The contractors were "directly affected and therefore regulated" within the meaning of the RFA.

services provided by companies that become subject to these proposed rules. Thus, the RFA requires the Board to perform a diligent cost-benefit analysis of the proposed rules.

In *Business Roundtable v. SEC*,[125] the Circuit Court of Appeals for the District of Columbia found that when an agency must conduct a cost-benefit analysis, it may not "fail[] adequately to quantify the certain costs or to explain why those costs [cannot] be quantified," or "inconsistently and opportunistically frame[] the costs and benefits" of a rule, "neglect[] to support its predictive judgments," "contradict[] itself," or "fail[] to respond to substantial problems raised by commenters." Under this standard, agencies may not "duck[] serious evaluation of the costs that could be imposed."[126] Promulgation of a rule without meeting these standards may be deemed arbitrary and capricious, and the rule may be set aside under the Administrative Procedures Act.[127]

We query what effects the proposal would have if a Money Fund or Money Funds were designated for Board oversight and made subject to the proposed standards. However, the Board has apparently not even considered how the proposal would impact any types of entities other than bank holding companies. In its Paperwork Reduction Act estimates, the NPR only indicates that the proposal would apply to bank holding companies.[128] There is no mention as to whether any other types of financial firms would be subject to the rules. Consequently, there is no estimate of the costs, burdens or benefits that would flow from application of the rules to a Money Fund or Money Funds. Unless the Board contemplates that no Money Funds will be designated, this type of analysis would be inadequate to satisfy the *Business Roundtable* standards.

[125] 647 F.3d 1144 (D.C. Cir. 2011).

[126] *Business Roundtable*, 647 F.3d at 1148-52.

[127] 5 U.S.C. § 551, 706(2)(A).

[128] 77 Fed. Reg. 643.

VI. Conclusion

Pursuant to a very simple, common sense regulatory approach, which permits investment only in short term, high quality instruments, Money Funds have succeeded in providing an efficient means by which investors' cash balances provide financing for American businesses and governmental units. They are very popular with consumers, and very useful to the economy.

Money Funds are subject to robust regulation by the SEC, which has an excellent track record in this regard. Prudential regulation under Title I of DFA, and the receivership process created by Title II of DFA are not appropriate for Money Funds. In fact, as noted above, no mutual funds, including Money Funds, can be defined as "nonbank financial companies" that would be subject to designation. As required by Section 170 of DFA, the Board should adopt exemptive rules that clearly reflect that Money Funds will ***not*** be designated for Board supervision under Title I of DFA or FDIC receivership under Title II.

Even if a Money Fund were to become subject to designation for Board supervision by the Council, the application of the rules proposed in the NPR, which are designed for large, complex, highly leveraged banking firms, would be inappropriate and would provide no benefits to financial stability. In fact, application of those requirements could prove to be destabilizing for the designated Fund. We suggest that the final rules or the release that will accompany the final rules state that the rules would only be applied to Covered Companies other than Money Funds, and that due to the comprehensive SEC regulation and supervision of Money Funds, in light of the definitions and criteria in the statute, Money Funds will not, in any event, be designated under Title I.

Regulation of Money Funds under the securities laws and regulations has been far more effective than banking regulation. In the past 40 years only two Money Funds have broken the buck, and both were liquidated with relatively minimal losses to investors on a percentage basis and zero cost to the federal government. During that same period, almost 2,900 depository institutions failed, and almost 600 were kept afloat with government infusions of capital, at a cost to the government of more than $188 billion. There is nothing in the historical record to suggest that imposing "bank like" regulatory requirements on Money Funds will make Money Funds, or the American economy, safer. The prudent course, in our view, is to continue to build upon what has worked and to continue the current system of regulation of Money Funds under the supervision of the SEC.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

Attachments

cc: Eugene F. Maloney
Executive Vice President
Federated Investors, Inc.

Appendix A

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Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Attention: Lance Auer

Re: Comments of Federated Investors, Inc. on Financial Stability Oversight Council Rulemaking Proposal "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies" 12 C.F.R. Part 1310, Billing Code 4810-25-P, RIN 4030-AA00

Dear Ladies and Gentlemen:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), and on behalf of money market mutual funds ("Federated Money Funds") for which a Federated subsidiary serves as investment adviser and distributor, to provide comments in response to the Financial Stability Oversight Council ("Council" or "FSOC") notice of proposed rulemaking captioned "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies" ("NPR").[1] Federated has served since 1974 as an investment adviser to money market mutual funds ("Money Funds").[2] We appreciate the opportunity to assist the Council as it considers the regulatory framework for designation of firms under Title I proposed in the NPR.

In the design of its criteria for designation of firms as systemically important under Title I of DFA, and in the designation of firms, the FSOC should be careful to do no harm to the financial system. Government actions taken with the best of intentions can have unintended consequences that cause more harm than good and increase financial instability. In finalizing the criteria and process for designating firms as part of this rulemaking, FSOC should be careful not to create a process that alters the structure of the

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1 76 Fed. Reg. 64264 (Oct. 18, 2011).

2 Federated has over thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

financial services industry and the broader economy in a way that ultimately undermines financial stability, economic growth and efficiency.

The process for designation of firms under Title I should include a process for formal consideration of the ripple effects of designation throughout the economy and the financial system. In view of the stated purposes of the DFA, we suggest that part of the initial stages of screening firms to be considered for designation under Title I include formal consideration of whether designation of that firm, the additional regulation and oversight that would be applied by the Federal Reserve, and the direct and indirect consequences of those actions, would enhance systemic financial stability or detract from it. Formal consideration should also be given to whether the designation would result in further growth of the largest systemically important financial institutions (SIFIs) that are supported by the Federal safety net of FDIC insurance and Federal Reserve lending and whose demise would be catastrophic.

Alongside the FSOC Title I implementation process, some are advocating drastic changes to the structure and regulation of Money Funds, including a continuously floating NAV, restrictions on the ability of investors to redeem shares, and introduction of financial leverage through a two-tier capital structure. We are concerned that the Title I process will be used inappropriately to designate and impose requirements upon Money Funds that are neither necessary nor helpful, that will undermine their usefulness in the financial system, and that will increase risk in the financial system. Before steps are taken in that direction, the FSOC and its members need to thoroughly consider all of the direct and indirect consequences of designation.

As discussed more fully in the attached memorandum, Federated and the Federated Money Funds are concerned that the rules and guidelines proposed in the NPR will be used inappropriately to designate and regulate Money Funds under Title I, with many unintended consequences across the U.S. economy. The consequences of such a designation, in our view, would include a decrease in competition and in the efficiency of the financial markets, coupled with a substantial increase in the size of the largest SIFI banks and the federal safety net that supports them. It would also lead to a delay in settlement cycles, less efficient inter-firm automated transaction processing systems, an increase in financing costs for business and government with resulting stress on jobs, economic growth and government deficits. Finally, it would cause harm to the banking system through an inflow of large balance short term deposits, requiring banks to maintain additional capital and increasing funding risk and interest rate risk. These changes would result in more financial instability throughout the system, and lead to outcomes directly opposite of those intended by Congress.

Before the FSOC even considers forcing structural changes upon the $2.6 trillion Money Fund industry it should thoroughly understand all of the consequences that would flow directly and indirectly from any such action.

Impact on 30 Million Money Fund Shareholders

More than 30 million Americans invest a portion of their liquid assets in Money Funds, a total shareholder balance exceeding $2.6 trillion. These investors view Money Funds as a convenient and efficient way to hold their liquidity. For large balances in excess of the $250,000 FDIC deposit insurance limits, Money Funds are a lower risk investment than are bank deposits. Due to the diversification and high credit quality of Money Fund portfolios, and the mandatory liquidity levels, they are also a more conservative investment than other fixed income alternatives, and far more efficient for an investor than attempting to manage an individual portfolio of bonds.

Different investors use Money Funds for different purposes. Many corporate users do not want and will not use a floating NAV Money Fund. This is not simply risk aversion. For technical reasons discussed in the attached memorandum, $1 per share pricing is critical to the usefulness of Money Funds to a variety of business applications involving automated accounting and settlement systems.

Use of stable value Money Funds to hold short-term liquidity is incorporated into many automated systems and the interfaces used in these systems. Examples, which are discussed in the attached memorandum, include bank trust accounting systems, corporate payroll processing, corporate and institutional operating cash balances, federal, state and local government cash balances, municipal bond trustee cash management systems, consumer receivable securitization cash processing, escrow processing, custody cash balances and investment manager cash balances, 401(k) and 403(b) employee benefit plan processing, broker-dealer and futures dealer customer cash balances, and cash management type accounts at banks and broker-dealers.

The automated systems have greatly reduced (i) the time required to post and settle transactions, (ii) the personnel required to post and settle transactions (and thus the overhead costs associated with those functions), (iii) the errors associated with posting and settling those transactions, (iv) the "fails" involved in settling those transactions, (v) the size and length of time outstanding of the "float," "due to," and "due from" balances tied up in processing of transactions, and (vi) the counterparty default risk associated with transactions between and among companies. These changes over the past four decades have reduced risk, increased the efficiency of many business activities, and greatly reduced the amount of funding required for businesses to conduct transaction processing.

Many of these systems have as a key element the use of Money Funds to hold short-term liquidity in connection with settlement of transactions. The features of Money Funds that are ideal for holding temporary balances in these systems include (1) stable $1 per share value during the time the transaction is being processed to allow certainty during the course of the day[3] of the exact dollar amounts that are being processed between different counterparty accounting systems so that the amount due and the amount paid do not diverge even by a few cents during the time in which the transaction is being processed, (2) same-day settlement capability (T+0 processing) which is possible only because of the use of amortized cost by Money Funds, (3) high credit quality and underlying portfolio issuer diversification which reduces risk of insolvency during the time the transaction is being processed, and (4) operation within a highly-automated secure computer environment that allows for 24/7 no downtime interfaces with accounting and data processing systems of all parties to the transactions.

Money Funds, like all mutual funds, must use the price next calculated after the purchase or redemption order is placed to set the price for the order. With amortized cost, the Money Fund knows at the beginning of the day what the portfolio values and share price will be at the end of the day (absent a major credit event), which makes same day transaction processing (T+0) possible. With a continuously floating NAV, funds must wait until the markets close to know portfolio values to price fund shares, so fund share purchases and redemptions are processed the next business day (T+1). This extra day's float means more risk in the system and a larger average float balance that each party must carry and finance.

A floating NAV would make Money Funds less useful to hold the large short-term cash balances as part of automated transaction processing systems across a wide variety of businesses and applications. At a minimum, imposing floating NAV requirements on Money Funds would require these systems to be redesigned and re-programmed on a wide scale, involving substantial effort from many people and years to complete.

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[3] This will be the case except if an unanticipated credit event occurs in portfolio assets during the day that causes the Money Fund's NAV to drop below $0.9950 per share. Over the entire four decades of the existence of Money Funds, with hundreds of Money Funds in operation, this has happened on only two occasions.

Impact on the Banking System and Further Growth of SIFIs

Shrinking Money Funds would increase systemic risk by causing further growth of the largest SIFI banks. Over 75% of recent deposit growth that was caused by unlimited deposit insurance of demand deposit accounts flowed into the ten largest banks. The ten largest US banks represent 65% of banking assets and 75% of US GDP. Institutional investors hold approximately two-thirds of Money Fund shares. If two thirds of Money Fund balances move into the banking system and 75% of that flows into the ten largest banks, that would increase the size of the ten largest SIFI banks by $1.3 trillion to 74% of US banking assets and 84% of US GDP. Increasing the concentration of the banking industry and the size and systemic importance of the largest banks is directly contrary to the purposes stated in the preamble to the Dodd Frank Act "to end 'too big to fail' [and] to protect the American taxpayer by ending bailouts."

This movement of balances from Money Funds to bank deposits would also result in a much larger federal safety net with fewer assets to backstop FDIC insurance. Each trillion dollars of balances shifted from Money Funds to bank deposits results in the FDIC's Bank Insurance Fund falling an additional $20 billion below its 2% target ratio of BIF assets to covered deposits. Even without this increase, the FDIC projects that it will not reach its target ratio until at least 2020.

Each trillion dollars of balances shifted from Money Funds to bank deposits would also require an additional $60-$80 billion in new capital to be raised by the banking industry to support leverage capital requirements. Shifting all $2.6 trillion in Money Fund balances to bank deposits would require significantly more new capital to be raised by US banks than the $147 billion in new capital currently required to recapitalize the entire European banking system from losses in the European government debt crisis.

A complicating factor is the expiration, on December 31, 2012, of the temporary program of unlimited FDIC deposit insurance coverage for noninterest-bearing demand deposit accounts at banks. If Money Fund "reform" renders Money Funds unattractive just as unlimited deposit insurance ends in 2012, holders of large cash balances will become very nervous indeed and those cash balances will become even more likely to be moved between banks in crisis. The precise effects of this change on the placement of cash balances by corporate treasurers and on banking system liquidity is not predictable, but it is not likely to increase financial stability.

The existence of Money Funds to hold these large, short-term corporate balances reduces the risk to the U.S. banking system by keeping them from sloshing across the balance sheets of U.S. banks, reducing the size of the federal safety net, and reducing the interest rate risk and funding risk that these balances would otherwise present to banks. Money Funds benefit the financial system by providing a relatively safe means for commercial users to store short-term liquidity away from the banking system and its explicit federal guarantee.

Nor do banks want a large new inflow of short-term deposits. Because of their cost structures, including the cost of capital, FDIC insurance premiums, and personnel and occupancy expense, banks cannot profitably invest deposit inflows into short-term money market assets. In order to avoid losing money on every new dollar, banks must invest the deposit inflows into loans and other long term, higher risk assets, which creates interest rate risk, funding risk and credit risk for the bank on these balances. These balances, coming in from corporate treasurers or through omnibus accounts, are often in very large dollar amounts and placed for short periods of time. The balance often exceeds FDIC deposit insurance limit of $250,000 many times over. Relying upon this type of balance to finance a part of a bank's balance sheet creates funding risk. In a crunch, the bank may need suddenly to replace this funding source just as cash availability is becoming much more expensive and much less available. This is why some banks have been turning away new large deposit balances or charging depositors a fee to hold the balance.

Impact on Cost and Availability of Credit

Another consequence to shrinking Money Funds would be the impact on the cost and availability of credit to businesses and state and local governments. Money Funds provide critical financing to every sector of the short-term credit market. If Money Funds were taken out of the financial system, and the role currently performed by Money Funds in providing short-term financing was performed solely by commercial banks, the economy would be harmed through increased financing costs to business and governments.

Banks are far less efficient than are Money Funds in providing funding to corporate and government borrowers in the money markets. As discussed in the attached memorandum, banks have overhead costs that are far higher per dollar of assets than the operations costs of Money Funds. A comparison of expense data shows that cost differential is between 200 and 300 basis points per year per dollar of assets. This large cost differential between the expense ratios of Money Funds as compared to banks means there are lower returns to savers and higher costs to borrowers when balances are intermediated through the banking system. If Money Funds disappeared and were replaced by banks, the higher cost of borrowing would translate directly into less economic growth, fewer jobs, and even further cuts to government programs, payrolls, pensions and benefits.

Do Not Aggregate Investment Company Balances to Reach $50 Billion Threshold

A footnote in the NPR indicates that the FSOC is considering aggregating the holdings of mutual funds in a given investment company family in the first stage of consideration in the designation process. Regardless of what specific investments are in a particular Money Fund, each Money Fund portfolio stands alone. The liabilities (if any) and shareholder interests of one Money Fund do not have a claim on the portfolio assets of another Money Fund, even if they are invested in the same issuers. The portfolio of each Money Fund is diversified by issuer and maturity resulting in limited exposure to any one issuer or group of issuers, such that a default by any one (or several) issuers of underlying investments does not mean that either or both Money Funds will fail to maintain a stable NAV.

Because Money Funds hold only very short term money market instruments, the portfolio composition of every fund is continuously changing. Two Money Funds may invest in many of the same issuers, but at different times with different maturity dates, such that the performance and payment on the two investments will differ and will not necessarily bear the same risks or market values. Similarity of the names of the issuers in two Money Funds on a given date does not mean the two Money Funds have the same risk profiles, investment returns or liquidity.

Aggregation by the FSOC of two Money Funds with the same investment adviser to reach the $50 billion size criteria based upon similarity of the names of the issuers held in the funds' respective portfolios creates a perverse incentive for the investment adviser to allocate the two Money Funds into different names, rather than selecting for each Money Fund the best portfolio of available money market instruments.

We believe that it would be inappropriate and counterproductive for the NPR to include a provision in the guidelines for designation that would aggregate Mutual Funds with the same investment adviser for purposes of the $50 billion size criteria based upon the degree of overlap between the underlying issuers of money market instruments held in their separate portfolios.

Existing Program of Comprehensive Prudential Regulation Should Be Given Far Greater Weight in Title I Designation Process

The existence of a comprehensive regulatory program should be given controlling weight in the Title I designation process. In light of the 2010 revision of Securities and Exchange Commission ("SEC") regulations governing Money Funds, and significant upgrades to the information systems and oversight by the SEC of Money Funds, formal and careful consideration must be given at an early stage of the designation process as to whether further changes to the structure and regulation of Money Funds are needed that a designation under Title I would address. There needs to be a formal analysis at an early stage in the Title I designation process of what improvements would be accomplished by designation and how designation is a better means to accomplishing those improvements than allowing the existing primary federal regulator to continue its regulation and supervision of the firm.

Money Funds are comprehensively regulated and supervised by the SEC under the Investment Company Act and other federal securities laws. This existing comprehensive program of SEC regulation and supervision of money funds is significant to the question of whether Money Funds should be designated under Title I in four key respects.

First, Title I of the DFA, and the proposed rules, expressly include consideration of whether a firm already is comprehensively regulated as a key element in weighing whether designation of that firm under Title I is necessary or appropriate to address systemic risk. The text of Sections 2 and 165(b)(1)(A) of the DFA clearly states that registered investment companies are already regulated by the SEC under the Investment Company and that regulatory program is *prudential* regulation. Unlike other types of organizations with a primary regulator named in Section 2 of the DFA, registered investment companies do not have holding companies, sister affiliates or other complex regulatory structures that place parts of the larger firm outside of the jurisdiction of the primary federal regulator. The registered investment company is itself the entire corporate structure, and the SEC comprehensively regulates and supervises it, as well as its key service providers, the investment adviser and principal underwriter. There is not an unregulated corner of the organization that requires designation under Title I to permit oversight of that part of the enterprise.

Second, consideration of the program of regulation and oversight of Money Funds by the SEC under the Investment Company Act and SEC rules, which are discussed in the attached memorandum, demonstrates that the ways of reducing systemic risk through designation under Title I and Federal Reserve oversight of less thoroughly regulated categories of firms, including capital requirements, leverage limits, liquidity requirements, risk management and stress-testing, conflict-of-interest restrictions, disclosures and transparency, liquidation, governance requirements, corporate structure, counterparty exposure and concentration monitoring and control, and limitation of off balance sheet activities, are already comprehensively addressed by the SEC. Indeed Section 165(b)(1) of the DFA uses investment companies subject to the requirements of the SEC's existing regulation of investment companies as an example of "a company subject to more stringent prudential standards" than the "capital and leverage limits" that could be imposed under Title I of the DFA.

Third, the SEC's program of regulation and oversight has been tried, tested and proven effective. The SEC spent eight years carefully considering the issues before adopting Rule 2a-7, and developed an extensive administrative record that included hearings before an administrative law judge, expert testimony, extensive SEC staff analysis, and comments from the investment management industry, investors and the public. The SEC's current program works, as demonstrated by the performance of Money Funds over the past forty years. The SEC has continued to refine and enhance its regulatory program, including with the 2010 amendments to Rule 2a-7 which substantially enhanced the required liquidity and credit quality of money funds and their ability to weather financial crises up to and including maintaining the redeemability of shares when and if a Money Fund "breaks a buck." These enhancements have been shown to be effective through several major financial crisis within the past year -- involving European government debt and the U.S. budget crisis. Most recently, the CFTC in December 2011 completed a lengthy re-evaluation of the asset types approved to hold futures firm customers' liquidity balances and determined that Money Funds continue to meet their safety and liquidity needs.

Fourth, if a company is already comprehensively regulated and supervised by a primary federal regulator, imposing a second layer of regulation through designation under Title I will impose additional costs and burdens upon the firm and persons who do business with it, upon the government agencies that must devote staff time and resources to conduct the supervision, and upon the economy as a whole through the costs and inefficiencies that ultimately are spread out through the economy. As indicated by the President earlier this year in Executive Order No. 13563, there needs to be a reason for imposing a second layer of costs and the benefit gained or the risk avoided must justify the additional burden imposed.

Insufficient attention has been paid to the effectiveness of the SEC's recent amendments to Rule 2a-7, which have demonstrated over the past several months by the resiliency of Money Funds in the face of very turbulent market conditions. Operating under the amended rule, Money Funds have been able, without incident, to handle large volumes of redemptions in short periods – volumes similar in size and percentage of assets to the redemptions that occurred during the September 2008 financial crisis. Under the amended Rule 2a-7, Money Funds are now required to maintain at least 10% of assets in overnight cash (currently $260 billion) and 30% with seven-day availability (nearly $800 billion). Most Money Funds maintain far more liquidity than is required by Rule 2a-7. Before further changes are made to the program of regulation of Money Funds, greater consideration should be given to evaluating the effectiveness of the existing regulatory program. In our view, the greater liquidity now required of Money Funds, together with robust surveillance by the SEC aimed at detecting and responding to excessive risk-taking – surveillance that focuses on the kind of unusually high levels of yield or growth at a Money Fund that led to the 2008 problem at the Reserve Primary Fund – should provide significant safeguards.

Stable NAV a Result of Stable Portfolio Assets, Not An Accounting Gimmick

A significant aspect of the SEC's regulation of Money Funds is the criteria for calculating the NAV of a fund. The stable NAV has also been a primary target of critics of Money Funds, who either misunderstand the accounting convention used by Money Funds or deliberately mischaracterize it. The stable NAV is not an accounting gimmick. It relies upon a method of accounting for portfolio assets widely utilized by banks and other institutions and recognized and approved by federal bank regulators.

Money Fund shares price at a dollar on a daily basis not because of any promise to do so (Money Funds do not make that promise) but because the aggregate daily value of all of the portfolio assets of the Money Fund, minus expenses and any liabilities, divided by the number of issued and outstanding shares, is worth, that day, between $0.995 and $1.005 per share. The managers of Money Funds work diligently to choose investments for the portfolio of the Money Fund so that the NAV per share will calculate every day to something very close to exactly $1.00 per share, and generally for most funds almost all of the time, the daily NAV before rounding to the nearest penny is between 99.9 cents and 100.1 cents per share.

A Money Fund is a pool of short-term debt investments owned by shareholders. There is no debt or other borrowing by the Money Fund. It is 100% equity. Investors are permitted to purchase or redeem Money Fund shares every business day, so it is therefore necessary to calculate the price at which shareholders may purchase or redeem shares every day. Like all mutual funds, Money Funds set the daily price for purchases and redemptions of shares at that day's net asset value (NAV). Like all mutual funds, a Money Fund calculates its daily NAV per share by determining the value as of that day of each and every asset held in the portfolio of the Money Fund and adding them up to determine that day's gross portfolio asset value, subtracting any liabilities (there generally are not any) and accrued expenses to reach a net portfolio asset value, and then dividing the net portfolio value by the number of shares of the Money Fund currently issued and outstanding to arrive at the NAV per share. As with most other mutual funds, this share price is rounded up or down to the nearest cent. Essentially, NAV per share is the value of each shareholder's pro rata slice of the overall assets of the fund.

The share price calculations of Money Funds differ from those of other mutual funds in only two respects. First, Money Funds may use "amortized cost" to value the individual short-term portfolio securities they own, while other mutual funds use a mark-to-market pricing. Second, because they use "amortized cost," Money Funds know portfolio values earlier and are able to calculate NAV and share prices early in the day, while other mutual funds must wait until after the markets close to obtain the closing market prices needed to calculate NAV. This ability to anticipate at the beginning of the day that the share price will be a dollar at the end of the day is a key feature of Money Funds that allows them to be used to hold short term liquidity in connection with a range of commercial systems, as discussed above and in the attached memorandum.

The "amortized cost" method of accounting for the value of portfolio assets is permitted only for funds that comply with the stringent portfolio liquidity, credit quality, maturity, and diversification requirements of Rule 2a-7. This ensures that these funds are as stable and low risk as possible, and can be used only for so long as the NAV calculated using the amortized cost method does not materially depart from the shadow price of shares calculated using mark-to-market asset values.

The difference between amortized cost and market prices in valuing portfolio securities is not significant for short term, high quality debt instruments of the types owned by Money Funds. Short-term paper is normally issued at a discount from the par value which represents the imputed interest over the days between the issuance date and the maturity date. Amortized cost is determined by subtracting the purchase price of the instrument from its maturity par value, dividing the small difference by the number of days remaining to maturity, and, for each day from the purchase date to the maturity date, adding to the purchase price one day's worth of the price difference.

The use of amortized cost accounting recognizes that the market value of the assets held by a Money Fund generally do not fluctuate from amortized cost to any material degree. Money Fund assets are short term to avoid interest rate and liquidity risk and long-term credit risk. Money Fund assets are diversified and high credit quality to minimize credit risk. The stable NAV of $1 per share is the result of very stringent portfolio restrictions that apply to all Money Funds under SEC regulations.

Money Funds are required to use market values of individual securities to calculate a "shadow price" of their shares to test whether the use of amortized cost fairly approximates what NAV would be using daily market values. This "shadow price" information is calculated at least weekly. That weekly data is reported to the SEC monthly, and is available to the public from the SEC or from the website of the Money Fund's sponsor.

Shadow price data demonstrates that Money Funds' $1 per share stable net asset value reflects the stable market values of the assets owned by Money Funds. A January 2011 Report, "Pricing of Money Market Funds," by the Investment Company Institute ("ICI"), shows that due to the portfolio restrictions in Rule 2a-7, Money Fund NAVs maintain their values in the face of credit events, interest rate changes and extraordinary market changes. ICI data shows that even in September 2008, average Money Fund shadow share prices did not break a buck – but stayed above 99.8 cents per share, and returned to an average NAV of 1.000 dollars within a very short period.

Banks also use amortized cost methods to account for valuing loan portfolios on their balance sheets. Banks, however, do not calculate or report a mark to market "shadow price" for these loans or otherwise gauge the degree to which the amortized cost at which loans are carried on the bank's balance sheet diverges from market values. Because the loans have durations well in excess of the maturity ranges of Money Fund portfolios and are lower in credit quality, the divergence between amortized cost of bank loan portfolios and current market values can be very large. If the federal banking agencies represented on FSOC do not believe that amortized cost appropriately values Money Fund portfolios comprised of high credit quality paper with weighted average maturities under 60 days and a weekly shadow mark-to-market benchmark on valuations for accuracy, how can they possibly permit banks to use amortized cost to value loan portfolios with weighted average maturities measured in years, no market price benchmarking, and much lower credit quality?

The Data Demonstrates That Continuously Floating NAV Does Not Stop Runs

Money Funds are sometimes compared to ultra-short bond funds that invest in relatively short-term debt instruments but have a floating NAV. Despite having a floating NAV, ultra-short bond funds faced investor redemptions in the Fall of 2008 at levels higher than those experienced by Money Funds. Similarly, floating NAV money funds in Europe also suffered investor withdrawals roughly equivalent to withdrawals from European stable NAV money funds. Whether a continuously floating NAV prevents runs is an empirical question, and the data shows overwhelmingly that it does not. What stops a run is liquidity.

Money Funds Represent a Regulatory Success

Money Funds have enjoyed a superior safety record compared to insured depository institutions. In the forty years that Money Funds have been in operation, only two have "broken the buck" and returned shareholders less than 100 cents on the dollar. Significantly, no taxpayer funds were used to bail out shareholders in either case.

Money Funds achieved this success under the regulation and oversight of the SEC and its Division of Investment Management. At the core of this regulatory program is SEC Rule 2a-7, which in thirteen pages imposes sound principals that are the secret of the stability and solvency of Money Funds: invest only in very short-term, high quality, marketable debt instruments in a diversified manner, and do not use any leverage.

In comparison, the regulation of banks involves four (formerly five) federal regulators and over fifty state regulators. The federal agencies alone require over 26,000 full-time employees. The federal banking code – Title 12 of the United States Code and Title 12 of the Code of Federal Regulations – totals fourteen volumes and many thousands of pages of requirements and prohibitions. Yet, during the 40 years since the launch of the first Money Fund – a period during which the Money Fund industry experienced exactly two instances in which shareholders did not receive 100 cents on the dollar – some 2,840 depository institutions have failed, and an additional 592 were the subject of "assistance transactions" in which the government injected capital to keep them afloat. From 1971 through 2010, total estimated FDIC losses incurred in connection with failed banks or assistance transactions amount to $188.5 billion.

Even in times of greatest financial stress, Money Funds have been more stable than banks. Since January 2008, as a result of the financial crisis that followed the burst of the housing bubble and the collapse of mortgage-backed securities investments, nearly

400 banks have failed, and even more would have failed but for dozens of federal programs that infused banks with cash. During the same period, only one Money Fund, the Reserve Primary Fund, failed to return investors' shares at 100 cents on the dollar. The other 806 Money Funds in operation in 2008 did not break a buck and more than 95% of those funds did not receive any support from their sponsors.

What if Amended Rule 2a-7 Had Been in Place in 2008?

The impact of the 2007-2009 Financial Crisis on Money Funds might have been different had the new regulatory requirements been in place in 2008. It was the bankruptcy of Lehman Brothers that caused the Reserve Primary Fund to "break the buck." The FDIC opined in a 2011 study that, had the Dodd-Frank Act been in effect in 2008, Lehman Brothers would have been quickly resolved by the FDIC at a far smaller loss to creditors than occurred under the bankruptcy court process. If that is correct, the losses to the Reserve Primary Fund would have been much less (potentially preserving the dollar per share) and the investment in Lehman commercial paper quickly repaid in cash by the FDIC as receiver at a discounted value.

Moreover, had the 2010 amended version of Rule 2a-7 and the SEC's new enhanced program of oversight of Money Funds been in place in 2008, including SEC staff's current program of analyzing the information submitted by Money Funds, the SEC would have detected the unusually rapid growth and high yield of the Reserve Primary Fund as early as 2007 and flagged it as a problem fund for closer scrutiny and rapid supervisory action. The Reserve Primary Fund likely would not have been permitted to grow to the size that it did, or take on the portfolio risk that it did. Low-credit quality and long maturity assets would not have been allowed in the Reserve Primary Fund portfolio under the amended version of Rule 2a-7. Consequently the illiquidity and risk associated with those positions would not have been in the Reserve Primary Fund.

During the week of September 15, 2008, investors redeemed roughly 15% of prime Money Fund shares. Had the SEC's 2010 amended rules been in place in 2008, Money Funds would have held at least 10% overnight cash and 30% seven day cash available to pay those redemptions. The 2010 amendments also require Money Funds to know enough about their investors to be able to anticipate likely redemption activity and factor it into the liquidity of the Money Fund. Given the other market events in the weeks and months prior to September 2008, Money Funds likely would have held far more liquidity than those 10%/30% levels due to the requirement in the amended Rule 2a-7 that the Money Fund assess its reasonable cash needs to meet redemptions and hold sufficient liquidity to do so. Amended Rule 2a-7 now requires Money Funds to hold enough cash and very short-term assets to be able to meet investor withdrawal requests on a scale comparable to those seen in September 2008 without any government assistance or market intervention and without having to sell portfolio assets into an illiquid market. This much stronger cash position likely would have permitted Money Funds to meet investor redemption requests as they occurred without needing to dump portfolio assets into the markets to raise cash, and would also have calmed investors, nipping the "run" before it began.

Moreover, had the new portfolio reporting obligations been in effect in 2008, investors would have a better understanding of what was (and was not) in the portfolios of other Money Funds, calming concerns that other Money Fund portfolios contained large positions in Lehman commercial paper or other similarly troubled issuers. Part of every financial panic is fear of the unknown. Better disclosure of Money Fund portfolios removes much of the uncertainty that investors had in September 2008 regarding the potential portfolio losses of other Money Funds.

The 2010 Revisions to Money Fund Supervision Proved Effective in 2011 European Debt Crisis, US Budget Impasse

In 2010, the SEC acted decisively to enhance the stability and liquidity of Money Funds through amendments to Rule 2a-7 and related rules and reporting forms. These changes have included a requirement to maintain liquidity sufficient to meet reasonably foreseeable redemptions, a requirement that taxable money market funds hold at least 10 percent of their assets in "daily liquid assets" and that all Money Funds hold at least 30 percent of their assets in "weekly liquid assets," and a new power for Money Funds to suspend redemptions in extreme circumstances, to ensure an orderly liquidation process. Most Money Funds in fact hold cash and near-cash items well above the 10% and 30% minimums. To put these ratios in perspective, Money Funds currently hold $2.6 trillion in assets. Of that amount, over $260 billion is in overnight cash and roughly $800 billion or more must have a maturity that permits it to be converted to cash within one week.

Since 2010, the SEC has also enhanced its methods and added staff to monitor Money Funds. Using data from the new Form N-MFP filings, the SEC has created a central database of Money Fund portfolio holdings. The database allows the SEC to analyze and sort reported data in a variety of ways, so that it can evaluate any Money Fund's overall maturity, diversification, credit quality, credit enhancements and liquidity. This database allows SEC officials to identify each Money Fund that holds a particular issuer's commercial paper. The SEC staff can also use reports of Money Funds to identify those that have experienced sudden growth in assets under management or high yields. Analysts within the SEC now sift through weekly portfolio data submitted each month electronically by all Money Funds, looking for risk. Using this data, the SEC Staff now follows up frequently with Money Fund managers, asking with detailed questions about reported data, trends in yields and portfolios, growth, repo counterparties, general market conditions and other issues, and for explanations of adverse trends, portfolio red flags and potentially risky investments.

The new liquidity requirement has proven effective. In 2011, at a time of extreme volatility in world markets caused by fear of major sovereign defaults and the potential for related contagion, Money Funds experienced dramatic shareholder redemptions in June and again in late July/early August. Investors reacted first to the Greek debt crisis and then to the U.S. federal budget deadlock. Money Funds handled massive redemption requests during both the Greek debt crisis and the U.S. federal debt ceiling impasse without disruptions. Much of the redemption activity was in short bursts around the key events of each financial episode. Yet no Money Fund broke a buck. None faltered or was unable to meet redemption requests. The key reforms adopted by the SEC in 2010, which shortened Money Fund maturities, increased cash holdings and portfolio diversification, and improved credit quality, worked exactly as intended.

Money Funds Should be Specifically Excluded Pursuant to DFA Section 170

Money Funds are subject to robust regulation by the SEC, which has an excellent record in its oversight of Money Funds and a superior track record in this area in comparison to bank-type regulation. Designating one or more Money Funds under Title I of the DFA is unnecessary to achieve the purposes of the Act, and would be contrary to the text and purposes of the Act. Therefore, Money Funds should not be designated for regulation by the Board under Title I. Section 170 of the DFA dictates that in connection with Council rules implementing Title I, the Board "***shall*** promulgate regulations in consultation with and on behalf of the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies... from supervision by the" Board. Section 170 is not merely a grant of authority, it is a specific rulemaking requirement that the exemptive rules ***shall*** be promulgated. Section 170 should be used to exclude Money Funds from designation under Titles I and II of the DFA.

The Proposed Rule Is Part of an Integrated Statutory Program That Is Fundamentally Flawed

The statute and the various proposed rules that would implement the statute contain a number of other flaws and shortcomings, which are discussed in more detail in the attached memorandum and in our previous comment letters, two of which are attached hereto and should be included in the comment file on the NPR. If applied to

Money Funds, the NPR is subject to these same flaws. Due to the procedural and practical linkages and statutory intertwining of Titles I and II of the DFA with Title I of the DFA and the rules under both Titles, the NPR is made defective by the shortcomings in other parts of Titles I and II and the related implementing rules.

Titles I and II of the DFA, which dramatically curtail judicial oversight of agency actions, particularly those related to designation of firms under Titles I and II and the resolution of firms, and the implementing rules, infringe inappropriately on the role of the Federal courts under Article III of the Constitution and the right of private parties to have access to Article III courts, rather than a federal agency, in the ultimate determination and disposition of their private property rights and interests. The curtailment of the role and authority of Article III federal courts in the process of reviewing agency action associated with the designation of nonbank financial companies under Titles I and II of DFA, and in adjudicating private rights, violates the Constitution.

Conclusion

Money Funds have been a success story in U.S. financial regulation. Using a very simple, common sense approach, which permits investment only in short term, high quality money market instruments, the SEC has succeeded in supervising an efficient and effective program by which investors' cash balances provide financing for American businesses and governmental units. Money Funds are an efficient and low-risk way to hold short-term liquidity and have been essential to development of a wide variety of automated commercial applications that have shortened processing times and settlement cycles. Money Funds are very popular with consumers, government and business investors, and very useful to the economy.

The enhancements made since 2010 by the SEC to its oversight and supervision of Money Funds, as well as to the liquidity and credit quality requirements applicable to Money Funds, have further reduced the risks associated with Money Funds.

There is a real danger of unintended consequences from radical changes to the regulation and structure of Money Funds through designation of one or more Money Funds under Title I of the DFA. We respectfully suggest that the proposed rules and guidelines to implement the designation process under Title I of the DFA be revised to include:

(1) a formal and thorough consideration of the direct and indirect impact of designation of a firm on the financial system and the economy;

(2) a process for formal and thorough consideration of whether the direct and indirect consequence of designation of a firm will reduce or increase economic risk associated with "too big to fail" institutions, protect the American taxpayer by ending bailouts or instead expand exposure to federal bailouts, and result in an increase or a decrease in the federal safety net as contemplated by the preamble to the DFA;

(3) greater weighting of an existing program of comprehensive supervision and regulation by a primary federal regulator of the firm being considered for Title I designation;

(4) an analysis of what is sought to be accomplished through designation of the firm and how designation is a better means to that end than allowing the firm's existing primary federal regulator to continue its supervision of the firm; and

(5) a clear statement pursuant to Section 170 of the DFA that Money Funds will not be designated under Title I.

Imposing "bank like" regulatory requirements on Money Funds will not make Money Funds, or the American economy, safer. The prudent course is to continue to build upon what has worked and to refine the current program of regulation of Money Funds under the supervision of the SEC.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

cc: Eugene F. Maloney
Executive Vice President
Federated Investors, Inc.

ARNOLD & PORTER LLP

Comments of Federated Investors, Inc. on Financial Stability Oversight Council Rulemaking Proposal "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies"
12 C.F.R. Part 1310

December 15, 2011

John D. Hawke, Jr.
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555 12th Street, N.W.
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I. Introduction & Executive Summary

We submit this memorandum on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), and on behalf of money market mutual funds ("Federated Money Funds") for which a Federated subsidiary serves as investment adviser and distributor, to provide comments in response to the Financial Stability Oversight Council ("Council" or "FSOC") notice of proposed rulemaking captioned "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies" ("NPR").[1] Federated has served since 1974 as an investment adviser to money market mutual funds ("Money Funds").[2] We appreciate the opportunity to assist the Council as it considers the regulatory framework for designation of firms under Title I proposed in the NPR.

Federated, as a participant in the money markets and a sponsor of the Federated Money Funds, and the Federated Money Funds themselves, are interested in many of the details of the NPR and related rulemakings. As an investor in and creditor of financial issuers, we are concerned that certain aspects of Titles I and II, the implementing rules, and the way in which they will be interpreted and applied, will increase uncertainty, risk and volatility in the money markets and other fixed income markets, particularly in times of crisis. We believe the process for designation of firms under Title I should include a process for formal consideration of the ripple effects of designation – the impact of a particular designation itself – throughout the economy and the financial system. A process that attempts to constrain the risk in a designated firm or group of designated firms may simply shift the risk to other parts of the financial system where the exposure of taxpayers and the financial system may be larger and more direct.

Federated and the Federated Money Funds are also concerned that the rules and guidelines proposed in the NPR will be used inappropriately to designate Money Funds under Title I, which would harm not only Money Funds but also persons who use Money Funds to hold temporary liquidity or obtain financing, with many unintended consequences across the U.S. economy. The net result of such a designation, in our view, would be a decrease in competition and in the efficiency of the financial markets; a delay in settlement cycles and less efficient inter-firm automated transaction processing systems; an increase in financing costs for business and government with resulting stress on jobs, economic growth and government deficits; and harm to the banking system through an inflow of large balance short term deposits, requiring banks to maintain additional capital and increasing funding risk and interest rate risk, resulting in more, rather than less, financial instability throughout the system.

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[1] 76 Fed. Reg. 64264 (Oct. 18, 2011).

[2] Federated has over thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

Federated therefore respectfully requests that the rules and guidelines proposed in the NPR be revised before they are adopted in final form to include:

(1) a process to assure formal and thorough consideration of the direct and indirect impact of designation of a firm on the financial system and the economy;

(2) a process for formal and thorough consideration of whether the direct and indirect consequence of designation of a firm will reduce the economic risk associated with "too big to fail" institutions and protect the American taxpayer by ending bailouts as contemplated by the preamble to the DFA or instead expand exposure to federal bailouts and result in an increase in the federal safety net;

(3) greater weighting of an existing program of comprehensive supervision and regulation by a primary federal regulator of the firm being considered for Title I designation;

(4) an analysis of what is sought to be accomplished in terms of the purposes of Title I and Title II through designation of the firm and how designation is a better means to that end than allowing the firm's existing primary federal regulator to continue its supervision of the firm; and

(5) a clear statement pursuant to Section 170 of the DFA that Money Funds will not be designated under Title I.

The NPR is part of an intertwined series of rulemakings by the Council, the Board of Governors of the Federal Reserve System (the "Board" or Federal Reserve"), and the Federal Deposit Insurance Corporation ("FDIC"), to implement Titles I and II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").[3] The Board and the FDIC are both represented on the Council, along with other federal and state financial regulators and industry experts.

[3] Pub. L. No. 111-203, 124 Stat. 1376 (2010). These intertwined rulemakings also include: Board of Governors of the Federal Reserve System and FDIC, *Final Rule:* Resolution Plans Required, 76 Fed. Reg. 67323 (Nov. 1, 2011); Board of Governors of the Federal Reserve System and FDIC, Notice of Proposed Rulemaking and Request for Comment Regarding Resolution Plans and Credit Exposure Reports Required, 76 Fed. Reg. 22648 (Apr. 22, 2011); Financial Stability Oversight Council, Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4555 (Jan. 26, 2011); FDIC, Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 C.F.R. pt. 380, 76 Fed. Reg. 16324-02 (Mar. 23, 2011), FDIC, Notice of Interim Final Rulemaking Regarding Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207 (to be codified at 12 C.F.R. pt. 380) (Jan. 25, 2011), and Board, Proposed Rule: Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

The NPR is intended to provide guidance on the criteria and process to be used by the Council in designating non-bank financial institutions under Title I of the DFA as systemically important, and thereby subjecting them to additional regulation and supervision by the Board under Title I of the DFA and to potential resolution by the FDIC under Title II of the DFA. The NPR is a follow-up proposal to an earlier Council rulemaking proposal[4] and is issued, in part, to address comments that the earlier proposal lacked clarity.

On behalf of Federated, we have filed comments with the FSOC and other regulators on a number of prior rule proposals and requests for comments. While we address many of the same issues in this comment, we also wish to bring to the attention of FSOC members additional information about the utility of Money Funds, in their current form, for millions of investors and business users and the potential unintended consequences that could flow from designating Money Funds under Title I or imposing other regulation that would alter their fundamental character. Federal Reserve regulation of Money Funds or other regulation that would change their utility would impose substantial costs on investors and on a wide range of business systems throughout the economy, impact the price and availability of credit, and drive perhaps trillions of dollars of short-term liquidity balances into the banking system and the Federal safety net. These issues are discussed in detail in Section II, below. It is imperative that the FSOC fully consider these issues before making any determination to designate one or more Money Funds under Title I, or to attempt to direct or pressure the prudential regulator of Money Funds, the Securities and Exchange Commission ("SEC"), to take action beyond the SEC's highly effective 2010 reforms. In Section III, below, we also discuss in detail aspects of the SEC's comprehensive regulatory and oversight program for Money Funds, which makes designation under Title I and the resolution authority under Title II unnecessary. This section also addresses the issue of Money Funds' stable NAV and use of the amortized cost method pursuant to stringent SEC regulation – an aspect of Money Funds that appears to cause undue consternation on the part of bank regulators but with respect to which the transparency to investors and pricing of portfolio holdings is markedly superior to bank valuations of their portfolios. Section IV states that money Funds should be specifically excluded under Section 170 of the DFA from designation under Title I. Sections V-VIII of this memorandum address other procedural aspects of the NPR. Section IX summarizes the effectiveness of the SEC's program of regulation and supervision of Money Funds.

II. Consider Direct/Indirect Impact of Designation and Potential for Unintended Consequences at an Early Stage of the Title I Designation Process

In the design of its criteria for designation of firms as systemically important under Title I of DFA, and in the designation of firms, the FSOC should be careful to do no harm to the financial system. The purpose is to make things better, not worse.

[4] Financial Stability Oversight Council, Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4555 (Jan. 26, 2011).

Government policies and actions taken with the best of intentions can have indirect and unintended consequences that cause more harm than good and increase, rather than decrease, financial instability.

In finalizing the criteria, process and guidelines for designating non-bank financial firms as part of this rulemaking, FSOC should be careful not to create a process and a set of presumptions, criteria and standards that harm firms, shape outcomes and directly or indirectly alter the structure of the financial services industry and the broader economy in a way that ultimately undermines financial stability, economic growth and efficiency. We suggest that part of the initial stages of screening firms to be considered for designation under Title I include formal consideration of whether designation of that firm, the additional regulation and oversight that would be applied by the Federal Reserve, and the direct and indirect consequences of those actions, would enhance systemic financial stability, or detract from it.

We note in this regard that, alongside the FSOC Title I implementation process, some members of the FSOC are championing a fast-track to drastic changes to the structure and regulation of Money Funds, including a continuously floating NAV, restrictions on investors' ability to redeem shares in a Money Fund, and a capital "buffer," which could further diminish investor returns.[5] Due to repeated calls for fundamental restructuring or elimination of Money Funds from persons within the Federal Reserve System and its alumni,[6] we are concerned that the Title I process will be used inappropriately to designate and impose requirements upon Money Funds that are neither necessary nor helpful, that will undermine their usefulness in the financial system, and that will increase, rather than decrease, risk to the financial system. Before steps are taken in that direction, the FSOC and its members need to thoroughly consider all of the direct and indirect consequences of designation.

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[5] *See, e.g.*, Mary L. Schapiro, SEC Chairman, Remarks at SIFMA's 2011 Annual Meeting, New York, New York (Nov. 7, 2011), *available at* www.sec.gov/news/speech/2011/spch110711mls.htm.

[6] *See, e.g.*, Janet L. Yellin, Vice Chair, Board of Governors of the Federal Reserve System, Remarks at the Fourteenth Annual Banking Conference, Federal Reserve Bank of Chicago: Pursuing Financial Stability at the Federal Reserve,(Chicago, Ill., Nov. 11, 2011) *available at* http://www.federalreserve.gov/newsevents/speech/yellen20111111a.htm; Eric S. Rosengren, President & Chief Executive Officer, Federal Reserve Bank of Boston: Towards Greater Financial Stability in Short Term Credit Markets, Remarks at Global Interdependence Center's Conference on Capital Markets in the Post Crisis Environment, Stockholm, Sweden (Sept. 29, 2011) *available at* http://www.bos.frb.org/news/speeches/rosengren/2011/092911/index.htm; Financial Stability Board, Shadow Banking: Strengthening Oversight and Regulation, at 20 (Oct. 27, 2011), *available at* http://www.financialstabilityboard.org/publications/r_111027a.pdf; Timothy F. Geithner, Treasury Secretary, Testimony before the Senate Comm. on Banking, Housing, and Urban Affairs (Oct. 6, 2011) *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1319.aspx; Paul A. Volcker, Three Years Later: Unfinished Business in Financial Reform, William Taylor Memorial Lecture to G-30 Conference (Sept. 23, 2011) *available at* http://www.group30.org/images/PDF/ReportPDFs/GRP30_WTML13_Volcker_FNLlo.pdf; Thomas M. Hoenig, Remarks before the Pew Financial Reform Project and New York University Stem School of Business: Do SIFIs Have a Future? (June 27, 2011), *available at* http://www.kc.frb.org/publicat/speeches/Hoenig-NYUPewConference-06-27-11.pdf.

With markets in turmoil and investors evidencing extreme nervousness, any governmental initiative that would designate a Money Fund under Title I or propose changes in the fundamental attributes of Money Funds runs the danger of being viewed by investors as a judgment by regulators that Money Funds are highly risky and present serious hazards to investors. Yet Money Funds have been and remain one of the most conservative investments available. We believe that there would be unintended consequences and serious damage to the industry and the economy resulting from governmental action that would change the structure of Money Funds. The adoption of the structural alternatives currently being discussed could dramatically shrink, or even eliminate, the Money Fund industry by reducing the utility of Money Funds to persons who use them to store liquidity or as a source of funding. The Council's first task in considering these policy issues should be to do no harm – to the 30 million shareholders[7] who find Money Funds an efficient and useful investment, to the fund industry, to those businesses and governmental units that rely on Money Funds as a source of short-term financing and cash management, to the banking industry – which does not want and is not prepared to accept or invest the proceeds of an additional $2.6 trillion in new daily liquidity deposits – or to the economy generally.

In the process for considering the designation of a particular firm under Title I, care should be taken first to consider carefully what exactly is the problem that the FSOC is seeking to solve at a particular firm through designation of that firm under Title I and its impact on the financial system as a whole. Next, the alternatives to designation of a firm under Title I for addressing that problem should be considered. The effectiveness for each of the alternatives should be carefully considered and analyzed. The effect upon the particular firm or business should be considered. The effects upon persons who do business with it need to be considered, as well as the broader effects upon the financial system as a whole, and the size of the exposure of the federal government and the taxpayer to the resulting system.

In the case of consideration of the designation of a Money Fund under Title I, in light of the extensive revision of SEC regulations governing Money Funds that were put in place in 2010, and significant upgrades to the information systems and oversight by the SEC of Money Funds that have been implemented, formal and careful consideration needs to be given at an early stage of the designation process as to whether further changes are needed at this time to the structure and regulation of Money Funds that a designation under Title I would be necessary to implement. As part of that formal consideration, in the context of Money Funds, questions that should be asked and answered include the following: What problem at a Money Fund would designation under Title I attempt to solve? What changes at a particular Money Fund are necessary to address that problem, and how would designation under Title I further that process? Would designation under Title I address the problem? What would be the costs and consequences of designation of one or more Money Funds under Title I to the designated

[7] *See* Investment Company Institute, *2011 Investment Company Fact Book*, at 164. This figure (calculated as of the end of 2010) includes a mix of individual and omnibus accounts, so the number of investors that actually hold money funds may be much larger.

Money Fund or other Money Funds, investors, and issuers of debt instruments that currently obtain financing from Money Funds? What would the impact of the changes resulting from Title I designation be on the financial system, on job creation and the economy? Is the solution of designation under Title I worth the cost of these direct and indirect consequences?

Designation of one or more Money Funds under Title I would affect not only the designated funds, but also the Money Fund industry as a whole, and all who interact with it, directly or indirectly. The FSOC should not force material structural changes upon the $2.6 trillion Money Funds industry without thoroughly understanding all that will flow directly, and indirectly, from that action.

At the May 2011 SEC roundtable on money funds, a panel of current and former bank regulators suggested that if Money Funds cannot continue under new and untested bank-like requirements imposed by the FSOC, Money Funds should simply disappear or be transformed into banks. For example, former Federal Reserve Board Chairman Paul Volcker stated at the roundtable:

> I think, particularly, that the money market mutual fund is already a special kind of bank. It may really want to be a real bank; maybe that's a good thing. ... It's a little bit attractive if you had; how many thousand money market funds there are? .... 650? This country needs -- could use 650 more banks. We just lost about a thousand due to the crises so it might be a good deal.

But imagine the consequences to the economy of major structural changes to or the elimination of Money Funds. Would our financial system generally, and the banking system in particular, have less systemic risk -- or more? Would economic efficiency and growth be adversely impacted? In the following sections, we discuss some of the uses served by Money Funds and the potential impact of substantial changes to or elimination of Money Funds upon those uses, the banking system and the economy. In our view, as discussed below, any regulatory action that would have the effect of substantially impairing the usefulness of Money Funds or eliminate them from the financial system, including designation of one or more Money Funds under Title I, would harm the financial system and the broader economy, impair efficiency and economic growth, and increase systemic risk.

A. Impact on 30 Million Money Fund Shareholders

Remarks such as those made by former Federal Reserve Chairman Volcker, reflect either a general lack of concern and utter disdain for or lack of awareness of the significance of Money Funds, in their current form, for millions of individual investors and businesses. More than 30 million Americans invest a portion of their liquid assets in

Money Funds,[8] a total shareholder balance exceeding $2.6 trillion. These investors view Money Funds as a convenient and efficient way to hold their liquidity. For large balances in excess of the $250,000 FDIC deposit insurance limits, Money Funds are a lower risk investment than are bank deposits. Due to the diversification and high credit quality of Money Fund portfolios, and the mandatory liquidity levels, they are also a more conservative investment than other fixed income alternatives, and far more efficient for an investor than attempting to manage an individual portfolio of short-term debt instruments.

Investor groups have stated that "money market funds have been a safe and sound investment for institutional and individual investors for more than twenty-five (25) years,"[9] and that "MMFs historically have been a paragon of stability."[10] This is largely a result of prudent regulation, with decades of cautious oversight by SEC over the development of a low-risk and reliable means for investors to obtain market rates of return on their cash investments, and through the application of very conservative rules for money market fund's structure, operations and assets. This SEC stewardship produced the first major regulatory changes in any financial industry to emerge after the crisis in 2008, when the SEC amended money market fund regulations in early 2010 to further enhance liquidity and credit quality of money market funds.

Money Funds are a familiar product to many retail investors. Academics and government policy makers have assumed that all investors use Money Funds for substantially the same reasons, and that their needs are all similar. This has led too quickly in some quarters to assuming that the household financial purposes to which the academics or government officials or members of their families use Money Funds are representative of how other users of Money Funds use them and assumptions as to what features are attractive and which can or should be changed for the "common good." These assumptions, however, are not accurate. Different investors use Money Funds for different purposes.

Requiring a floating NAV or imposing bank-like capital requirements will reduce or eliminate the features of Money Funds that make them attractive as a cash management vehicle to many types of users of Money Funds. Many cash investors do not want and will not use a floating NAV fund. Investors are well aware of the fact that Money Funds are not guaranteed, are not Federally insured, and may lose value. These warnings are clearly disclosed, as are Money Fund shadow NAVs. Nonetheless, the ability to invest on a "dollar-in/dollar-out" basis under all but the most extraordinary circumstances is a main reason Money Funds hold $2.6 trillion in assets. This is not

[8] Investment Company Institute, *2011 Investment Company Fact Book*, at 164. This figure includes a mix of individual and omnibus accounts, so the number of investors that actually hold money funds may be much larger.

[9] Comments of the Coalition of Mutual Fund Investors (Sept. 10, 2009), *available at* http://www.sec.gov/comments/s7-11-09/s71109-135.pdf.

[10] Comments of Fund Democracy and the Consumer Federation of America (Sept. 8, 2009), *available at* http://www.sec.gov/comments/s7-11-09/s71109-79.pdf.

simply about risk aversion. For a number of technical reasons discussed in the sections below, $1 per-share pricing is critical to the usefulness of Money Funds for holding short-term liquidity in a variety of business applications involving automated accounting and settlement systems. A floating NAV simply will not work due to the way in which these systems are designed. Much of this money would leave the funds if they were forced to convert to a floating NAV.

B. Impact on Specialized Systems That Use Money Funds to Hold Temporary Liquidity Balances

The Money Fund business developed during a period in which a wide range of businesses moved from archaic manual systems to automated systems for processing the posting and settlement of various types of transactions. As a result, use of stable value Money Funds to hold short-term liquidity was incorporated into many of the accounting systems and the automated interfaces used in these systems. Examples, which are discussed in more detail in the following sections of this memorandum, include trust accounting systems at bank trust departments, corporate payroll processing, corporate and institutional operating cash balances, federal, state and local government cash balances, municipal bond trustee cash management systems, consumer receivable securitization cash processing, escrow processing, custody cash balances and investment manager cash balances, 401(k) and 403(b) employee benefit plan processing, broker-dealer and futures dealer customer cash balances, and cash management type accounts at banks and broker-dealers.

The systems changes that have been implemented in many different businesses over the past four decades have greatly reduced (i) the time required to post and settle transactions, (ii) the personnel required to post and settle transactions (and thus the overhead costs associated with those functions), (iii) the errors associated with posting and settling those transactions, (iv) the "fails" involved in settling those transactions, (v) the size and length of time outstanding of the "float," "due to," and "due from" balances tied up in processing of transactions, and (vi) the counterparty default risk associated with transactions between and among companies. These changes have had the net result over the past four decades of reducing risk and increasing the efficiency of many business activities and greatly reducing the amount of funding required for businesses to conduct transaction processing.

Many of these systems have as a key element the use of Money Funds to hold short-term liquidity in connection with settlement of the transactions. The features of Money Funds that are ideal for holding temporary balances in these systems include (1) stable $1 per-share value during the time the transaction is being processed to allow certainty of the day of the exact dollar amounts that are being processed between different counterparty accounting systems so that the amount due and the amount paid do not diverge even by a few cents during the time in which the transaction is being processed, (2) same-day settlement capability (T+0 processing) which is possible only because of the use of amortized cost by Money Funds, (3) high credit quality and underlying portfolio issuer diversification which reduces risk of insolvency during the time the transaction is being processed, and (4) operation within a highly-automated secure computer environment that allows for 24/7 no downtime interfaces with accounting and data processing systems of all parties to the transactions.

The use of amortized cost and the resulting stable NAV are crucial features of Money Funds that allow them to work with automated processing systems. Amortized cost allows the use of a stable $1 per-share pricing by money funds. The valuation method accretes one additional day's worth of imputed interest on each portfolio asset each day using factors and information known in advance. This means that, absent a material credit event during the day that drops NAV below 99.5 cents per share, at 6:00 a.m., the system operators know what a share will be worth at 6:00 p.m. It will be priced at exactly $1.00 per share. If Money Funds were required to use continuously floating NAV, the exact price of a share as of the close of the day would not be known until after the markets close that day. Floating NAV funds must determine the purchase or redemption price of a share using the market-closing prices of the portfolio securities that are not known until the next close of markets *after* that purchase or redemption order is placed.[11]

In other words, if Money Funds used a floating NAV, the system operator would not know until 4:00 p.m. whether a share would be worth $1.00001 or $0.99999 at the end of the day. When the automated system learned in the morning that it must purchase or liquidate Money Fund shares to process a payment of say, $10,000,000 that afternoon, and placed that order, it would not be clear at the time the order was placed exactly how many Money Fund shares would have to be liquidated to reach that exact amount. It might be a few cents more or less at the end of the day than anticipated. This few extra or short pennies would be a discrepancy that would need to be manually reconciled and the difference trued up before the transaction could be finished. Manual processing would mean more staffing requirement, more costs associated with staffing the function, and errors and delays in completing the process.

Furthermore, because the purchase and redemption price would not be known earlier, and the market-closing prices from after the purchase or redemption order was placed must be used to set the price for the purchase or redemption order, the settlement payment could not occur the same day the order is placed (T+0), but instead is made the next business day (T+1). This means one party to the transaction owes the other money for one more day (three if it is a weekend, four if a holiday weekend). Both parties would carry the unsettled transaction as an open position for one extra day and each party would be exposed for that time to the risk that its counterparty would default during the extra day, or that the bank holding the cash overnight (or over the weekend) would fail. For a bank involved in making a payment in anticipation of an incoming funds transfer as part of these processing systems, this change from same-day to next-day processing of money fund redemptions would turn intra-day overdrafts into overnight overdrafts, resulting in much greater default and funding risks to the bank. This extra day's float would mean more risk in the system and a larger average float balance that each party must carry and finance.

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[11] 17 C.F.R. §§ 270.2a-4, 270.22c-1.

The net result of a floating NAV would be to make Money Funds not useful to hold the large, short-term cash balances used in these automated transaction processing systems across a wide variety of businesses and applications. A generation's worth of work in automating settlement systems, shortening settlement times, and limiting counterparty risk would be undermined. At a minimum this would require systems to be re-programmed on a wide scale, involving substantial personnel, time and years to complete. This would be comparable in some ways to the Y-2K effort, although the effort would be concentrated at fewer firms, but more work required at each affected firm to redesign and reprogram their processing and accounting systems. Completion of the systems would take many years and hundreds of millions of dollars to complete across a wide range of businesses and applications for which stable value money funds currently are used to hold short-term liquidity. Until these systems could be redesigned, reconfigured and rebuilt, processing of transactions would essentially be back to the manual processes that existed in the early 1970s.

If Money Funds no longer provide a business solution for holding short-term cash balances for each of these various processing functions, something else would need to be used. The vehicles that formerly held these pending balances before Money Funds filled this need included credit balances at the commercial counterparty (due to and due from amounts at a commercial company, or free credit balances at a broker), bank short-term investment funds, corporate variable amount notes, and bank deposits. These vehicles have fallen out of use for this purpose or might no longer be available, and each carries with it much greater and more concentrated default risks.

Examples of some of the transaction processing systems that use Money Funds to hold short-term cash balances are set forth below, along with a description of how Money Funds fill a business need of that particular system.

Bank Trust Accounting Systems. Bank trust departments are responsible for receiving, tracking, accounting for, holding in custody, investing, and paying out cash balances for large numbers of trust accounts. This cash includes balances from many different trust and fiduciary accounts. It represents cash received from the proceeds of sales of securities or other assets, dividends and interest on client investments, and new balances placed in trust. The cash is held briefly pending distribution to beneficial owners, payment of expenses and taxes on behalf of clients, and payments for purchases of securities and other assets for client fiduciary accounts. At any given time, the balance for any one client account may be very large or very small, but in the aggregate the trust department as a whole represents a very large, short-term cash balance. Trust departments have an obligation to keep trust assets productive, minimize the time cash balances remain uninvested, and seek a competitive return on cash balances consistent with prudent investment principles.[12]

Tracking, investing and accounting for these cash balances is a complex effort, due to the large numbers of fiduciary accounts which must be tracked, the many and

[12] 12 C.F.R. § 9.10.

varied inbound and outbound streams of cash, the need to plan and manage payments and distributions for the various client accounts, tax considerations, the non-uniform provisions of the many different trust instruments that govern the requirements of each different account, and the complex and overlapping requirements of state and federal laws governing fiduciary accounts. Fiduciary laws in many jurisdictions designate certain types of assets as permitted investments for trusts and certain other fiduciary accounts. Money Funds have been recognized as permitted fiduciary investments in many states.[13] A change to the regulatory requirements for Money Funds that precluded Money Funds from using amortized cost or seeking to maintain a stable net asset value per share could require state fiduciary statutes to be amended by state legislatures to permit the continued use of Money Funds to hold trust cash balances in certain states.

Among the many complexities of applicable fiduciary laws is a requirement in many jurisdictions to track and separately account for principal and income on each account, and requirements on diversification and in what assets a particular type of fiduciary account can be invested, as well as restrictions on conflicts of interest by the trustee bank.

Most bank trust departments operate on trust accounting systems provided by one of ten large national vendors. These automated, computer-based systems are designed to maintain records of client accounts, generate internal and external reports used by the trust department, as well as tax records and client statements, and interact with the investment and cash management programs of the bank on an automated basis.

In the past, trust departments generally held trust cash either on deposit with the commercial side of the bank, or in a "short term investment fund" maintained by the trust department. Both of these alternatives had significant operational problems. If placed on deposit with the commercial side of the bank, the fiduciary account deposit generally must be collateralized by high quality bonds,[14] and must bear a competitive rate of interest.[15] Depositing with the commercial side presents a conflict of interest that must be carefully managed and maintained only for a short period.[16] This presents further complications under the reserve requirements of Regulation D, which require reserves to be placed by the bank with the Federal Reserve equal to 10% of a "demand deposit" portion of these cash balances.[17] The combination of these factors makes it impractical in many cases for the commercial side of the bank to accept fiduciary deposits.

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[13] *See, e.g.*, Ala. Code § 19-4A-3; Cal. Prob. Code § 9730; Fla. Stat. Ann. § 736.0816;.

[14] *See* 12 U.S.C. § 92a(d); 12 C.F.R. § 9.10.

[15] 12 C.F.R. § 9.10; *Md. Nat'l Bank v. Cumins*, 322 Md. 570, 588 A.2d 1205 (Md. 1991); *Van de Kamp v. Bank of Am. Nat'l Trust & Savs. Ass'n*, 204 Cal. App. 3d 819, 841, 251 Cal. Rptr. 530, 538 (1988); *In re Orrantia's Estate*, 36 Ariz. 311, 285 P. 266 (1930); *New England Trust Co. v. Triggs*, 334 Mass. 324, 135 N.E.2d 541 (1956); *In re Doyle's Will*, 191 Misc. 860, 79 N.Y.S.2d 695 (1948); *In re Haigh's Estate*, 133 Misc. 240, 232 N.Y.S. 322 (1928); *Reid v. Reid*, 237 Pa. 176, 85 A. 85 (1912).

[16] *Id.*

[17] 12 C.F.R. § 204.

Short-term investment funds (or STIFs) present other challenges as a cash management vehicle for trust department cash. STIFs are a form of bank common trust fund invested in relatively short-term high quality debt instruments,[18] and only certain types of bona fide fiduciary account balances from the bank that maintains the STIF and its affiliated banks can be placed in them. Revocable grantor trusts, investment management and custody accounts, IRA and pension and employee benefit plan assets cannot be placed with the other trust assets in a STIF due to requirements of the Investment Company Act exemption within which STIFs operate.[19] This results in a relatively small investable balance for each STIF (compared to Money Funds) and therefore a substantial challenge in keeping the portfolio of the STIF fully invested in a diverse pool of high quality assets while matching the timing of cash flow requirements dictated by trust account investments in and redemptions from the STIF.[20]

One of the first major uses of Money Funds was to hold these trust department temporary cash balances. Money Funds provided a useful solution to bank trust departments which allowed them to invest balances of fiduciary accounts for short periods of times in an asset permitted by state fiduciary laws and trust instruments, at a competitive yield in a liquid, diverse pool of high quality debt instruments. Because a Money Fund can accept investors from many different banks' trust departments as well as other types of retail or institutional investors, a Money Fund can be much larger than a STIF and can accordingly achieve more portfolio diversification, better management of liquidity needs, and lower operating costs per dollar of assets, as compared to a STIF, and pay higher returns with less concentration of risk to trust accounts than a bank deposit. Use of amortized cost permits a Money Fund to anticipate NAV and share prices at the beginning of the day for the entire day (subject to the remote possibility that there will be an unexpected substantial credit event during the day that drops NAV below 99.5 cents per share), rather than needing to wait until after the close of the trading markets at 4 pm to know end-of-day NAV. This means the price of a Money Fund share can be anticipated at 6 am when the processing day begins.

Trust accounting systems interface with many different external systems on a daily basis. These include interfaces with systems of broker-dealer firms through which the trust department executes purchases and sales of securities for fiduciary accounts, systems providing notification of dividend and interest payments received through securities clearinghouses and payment agent banks, and systems for receiving and sending incoming and outbound payments through the banking system on behalf of fiduciary accounts. These electronic data communications generally involve a bilateral

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[18] 12 C.F.R. § 9.18(b)(4)(ii)(B).

[19] Investment Company Act 3(c)(3) (exemption for bank common trust funds), 3(c)(11) (exemption for bank collective funds for pension and employee benefit plans); *In the Matter of Commercial Bank and Marvin C. Abeene*, SEC Rel. 33-7116 (Dec. 6, 1994).

[20] *See* Martin E. Lybecker, *Regulation of Bank Trust Department Investment Activities: Eight Gaps, Seven Remedies, Part II*, 91 Banking L.J. 6 12-14 (1974); Martin E. Lybecker, *Regulation of Bank Trust Department Investment Activities*, 82 Yale L.J. 977, 984-86 (1973).

exchange of pending payment amounts stated in dollars and cents, which are followed subsequently by deliveries of those amounts.

In order to reduce errors and cash shortfalls, trust accounting systems typically post a debit to the cash position in the account immediately before or simultaneously with the placement of an order to purchase a security, which is transformed into a redemption order for shares of the Money Fund to generate cash to pay, the next day, for the security being purchased.[21] These accounting systems require a predictable Money Fund NAV share value at the time the redemption order is placed for (i) the cash position to match the cash needed to settle the purchase order and (ii) the ending balance reflected as available in the Money Fund to be accurate for processing any other transactions in the customer account that day.

Predictability in the per share price of Money Funds is critical to the operation of trust accounting systems, allowing them to be more fully automated (rather than relying on manual processes and the staffing costs, delays and errors associated with manual posting and processing of transactions and cash balances), allowing an exact sweep of cash balances to the penny, and permitting same day processing of cash payments. This permits same day (T+0) or next day (T+1) settlement of portfolio securities transactions for fiduciary accounts, which in turn reduces the amount of settlement cash, "due to" and "due from" "float" in the trust department and overnight overdrafts and out-of-balance trust accounts. This, in turn, means less counterparty risk and shorter time for client fiduciary assets to be less than fully invested.

Federated has been informed by the vendors of each of the major trust accounting systems that their systems are not designed to process cash balances using Money Funds with a continuously floating NAV. Forcing Money Funds to move to a continuously floating NAV would make Money Funds incompatible with the major trust accounting systems. Until these trust accounting systems could be redesigned and reprogrammed either to accept a continuously floating NAV (assuming it could be done at all and trust departments would accept it) or use some other vehicle to hold cash balances, trust departments would essentially be forced to use more manual processing, returning them essentially to the 1970s.

Corporate Payroll Processing. Most companies pay their employees either twice per month or every two weeks. Generally, pay is disbursed to all employees on the same days. The pay is either distributed in a direct deposit to an account previously designated by the employee, or in a physical paycheck given to the employee. The aggregate amount of money involved in each payroll disbursement is very large. The bigger the company, and the larger its employee base, the larger is the aggregate amount of cash involved. The corporate treasury department manages its cash availability through a variety of short-term investments that are sufficiently liquid to address scheduled payments that must be made. Payroll is a very large and recurrent payment amount.

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[21] *See* Letter from ASC to Eugene F. Maloney (Oct. 16, 2008) (copy attached hereto as Appendix A).

Pending distribution to employees, the cash must sit somewhere. Large companies commonly use third-party vendors to handle payroll processing, but employers are not eager to incur the credit risk of such vendors on payroll balances, even for a short period of time. For a given pay period, the aggregate payroll amount for a large company is many millions of dollars, well in excess of the standard $250,000 FDIC deposit insurance limits (which limits are only temporarily suspended on noninterest bearing demand deposits until year-end 2012). If the entire balance is placed on deposit at a bank, and the bank fails, the company is at risk of losing a large portion of the payroll balance in excess of $250,000. Companies with large payrolls are understandably anxious about limiting their loss exposure in the event of the insolvency of a bank. From the bank's perspective, many banks are not eager to take on multi-million dollar deposit balances for periods of a few days each month, because there are costs involved with having those balances on the bank's balance sheet and the bank is not able to profitably invest the cash for such a short period of time.

As an alternative, many large employers place cash pending distribution of payroll into Money Funds, with an automated sweep into the payment system and vendor used by the employer. A Money Fund knows in advance, through communications with the employer and experience, how much money is coming in and out and when it will arrive and depart, and is able to profitably invest the proceeds through the Money Fund's portfolio for a few days in short term instruments, carefully managing the cash position of the Money Fund with advance knowledge of the amounts and schedules of the payroll arrival and disbursement.

Key features that allow Money Funds to work to hold short-term balances for corporate payrolls pending distribution include the use of amortized cost and a stable NAV of $1 per share, which allows for a predictable value of share prices throughout the day (rather than needing to wait for end-of-day market close prices to know share prices and processing of purchases and redemptions after 4:00 p.m.) and same-day processing of investments and redemptions of shares. The bank that is processing the payroll distributions makes payments as checks and other items are presented through the banking system, and is able to redeem shares of the Money Fund and receive payment on a same day basis and avoid an overnight overdraft. If Money Funds were required to use a continuously floating NAV, purchases and redemptions would need to be processed on a next-day basis. This would require either (i) that large balances be redeemed and held as cash overnight or over a period of days as items are presented to the bank, creating an exposure by the employer to the credit risk of the bank for large amounts of money, or (ii) leaving the bank exposed to the risks associated with overnight overdrafts pending receipt of cash from the Money Fund or directly from the employer.

Moreover, if a continuously floating NAV is required for Money Funds, on a multi-million dollar balance, the value of the Money Fund shares would move around a small amount, such that the payment sent by the employer and held in the Money Fund for a few days would be a few dollars over or a few dollars short of the gross payroll amount each payroll period. This, in turn, would require more manual processing, creating more delays and errors, and significantly undermining the usefulness of Money Funds to employers, banks and payroll processors.

Corporate and Institutional Operating Cash Balances. In addition to payroll balances, companies have other payments received, as well as incoming cash from operations, and closely manage those cash balances in order to meet their payment obligations as they occur. Large companies typically have a corporate treasury management function to handle the liquidity needs and short-term investment of the company's assets.

The balances involved at a company at any given time can be very large. Due to low (or zero) interest rates on short-term corporate deposits and the risk of bank failure when balances are in excess of the $250,000 FDIC deposit insurance limits, leaving large amounts of cash on deposit at a bank is not a good alternative. Although the FDIC deposit insurance coverage on non-interest bearing demand deposits has been temporarily increased to an unlimited amount until December 31, 2012, that remains a short-term and not a highly attractive solution for corporate treasurers for holding large cash balances.[22]

Traditionally, larger corporate treasury departments managed cash balances by holding separately managed portfolios of direct investments in commercial paper, treasury bills, and other high quality short-term debt instruments. Many corporate treasurers have found it more efficient to invest a portion of those short-term balances in Money Funds. This allows for professional management at a lower cost of a diverse portfolio with greater liquidity than the company's treasury desk could accomplish on its own. In this context, Money Funds are an alternative to an individually-managed portfolio of securities.

Use of amortized cost accounting which has resulted in nearly all circumstances over the past 35 years in a stable NAV of $1 per share provides a simple means for Money Fund balances to be integrated into the internal accounting and cash management systems used in corporate treasury departments. Same day processing of Money Fund share purchases and redemptions, which is not possible with a floating NAV Money Fund, allows Money Funds to be used more efficiently by corporate treasurers and permits a more automated interface among the internal accounting systems used by the corporate treasury department, the banks through which the company sends and receives payments, and the Money Fund's transfer agent. This, in turn, reduces float in the system, overnight overdrafts by the corporation's banks and the balances of the corporation with its banks in excess of FDIC deposit insurance limits.

Federal, State, Local Government Cash Balances. Like businesses, governments have cash management needs. Many state, local and federal government bodies use Money Funds as an efficient means to invest short term liquidity balances. Governments have payrolls to pay and operating cash balances to invest for short and medium periods of time. Government cash balances often are tied to tax payment cycles

[22] The statutory deadline was imposed by Section 343 of the DFA and is codified in 12 U.S.C. 1821(a). As discussed below in Section II-D, further extension of unlimited deposit insurance would be inconsistent with the goal of reducing the size of the Federal safety net and would also further fuel the growth of the largest banks.

and expenditures tied to fiscal year budgets. Investment of the balances is subject to a myriad of state and local government requirements on investment of government assets, and in some cases to Internal Revenue Service requirements. These state and local laws commonly include lists of permitted investments that specifically authorize investments in Money Funds, defined in terms of a fund that seeks to maintain a stable net asset value per share.[23] A change to the regulatory requirements for Money Funds that precluded Money Funds from using amortized cost or seeking to maintain a stable net asset value per share would require many state and local government statutes to be amended by the state legislature to permit the continued use of Money Funds by the state or local government.

Although placing the funds on deposit at a bank is an alternative, government deposits frequently are required to be collateralized with high quality bonds,[24] which make them expensive for the bank to hold. Another alternative is for the state or local government to attempt to manage a portfolio of direct investments in individual money market instruments, although this is a more expensive, higher risk and ultimately less liquid means of investing cash balances of state and local governments than investing in Money Funds. An unintended consequence to a movement away from amortized cost and a stable value of $1 per share would be to diminish the ability of state and local governments to use Money Funds and to force them into less liquid, more expensive, higher risk alternatives for investment of cash portfolios.

Municipal Bond Trustee Cash Management Systems. State and local governments raise money for general operations and for specific projects through the issuance of municipal bonds. Each bond issuance has an indenture with a bank as bond indenture trustee and payment agent to handle various aspects of the bonds' issuance, payment of interest and ultimate retirement. Substantial cash balances flow through the bond trustee and paying agent bank, with which cash payment must be made on time every time pursuant to the contractual terms of the bonds to avoid default. In many cases, the credit quality and credit rating of the bond issuance is tied to a very carefully developed cash management program designed to assure that there will be cash available to make scheduled interest payments and sinking fund retirements of the bonds. The trust indenture of the bond, as well as state and local government laws and IRS requirements dictate certain aspects of how and into what types of assets the cash balances can be invested pending payment or distribution.

Leaving large amounts of cash on deposit at a bank results in a concentration of credit exposure that in some cases is not acceptable to bondholders. In addition, because the liquidity balances flow through the bond trustee and payment agent over relatively short periods of time, a bank may not be able to profitably invest the cash on a short term

[23] *See, e.g.*, N.J. STAT. ANN. § 18A:20-37; S.C. CODE ANN.§§ 6-5-10(6), 12-45-220; Tex. Gov't Code Ann. § 2256.014 (West); COLO. REV. STAT. § 24-75-601; CONN. GEN. STATS. § 7-400(1)(B); MICH. COMP. LAW. §§ 129.91, 129.93; Op. Ind. A.G. No. 96-3 (Sept. 5, 1996).

[24] 12 U.S.C. §§ 1821(a)(2), 1823(e)(2).

basis. As a result, Money Funds are used in many cases to hold portions of the short term liquidity pending payment or distribution on scheduled dates.

Use of amortized cost accounting and a stable NAV of $1 dollar per share allows Money Fund balances to be integrated into the accounting systems used in the corporate trust department of the bank that serves as bond trustee. Same day processing of Money Fund share purchases and redemptions, which is not possible with a floating NAV Money Fund, allows Money Funds to be used more efficiently by the bond trustee and payment agent. This, in turn, reduces float in the system, overnight overdrafts by the payment agent bank and the balances of the issuer with its bank in excess of FDIC deposit insurance limits.

A trust company president described the importance of Money Funds with a stable NAV of $1 per share to the investment of cash amounts associated with municipal bonds as follows:

> Until the advent of money market mutual funds, state and local government entities investing bond proceeds for infrastructure projects were extremely limited in scope to the manner in which bond proceeds could be invested. The work that we did collectively to have state statutes passed to allow a broader investment product array by utilizing money market funds as "permitted investments" has allowed for the minimization of market risk ....
>
> If for some reason the maintenance of a stable $1.00 value by money market mutual funds is at risk, we will see a mass exodus of investors from the institutional side of the business, such as Reliance Trust Company. This exodus will expose all investors to increased processing costs, substantially greater risk and liability, limited choices of investment vehicles primarily because of statutory restrictions and far greater exposure to credit risk.[25]

Consumer Receivable Securitization Cash Processing. The structures used for issuance of mortgage-backed bonds and other securitizations of consumer receivables share some of the attributes and cash management needs of municipal revenue bonds, but the cash flows are far more complicated and less predictable. Many of the structures require an initial cash balance and additional retention, build-up and hold back of significant amounts of cash from payments received on the underlying consumer receivables as a "prefunded account" in order to assure timely payment of the senior tranches of the securitization.[26] These cash hold-backs serve some of the same purposes as a back-stop letter of credit from a bank, which may also be in place in addition to the

[25] Letter from Anthony A. Guthrie, President, Reliance Trust Company to Eugene F. Maloney, Federated Investors, Inc. (Oct. 17, 2008) (attached as Appendix B).

[26] *See Federated Investors, Inc.*, SEC Staff Letter 1997 SEC No-Act LEXIS 716 (July 8, 1997).

cash hold-back. The prefunded account reduces the likelihood of the need to draw on the letter of credit and the potential size of that draw. Money Funds are used as a more efficient and lower risk alternative to direct investment by the indenture trustee of the prefunded balances in a portfolio of individual money market instruments.

Money Funds are used in some cases to hold portions of these cash balances, for essentially the same reasons described above -- Money Funds limit counterparty risk exposure to any one bank, and the stable NAV permits same day processing of share redemptions and more convenient inclusion of balances in the complex accounting systems needed to track payments and disbursements in these securitization structures.

The permitted instruments into which cash balances can be invested generally are specified in the trust indenture and other governing documents of the structure and cannot readily be changed after the securitization structure is launched and its securities sold to investors. Changing the regulatory attributes of Money Funds could compromise their role in holding short-term liquid assets in securitization structures.

Escrow Processing. Money is placed in escrow in connection with a variety of transactions ranging from the purchase of a home to corporate acquisitions. The basic purpose is similar -- to place a cash balance into the hands of an independent party to make a payment on a contractually specified amount when certain conditions are met. The amounts per customer may be a few thousand dollars for mortgage escrows to hold tax and insurance payments, or billions of dollars in a corporate M&A transaction. The funds may be held for a few hours, days or months. The amounts held by an escrow agent commonly exceed deposit insurance limits of $250,000. If pass-through deposit insurance treatment is not available, or if the amounts per ultimate beneficial owner exceed $250,000, allowing the escrow agent to place the escrow balance in a bank deposit may not be an acceptable risk to the parties. Escrow agreements commonly allow the parties to direct the escrow balances be held in shares of a designated Money Fund, as a way of limiting counterparty risk.

Money Funds are useful for this purpose because they do not represent the credit risk of a single issuer, but instead represent a diversified pool of high-quality short term debt obligations of many underlying issuers. In addition, because the value of the shares do not fluctuate, the escrow agent can hold an amount representing exactly what must be paid if the conditions to completion are met and the escrow amounts paid out on settlement. For escrows on purchases of companies with many shareholders, the accounting systems needed to assure exactly the correct amounts are paid to the proper shareholders are complex. Similarly, escrow agents that process mortgage-related tax and insurance escrows use complex automated accounting systems that must track and account for a large number of consumer escrow accounts each with different balances and payment amounts.

The use of amortized cost permits the share price of a Money Fund to be anticipated in the morning (because the daily amortization factors are known for each portfolio security) for the day, rather than known only after the closing of the markets at 4:00 p.m. This permits a share price to be used at a stable dollar amount throughout the day by the automated accounting and payment processing systems used by escrow agents. Moreover, the use of amortized cost also permits same-day settlement of purchases and redemptions of Money Fund shares. These two features – a stable share price throughout the day and same-day settlement – are key to the utility of Money Funds to hold temporary cash balances for escrow agents. If Money Funds were required to use a continuously floating NAV, they would not be as useful to escrow agents, the escrow agents' accounting systems would need to be redesigned and reprogrammed to accommodate a floating NAV, and payment cycles would be delayed by a day. If escrow agents continued to use Money Funds at all, there would be one extra day to closing required, and that delay means one extra day of counterparty risk. In addition, the cash balance would likely need to sit in a bank account overnight, adding the risk of bank failure during that period.

Custody Cash Balances and Investment Manager Cash Balances. Banks serve as custodians for securities accounts of commercial and individual customers. Securities purchases and sales orders are placed by the customer (or its investment adviser)[27] with a securities broker and the custodian bank is notified of the transaction. The custodian bank communicates settlement instructions with the broker-dealer. Custodial cash is commonly invested in Money Fund shares, in part because the cash balances commonly exceed the $250,000 FDIC deposit insurance limit. When it receives instructions to deliver cash to a broker-dealer to settle a transaction, the custodian bank redeems shares of the Money Fund. Same-day settlement of Money Fund shares (T+0) permits the cash to be available to settle the securities transactions the next day (T+1). With a continuously floating NAV, there would be an additional business day required to redeem Money Fund shares, which would move the settlement cycle for the securities transaction back one day (T+2).

401(k) and 403(b) Employee Benefit Plan Processing. Private employers over the past few decades have shifted from defined benefit retirement plans to defined contribution plans due to the high costs and potentially large unfunded liabilities associated with defined contribution plans. Two common and highly popular forms of participant-directed defined contribution plans are 401(k) and 403(b) plans, which draw their names from provisions of the Internal Revenue Code. Among the requirements applicable to these plans under the Department of Labor rules implementing the Employee Retirement Income Security Act (ERISA) are that, in order to limit the liability of plan trustees, a stable value option be included as part of the plan to hold cash contributions for which a participant has not yet provided investment instructions.[28] Money Funds are an investment option eligible to meet this requirement for up to 120 days.

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[27] *See* 17 C.F.R. § 275.206(4)-2 (customer accounts of registered investment advisers required to be held in custody of bank or broker-dealer).

[28] *See* 29 C.F.R. § 2550.404c-5 (Department of Labor Qualified Default Investment Alternative Regulations).

In addition, cash balances in participant accounts must be segregated from the assets of the plan trustee and held during brief periods of time when a plan participant is changing the investment allocation of the participant's account. Money Funds serve this purpose within 401(k) and 403(b) plans.

The use of amortized cost and $1 per-share pricing at Money Funds allows for same-day settlement, and allows the value of shares to be known throughout the day. If Money Funds were required to use a continuously floating NAV, they would need to move to next-day settlement of transactions and share prices could fluctuate very slightly and would not be known with certainty until after 4:00 p.m. each business day. This would limit the utility of Money Funds for use with the automated accounting and processing systems used by vendors that provide 401(k) and 403(b) plans, and if Money Funds continued to be used at all, would increase settlement times by at least one day, increase float in the system, require a process for reconciling and truing up order amounts to reflect small variations in the value of Money Fund balances and require a significant redesign and reprogramming of the accounting and processing systems used by 401(k) and 403(b) plans to accept a floating NAV Money Fund to hold temporary cash balances.

Broker-Dealer and Futures Dealer Customer Cash Balances. Customer accounts at securities broker-dealers carry cash balances that are used to make payments on amounts owed by the customer on purchases of securities. This cash belongs to the brokerage customer. Cash flows into the brokerage account through cash amounts added to the account by the customer, dividends and interest on investments held in the account, and from the proceeds of sales of securities.

If the brokerage customer's cash balance is not invested in something, it sits as a "free credit balance" which is simply a "due to" amount owed to the customer by the brokerage firm. To protect customers against the risk of a failure of the broker-dealer firm (and ultimately the SIPC which guarantees customer cash balances up to $250,000 per account), the broker-dealer is required to hold bank deposits or certain types of securities in a segregated account for the exclusive benefit of its customers, in an amount at least equal to the net unencumbered amounts of customer "free credit balances."[29]

As an alternative to holding customer cash as free credit balance liabilities of the broker-dealer, brokerage firms normally provide a cash sweep program by which customer cash balances are "swept" into investments in shares of Money Funds which are then owned by the customer but held in custody through the broker-dealer. Investment of the cash balances into Money Fund shares segregates these customer assets from the assets of the broker-dealer and removes them from the balance sheet liabilities of the broker-dealer.

Because Money Fund redemptions settle same day (T+0), cash is available very quickly to pay for customer purchases of securities, or to receive incoming cash from the sale by the customer of a security. This same day cash availability is important to avoid

[29] 17 C.F.R. § 240.15c3-3.

customer "fails," and to assure compliance with the margin rule requirements applicable to brokerage accounts which require cash availability in the account when a customer places an order in a customer cash account and margin collateral coverage in a customer margin account.[30] In addition, the use of amortized cost and a stable NAV of $1 per share allows efficient processing of cash balances by the accounting system of the broker-dealer throughout the transaction processing cycle at a known and predictable amount, and communication with the accounting systems of the transfer agent of the Money Fund. This allows the use of Money Funds as a means to hold cash balances within the automated accounting and transaction processing systems used by the broker-dealers, which in turn reduces settlement times, pending transaction float balances and fails, and the counterparty risk in the system.

Similarly, rules of the Commodity Futures Trading Commission ("CFTC") require the segregation of customer cash balances at a futures firm used to pay for (and provide margin collateral for) futures transactions place by a customer.[31] Money Funds serve the same function at futures firms as they serve at securities broker-dealers -- hold customer cash balances, and to collateralize amounts due or potentially due on futures positions of the customer held through the futures firm. The CFTC reaffirmed the continued appropriateness of Money Funds to hold customer liquidity balances in December 2011 after careful review and a lengthy rulemaking proceeding.[32] The CFTC determined through this process that Money Funds satisfy the statutory objective that "customer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers ... and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk"[33] as well as the Regulation 1.25 prudential standard that all permitted investments be "consistent with the objectives of preserving principal and maintaining liquidity."[34]

Broker-dealers and futures dealers are subject to regulatory requirements specifying the types of assets that the entity can own and the types of assets that can serve as collateral or be used to invest client cash balances. Many of these regulatory provisions specifically include as a permitted investment Money Fund shares that seek to maintain a stable net asset value per share.[35]

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30 *See* Regulation T, 12 C.F.R. pt. 220. The margin rule treats Money Funds shares essentially as the equivalent of cash for this purpose.

31 17 C.F.R. § 1.20.

32 CFTC, *Investment of Customer Funds and Funds Held in an Account for Foreign Futures*, 76 Fed. Reg.. _____ (Dec. 5, 2011) ("CFTC 2011 Release").

33 CFTC 2011 Release at 5.

34 *Id.* at 6, citing 17 C.F.R. § 1.25(b).

35 N.Y. Mercantile Exchange Letter to Mr. Richard Recker, Federated Securities Corp. (May 18, 2001); Options Clearing Corp. Memorandum to all Clearing Members (Feb. 18, 2005).

The ability of securities broker-dealers and futures commission merchants to shorten settlement times and reduce the systemic risks associated with unsettled transactions has been facilitated by the ability of Money Funds to process purchases and redemptions of shares on a same day (T+0) basis, which in turn is only possible as a result of using the amortized cost method of accounting. Requiring Money Funds to use a continuously floating NAV would require them to move to next-day settlement and lengthen settlement times of securities transactions by at least one day. The securities industry has spent the past 35 years shortening settlement times to in order to reduce systemic risk. Using Money Funds to hold short-term cash balances in connection with the transaction settlement process has been an integral part of how that was accomplished. An unintended consequence of the movement of Money Funds to a continuously floating NAV (or the elimination altogether of Money Funds) would be longer securities transaction settlement cycles and an increase in systemic risk.

Cash-Management Type Accounts at Banks and Broker-Dealers. Brokerage firms and banks offer "cash management" type accounts that permit customers to access cash balances in their brokerage accounts by check or debit card. Millions of retail customers find these accounts to be convenient. Cash balances in these accounts are held either in Money Funds or in brokered deposits at banks. Checks and debit cards are processed by a bank for the brokerage firm. The payments of these items are funded by cash received from redemptions of Money Fund shares held in the customer's brokerage account. The bank runs nightly files of items presented for payment, which triggers a redemption of Money Fund shares. The bank advances payment on the items after confirming electronically Money Fund shares are being redeemed to repay the bank on the advance of Funds. The cash from the redemptions is then sent to the bank.

Processing the transactions is done on an automated basis, requiring a series of electronic data exchanges among the bank that issues the debit card and processes the checks, the brokerage firm that carries the customer's brokerage account, and the transfer agent of the Money Fund which processes the redemption requests and forwards payment to the bank. A diagram of the process is attached as Appendix C to this memorandum.

Use of amortized cost and stable value of $1 per share is crucial to processing these accounts because it permits same-day processing of Money Fund share redemptions. This allows the bank to limit its credit exposure and avoid overdrafts and "NSF" or "bounced" checks. Use of a predictable $1 per share value is also critical to the interface among the accounting systems. The systems are programmed to work on a stable value of $1 per share. A continuously floating NAV would result in transactions being a few pennies over or short each day, which would require manual processing of the transactions. In the alternative, if the accounting systems were reprogrammed to address a continuously floating NAV by submitting the redemption request as a dollar amount rather than a number of Money Fund shares, the account balance remaining after a Money Fund share redemption is processed would be off by a few pennies per day, requiring inclusion of a larger buffer balance in the customer's account to ensure a sufficient available cash balance to avoid fails and overdrafts in subsequent transactions by the customer in the account, and additional work by the customer to keep track of available balances in the account.

For debit cards, there is a two step-process notification and payment of items is separated by a few days. First, at point of sale, the merchant sends an electronic signal through the banking system that the customer is buying something at a certain price, and the available balance is confirmed and a hold placed on that balance at the Money Fund. A few hours or days later, the merchant submits the debits for payment through the banking system, which submits the items for payment to the bank that issued the debit card and, which makes the payments. The bank then sends a signal to redeem the Money Fund shares that are on hold, to repay the bank for the advance. If the Money Fund shares continuously floated up and down in price between the time between when the hold was placed and the shares redeemed, the payments would be off a little bit each time, requiring manual processing. If same day settlement of Money Fund redemptions were not available, the bank would not be reimbursed on the same day that it advanced payment on the debit card items. Same-day cash would not be available to the entity "sourcing" the transaction. This would require cash funding flow changes throughout the funding chain and could require some participants in the process to carry an overnight overdraft until the cash arrives the next business day. Additionally, as entities authorizing debit/POS/ATM transactions based on an "Available Balance" data delivered to them by the transfer agent or brokerage platform, that balance could be slightly off as the shares representing that balance change based on end-of-day floating NAV pricing. Currently, these workflows and systems all assume a stable NAV of $1 per share throughout the chain of processing and same day processing of Money Fund share redemptions. Any change to that assumption will require a retooling of the workflow and cashflow timing to accommodate cash availability and delivery.

Banks offer a substantially similar product without the brokerage account. In the bank version, the bank offers a checking account with a debit card and ATM access, with balances above a set dollar minimum (which often is $0) swept into shares of a Money Fund.[36] The bank pays items after they are presented and after verifying there are enough Money Fund shares owned by the Customer. The bank places an order to redeem Money Fund shares to repay the advance.

C. Impact on Cost and Availability of Credit to Businesses and Governments

Money Funds are a vital source of funding for the economy. Money Funds provide critical financing to every sector of the short-term credit market. Money Funds held more than $750 billion in U.S. Treasury bills, securities, and other U.S. agency issues at the end of 2010,[37] and typically hold approximately 40% of commercial paper and two-thirds of short-term municipal securities.[38] If Money Funds were taken out of

[36] *See* 1934 Act § 3(a)(4)(B)(v) (Money Fund sweep account exemption for banks in definition of securities "broker"), Regulation R, 12 C.F.R. § 218.741, 17 C.F.R. § 247.741 (same).

[37] Investment Company Institute, 2011 Investment Company Act Fact Book (2011) at 164, 170, 171.

[38] Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options ("*PWG Report*"), at 7 (Oct. 2010) *available at* http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf. *See also PWG Report* at 21 ("MMFs are the

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the financial system, and the role currently performed by Money Funds in providing short-term financing was performed solely by commercial banks, the economy would be harmed through increased financing costs to business and governments.[39]

Banks are far less efficient than are Money Funds in providing funding to corporate and government borrowers in the money markets. As discussed below, banks have overhead costs – principally occupancy and staff expense – that are higher per dollar of assets than the operations costs of Money Funds. A comparison of expense data contained in aggregate FFIEC call report data on banks[40] with expense ratios of Money Funds[41] shows that Money Funds are far more efficient than banks in recycling investor cash into financing of businesses and governments, and the size of the efficiency differential is between 200 and 300 basis points per year per dollar of assets. As of year-end 2010, the average expense ratio for Money Funds was 32 basis points.[42] By comparison, the non-interest overhead expenses (including costs of personnel, office space, deposit insurance premiums, marketing, etc.) represented over 3% of average assets for banks.[43] This suggests that it costs 2.5% more per annum for a bank to intermediate each dollar's worth of balances from savers to borrowers as compared to a Money Fund. The high bank cost structure affects not only the banks themselves, but also means borrowers must pay more to obtain financing from banks, in contrast with the lower financing costs of businesses and governments whose short-term paper is held by Money Funds. This large cost differential means there is much less efficiency, lower

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dominant providers of some types of credit, such as commercial paper and short-term municipal debt, so a significant contraction of MMFs might cause particular difficulties for borrowers who rely on these instruments for financing.").

39 Comments filed with the SEC in response to the PWG Report by numerous public and private issuers of short-term debt confirm their concerns that significant reforms to money fund regulation may have serious negative effects on their ability to obtain short-term financing (*See* attached Appendix A, *Summary of Comments on Floating NAV*). The Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce has also written to SEC Chairman Schapiro to urge caution before implementing reforms to the regulation of money funds because they "represent a major source of funding to the $1.1 trillion commercial paper market" and because "[c]orporate treasurers rely on [them] to efficiently and affordably manage liquidity." Letter from David Hirschmann to SEC Chairman Mary Schapiro (Nov. 17, 2011) (copy attached).

40 Federal Financial Institutions Examination Council, *Uniform Bank Performance Report, Peer Group Average Report for All Banks in Nation* as of September 30, 2011 *available at* https://cdr.ffiec.gov/public/ManageFacsimiles.aspx.

41 *See 2011 Investment Company Fact Book* at 63.

42 *2011 Investment Company Fact Book*, at 68 *available at* http://www.ici.org/pdf/2011_factbook.pdf. This is down from 2009's 54 points, because many funds waived expenses to ensure positive returns for investors while interest rates are being kept low. *2010 Investment Company Fact Book*, at 68 *available at* http://www.icifactbook.org/pdf/2010_factbook.pdf; *ICI Research Perspective: Trends in the Fees and Expenses of Mutual Funds, 2010*, Investment Company Institute, at 1 (Mar. 2011).

43 Federal Financial Institutions Examination Council, *Uniform Bank Performance Report, Peer Group Average Report for All Banks in Nation* as of September 30, 2011 (available at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx).

returns to savers, and higher costs to borrowers when balances are intermediated through the banking system.

This large expense differential is also reflected in the interest rates on commercial paper, which are far lower than rates on bank loans. Federal Reserve Board statistics indicate that bank loans are consistently more expensive – often 200 basis points or more – than rates on commercial paper.[44] On $2.6 trillion in aggregate Money Fund balances, that would amount to between $50 billion and $80 billion in annual costs to investors and borrowers that would be incurred by moving these balances to intermediation through banks. Absent a compelling reason, there is no way to justify hanging a millstone of that size around the neck of the economy. If Money Funds disappeared and were fully replaced by banks, the higher cost of borrowing would translate directly into less economic growth, fewer jobs, and less money available for state and local governments to provide services. The additional cost to issuers would constrain profitability and growth of issuers by increasing the cost of financing their operations, and would push government borrowers that much further into the red, requiring even further cuts to government programs, payrolls, pensions and benefits.

D. Impact on Other Systemic Benefits Provided By Money Funds

Money Funds provide a number of other benefits to the financial system, which would be lost if they no longer existed. As discussed above, Money Funds are a key adjunct to a variety of accounting and settlement systems applied by many different types of businesses. The use of Money Funds to hold short-term liquidity (rather than due to or due from amounts of the parties to the transactions, or bank deposits) reduces counterparty risk and the risk of a default causing a loss of value, and allows automated systems to operate in a way that shortens settlement times, reduces processing costs and errors, and consequently reduces transaction float that must be financed and the counterparty risk associated with the aggregate size and duration of unsettled transactions.

In addition, managers of Money Funds have substantial staffs of researchers, analysts and portfolio managers that devote their efforts to gathering information on and continuously analyzing the credit risks of issuers of short-term debt instruments. The research and credit analysis performed by managers of Money Funds is reflected in the market allocation and pricing of credit through the issues bought and the prices paid for short-term credit obligations in the money markets. This information also finds its way into the market through the portfolio disclosures required from Money Funds, making the markets more informed and more efficient in pricing credit to particular issuers and investment types and structures. This research and credit analysis is a valuable function – an externality – provided by managers of Money Funds to the financial system. The

[44] Selected Interest Rates (Daily) for September 14, 2011 (showing rates for commercial paper and bank prime loans); Interest Rates for 90-Day AA Nonfinancial Commercial Paper 1997 - 2010 and Average Majority Prime Rate Charged by Banks on Short Term Loans to Business, 1956 - 2010 (attached as Appendix D). These reports are available on the website of the Federal Reserve Board, which publishes this data at http://www.federalreserve.gov/econresdata/releases/statisticsdata.htm.

research conducted by managers of Money Funds, and the criteria, investment quality standards and market discipline that they impose, enhances the overall quality and transparency of commercial paper issuers. Without Money Funds, this work would not be performed, and the financial markets would be less informed and less efficient.

E. Impact on Banking System and Further Growth of SIFIs

If Money Funds were to shrink substantially because investors found structural changes dictated as part of the Title I process unattractive, or the industry were to be restructured into oblivion, what would fill the functions currently performed by Money Funds of holding short-term liquidity and investing in short-term high quality debt instruments? It is reasonable to assume that a large portion of those balances would move to deposits at banks. It is necessary to consider how the sudden inflow of up to $2.6 trillion in short-term deposits would affect banks.

First, consider the situation from the perspective of individual banks. At first blush, it might seem that the availability of an enormous new source of short-term deposit balances would be attractive to a bank. But on closer consideration, this is not necessarily the case. The balances represented in Money Funds are often held for very short periods, sometimes intra-day, simply by the nature of the use being made of the short term cash that is placed temporarily in the Money Fund. Moreover, these liquidity balances, coming in from corporate treasurers or through omnibus accounts, are often in very large dollar amounts, tens or even hundreds of millions of dollars at a time. Adding to the instability, this institutional funding source is highly sensitive to run risk. Because the balance often exceeds FDIC deposit insurance limit of $250,000 many times over, it will suddenly be withdrawn at the first hint of a problem at a bank. Relying upon this type of balance to finance a part of a bank's balance sheet creates funding risk. In a crunch, the bank may need suddenly to replace this funding source just as cash availability is becoming much more expensive and much less available. Runs of short-term corporate funding brought down Washington Mutual Savings Bank, Wachovia and IndyMac, among other banks, during the recent financial crisis.[45]

In addition to funding risk, this type of large balance short-term deposit poses challenges to banks in investing the money at a profit on a short-term basis and creates serious interest rate risks for banks. As required by amended Rule 2a-7, Managers of large Money Funds now conduct extensive diligence on large corporate shareholders and very carefully assess the anticipated times that large commercial Money Fund share balances will be invested and redeemed and that information is factored into the duration of the investments made by the Money Fund, in order to predict cash movements and assure liquidity through investment of appropriate amounts in short-term instruments.

Banks, in contrast, currently have no ready means to invest the cash profitably on a short-term basis after taking into account their high cost structures. Even if it pays no

[45] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, at 302, 308, 355 (Jan. 2011) (available at: http://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html).

interest, holding deposits costs a bank money. The bank must pay FDIC deposit insurance premiums on its balance sheet obligations. More deposits means more deposit premiums. Premiums going forward for most banks will range somewhere between 2.5 and 45 basis points per year on balances,[46] and averaged approximately 17.72 basis points during 2010.[47] The bank must also carry leverage capital on its aggregate balance sheet as well. Although the theoretical minimum leverage requirement is 4%, banks are expected to carry several percent more in leverage capital, depending on a variety of factors, and typically carry at least 7 to 9% leverage capital.[48] Assuming that the cost of equity capital in the banking industry as of 2011 averages around 7% per annum,[49] the implied cost of carrying 7% leverage capital against each additional dollar on the balance sheet of a bank is approximately 49 basis points per year. This means a bank must earn a net return of at least 0.66% per year on its investments in loans, securities and other assets simply to break even on a zero interest rate deposit. But the cost to the bank of operating, including the cost of making and servicing loans, the cost of loan losses, and the noninterest overhead expense of operating the bank (the largest parts of which are personnel costs and occupancy expense, which are ultimately variable costs) generally exceed an additional 2% per year for every dollar on a bank's balance sheet.[50] All told, the noninterest expenses of each dollar of a bank's balance sheet total over 3% per year.[51]

Obviously, with this cost structure, a bank cannot invest deposits in short-term low risk commercial paper and government notes and turn a profit. To cover the expense of operating, a bank must invest in longer term higher risk assets just to break even. The bank is exposed to the credit risk of the underlying loan and other assets in which it invests the proceeds of the deposit. Unlike Money Fund shares, where the investor agrees to share pro rata in portfolio losses of the fund, bank deposits are unconditional obligations of the bank to repay a sum certain to the depositor. Banks are also exposed to interest rate risk in investing out the yield curve to try to cover the cost of operating. If rates rise materially, the bank must pay more to keep deposits, but may not be able to increase the interest charged on the loan or earned on the other portfolio asset in the near term. And, as noted above, banks are exposed to funding risk. If a large amount of deposits are withdrawn, and the bank has invested the proceeds in illiquid loans or other

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[46] *See* FDIC: Historical Assessment Rate Schedules, *available at* http://www.fdic.gov/deposit/insurance/historical.html.

[47] 2010 FDIC Ann. Rep. 90, *available at* http://www.fdic.gov/about/strategic/report/2010annualreport/AR10final.pdf.

[48] FDIC Quarterly Banking Profile, Vol. 5, No. 3, at 5 (Jun. 30, 2011) (providing leverage ratios from 2006 through June 30, 2011) (*available at* http://www2.fdic.gov/qbp/qbpSelect.asp?menuItem=QBP).

[49] Aswath Damodaran, NYU Stern School of Business, *Cost of Capital by Sector* (Jan. 2011), *available at* http://w4.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wacc.htm.

[50] Federal Financial Institutions Examination Council, *Uniform Bank Performance Report, Peer Group Average Report for All Banks in Nation* as of September 30, 2011 (available at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx).

[51] Federal Financial Institutions Examination Council, *Uniform Bank Performance Report, Peer Group Average Report for All Banks in Nation* as of September 30, 2011 (available at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx).

assets (as typically is the case) the bank may need suddenly to replace that funding at the most inopportune time.

For these reasons, a number of banks currently are turning away large short-term corporate deposits, or charging depositors a fee or negative interest for holding onto the deposit.[52] This suggests that the banking industry does not need, does not want, and does not have the capacity to take on an additional $2.6 trillion in new deposits.

Second, consider the systemic impact. The business challenges faced by individual banks in accepting large amounts of new deposit balances impose systemic risks and costs on the banking system as a whole. Large deposit inflows have in the past caused financial problems at banks. Growth in brokered deposits and other sources of non-core deposits and unstable short-term funding have been associated with many bank failures, from the thrift crisis of the 1980s and early 1990s through the financial crisis of 2008. This is why the Federal Deposit Insurance Act limits use of brokered deposits by banks that are not well capitalized and why bank regulators are so concerned about the funding risk, liquidity risk, and interest rate risk that follows when large, unstable deposit sources are tapped by banks.[53] The FDIC recently amended its methodology for determining deposit insurance assessment rates so that banks will pay higher risk-based premiums when they rely on more short-term, "non-core" deposits.[54] If corporate Money Fund investors were to shift large balances from Money Funds into bank deposits, banks individually, and the banking system as a whole would face exactly the same issues. This short-term liquidity can leave as quickly as it arrives. These sudden cash outflows or "silent runs" can cause a bank to become liquidity insolvent.

Liquidity problems resulting from a shortage of cash on hand to repay depositors and other creditors, rather than capital shortfalls, is the main cause of bank runs and

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[52] Rachel Witkowski, *Bankers Face Tough Calls as Deposits Pour In*, AM. BANKER,Aug. 30, 2011; Bradley Keoun, Dakin Campbell and Dawn Kopecki, *Banks Seeking Relief From Regulators as Deposits Swell,* WASH. POST, Aug. 26, 2011.

[53] *See* Office of the Comptroller of the Currency, *Handbook on Liquidity*, at 4, 6 (Feb. 2001) (*available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/liquidity.pdf) ; FDIC, *Risk Management Manual of Examination Policies*, Section 6.1 (both describing rapid asset growth funded by potentially volatile sources as early warning indicators) (*available at* http://www.fdic.gov/regulations/safety/manual/section6- 1.html). The influx of petrodollars to U.S. banks in the 1970s illustrates how sudden inflows of funds can have a destabilizing effect. As oil prices rose at that time, oil exporting countries deposited large amounts with U.S. banks, which lent heavily to developing countries, especially in Latin America. This set the stage for the Latin American Debt Crisis, which was triggered when interest rates rose and commodity prices fell in the 1980s. FDIC, *History of the Eighties - Lessons for the Future*, Chapter 5: The LDC Debt Crisis, pp. 191-211 (Jun. 5, 2000) (*available at* http://www.fdic.gov/bank/historical/history/).

[54] FDIC Final Rule, *Assessments, Large Bank Pricing*, 76 FR 10672 (Feb. 25, 2011). *See also* FDIC, *Final Guidelines, Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions,* 76 Fed. Reg. 57992 (Sept. 13, 2011).

panics.[55] Banks attempt to address the asset funding risk through access to the Federal Reserve discount window and the ability to attract FDIC-insured deposits, both of which are dependent upon the Federal safety net. Money Funds, which normally do not have access to federal funding sources but have a much lower expense structure, address the liquidity issue by holding a high-quality portfolio of very short-term assets that will mature and produce large amounts of cash in the near term sufficient to meet substantial redemptions of shares without the need to resort to borrowing or a "forced sale" of assets. This is coupled with carefully-managed "know your investor" programs through which fund managers question large investors and monitor investment and redemption patterns to gain an understanding of the normal liquidity needs and purchase and redemption patterns of the investor base. Money Funds manage funding issues by anticipating cash needs and being able to shrink dramatically in size very quickly to pay out redemption requests as they occur without selling assets. Banks, in contrast, manage their liquidity needs by being able to borrow very large amounts of federally-guaranteed money on short notice.

In addition, any substantial flow of dollars out of Money Funds and into bank deposits would impose significant new capital needs on banks at the very time banks are already under capital pressures. Assuming seven percent leverage capital on each additional dollar of deposits, banks would need an additional $182 billion in new equity capital to handle the entire balance of the Money Fund industry. To put that amount of new capital in perspective, the European Banking Authority recently estimated their banks will need approximately $147 billion in new capital to address the current European sovereign debt crisis.[56] In other words, having the banking system absorb all current Money Fund balances would require U.S. banks to raise more new equity capital than is needed to recapitalize the European banking system to address the European sovereign debt crisis.

Another systemic impact of the substitution of bank deposits for Money Fund shares would be a major increase in the overall size of the federal safety net. Bank deposits are federally insured (at least up to $250,000 per depositor on interest bearing accounts), so when a bank fails, the government pays. Money Fund shares are not insured by the federal government; in the two instances (in forty years) where a Money Fund broke a buck, investors lost a small amount of money but taxpayers were not on the hook. Increasing the size of the federal safety net was not the purpose of the Dodd Frank Act, yet that would be the most likely result of the use of Title I of the Act to shrink or eliminate Money Funds.

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[55] Kathleen McDill and Kevin Sheehan, *Sources of Historical Banking Panics: A Markov Switching Approach*, Working Paper 2006–01 (Nov. 2006), *available at* www.fdic.gov/bank/analytical/working/wp2006.../wp2006_01.pdf.

[56] Ben Moshinsky & Jim Brunsden, *EU Banks Must Raise $147B of Extra Capital, EBA Says*, Bloomberg (Oct. 26, 2011), (*available at* http://www.bloomberg.com/news/2011-10-26/eu-banks-must-raise-147-billion-of-extra-capital-eba-says.html); Press Release, European Banking Authority, The EBA details the EU measures to restore confidence in the banking sector (Oct. 26, 2011) (available at: http://www.eba.europa.eu/News--Communications/Year/2011/The-EBA-details-the-EU-measures-to-restore-confide.aspx).

Moreover, because the FDIC sets its premiums in part based upon the relationship between the current balance of the Deposit Insurance Fund and the amount of insured deposits, with a minimum statutory target ratio of 1.35% and an FDIC-designated desired ratio of 2%[57] a sudden increase of a couple of trillion dollars in deposit balances at FDIC-insured banks would mean there would be an even greater current shortfall in the ratio of the Deposit Insurance Fund to covered deposits that would need to be made up through increased assessments on insured banks over a period of many years. For every trillion dollars in new insured deposits coming into the deposit insurance system through outflows from Money Funds, the shortfall in the Deposit Insurance Fund target reserve ratio would equal an additional 20 billion dollars. Even without this change, the Deposit Insurance Fund is not projected to achieve the statutory minimum ratio of 1.35% until September 2020.[58] The Deposit Insurance Fund would essentially become further undercapitalized as a direct result of movement of Money Fund balances into the banking system, and bank earnings would need to be further stretched for many years to come through higher FDIC insurance assessments to make up that shortfall.

A further consequence to the banking system would likely be additional growth of the largest U.S. banks fueled by deposits of cash redeemed from Money Funds. The new inflows into banks of deposit balances exiting Money Funds would likely not be evenly distributed among all of the banks in the banking system. Particularly in view of the sophisticated cash management uses of Money Funds, it would appear likely that much of the deposit flows would be into large money center and superregional banks. That is what happened when the FDIC and then Congress provided for temporary unlimited insurance for demand deposits.[59] Corporate cash became concentrated in a handful of major money center banks.

Richard Fisher, President and CEO of the Federal Reserve Bank of Dallas, recently highlighted the systemic danger posed by the concentration of our banking system and the size of our largest banks.[60] As Mr. Fisher discussed in a November 15, 2011 speech,

> [w]ith each passing year, the banking industry has become more concentrated. Half of the entire banking industry's assets are now on the books of five institutions. Their combined assets presently

[57] FDIC Final Rule, Assessments, Large Bank Pricing, 76 Fed. Reg. 10672, 10674 (Feb. 25, 2011); 12 U.S. § 1817(b)(3).

[58] FDIC Notice, Adoption of Federal Deposit Insurance Corporation Restoration Plan, 75 Fed. Reg. 66293 (Oct 27, 2010).

[59] *See* FDIC Quarterly Banking Profile, Vol. 3, No. 1, at 4 (Dec. 31, 2008) (noting that total deposits increased by $307.9 billion (3.5%) in the fourth quarter of 2008, the largest increase in ten years) *available at* http://www2.fdic.gov/qbp/qbpSelect.asp?menuItem=QBP.

[60] Richard W. Fisher, President, Federal Reserve Bank of Dallas, Taming the Too-Big-to-Fails: Will Dodd–Frank Be the Ticket or Is Lap-Band Surgery Required? Remarks before Columbia University's Politics and Business Club, New York City (Nov. 15, 2011), *available at* http://dallasfed.org/news/speeches/fisher/2011/fs111115.cfm.

> equate to roughly 58 percent of the nation's gross domestic product (GDP). The combined assets of the 10 largest depository institutions equate to 65 percent of the banking industry's assets and 75 percent of our GDP.[61]

The failure of any of these banks would be catastrophic to the economy and our financial system. We do not have available financial resources to bail them out if they fail. Mr. Fisher concludes that the only effective way to address the "pernicious threat to financial stability that megabanks or 'systemically important financial institutions'—the SIFIs—have become" is to "contain the relentless expansion of these banks and downsize them to manageable proportions."[62] One consequence that would almost certainly follow from a substantial shrinkage of Money Funds would be an offsetting further growth of the largest banks, potentially by as much as $2.6 trillion in deposits and assets.

Shrinking Money Funds would increase systemic risk by causing further growth of the largest SIFI banks. Over 75% of recent deposit growth that was caused by unlimited deposit insurance of demand deposit accounts flowed into the ten largest banks.[63] The ten largest US banks represent 65% of banking assets and 75% of US GDP.[64] Institutional investors hold approximately two-thirds of Money Fund shares. If two thirds of Money Fund balances move into the banking system and 75% of that flows into the ten largest banks, that would increase the size of the ten largest SIFI banks by $1.3 trillion to 74% of US banking assets and 84% of US GDP. Increasing the concentration of the banking industry and the size and systemic importance of the largest banks is directly contrary to the purposes stated in the preamble to the Dodd Frank Act "to end 'too big to fail' [and] to protect the American taxpayer by ending bailouts."

A further systemic impact would be that the means by which our financial system intermediates cash balances and reinvests them would become less diverse. If Money Funds are regulated out of existence, the banking system would effectively be the sole means by which cash balances are rechanneled into financing the economy. Currently, debt financing in the European financial system involves less intermediation of investor balances through capital markets transactions than does the U.S., with less financing obtained by issuing securities into financial markets where they are traded, and relies far more heavily on banks providing financing and intermediating a greater percentage of

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[61] *Id.*

[62] *Id.* This trend continues, as confirmed by the most recent data from the FDIC. According to the FDIC, during the third quarter of 2010, domestic deposits increased by $279.5 billion. Of this amount, nearly two-thirds ($183.8 billion or 65.8 percent) "consisted of balances in large noninterest-bearing transaction accounts that have temporary unlimited deposit insurance coverage. The 10 largest insured banks accounted for 75.7 percent ($139.1 billion) of the growth in these balances." FDIC Press Release, *FDIC-Insured Institutions Earned $35.3 Billion in The Third Quarter of 2011* (Nov. 22, 2011) *available at* http://www.fdic.gov/news/news/press/2011/pr11182.html.

[63] FDIC Press Release, Insured Institutions Earned $35.3 Billion in The Third Quarter of 2011(Nov. 22, 2011).

[64] Fisher, *supra* note 55.

balances between savers and borrowers. That structure increases the systemic importance and risk of banks within the European system, by funneling a greater portion of investment intermediation through banks' balance sheets with a *de facto* government backstop. That is one of the weaknesses in the European financial system as compared to the U.S. system. But that is essentially the direction in which hobbling Money Funds would take us. A system reliant solely on banks to perform this liquidity balance intermediation function is more brittle than one that includes alternate means of intermediation currently provided by Money Funds. The existing U.S. approach, with a mix of market and bank financing, is far deeper, more diverse, more robust and more transparent than the European system.

A further complicating factor is the expiration, on December 31, 2012, of the statutory unlimited FDIC deposit insurance coverage for noninterest-bearing deposit accounts at banks.[65] This unlimited deposit insurance was originally put in place by FDIC order at the height of the financial crisis in 2008 in order to stabilize the banking system and reduce the risk of bank runs.[66] The unlimited deposit insurance program was extended twice by FDIC order, and finally included in the statute by Section 343 of the DFA (codified at 12 U.S.C. § 1821), but with a statutory end date. One of the attractive features of Money Funds to businesses with large cash balances to invest is that they are less exposed to single counterparty risks than are bank deposits in amounts in excess of the otherwise applicable FDIC deposit insurance limit of $250,000 per depositor. For so long as noninterest bearing deposits carry unlimited deposit insurance, that feature of Money Funds is temporarily matched by an unlimited federal guarantee of the deposit. If Money Fund "reform" renders Money Funds unattractive to large holders of liquidity just as unlimited deposit insurance ends in 2012, holders of large cash balances will become very nervous indeed and those cash balances will become even more likely to be moved between banks in crisis. The precise outcome of this change on the placement of cash balances by corporate treasurers and on banking system liquidity is not predictable, but it is not likely to increase financial stability. The existence of Money Funds to hold these large, short-term corporate balances reduces the risk to the U.S. banking system by keeping them from moving briefly across the balance sheets of U.S. banks, reducing the size of the federal safety net, and reducing the interest rate risk and funding risk that these balances would otherwise present to banks. Money Funds benefit the financial system by providing a relatively safe means for commercial users to store short-term liquidity away from the banking system and its explicit federal guarantee.

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[65] FDIC, Final Rule: Temporary Unlimited Coverage for Noninterest - Bearing Transaction Accounts, 75 FR 69577 (Nov. 15, 2010).

[66] FDIC Temporary Liquidity Guarantee Program ("The FDIC has created this program to strengthen confidence and encourage liquidity in the banking system . . . by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount.") (*available at* http://www.fdic.gov/regulations/resources/TLGP/index.html). *See also* FDIC Proposed Rule, Deposit Insurance Regulations; Unlimited Coverage for Noninterest Bearing Transaction Accounts, 75 FR 60341 (Sept. 30, 2010).

F. Need for the FSOC to Incorporate Formal and Thorough Consideration of the Economic and Systemic Impact of Designation into the Title I Screening and Designation Process

As discussed above, there is a real danger of unintended consequences from radical changes to the regulation and structure of Money Funds through designation of one or more Money Funds under Title I of the DFA. These potential consequences include delays in settlement times for a wide range of transactions that rely on Money Funds to achieve same day processing of cash balances, increased funding costs to corporate and government issuers that currently are financed by Money Funds, a negative effect on economic growth and jobs, and serious damage to the economy. These consequences may also include the movement of very large amounts of liquidity out of Money Funds and into the banking system which could be destabilizing, or into unregistered and largely unregulated private funds. None of these consequences would be good for financial stability or for the economy. We respectfully suggest that as part of the rules proposed in the NPR implementing the Title I designation process, a formal element be added to the procedures to require, in the early stages of screening a firm for designation as systemically important under Title I, thorough consideration by the FSOC of the systemic impact of designation of that firm on the economy and the financial system.

III. Existing Program of a Comprehensive Prudential Regulation Should Be Given Far Greater Weight In Title I Designation Process

The NPR states that three of the six categories into which it groups the statutory considerations for designation – leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny of the nonbank financial company – seek to assess the vulnerability of a nonbank financial company to financial distress. It states, "[n]onbank financial companies that are highly leveraged, have a high degree of liquidity risk or maturity mismatch, and are under little or no regulatory scrutiny are more likely to be more vulnerable to financial distress."[67] Of course, the converse also is true. Nonbank financial companies that have no leverage, that have a high degree of liquidity, and that are under comprehensive regulatory scrutiny are much less vulnerable to financial distress. As discussed below, Money Funds have no leverage, have a higher level of liquidity than any other type of financial institution, and are subject to comprehensive regulation and oversight by the SEC.

The designation of a firm under Title I of the DFA and supplemental regulation by the Federal Reserve of the designated firm allows application of several categories of regulatory requirements to the designated firm that are specified in the Act. These include imposition of requirements for information gathering and reporting to regulators and the public, stress-testing, capital, leverage limits and liquidity requirements, risk controls, governance requirements, assessment of counterparty exposures, plan for

[67] FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. at 64278.

liquidation/wind-down (and being subject to FDIC receivership), and limitation of off balance sheet activities.

Designation of a Money Fund for additional regulation by the Federal Reserve under Title I is unnecessary to address these regulatory requirements. Each of these areas is already addressed in a comprehensive manner by the SEC.

Money Funds do not have a complex structure. A Money Fund is simply an investment pool that holds short-term high quality, marketable fixed income instruments, with a readily available asset value. Money Funds are entirely transparent. There are no holding companies, foreign affiliates, off-balance sheet structures or complex structures of any kind allowed within a Money Fund. Money Funds do not use leverage or other forms of borrowing to any material degree. Money Funds do not have concentrated exposures to other companies. They do not have complex capital structures. Money Fund balance sheets are all simple common equity. Money Fund capital ratios are 100% equity, and they hold only high quality, liquid assets. If the fund manager does not continue to reinvest the portfolio, a Money Fund converts to cash in very short order through the customary maturity of its portfolio of assets. All of this is dictated by the Investment Company Act and rules of the SEC that apply to Money Funds.

Money Funds and the SEC over the past 40 years have worked through in detail the issues of maintaining liquidity and asset values in the absence of a federal safety net. These are exactly the type of issues with which the banking regulators are now struggling under the DFA. Money Funds and the SEC have come at this problem from a very different direction and used a much simpler approach than have the banks and their regulators over this period: do not use leverage, only equity, and invest only in short-term, high-quality, liquid debt instruments. That is why, over four decades and through many business cycles, only two Money Funds have ever "broken the buck" (one returning 96 cents on the dollar to investors and the other over 99 cents on the dollar to investors, and no loss to the federal government), while over the same period over 2800 banks have failed at a cost to the federal government in excess of $188 billion.[68]

A. Money Funds Already Have the SEC As Prudential Regulator

Money Funds are comprehensively regulated and supervised by the SEC under the Investment Company Act and other federal securities laws. The DFA expressly recognizes that registered investment companies are already *prudentially regulated* by the SEC,[69] and designates the SEC as the "primary financial regulatory agency" with respect to investment companies registered under the Investment Company Act.[70] Oft repeated statements that Money Funds and other SEC-registered investment companies are not

[68] FDIC Historical Statistics on Banking, Failure and Assistance Transactions, 1971 - 2011, *available at*: http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[69] D.F.A. § 165(b)(1)(A), (codified at 12 U.S.C. § 5365(b)(1)(A)).

[70] D.F.A. § 2(12)(B)(ii), (codified at 12 U.S.C. § 5301(12)(B)(ii)).

regulated,[71] not comprehensively regulated, or not prudentially regulated, are counterfactual and refuted by the plain language of the DFA that was enacted by Congress and signed by the President in 2010.

This existing, comprehensive program of SEC regulation and supervision of Money Funds is significant to the question whether Money Funds should be designated under Title I in four key respects. First, Title I of the DFA, and the proposed rules, expressly include consideration of whether a firm already is comprehensively regulated as a key element in weighing whether designation of that firm under Title I is necessary or appropriate to address systemic risk.[72] The text of Sections 2 and 165(b)(1)(A) of the DFA clearly state that registered investment companies are already regulated by the SEC under the Investment Company Act and that regulatory program is *prudential* regulation. Unlike other types of organizations with a primary regulator named in Section 2 of the DFA, registered investment companies do not have holding companies, sister affiliates or other complex regulatory structures that place parts of the larger firm outside of the jurisdiction of the primary federal regulator. The registered investment company is itself the entire corporate structure, and the SEC comprehensively regulates and supervises it, as well as its key service providers, the investment adviser and principal underwriter.[73] There is not an unregulated corner of the organization that requires designation under Title I to permit oversight of that part of the enterprise.

Second, consideration of the program of regulation and oversight of Money Funds by the SEC under the Investment Company Act and SEC rules, which is discussed further below, demonstrates that the issues of systemic risk that might be addressed by designation under Title I and Federal Reserve oversight of less thoroughly regulated categories of firms, including capital requirements, leverage limits, liquidity requirements, risk management, conflict-of-interest restrictions, disclosures and transparency, liquidation or resolution, corporate structure, counterparty exposure and

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[71] *Volcker Wants Crackdown On Money Market Funds, GSEs*, Reuters (Oct. 23, 2011) *available at* http://www.reuters.com/article/2011/10/23/us-volcker-regulations-idUSTRE79M2B520111023; Letter to Elizabeth Murphy, Secretary, SEC from former Federal Reserve Chairman Paul Volcker (Feb. 11, 2011) *available at* http://www.sec.gov/comments/4-619/4619-79.pdf; . These arguments have all been raised and rejected before. *See* Karen W. Arenson, *Volcker Proposes Money Funds Be Subject to Rules on Reserves,* N.Y. Times, Jun. 26, 1981 (noting that former Chairman Volcker testified before a Congressional subcommittee that money market funds should be subject to regulations that would make them more competitive with banking institutions and less attractive to investors. Mr. Volcker also testified that since reserve requirements were a key part of monetary policy that could not be removed from banking institutions, they also should apply to other investment vehicles).

[72] D.F.A. § 113(a)(2)(H); FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64268, 64274, 64279.

[73] *See e.g.* Investment Company Act § 8 (investment company registration); § 9 (disqualification of certain persons from affiliation or underwriting relationships with investment companies); § 10 (addressing conflicts of interest between investment company and service providers); § 15 (requirements for investment advisory and underwriting contracts). Fund underwriters are subject to regulation by the SEC and the Financial Industry Regulatory Authority ("FINRA") under the Securities Exchange Act of 1934 (15 U.S.C. 78a, *et seq.*) and FINRA rules. Investment advisers to mutual funds, including Money Funds, are regulated by the SEC pursuant to the Investment Advisers Act of 1941 (15 U.S.C. 80b-1 *et seq.*).

concentration monitoring and control, are already comprehensively addressed by the SEC. Indeed, Section 165(b)(1) of the DFA uses investment companies subject to the requirements of the SEC's existing regulation of investment companies as an example of "a company subject to more stringent prudential standards" than the "capital and leverage limits" that could be imposed under Title I of the DFA.

Third, the SEC's program of regulation and oversight has been tried, tested and proven effective. It works, as demonstrated by the performance of Money Funds over the past forty years. The SEC has continued to refine and enhance its regulatory program, including with the 2010 amendments to Rule 2a-7 which substantially enhanced the required liquidity and credit quality of money funds and their ability to weather financial crises up to and including maintaining the redeemability of shares when and if a money fund "break a buck." As the SEC Chairman recently acknowledged, these enhancements have already been shown to be effective through several major financial crisis – involving European government debt and the U.S. budget crisis.

Fourth, imposing a second layer of regulation through designation under Title I will impose additional costs and burdens upon the firm and persons who do business with it, upon the government agencies that must devote staff time and resources to conduct the supervision, and upon the economy as a whole through the costs and inefficiencies that ultimately are spread out through the economy. There needs to be a reason for imposing a second layer of costs and the benefit gained or the risk avoided must justify the additional burden imposed.[74]

Insufficient attention has been paid to the effectiveness of the Commission's recent amendments to Rule 2a-7, which have protected the resiliency of Money Funds in the face of very turbulent market conditions. Operating under the amended rule, Money Funds have been able, without incident, to handle large volumes of redemptions in short periods – volumes similar in size and percentage of assets to the redemptions that occurred during the September 2008 financial crisis. Under amended Rule 2a-7, Money Funds are now required to maintain at least 10% of assets in overnight cash (currently $260 billion) and 30% with seven-day availability (nearly $800 billion). Most Money Funds maintain far more liquidity than is required by Rule 2a-7. Before further changes are made to the program of regulation of Money Funds, greater consideration should be given to evaluating the effectiveness of the enhanced regulatory program. Proposals that have been made by academics for further regulatory changes were formulated before the beneficial effects of the amended Rule 2a-7 were demonstrated. The greater liquidity now required of Money Funds, together with robust surveillance by the Commission aimed at detecting and responding to excessive risk-taking – surveillance that focuses on the kind of unusually high levels of yield or growth at an Money Fund that led to the 2008 problem at the Reserve Primary Fund – provide significant safeguards.

[74] In January of this year, the President specifically directed each federal agency to propose or adopt regulations "only upon a reasoned determination that its benefits justify its costs" and to "tailor ... regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations." Exec. Order No. 13563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

B. Governance Structure of Money Funds Is Consistent With Regulatory Best Practices for Controlling Risk and Limiting Conflicts of Interest

One of the central elements to all of the compliance programs required in recent years by the federal banking regulators is the active involvement of the board of directors. Recent examples include the rules recently proposed or adopted to implement various provisions of the DFA, such as management of risks in incentive based compensation arrangements,[75] the Volcker Rule restrictions on proprietary trading by banking entities,[76] as well as compliance programs for oversight of trust operations[77] and general programs for compliance with banking laws,[78] each of which is built around active involvement by the board of directors in adopting policies and procedures and oversight of the banking entity's compliance effort.

The Investment Company Act requires the board of directors of each registered investment company, including all Money Funds, to play a central role in oversight of the fund, including such things as oversight of the fund's investment adviser and distributor and annual review of their contracts,[79] approval of custody arrangements,[80] prohibitions on conflicts of interest,[81] risk controls, compliance,[82] and, significantly, the valuation of portfolio securities and the pricing of the shares of Money Funds.[83]

Moreover, boards of directors of Money Funds are required by Rule 2a-7 to approve the use of amortized cost accounting and provide on-going oversight of its continued use, adopt procedures for shadow pricing the portfolio to check whether amortized cost continues to accurately reflect the value of its portfolio, determine that the portfolio of securities held present minimal credit risks and adopt procedures for periodic credit reviews, take action in the case of a portfolio event affecting a portfolio security to review the credit risk and make determinations on the value of the affected portfolio security and whether to continue to hold it, determine that the investments meet the investment criteria specified in the Rule, oversee the review of the liquidity needs of the

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75 Department of Treasury, Federal Reserve Board, FDIC, OTS, NCUA, SEC, FHFA, Proposed Rule, Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21170 (Apr. 14, 2011).

76 OCC, Federal Reserve Board, FDIC, SEC, Proposed Rule, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (Nov. 7, 2011).

77 12 C.F.R. §§ 9.4(a), 9.9(c).

78 Federal Reserve Bank of Kansas City, *A Banker's Guide to Establishing and Maintaining an Effective Compliance Management Program* (2002), *available at* www.philadelphiafed.org/bank-resources/publications/compliance-corner/2002/third-quarter/q3cc1_02.cfm

79 Investment Company Act § 15.

80 17 C.F.R. §§ 270.17f-1 *et seq.*

81 17 CFR § 270.17d-1.

82 17 C.F.R. § 270.38a-1.

83 17 C.F.R. §§ 270.2a-4, 2a-7.

fund above and beyond the 10%/30% minimum standards, and adopt procedures for stress-testing the fund's portfolio.

C. Money Funds Are Financed By Equity, Not Debt, and Cannot Default in the Way Contemplated by Title II of DFA

Resolution plans are required of companies designated as systemically important under Title I of DFA, in preparation for, and as a bankruptcy court alternative to, a potential FDIC receivership and liquidation under Title II. However, the basis for either a bankruptcy or conducting an FDIC resolution under Title II will not exist for Money Funds. Money Funds do not borrow money or rely on leverage. Money Funds are financed 100% by equity. Shareholders do not have a right to the payment of $1 per share. Instead, Money Fund shareholders have a right to the return of their pro-rata portion of the net asset value of the Money Fund upon redemption. If a Money Fund "breaks a buck" and falls below $1 per share, the Money Fund has not defaulted on an obligation or breached a contractual right of shareholders. "Breaking the buck" is not an insolvency. Money fund shareholders are not creditors. The statutory "hook" for resolution by the FDIC under Title II is simply not triggered.

The central criteria in triggering a receivership under Section 203(a) of the DFA through a recommendation by the Board and the FDIC for a designation under Title II, as well as the determinations that must be made by the Secretary of Treasury under Section 203(b), are premised on a default or potential default by a financial company on its debt obligations. The terms "default or in danger of default" are defined in Section 203(c)(4) in a way that could not reasonably be triggered in the context of a company, such as a Money Fund, that has only equity capital and no material debt, and thus has no debt or other obligations that it could default on. As defined in Section 203(c)(4) of the DFA, a financial company may be considered to be in default or in danger of default if:

> (A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;
>
> (B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
>
> (C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or
>
> (D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

The Joint Federal Reserve/FDIC NPR on resolution plans similarly defines "material financial distress" (the event which triggers the resolution plan being actually used) with regard to a Covered Company to mean that:

> (i) The Covered Company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for

> the company to avoid such depletion; (ii) the assets of the Covered Company are, or are likely to be, less than its obligations to creditors and others; or (iii) the Covered Company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.[84]

None of these statutory or proposed regulatory conditions to a resolution plan actually being used can exist at a Money Fund, because a Money Fund (i) is financed entirely by equity capital, (ii) does not use debt or other forms of leverage or derivatives to a significant degree and thus does not have significant obligations to creditors and others, and (iii) since it has no material debts or similar obligations and is financed entirely by equity capital, it cannot be in a situation where it is unable to pay its obligations in the normal course of business.

Moreover, the ultimate FDIC "recapitalization" authority under Title II is to convert creditors into equity shareholders. Money Fund investors are already equity shareholders, not creditors, further highlighting the inappropriateness of the designation of Money Funds under the DFA.

If the statutory and regulatory conditions requiring the use of a resolution plan cannot realistically exist at a Money Fund, it makes no sense to require Money Funds to prepare a resolution plan, and have it reviewed and approved by the Board and FDIC.

D. Money Funds By Nature Are Self-Liquidating Because They Hold Short-Term, High Quality Debt Instruments and Have an Average Portfolio Maturity of 60 Days or Less

It does not take an elaborate roadmap to understand and figure out how to liquidate a Money Fund. Money Fund balance sheets are filed with the SEC and available to the public online. If there is a need to liquidate a Money Fund, the fund manager can simply wait for the portfolio assets to repay at maturity. Due to the very short weighted average maturity of a Money Fund's Portfolio mandated by SEC rules, most of the assets will be fully repaid in cash in very short order. In the alternative, some or all of the portfolio assets can be sold into the open market for cash. Or, some assets can be held to maturity and others sold. This is not very complicated.

The liquidity of Money Funds is dictated by SEC rules, including Rule 2a-7 under the Investment Company Act.[85] Money Funds are allowed to invest only in short-term, high-quality debt. Rule 2a-7 and related SEC rules impose requirements on Money Funds in the following areas:

Liquidity Matching of Portfolio Maturities to Cash Needs for Redemptions. Under the 2010 amendments to Rule 2a-7 -- promulgated in large part in response to the

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[84] Federal Reserve and FDIC, Resolution Plans and Credit Exposure Reports Required, 76 Fed. Reg. 22648, 22649 (Apr. 22, 2011).

[85] *See* 17 C.F.R. § 270.2a-7.

financial crisis -- a Money Fund is required to have a minimum percentage of its assets in highly liquid securities so that it can meet reasonably foreseeable shareholder redemptions.[86] Under new minimum daily liquidity requirements applicable to all taxable Money Funds, at least 10 percent of the assets in the fund must be in cash, U.S. Treasury securities, or securities that convert into cash (*e.g.*, mature) within one business day. In addition, under a new weekly requirement applicable to all Money Funds, at least 30 percent of assets must be in cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, or securities that convert into cash within five business days. No more than 5 percent of a fund's portfolio may be "illiquid" (i.e., cannot be sold or disposed of within seven days at carrying value).

High Credit Quality. Rule 2a-7 limits a Money Fund to investing in securities that are, at the time of their acquisition, "Eligible Securities." "Eligible Securities" include a security with a remaining maturity of 397 calendar days or less, that meet stringent credit quality standards dictated by the rule.[87] Under the 2010 amendments, 97% of a Money Fund's assets must be invested in "First Tier Securities."[88] Only 3 percent of its assets may be held in "Second Tier Securities."[89] In addition, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer (rather than the previous limit of the greater of 1 percent or $1 million). Under the 2010 amendments, a Money Fund also is prohibited from purchasing "Second Tier Securities" that mature in more than 45 days (rather than the previous limit of 397 days). As required by the DFA, the SEC has proposed to remove the references to

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[86] Depending upon the volatility of the fund's cash flows (in particular shareholder redemptions), a fund may be required to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements set forth in Rule 2a-7. *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

[87] Under Rule 2a-7(a)(12), if only one designated NRSRO has rated a security, it will be considered a rated security if it is rated within one of the rating agency's two highest short-term rating categories. Under certain conditions, a security that is subject to a guarantee or that has a demand feature that enhances its credit quality may also be deemed an "Eligible Security." In addition, an unrated security that is of comparable quality to a rated security also may qualify as an "Eligible Security."

[88] A "First Tier Security" means any Eligible Security that:

(i) is a Rated Security (as defined in Rule 2a-7) that has received a short-term rating from the requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);

(ii) is an unrated security that is of comparable quality to a security meeting the requirements for a rated security in (i) above, as determined by the fund's board of directors;

(iii) is a security issued by a registered investment company that is a Money Fund; or

(iv) is a Government Security.

The term "requisite NRSROs" is defined in Rule 2a-7(a)(23) to mean "(i) Any two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) If only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO."

[89] Second Tier Securities are any Eligible Securities that are not First Tier Securities.

NRSRO ratings and replace them with equivalent high credit quality determinations by the fund board or its designee.[90]

Short Maturity Limits. Rule 2a-7 limits the exposure of Money Funds to risks like sudden interest rate movements by restricting the average maturity of portfolio investments. (This also helps a Money Fund maintain a stable NAV). Under the 2010 amendments to Rule 2a-7, the "weighted average maturity" of a Money Fund's portfolio is restricted to 60 days. In addition, the 2010 amendments introduced limits to the maximum "weighted average life" maturity of a fund's portfolio to 120 days.[91] This restriction limits Money Funds' investment in long-term floating rate securities. In practice, 93% of "prime" Money Funds at year-end 2010 had a weighted average life of 90 days or less, and 80% had a weighted average maturity of 50 days or less.[92]

E. Money Funds Are Already Required by SEC Rules to Structure their Portfolios and Conduct Operations to Address Liquidity Needs

Money Funds are subject to detailed SEC requirements on the tracking and reporting of portfolio asset values and per-share NAV, maintenance of a portfolio with sufficient liquidity to pay reasonably foreseeable investor redemptions, the ability to pay fund redemption requests at NAV even during a market crisis or if NAV drops below $1 per share, and a program to temporarily suspend redemptions and liquidate, if needed. Key elements of these requirements are highlighted below.

Shadow Pricing. To reduce the chance of a material deviation between the amortized cost value of a portfolio and its market-based value, Rule 2a-7 requires Money Funds to "shadow price" the amortized cost net asset value of the fund's portfolio against its mark-to-market net asset value. If there is a deviation of more than ½ of 1 percent, the fund's board of directors must promptly consider what action, if any, it should take,[93] including whether the fund should discontinue using the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share.[94] Regardless of the extent of the deviation, Rule 2a–7 obligates the board of a Money Fund to take action whenever it believes any deviation may result in material dilution or other unfair results to investors.[95]

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[90] References to Credit Ratings in Certain Investment Company Act Rules and Forms, 76 Fed. Reg. 12896 (Mar. 9, 2011).

[91] The "weighted average maturity" of a Money Fund's portfolio is usually shorter than its "weighted average life" because the former is measured at the earlier of repayment or reset of interest rates, while the latter is tied to the contractual repayment date on the fixed income instrument.

[92] Money Fund Regulatory Changes Post Financial Crisis, 2011 Investment Company Institute ("ICI") Money Market Funds Summit (May 16, 2011) (slides available on ICI website).

[93] 17 C.F.R. § 270.2a-7(c)(8)(ii)(B) (2010).

[94] *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

[95] 17 C.F.R. § 270.2a-7(c)(8)(ii)(C).

Monthly Disclosure of Weekly Portfolio Information. Under the 2010 amendments, Money Funds must now file monthly reports of weekly portfolio holdings with the SEC, and post their portfolio holdings each month on their websites,[96] which must include the market-based values of each portfolio security and the fund's "shadow" NAV.[97] The information becomes publicly available after 60 days.[98]

Maintaining Cash to Pay Reasonably Foreseeable Redemptions/Know Your Customer. Under a new requirement added to Rule 2a-7 in 2010, Money Funds must hold securities portfolios that are sufficiently liquid to meet reasonably foreseeable redemptions. To satisfy this new requirement, a Money Fund must adopt policies and procedures to identify the risk characteristics of large shareholders and anticipate the likelihood of large redemptions.[99] Larger Money Fund complexes have dedicated departments whose function is to gather information from end shareholders and financial intermediaries on the anticipated timing and volume of future purchases and redemptions, monitor actual transaction experience from those shareholders and follow up on discrepancies, and generate a forward-looking estimate of cash availability and needs within each portfolio that are used by portfolio managers in managing the liquidity and portfolio maturities of the fund. Depending upon the volatility of its cash flows, and in particular shareholder redemptions, this may require a fund to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements discussed above.[100]

Processing of Transactions. Under the amendments adopted in 2010, Rule 2a–7 requires a Money Fund to have the capacity to redeem and sell its securities at a price based on its current NAV. This requirement applies even if the fund's current NAV does not correspond to $1 per share. The new requirement minimizes operational difficulties in satisfying shareholder redemption requests and increases speed and efficiency if a fund breaks the buck. This change requires Money Funds to be able to process redemptions and thus provide liquidity if market prices of their portfolio assets decline, rather than defer share redemptions and corresponding sales of portfolio assets in order to avoid recognizing that decline in portfolio value. In essence, if market conditions dictate a movement to a floating NAV in order to process transactions and provide liquidity to redeeming shareholders, Rule 2a-7 requires Money Funds to do so, or close and liquidate. By forcing shareholder transactions to be processed at a price other than $1.00 when portfolio asset market conditions dictate, this rule change both enhances liquidity and addresses policy concerns over investors in Money Funds being unable to access cash in order to satisfy payment obligations using the proceeds of the Money Fund redemptions (and the "ripple effect" that inability to pay might have in other parts of the markets or in

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[96] 17 C.F.R. § 270.2a-7(c)(12); 17 C.F.R. § 270.30b1-7(a).

[97] *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10083 (Mar. 4, 2010).

[98] 17 C.F.R. § 270.30b1-7(b).

[99] *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10075, n.198 and accompanying text (Mar. 4, 2010).

[100] *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

the economy), although it may not stave of potential "runs" by shareholders seeking to redeem Money Fund shares ahead of unrecognized portfolio price declines.

Handling Default in a Portfolio Instrument. Rule 2a-7 establishes procedures that a Money Fund must follow if a portfolio instrument is downgraded or a default or other event occurs with respect thereto. In some cases, a fund may be required to dispose of, or reduce its investments in, the issuers of such instruments.

Risk Management. Money Funds have robust risk management requirements, beginning with Rule 2a-7's requirements that they limit holdings to the safest, most liquid and short-term investments and strict diversification requirements. Moreover, boards of Money Funds have substantial, detailed, and ongoing risk management responsibilities. For example, Money Fund boards must adopt written procedures regarding:

- Stabilization of NAV (which must take current market conditions, shadow pricing and consideration of material dilution and unfair results into account);
- Ongoing review of credit risks and demand features of portfolio holdings;
- Periodic review of decisions not to rely on demand features or guarantees in the determination of a portfolio security's quality, maturity or liquidity; and
- Periodic review of interest rate formulas for variable and floating rate securities in order to determine whether adjustments will reasonably value a security.

In order to ensure that boards are diligent and act in good faith, funds must also keep records of board consideration and actions taken in the discharge of their responsibilities. Management's decision-making processes must also be reflected in records such as whenever a security is determined to present a minimal credit risk, or when it makes a determination regarding deviations in amortized value and market value of securities.

Delegations of responsibilities by the board must be pursuant to written guidelines and procedures, and the Board must oversee the exercise of responsibilities. Even then, boards may not delegate certain functions, such as any decisions as to whether to continue to hold securities that are subject to default, or that are no longer eligible securities, or that no longer present minimal credit risk, or whose issuers have experienced an event of insolvency, or that have been downgraded under certain circumstances Nor may boards delegate their responsibility to consider action when shadow pricing results in a deviation of 1/2 of 1%, or to determine whether such deviations could result in dilution or unfairness to investors.

Rule 2a-7 provides that if a "First Tier Security" is downgraded to a "Second Tier Security" or the fund's adviser becomes aware that any unrated security or Second Tier Security has been downgraded, the board must reassess promptly whether the security continues to present minimal credit risks and must cause the fund to take actions that the board determines is in the best interests of the fund and its shareholders.[101] A reassessment is not required if the fund disposes of the security (or it matures) within five business days of the event.[102]

If securities accounting for 1/2 of 1% or more of a Money Fund's total assets default (other than an immaterial default unrelated to the issuer's financial condition) or become subject to certain events of insolvency, the fund must promptly notify the SEC and state the actions the Money Fund intends to take in response to such event.[103] If an affiliate of the fund purchases a security from the fund in reliance on Rule 17a-9, the SEC must be notified of the identity of the security, its amortized cost, the sale price, and the reasons for such purchase.[104]

In the event that after giving effect to a rating downgrade, more than 2.5% of the Money Fund's total assets are invested in securities issued by or subject to demand features from a single institution that are "Second Tier Securities," the fund must reduce its investments in such securities to 2.5% or less of its total assets by exercising the demand features at the next exercise date(s), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[105]

When a portfolio security defaults (other than an immaterial default unrelated to the financial condition of the issuer), ceases to be an Eligible Security, has been determined to no longer present minimal credit risks, or certain events of insolvency occur with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee of a portfolio security, the Money Fund is required to dispose of the security as soon as practicable consistent with achieving an orderly disposition of the security (by sale, exercise of a demand feature, or otherwise), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[106]

Periodic Stress Tests. Under the 2010 amendments to Rule 2a-7, the board of directors of each Money Fund must adopt procedures providing for periodic stress testing of the funds' portfolio. Fund managers are required to examine a fund's ability to maintain a stable NAV per share based upon certain hypothetical events. These include a change in short-term interest rates, higher redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an

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[101] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(A).

[102] Where a Money Fund's investment adviser becomes aware that any unrated security or "Second Tier Security" held by the fund has, since the security was acquired by the fund, been given a rating by a Designated NRSRO below the Designated NRSRO's second highest short-term rating category, the board must be subsequently notified of the adviser's actions. *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(B).

[103] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(A).

[104] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(B).

[105] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(C).

[106] *See* 17 C.F.R. § 270.2a-7(c)(7)(ii).

appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.

Diversification. In order to limit the exposure of a Money Fund to any one issuer or guarantor, Rule 2a-7 requires the fund's portfolio to be diversified with regard to both issuers of securities it acquires and guarantors of those securities.[107] Money Funds generally must limit their investments in the securities of any one issuer (other than Government securities) to no more than five percent of fund assets.[108] Money Funds also must generally limit their investments in securities subject to a demand feature or a guarantee to no more than ten percent of fund assets from any one provider.[109] Under the 2010 amendments to Rule 2a-7, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer.

Fund Liquidation. New SEC Rule 22e-3,[110] adopted in 2010, permits a Money Fund's board of directors to suspend redemptions and postpone payment of redemption proceeds if the fund is about to break the buck and the board decides to liquidate the fund. This amendment is designed to facilitate an orderly liquidation of fund assets in the event of a threatened run on the fund.[111]

As described further below, the SEC has broad powers under the Investment Company Act and other federal securities laws to oversee the liquidation of a Money Fund.

F. Money Funds Are Already Subject to Highly Successful SEC and Judicial Resolution Authority

The SEC has ample authority to enforce regulatory requirements and take comprehensive emergency actions involving Money Funds. In addition to its comprehensive program of regulation and supervision of Money Funds, the SEC has broad powers to take prompt action to address emergency situations at a Money Fund and

[107] 17 C.F.R. § 270.2a-7(c)(4)(i).

[108] Rule 2a-7(c)(4)(i)(A). Rule 2a-7 includes a safe harbor that permits a taxable and national tax exempt fund to invest up to 25 percent of its assets in the first tier securities of a single issuer for a period of up to three business days after acquisition (but a fund may use this exception for only one issuer at a time). Rule 2a-7(c)(4)(i)(A).

[109] Rule 2a-7(c)(4)(iii). With respect to 25 percent of total assets, holdings of a demand feature or guarantee provider may exceed the 10 percent limit subject to certain conditions. *See* Rule 2a-7(c)(4)(iii)(A), (B), and (C). *See also* Rule 2a-7(a)(9) (definition of "demand feature") and (a)(15) (definition of "guarantee").

[110] *See* 17 C.F.R. § 270.22e-3.

[111] The rule permits a fund to suspend redemptions and payment of proceeds if (i) the fund's board, including a majority of disinterested directors, determines that the deviation between the fund's amortized cost price per share and the market-based net asset value per share may result in material dilution or other unfair results to investors, (ii) the board, including a majority of disinterested directors, irrevocably has approved the liquidation of the fund, and (iii) the fund, prior to suspending redemptions, notifies the SEC of its decision to liquidate and suspend redemptions.

promptly resolve the problem. In the Reserve Primary Fund situation, the SEC successfully invoked certain of these powers. Should such a situation arise again in the future, the SEC is able to draw upon the experience it gained in the Fall of 2008, and promptly intervene to oversee an orderly and prompt wind-down of the Money Fund. An FDIC receivership is not necessary to accomplish a wind-down of a Money Fund. The SEC powers to address emergency situations at a Money Fund (some of which must by rule occur automatically without action by the SEC) include:

- SEC rules impose a requirement that the Money Fund make an immediate shift to floating NAV if it departs from the stable NAV;
- Money Fund trustees' are authorized to defer share redemptions, and liquidate the Money Fund, thus treating all investors the same;
- The SEC has the ability to immediately intervene and force a court-supervised liquidation of a troubled Money Fund where the trustees are unwilling or unable to take the above steps;
- The SEC has emergency power under Section 12(k) of the 1934 Act to act by order in an emergency with respect to any matter subject to its regulation, including investment companies;
- The SEC is authorized under Section 25 of the Investment Company Act to intervene in respect of reorganizations and liquidations of investment companies;
- The SEC has cease-and-desist powers under Section 9(f) of the Investment Company Act;
- The SEC has power to obtain injunctive relief under Sections 36 and 40(d) of the Investment Company Act;
- The SEC has power to impose civil money penalties on Money Funds and their related persons under Sections 9(d) and 40(e) of the Investment Company Act;
- The SEC can bring a judicial action and invoke the Federal courts' 1934 Act Section 21(d)(5) equitable remedies powers; and
- The SEC can bring a judicial action and petition the Federal court to invoke the All Writs Act[112] powers to enjoin other proceedings that interfere with the court's jurisdiction over the matter.

Other than a federal guarantee of investors, an injection of liquidity into a Money Fund, or a bail-out of Money Fund shareholders because of a credit or liquidity event (the "too big to fail" federal safety net that Title I of the DFA was designed to limit, Title II prohibits, and which public opinion strongly opposes) there are no additional steps involving Money Funds that the Board could take under Title I of the DFA or the FDIC could take under Title II of the DFA that have not already been addressed by the SEC or for which the SEC does not have ample statutory authority to address going forward.

One of the regulatory requirements applicable to every firm designated under Title I of the DFA is the resolution plan requirement under Section 165(d) of the DFA. The contents of the resolution plan analyzes the use of bankruptcy as an alternative to

[112] 28 U.S.C. § 1651.

Title II FDIC receivership and helps prepare the FDIC for a resolution of the financial company, if needed, under the receivership powers of Title II of the DFA. The FDIC stated in its January 25, 2011 Release that the receivership provisions under Title II were enacted due to the inadequacy of disparate insolvency regimes to effectively address the actual or potential failure of a financial company that could adversely affect economic conditions or financial stability in the United States.[113] Under Title II, the FDIC may be appointed receiver for a nonbank financial company only if the Treasury Secretary finds that the company is in default or in danger of default and "its resolution under otherwise applicable Federal or State law would have serious adverse consequences on financial stability in the U.S." and there is no other viable private sector alternative. This finding cannot be made in respect of a Money Fund, because Money Funds do not use leverage or debt that can be defaulted on, because they hold only short-term, high-quality, marketable assets that are effectively self-liquidating, because they are required by rule to be in a position to self-liquidate if needed, and because the SEC has broad regulatory and supervisory authority to oversee the orderly liquidation of a Money Fund.

G. Stable NAV a Result of Stable Portfolio Assets, Not An Accounting Gimmick; And Use Fully Transparent Valuation Methodologies

A significant aspect of the SEC's comprehensive regulation of Money Funds is the criteria for calculating the NAV of a fund. The stable NAV, which is essential for each of the uses of Money Funds described in section II-B above, is not an accounting gimmick. It relies upon a method of accounting widely utilized by other types of institutions and recognized and approved by other regulators in circumstances where the variation between the true "mark to market" value of an instrument and the value using the amortized cost method is significantly wider (and less knowable and less transparent) than is the case with Money Funds. These issues are discussed in more detail below.

Mechanics of Calculating NAV of a Money Fund. Money Funds are not complicated. Each Money Fund is just a portfolio of short-term debt investments owned in a pool for a single class of shareholders. There are no debt securities or other borrowing by the Money Fund. It is 100% equity. Investors are permitted to purchase or redeem shares of a Money Fund every business day. It is therefore necessary to have a method of calculating the price at which shareholders may purchase or redeem shares every day. Like all mutual funds, Money Funds set the daily price for purchases and redemptions of shares at that day's net asset value (NAV). Like all mutual funds, a Money Fund calculates its daily NAV per share by determining the value as of that day of each and every asset held and adding them up to determine a gross portfolio asset value, subtracting any liabilities (there generally are not any) and accrued expenses to reach a net portfolio asset value, and then dividing the net portfolio value by the number of shares of the Money Fund currently issued and outstanding. As with most other mutual funds, this share price is rounded up or down to the nearest cent. Essentially, NAV per share is the value of each shareholder's pro rata slice of the overall assets of the fund.

[113] FDIC, Notice of Interim Final Rulemaking Regarding Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. at 4207, 4208 (Jan. 25, 2011).

The share price calculations of Money Funds differ from the share price calculations of other mutual funds in two respects. First, Money Funds are permitted to use "amortized cost" to value the individual short-term portfolio securities they own, while other mutual funds use a mark-to-market price to value most portfolio securities. Second, because they use "amortized cost," Money Funds are able to calculate NAV and set share purchase and redemption prices early in the day, while other mutual funds must wait until after the markets close to obtain the closing market price inputs needed to "market value" each portfolio security and calculate NAV and thus the purchase and redemption prices of their shares. This ability to know at the beginning of the day that, absent an unforeseen major credit event that brings NAV below 99.5 cents per share, the shares will be priced at a dollar at the end of the day is a key feature of Money Funds that allows them to be used to hold short term liquidity in connection with a range of commercial systems, as discussed above.

Rule 2a-7 permits a Money Fund to use the "amortized cost" method of accounting for the value of assets held in portfolio.[114] This method of valuing short-term debt instruments, and rounding share prices to the nearest penny, is a convenience that allows investors, broker-dealers, banks, investment advisers and Money Funds to keep track of asset values (and indirectly, customer account values which are calculated by dividing the total net value of the portfolio by the number of outstanding shares of the Money Fund) without account-level daily price tracking of fractions of a cent. This use of stable NAV pricing is permitted by SEC rules only for funds that comply with the strict requirements of Rule 2a-7 to ensure that these funds are as stable and low risk as possible, and only for so long as the NAV calculated using the amortized cost value of the portfolio does not materially depart from the shadow price of shares calculated using mark-to-market assets values. A Money Fund must meet stringent portfolio liquidity, credit quality, maturity, and diversification requirements. These requirements were strengthened by amendments in 2010 that were "designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market mutual fund that is unable to maintain a stable net asset value per share."[115]

Money Fund shares price at a dollar on a daily basis not because they have promised to repay shares at a dollar (Money Funds do not make that promise and explicitly state otherwise) but because the aggregate daily value of all of the portfolio assets of the Money Fund, minus expenses and any liabilities, divided by the number of issued and outstanding shares, is worth, that day, between 99.5 cents and 100.5 cents per share. The managers of Money Funds work diligently to choose investments for the

[114] Under the "amortized cost" method of accounting, Money Funds value the securities in their portfolios at acquisition cost as adjusted for amortization of premium or accretion of discount rather than market value. *See* 17 C.F.R. § 270.2a-7(a)(2). The Rule also allows Money Funds to use the "penny-rounding" method of pricing, which permits rounding to one cent rather than one-tenth of a cent. 17 C.F.R. § 270.2a-7(a)(20). However, this method is seldom used because it does not eliminate daily "mark to market" accounting requirements.

[115] *See* Release No. IC-29132, 75 Fed. Reg. 10060 (Mar. 4, 2010).

portfolio of the Money Fund so that the NAV per share will calculate every day to something very close to $1.00 per share, and generally the daily NAV before rounding to the nearest penny, is between 99.9 cents and 100.1 cents per share.

The price difference between using amortized cost and market prices to value underlying portfolio securities is not significant for short term, high quality debt instruments of the types owned by Money Funds. Short-term paper is normally issued at a discount from the par value at maturity which represents the imputed interest over the days between the issuance date and the maturity date. Amortized cost is determined by subtracting the purchase price of the instrument from its pending maturity value, dividing the small difference by the number of days remaining to maturity, and, for each day from the purchase date to the maturity date, adding to the purchase price one day's worth of the price difference.

This is not an accounting gimmick. The use by Money Funds of amortized cost accounting recognizes that the underlying market value of the assets held by a Money Fund are, and are required to be, types of assets for which the market value generally will not fluctuate from amortized cost to any material degree. Money Fund assets are short term to avoid interest rate and liquidity risk and long-term credit risk. Money Fund assets are diversified and high credit quality to minimize credit risk. The ability of Money Funds to maintain a stable net asset value of $1.00 is the result of very stringent portfolio restrictions that apply to all Money Funds under SEC regulations.

Amortized cost can only be used by a Money Fund if the fund's board determines that use of amortized cost does not resulting in a materially different NAV than the use of market pricing. In particular, amortized cost cannot be used to value a security if there has been an event, such as a default or significant downgrade of the issuer, that makes the use of amortized cost not an accurate approximation of the true value of the portfolio security. Those portfolio securities must be marked to market. Use of amortized cost to value short term high quality debt instruments with 60 days or less of remaining maturity is consistent with GAAP valuation principles for any issuer (not just Money Funds), and was permitted and used by mutual funds and other public companies long before Money Funds were created.[116] Under Rule 2a-7 as amended in 2010, the debt instruments held by a Money Fund have average maturities below 60 days. These very short term debt instruments do not fluctuate in market value due to interest rate changes. It is also very unusual for the credit of an issuer to decline rapidly from prime quality to default in that short time period. Under amended Rule 2a-7, Money Fund portfolios are very diversified

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[116] Notably, the strongest advocates for the use of amortized cost and other historical cost methods for valuing balance sheet assets have been the members and staff of the Board of Governors of the Federal Reserve System. *See, e.g.*, Comment Letter to Robert Herz, Chairman, Financial Accounting Standards Board from Susan Schmidt Bies, Member of the Board of Governors of the Federal Reserve System, on Fair Value Measurements Exposure Draft, Oct. 4, 2004. Banks use amortized cost methods to value loan portfolios on their balance sheets. Office of the Chief Accountant, SEC: *Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting* (Dec. 30, 2008) at 27. As receiver for failed banks, the FDIC uses a similar method, "accreted value," to determine principal amounts of bank obligations.

among issuers, so there is limited credit exposure to any one issuer. As a result, within the strict investment constraints of Rule 2a-7, the amortized cost of each portfolio security closely tracks its market price, and the NAV of the portfolio as a whole closely tracks what NAV per share would be using market pricing of the portfolio securities.

Unlike banks, Money Funds are required to use market values of individual securities to calculate a "shadow price" of their shares to test whether the use of amortized cost fairly approximates what NAV would be using daily market values. If amortized cost does not track market value NAV within less than half a cent per share, the board of directors of the Money Fund must determine what action to take, which may include movement to market values to calculate NAV and purchase and redemption prices of shares. This "shadow price" information is calculated at least weekly and that weekly data is reported to the SEC monthly, and is available to the public from the SEC or from the website of the Money Fund's sponsor. A review of these shadow price calculations shows that NAV using amortized cost closely tracks NAV using market pricing. They are usually identical (even before rounding NAV to the nearest cent) and only occasionally deviate from one another by plus or minus a few one-hundredths of a cent.[117] To put this in perspective, a deviation of a hundredth of one percent is equal to \$100 on a million dollars worth of Money Fund shares. It is not a material difference, and certainly not worth the programming expense that would be required to revise all of the automated systems used in commercial applications that need a predictable NAV to track short term liquidity. Unless the Money Fund is suddenly liquidated, even that small price deviation is not translated into actual losses, because the underlying portfolio investments mature in short order and are repaid at par, which returns shadow NAV to \$1 per share. Due to the very high levels of liquid assets that Money Funds are required to hold under amended Rule 2a-7, it is now even less likely that a Money Fund would need to sell portfolio assets before maturity to raise cash and recover less than par value.

An analysis of shadow price data demonstrates that Money Funds' \$1 per share stable NAV is not an accounting trick, but instead reflects the stable market values of the assets owned by Money Funds. A recent study of Money Fund shadow prices published by the Investment Company Institute ("ICI"), show that, due to the portfolio restrictions in Rule 2a-7, Money Fund NAVs maintain their values in the face of credit events, interest rate changes and extraordinary market changes.[118] Even in September 2008, in the worst days of the financial crisis, average Money Fund shadow share prices did not break a buck – but stayed above 99.8 cents per share, and returned to an average NAV of 100.0000 cents within a very short period.[119]

The stability of Money Fund NAVs is driven by the stable market value of the underlying assets of Money Funds. This is why, in 2008, during the worst financial crisis

[117] ICI Research Report, Pricing of U.S. Money Market Funds (Jan. 2011).

[118] ICI Research Report, Pricing of U.S. Money Market Funds (Jan. 2011).

[119] Money Fund Regulatory Changes Post Financial Crisis, 2011 ICI Money Market Funds Summit (May 16, 2011) (slides available on ICI website).

since the 1930s, only one Money Fund "broke a buck," over 800 Money Funds did not "break a buck," and the overwhelming majority of those did not require any sponsor support to maintain stable net asset value of $1 per share.

The 2010 amendments to Rule 2a-7 have further removed price movements from the portfolios of assets owned by Money Funds. As of year-end 2010, for example, 50% of "prime" Money Funds' reported shadow prices are between 99.96 cents and 100.01 cents per share, 38% were between 100.01 and 100.10 cents per share, 6% were between 99.91 and 99.95 cents per share, and the remaining 6% had a shadow price between 99.80 and 99.90 cents per share. Money Fund "shadow prices" must move below 99.5 cents per share or above 100.5 cents per share to cause the Money Fund to "break a buck."[120] Nonetheless, Money Funds continue to warn investors that a Money Fund may not always be able to maintain a stable NAV.

Nor is there a lack of transparency of the valuation methods used by Money Funds. Money Funds are also required to calculate the "shadow price" value of their shares, based on a mark-to-market valuation of portfolio assets, file that information with the SEC and publish it on the Money Fund's website. The use of the amortized cost method of accounting, and of rounding share prices to the nearest penny, is clearly disclosed to investors in the offering documents and reports provided to Money Fund investors. Moreover, if the NAV of Money Fund shares calculated using the amortized cost method departs materially (0.50 cents per share or more) from the "shadow price" calculated using mark-to-market values, the Money Fund is required to notify the SEC and move to the shadow price in offering and redeeming shares with investors. These disclosures to every Money Fund investor, as well as the periodic public disclosure of the shadow NAV and portfolio holdings, make Money Funds perhaps the most thoroughly transparent investment available to the public.

History of Use of Historical Cost to Price Short-term Portfolio Securities. Money Funds were not the first issuers to use amortized cost to calculate the value of their portfolio assets. Bank-sponsored short-term investment funds (STIFs) have a long history of use within bank trust departments, and have long been permitted by the federal bank regulators to use amortized cost of portfolio assets to calculate unit prices for purchases and redemptions.[121]

At the time of the creation of the first Money Funds in the early 1970s, NAVs for all mutual funds were determined much as they are today: by adding up the prices of the individual assets in the fund's portfolio, subtracting any liabilities and accrued expenses, and dividing by the number of shares outstanding. In valuing portfolio securities, mutual

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[120] *Id.*

[121] 12 C.F.R. 9.18(b)(4)(ii)(B). Banks also use historical cost to value most assets on their balance sheets, and use amortized cost to value their loan portfolios, Office of the Chief Accountant, SEC: Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting (Dec. 30, 2008) at 27, even though bank loan portfolios have much longer average maturities and lower credit quality than Money Fund or STIF portfolios.

funds were directed to use current market prices if they are readily available, and otherwise to use "fair value" as determined in good faith by the board of directors.[122] In valuing very short-term high quality debt securities (for which there frequently were not current prices available from an active trading market), mutual fund directors in the early 1970s commonly determined that use of amortized cost was the best estimate of the fair value of those types of securities, in part because they planned to hold the short-term securities to maturity when the instruments would repay at par, rendering irrelevant any small short-term market price fluctuations.[123] If there was an error made in pricing a particular portfolio security, the "materiality" standard used to determine whether the shares needed to be repriced and shareholder accounts corrected was established for all mutual funds at 0.5% of NAV.[124] Mutual funds in the early 1970s (and today) normally rounded NAVs to the nearest penny in determining share prices for purchases and redemptions.[125]

When the first Money Funds were created, it was accepted practice at mutual funds generally to (1) use amortized cost for valuing very short term debt instruments, (2) to round share prices to the nearest penny, and (3) to treat NAV as materially correct if it was accurate within 0.5 percent. Accordingly, when the first Money Funds were created, these were already widely accepted and broadly used accounting and valuation practices in the mutual fund industry, and the first Money Funds followed this normal valuation practice in calculating NAV.

In 1975, the SEC became concerned that the NAV determined using amortized cost to value portfolios of a mutual funds whose assets consist primarily of short-term debt instruments (i.e. a Money Fund) might be materially different from the NAV of the fund using mark-to-market portfolio valuations and issued a release to address the question.[126] After considering public comments and studying this valuation issue for two years, the SEC in 1977 issued an interpretive release permitting the continued use of amortized cost to value short-term high quality debt instruments with 60 days or less of remaining maturity as an appropriate valuation method that reflects accurately the value

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[122] 17 C.F.R. § 270.2a-4.

[123] J. Fisch, & E. Roiter, *A Floating NAV for Money Market Funds: Fix or Fantasy?* at 7, 8-11 (2011), *Scholarship at Penn Law.* Paper 390 (*available at* http://lsr.nellco.org/upenn_wps/390). *See also* SEC, Proposal Concerning Valuation of Short-Term Debt Instruments Owned by Registered Investment Companies Including Money Market Funds, 40 Fed. Reg. 18467 (Apr. 28, 1975); SEC, Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, 42 Fed. Reg. 28999 (May 31, 1977); SEC, Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), 48 Fed. Reg. 32555 (Jul. 18, 1983).

[124] 17 C.F.R. § 2a-7(c)(ii)(8)(B); 17 C.F.R. § 22c-1.

[125] *See* J. Fisch, & E. Roiter, *A Floating NAV for Money Market Funds: Fix or Fantasy?,* at 7, 8-11 (2011), *Scholarship at Penn Law.* Paper 390,*available at* http://lsr.nellco.org/upenn_wps/390.

[126] SEC, Proposal Concerning Valuation of Short-Term Debt Instruments Owned by Registered Investment Companies Including Money Market Funds, 40 Fed. Reg. 18467 (Apr. 28, 1975).

of the asset.[127] As for valuation of portfolio assets with remaining maturities in excess of 60 days, the SEC in the 1977 interpretive release did not permit the fund to use amortized cost, without first obtaining an exemptive order permitting the use of amortized cost. The SEC, however, issued a series of exemptive orders to individual Money Funds setting out a series of conditions under which the funds that obtained the orders could use amortize cost to value portfolio assets with maturities in excess of 60 days.

Those old SEC order conditions were a set of standards designed to assure that amortized cost would be an appropriate reflection of the true value of the portfolio assets and NAVs calculated with amortized cost valuations would not materially depart from NAV determined using mark-to-market valuations. The SEC conducted extensive information gathering and analysis before adopting Rule 2a-7. The administrative process included extensive live hearings before an administrative law judge over a two-year period, expert testimony, written submissions and filings, input from the SEC Staff, the investment management industry, investors and the general public, and creation of a large administrative record.[128] The use of amortized cost accounting and the capital and asset structure of Money Funds were among the central issues considered in great detail in that process.

Eventually, in 1983, the conditions in the prior orders, the administrative rulemaking and hearing record, and SEC experience were distilled into a rule of general applicability for mutual funds that called themselves money market funds and permitting those that followed the rule to use the amortized cost method to value portfolio securities.[129] Rule 2a-7, adopted originally in 1983, has been amended on several occasions, most recently in 2010, to further refine its provisions based on experiences learned in the operation of Money Funds. Since 1983, however, Rule 2a-7 has always made clear that shareholders do not have an unconditional right to redeem their shares at a stable price, that a Money Fund can use amortized cost "only so long as the [Money Fund's] board of directors believes that it fairly reflects the market-based net asset value per share" of the Money Fund, that if amortized cost does not reflect the fair value of a portfolio asset then amortized cost cannot be used for that asset, and if the mark to market value of the Money Fund's portfolio deviates by 0.50% or more from its amortized cost value (i.e. 1/2 cent per $1 share), then the board of the directors of the Money Fund must determine what action to take.

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[127] *See* Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, 42 Fed. Reg. 28999 (May 31, 1977). For a general discussion of the development of the rules regarding calculation of the NAV of Money Funds, see J. Fisch, & E. Roiter, "*A Floating NAV for Money Market Funds: Fix or Fantasy?*" (2011), *Scholarship at Penn Law.* Paper 390 (*available at* http://lsr.nellco.org/upenn_wps/390).

[128] *In re Matter of Inter-Capital Liquid Asset Funds, Inc.* 18 SEC Docket 52 (Aug. 8, 1979).

[129] Rule 2a-7, 17 C.F.R. § 270.2a-7. SEC, Proposed Rule, Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies, 47 FR 5428 (Feb. 5, 1982); SEC, Final Rule, Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), 48 Fed. Reg. 32555 (Jul. 18, 1983).

The 2010 amendments to Rule 2a-7 also cap the maximum weighted average maturity of a Money Fund's portfolio at not more than 60 days.[130] Notably, even under the SEC's restrictive valuation interpretations in place from 1977 until the adoption of Rule 2a-7 in 1983, use of amortized cost for valuing portfolio assets with remaining maturities of 60 days or less was permitted without an exemptive order or the conditions that came along with it.

Moreover, the 2010 amendments require Money Funds to hold overnight cash equal to at least 10% of fund assets and cash available within seven days equal to at least 30% of the fund's assets (and more if needed under the circumstances to meet anticipated needs). During the week of September 15, 2008, when Lehman Brothers filed for bankruptcy and the Reserve Primary Fund "broke the buck," the net outflow from all prime Money Funds was approximately 15% of aggregate prime Money Fund assets.[131] Holding this much cash greatly reduces the probability that a Money Fund would be required to sell portfolio assets at a loss to raise cash to fund redemptions, further assuring that use of amortized cost to value portfolio assets and calculate NAV per share will remain an appropriate and accurate way to calculate share values of Money Funds.

From the perspective of a commercial user of Money Funds to store short-term liquidity, the main purpose of using amortized cost to value portfolio assets is not to stabilize the value of Money Fund shares at $1 per share. That price stability is achieved by the very short term nature and high quality of the portfolio assets and rounding the NAV to the nearest penny per share, and would be the same $1 per share if mark-to-market accounting were used for valuing portfolio assets. The main purpose for using amortized cost in the commercial context is to allow the NAV of Money Fund shares to be anticipated at the beginning of the day, rather than known only after markets close, so that the share value can be used in a broad range of accounting applications that interface between the Money Fund, its transfer agent and the accounting systems of the various companies that use Money Funds to hold temporary liquidity, and can be redeemed on a same-day basis (T+0). This allows movement away from manual processing, facilitates same day processing of transactions, shortens settlement cycles, and helps reduce float balances and counterparty risk.

How Other Stable Value Products Maintain Stable Values. Money Funds are one of several different financial products used to hold liquidity at a stable value. The others include bank deposits, STIFs (discussed above), guaranteed investment contracts (GICs) and bank-sponsored funds that invest in GICs. GICs are issued primarily by insurance companies for set time periods and can be redeemed early under certain conditions specified in the contract, and are used as an investment alternative for pension

[130] 17 C.F.R. § 2a-7(c)(2)(ii); Money Market Fund Reform, 75 Fed. Reg. 10060, 10071-10072 (Mar. 4, 2010).

[131] SEC Chairman Mary L. Schapiro, Remarks at SIFMA's 2011 Annual Meeting, New York, New York (Nov. 7, 2011), *available at* www.sec.gov/news/speech/2011/spch110711mls.htm.

assets.[132] GICs are marketed as an alternative to Money Funds and bank deposits.[133] Stable value GICs are essentially debt obligations of an insurance company, and GIC funds are investment funds (generally bank collective investment funds for pension assets) that invest in GICs. The value of the GICs themselves are dependent upon the solvency of the insurance company that issues them, the contractual rate and the terms and condition to full or partial redemption. Because GICs are not transferrable and do not trade in the secondary market, there generally are not true mark to market valuations available for GICs, and valuation of GICs and GIC funds is therefore often problematic.[134]

STIFs are a type of bank common trust fund or collective investment fund that are sponsored and maintained by bank trust departments for fiduciary and pension assets. STIFs originated under regulatory interpretations starting in the 1930's at a time when the Federal Reserve was the primary regulator of bank trust operations.[135] This primary rulemaking authority over STIFs and other common trust funds was transferred in 1963 by Congress to the OCC,[136] which continues to authorize banks to operate STIFs as a type of stable value common trust fund.[137] Like a mutual fund, an interest in a STIF is an equity security that is an interest in a pool or fund that is effectively a pro-rata claim to a portion of the net value of the portfolio assets held by the STIF. Although they are permitted to use amortized cost to calculate portfolio values, STIFs are subject to less stringent investment restrictions, investment quality requirements and maturity limits than are Money Funds.[138] As bank common trust funds or collective investment funds, STIFs are exempt from registration or regulation under the Investment Company Act.[139] With the exception of the largest bank trust operations, most banks do not have sufficiently large cash balances to make it feasible to continue to operate STIFs in an

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[132] *See* American Institute of Certified Public Accountants, *Stable Value Investments available at* http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Resources/AccountingandAuditingResourceCenters/Pages/StableValueInvestments.aspx.

[133] *See, e.g.*, Financial Web, *Guaranteed Investment Contracts*, *available at* http://web.finweb.com/investing/guaranteed-investment-contracts.html; Stable Value Contracts and GICs, *available at* http://www.lmstrategies.com/types~2.html.

[134] *See* OCC Interpretive Letter No. 716 (Dec. 21, 1995) (permitting valuation of benefit responsive GICs in bank collective fund at contract value rather than fair value); OCC Trust Interpretations No. 212 (Mar. 27, 1989), 265 (Mar. 19, 1992), 271 (Sept. 10, 1992) (requiring use of fair value).

[135] Saxon & Miller, Common Trust Funds, 53 Georgetown L.J. 994, 1001 (1965); 19 Fed. Res. Bull, 187-88 (1933).

[136] *See generally*, Common Trust Funds-- Overlapping Responsibility and Conflict in Regulation, Hearing bef. Subcomm. of House Comm. on Government Operations, 88th Cong. 1st Sess. (May 20, 1963).

[137] 12 C.F.R. § 9.18(b)(4)(ii)(B).

[138] *Compare* 12 C.F.R. § 9.18(b)(4)(ii)(B) (permitting up to 90 day weighted average maturity, not imposing minimum liquidity requirements and not specifying diversification or credit quality requirements for individual securities) with 17 C.F.R. § 270.2a-7 (maximum weighted average maturity of 60 days, and imposing very strict and specific liquidity, credit quality and diversification requirements).

[139] Investment Company Act § 3(c)(3), 3(c)(11).

efficient manner. For the great majority of banks, Money Funds replaced STIFs many years ago as the primary means of holding short term cash balances for trust accounts.

Bank deposits are unconditional obligations of the bank to repay the depositor, either upon demand (demand deposits and some savings deposits) or at a date in the future (CDs and other time deposits). Deposits are debt obligations of the bank, rather than equity investments in the bank. The amount that a bank owes its depositors is fixed by contract and does not go up or down with the value of the bank's portfolio of loans and other assets. With the exception of securities trading portfolios that generally represent a relatively small percentage of bank assets, most bank portfolio assets are loans and other nonmarketable assets for which market price quotes are not readily available. Banks are required to disclose some fair valuation data on their assets, but it is very approximate and does not represent a full mark-to-market accounting of the bank's assets. The value of a bank's portfolio is determined primarily using historical cost accounting (subject to adjustments), rather than market valuations. Banks use amortized cost methods to account for loan portfolios on their balance sheets.[140] Banks do not calculate or report a mark to market "shadow price" for these loans or otherwise seek to gauge the degree to which the amortized cost at which loans are carried on the bank's balance sheet diverges from market values. Because the loans have durations well in excess of the maturity ranges of Money Fund portfolios and are lower in credit quality, the divergence between amortized cost of bank loan portfolios and current market values can be very large.

If a bank is unable to repay a deposit, or another debt obligation, when a demand for payment is made, the bank is insolvent and is taken over by the FDIC as receiver. A bank can become insolvent in either of two ways. A bank is insolvent if the accounting value of its assets is lower than the accounting value of its deposits and other liabilities. This is capital insolvency. Banks attempt to avoid this type of insolvency by holding enough equity capital to absorb loan losses and other downward accounting adjustments to their portfolio asset values so that the accounting values of the bank's assets exceed the bank's deposits and other liabilities. Banks normally hold between four and ten percent capital against their assets on a leverage basis. Because capital is simply the difference between the value of the bank's assets (at historical cost) and its liabilities, and the historical cost of relatively long-term, high risk bank loans and other assets do not closely approximate current market values, it is hard to predict whether any particular level of capital is sufficient. When the FDIC liquidates a failed bank, it generally finds that the market value of the bank's portfolio assets is substantially less than the accounting values at which those assets are carried on the bank's balance sheet, and consequently the true capital levels of the bank are far lower than indicated on the bank's financial statements

[140] Office of the Chief Accountant, SEC: Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting (Dec. 30, 2008) at 27.

(and are often negative, requiring an infusion of cash from the FDIC to pay off the deposits).[141]

A bank can also become insolvent if it runs out of cash to repay depositors and other creditors when a demand for payment is made. This type of insolvency is liquidity insolvency. Banks attempt to avoid this type of insolvency by maintaining a sufficient amount of cash and liquid assets to pay anticipated demands, and by access to the Federal Reserve's discount lending window. Ultimately, if bank capital and liquidity are insufficient, it is the federal safety net -- in the form of FDIC deposit insurance and access to cash from the Federal Reserve's lending window -- that allows a bank to repay deposits under most circumstances.

Thus, broadly speaking, there are two different ways in which providers of stable value investments seek to maintain their stable value. Fund products, including Money Funds and bank STIFs, are equity interests in unleveraged investment pools that seek to maintain a stable value by investing in a diverse pool of high quality, liquid, short-term debt instruments whose market values remain stable throughout their short lives. Maintaining the stable value is not a function of the credit quality of the fund manager, but of the success of the fund manager in managing the pool of assets for diversity, duration, liquidity and credit quality. Regulations such as Rule 2a-7 which focus on those subjects are the means to address the issue of the stable value of the fund. In contrast to bank deposits and GICs, Money Funds seek to maintain a stable NAV of $1 per share, but do not promise to investors that they will be able to do so, and fully disclose to investors that they might not be able to do so. [142]

In contrast, deposit and GIC products are debt instruments issued by companies that invest in a wide portfolio of marketable and unmarketable and generally non-transparent investments, for which the value of the stable value product is dependent upon the creditworthiness of the issuing bank or insurance company and any restrictions on redemption. In this case, regulatory capital levels and the other trappings of bank or insurance regulation are appropriate (subject to the caveat that bank and insurance capital levels are themselves derived from historical cost difference between assets and liabilities of the issuer and thus may not provide the amount of protection they might appear to based on balance sheet numbers), with the ultimate backstop being the federal government in the case of banks and state insurance pools, reinsurance and assessability of the industry for shared losses.

[141] FDIC, *Purchase and Assumption Transactions* (*available at* www.fdic.gov/bank/historical/reshandbook/ch3pas.pdf) ("Because asset values are generally overstated in a failing bank or thrift, the FDIC's ability to sell assets to an acquiring institution based on book value was limited.")

[142] J. Fisch, & E. Roiter, "*A Floating NAV for Money Market Funds: Fix or Fantasy?*" (2011), *Scholarship at Penn Law.* Paper 390 ("Nonetheless, money market funds differ fundamentally from banks. While a bank's obligation to pay its depositors in full is unconditional (as long as the bank is solvent), a money market fund's obligation to its shareholders is not."), *available at* http://lsr.nellco.org/upenn_wps/390.

Applying bank-like capital standards to Money Funds is simply not an appropriate means to address maintaining stable value within the structure of fund products, any more than applying continuous mark-to-market accounting to bank assets and restricting bank balance sheets to the strictures of SEC Rule 2a-7 would be an appropriate way to maintain the solvency of the banking industry.

Data Demonstrates that Continuously Floating NAV Does Not Stop Runs. Money Funds are sometimes compared to ultra-short bond funds, which are mutual funds that invest in relatively short-term debt instruments, but do not use amortized cost accounting and have a floating NAV. Notably, ultra-short bond funds are not subject to the tight investment and credit quality restrictions, maturity limits or liquidity requirements that apply to Money Funds under Rule 2a-7. The weighted average maturity of ultra-short bond funds is about 12 months, as compared to 60 days or less for a Money Fund.[143] Although they have a higher yield than Money Funds, ultra-short bond funds are not as popular with investors or with commercial users of Money Funds, with aggregate assets of only \$36 billion in assets as of year-end 2010,[144] as compared to \$2.6 trillion currently invested in Money Funds. This demonstrates that many Money Fund shareholders do not find that ultra-short bond funds have the same usefulness as Money Funds.

Significantly, despite having a floating NAV, ultra-short bond funds faced investor redemptions in the Fall of 2008 at levels higher than those experienced by Money Funds.[145] Similarly, floating NAV money funds in Europe also experienced investor withdrawals roughly equivalent to withdrawals from European stable NAV money funds.[146] Whether a continuously floating NAV prevents runs is an empirical question, and the data shows overwhelmingly that it does not. What stops a run is liquidity.

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[143] J. Fisch, & E. Roiter, "*A Floating NAV for Money Market Funds: Fix or Fantasy?*" at n.183 (2011) ("The investment portfolios of ultra-short bond funds have longer weighted average maturities (around 12 months) than those of money market funds."), *Scholarship at Penn Law.* Paper 390, *available at* http://lsr.nellco.org/upenn_wps/390.

[144] Jonathan Burton, *A Place for Ultrashort?* Wall Street Journal (March 8, 2011) *available at* http://online.wsj.com/article/SB10001424052748703775704576162310225799344.html.

[145] *Id.* at n.181-85 ("While their share of assets pales in comparison to MMFs, ultra-short bond funds faced waves of redemptions comparable in respective magnitude to what MMFs faced. Indeed, contractions of ultra-short bond funds likely exacerbated the freeze in the short term credit markets. By the end of 2008, assets in these funds were 60% below their peak level in 2007." (*citing* In re David W. Baldt, SEC Admin Proc. File No. 3-13887, at 5-6, Apr. 21, 2011, *available at*www.sec.gov/litigation/aljdec/2011/id418rgm.pdf (detailing large redemptions from Schroder short term bond funds); Statement of the Investment Company Institute, SEC Open Meeting of the Investor Advisory Committee, May 10, 2010, at 4, *available at* www.ici.org/pdf/24289.pdf; HSBC Global Asset Management, Working Paper: *Run Risk at Money Funds* (Nov. 3, 2011).

[146] Fisch andRoiter, *supra* note 137 at n.186-88 ("Floating NAV money market funds suffered substantial redemptions during the credit crisis in 2008, leading more than a dozen of them to suspend redemptions temporarily and four of them to close altogether. French floating NAV money market funds lost about 40% of their assets during a three month period in the summer of 2007.") (citations omitted).

The lack of investor demand for floating NAV short-term bond funds, together with the substantial redemptions seen by those funds in the Fall of 2008, demonstrate that floating NAV funds are not an effective substitute for Money Funds because they do not meet the needs of investors that are served by Money Funds, but are subject to the same liquidity issues as Money Funds, without the benefit of the liquidity standards that apply to Money Funds under Rule 2a-7. None of the objectives of reducing systemic risk, addressing practical needs of investors, and fostering efficient markets, would be served by requiring Money Funds to move to a continuously floating NAV.

H. Money Funds Are Not "Shadow Banks"

In recent months, some have called for bank-type regulation of Money Funds on the theory that they are "shadow banks." Until recently, the term "shadow bank" meant an offshore parallel bank operating in an unregulated jurisdiction and engaged in shady dealings. During the financial crisis, the term was repurposed by bank regulators as a pejorative label for segments of the financial services industry that they did not regulate.[147] As redefined, the term "shadow bank" has been used to mean an unregulated financing vehicle with a lot of leverage and little capital.[148] The exemplar is a securitization vehicle, with an asset base of loans and receivables and a capital structure consisting of a couple of percentage points of equity, a tranche of subordinated debt, and a large slug of secured short-term notes, commonly referred to as "asset backed commercial paper" ("ABCP").

Money Funds differ from these entities in that they are heavily regulated by the SEC, subject to extensive audit, public reporting and transparency requirements, and do not use leverage. Unlike true "shadow banks," Money Funds are financed 100 percent by common equity. In essence, Money Funds do not meet any of the criteria used to define a "shadow bank."

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[147] Zoltan, Pozsar, et al., Tobias, Federal Reserve Bank of New York, Staff Report no. 458, Shadow Banking, at 4 (July 2010) ("We use the term 'shadow banking system' for this paper, but we believe that it is an incorrect and perhaps pejorative name for such a large and important part of the financial system.") *available at* http://www.ny.frb.org/research/staff_reports/sr458.pdf. The first use of the term "shadow bank" in August 2007 to refer to ABCP and similar off-balance sheet issuers was apparently by an economist and management officials at a mutual fund management firm, PIMCO, who were seeking to draw bank regulatory policy makers' attention to the risks inherent in the bank regulators allowing these financing structures to grow. *See* Bill Gross, *Beware our shadow banking system*, Fortune Magazine (Nov. 28, 2007) *available at* http://money.cnn.com/2007/11/27/news/newsmakers/gross_banking.fortune/; McCulley, PIMCO Global Central Bank Focus, *The Shadow Banking System and Hyman Minsky's Economic Journey* (May 2009). In a classic display of the maxim that "no good deed goes unpunished," the federal bank regulators. who ignored these warnings about the risks associated with ABCP and other off-balance sheet financing in 2007 and early 2008, have now sought to blame the problem on the mutual fund industry that called the issue to their attention in the first place.

[148] The Financial Crisis Inquiry Report: Final Report of the National Commission of the Causes of the Financial and Economic Crisis in the United States, at xxi, 27-37 (Jan. 2011) *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

Some in the policy debate have sought to label Money Funds' shares as "debt" (it is equity), argue that shareholders have a "put" to the fund or its manager at $1 per share (they do not)[149] or that the manager or the fund "guarantees" the $1 per share net asset value (they do not). To the contrary, Money Fund investors receive explicit disclosure that investments in Money Funds may lose value and are not insured or guaranteed. Item 4(b) of the Form N-1A registration form that is used by open-end management investment companies to register under the Investment Company Act and to offer their shares under the Securities Act states that if a fund is a Money Fund, it must state:

> An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.

In addition, if a Money Fund is advised by or sold through an insured depository institution, the above disclosure must be combined in a single statement with disclosure that an investment in the fund is not a deposit of, or guaranteed by a bank and is not insured or guaranteed by the FDIC or any other government agency. The Investment Advisers Act of 1940 ("Advisers Act"), prohibits a registered investment adviser from guaranteeing the value of an advised account's assets, including a mutual fund.[150]

Others have sought to label Money Funds as "shadow banks" by claiming that Money Funds are unregulated. For example, a former Federal Reserve Board Chairman testified before the Financial Crisis Inquiry Commission ("FCIC") that Money Funds were not regulated, and the FCIC summarized in its report that:

> money market funds had no capital or leverage standards.... The funds had to follow only regulations restricting the type of securities in which they could invest, the duration of those securities, and the diversification of their portfolios. These requirements were supposed to ensure that investors' shares would not diminish in value and would be available anytime-- important reassurances, but not the same as FDIC insurance.[151]

The truth is that Money Funds are ***comprehensively regulated*** by the SEC under a statute and regulations that essentially require them to be capitalized entirely with equity and that preclude the use of leverage. The SEC regulations restricting the type of securities in which Money Funds can invest and their maturity and duration are a central

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[149] SEC Roundtable Discussion on Money Funds and Systemic Risk (May 10, 2011) (archived webcast *available at* http://www.sec.gov/news/otherwebcasts/2011/mmf-risk051011.shtml).

[150] Representations of guarantees violate Advisers Act Sections 206(1), (2) and (4), which prohibit fraudulent and misleading statements by investment advisers (15 U.S.C. §80b-6(1), (2) and (4)), as well as Rule 206(4)-8 under the Advisers Act, which prohibits fraudulent and misleading statements by investment advisers of pooled investment vehicles, including mutual funds. 17 C.F.R. §275.206(4)-8. *See SEC v. Wehrs*, Lit. Rel. No. 21399, 2010 SEC Lexis 259 (Feb. 1, 2010).

[151] Final Report of the National Commission on the Causes of the Financial and Economic Crisis In the United States, at 33 (Jan. 2011).

reason why only two Money Funds have broken the buck in forty years of the industry's existence; and in those two cases investors got back the overwhelming majority of their investments relatively quickly. The regulatory regime governing Money Funds is not the same as FDIC insurance, it is far more effective than the FDIC and the regime of federal banking regulation, both in protecting Money Funds and their customer/investors against insolvency and in protecting the federal government from having to bail them out. Money Funds do not represent a case of no regulation, but of profoundly successful, yet simple and extraordinarily elegant, regulation.

The stability of Money Funds – especially when compared with banks – is due in large part to a regulatory system that provides for investor protection, active oversight, inspections and a competitive environment. The investment restrictions applicable to Money Funds are far more stringent than those that apply to banks in terms of duration, credit quality, and liquidity. In brief, Money Funds may invest in short-term debt instruments in which a national bank may invest, including prime commercial paper, bank deposits, short-term U.S. government securities, and short-term municipal government securities.[152] However, they may not invest in many of the higher risk, less liquid and longer-term investments that national banks may own, such as medium and long-term government or corporate debt and most types of loans (*e.g.,* mortgages and consumer loans). In short, Money Fund investment portfolios are far less risky and far more liquid than those of banks. They need to be. Money Funds do not rely on a Federal government guarantee to operate.

Money Funds are a type of mutual fund. As such, they must register with the SEC as "investment companies" under the Investment Company Act, which subjects them to stringent regulatory, disclosure, and reporting provisions. Thus, they must register offerings of their securities with the SEC and provide perpetually updated prospectuses to potential investors. They must also file periodic reports with the SEC and provide shareholders with annual and semi-annual reports, which must include financial data and a list of portfolio securities. In addition, the Investment Company Act governs virtually every aspect of a mutual fund's structure and operations, including its capital structure, investment activities, valuation of shares, the composition of the board, and the duties and independence of its directors. Mutual funds also are subject to extensive recordkeeping requirements and regular inspections. In addition, the advisers to mutual funds, including Money Funds, are subject to SEC registration under the Advisers Act, which imposes its own reporting and recordkeeping requirements, prescribes the terms of advisory contracts, and provides for SEC inspections and examinations. As described elsewhere in this memorandum, the SEC has adopted and enforces detailed and elaborate rules governing the portfolios and operations of Money Funds, including Rules 2a-7, 17a-9, 22e-3, 30b1-7, and Form N-MFP (17 C.F.R. §§ 270.2a-7, 270.17a-9, 270.22e-3 and 270.30b1-7, and 17 C.F.R. §274.201. No realistic assessment of Money Funds can conclude that they are not regulated.

[152] 12 U.S.C. § 24 (Seventh), 12 C.F.R. pt. 1 (2008).

Money Funds have been lumped in with "shadow banks" by some voices in the policy debate in part because prior to 2008, Money Funds were significant investors in ABCP and thus were characterized by some as helping to finance the shadow banking system.[153] Notably, commercial banks have been and continue to be significant investors in ABCP.[154] Indeed, a very large portion of the ABCP market, and the special purpose investment vehicle ("SIV") financing market was created, controlled and driven by commercial banks and was designed and developed to address commercial bank regulatory and accounting issues in getting financing structures off the balance sheets of banks that effectively controlled the conduits that were the issuers of the paper. However, with changes to accounting and commercial bank regulatory capital treatment of commercial-bank-sponsored commercial paper conduits, and to a lesser extent the 2010 amendments to Rule 2a-7, and changes to the ABCP, SIV, and commercial paper markets, issuances of ABCP have fallen by roughly two-thirds since 2007. As a consequence, Money Funds' investments in ABCP have been substantially reduced.[155] Thus, the characterization of Money Funds as "shadow banks" by virtue of these investments no longer has a factual basis, to the extent it ever did, and the true focal point of financing for ABCP and SIVs was commercial banks, not Money Funds.

In summary, Money Funds are not "shadow banks" and are not part of the "shadow banking system."

IV. Money Funds Should be Specifically Excluded Pursuant to DFA Section 170

Money Funds are a regulatory success. They are subject to robust regulation by the SEC, which has an excellent record in its oversight of Money Funds and a superior track record in this area in comparison to bank-type regulation or FDIC receivership.

Money Funds should not be designated for regulation by the Board under Title I. The receivership process created by Title II of the DFA is inappropriate for Money Funds which rely on equity, rather than debt financing, are essentially self liquidating by the nature of their assets, and are already covered by existing regulatory and judicial protocols when necessary for a prompt and efficient wind-down of a Money Fund.

Section 170 of the DFA dictates that in connection with Council rules implementing Title I, the Board "***shall*** promulgate regulations in consultation with and on behalf of the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies... from supervision by the" Board. Section 170 is not

[153] Zoltan, Pozsar, et al., Tobias, Federal Reserve Bank of New York, Staff Report no. 458, Shadow Banking, at 11 (July 2010); Mike Konczal, Shadow Banking: What It Is, How It Broke, and How to Fix It, *The Atlantic* (July 13, 2009) *available at* http://www.theatlantic.com/business/archive/2009/07/shadow-banking-what-it-is-how-it-broke-and-how-to-fix-it/21038/.

[154] *See* 12 C.F.R. pt. 1 (commercial paper a permitted investment for national banks in an amount of up to 10% of the bank's capital per issuer).

[155] *See* Crane Data, *ICI's Latest Shows MMF Assets Rising, Cont. Shift from Repo to CDs* (May 27, 2011) *available at* http://www.cranedata.com/archives/all-articles/3457/.

merely a grant of authority, it is a specific rulemaking requirement that the exemptive rules ***shall*** be promulgated.

In oversight hearings before the Senate Banking Committee on February 17, 2011, the FDIC's former Chairman Sheila Bair testified, when asked what criteria will be used to designate companies under Titles I and II, that it is easier to define what companies will *not* be subject to designation.[156] The former Chairman is correct. That should be done through the Section 170 exemption criteria rulemaking that the Board is required to conduct, to provide more certainty around the process.

The U.S. economic system demands stability and a clear regulatory framework. Indeed, the President's recent Executive Order directs that regulations "must promote predictability and reduce uncertainty."[157]

As one of the Federal Reserve Banks noted in comments earlier this year to the FDIC, the uncertainty over the terms, standards and processes to be used under Titles I and II presents a danger and may increase, rather than decrease, risks in the financial system.[158] In comments filed with the FDIC on its rulemaking proposal earlier this year, the Federal Reserve Bank of Richmond stated that:

> the orderly liquidation authority should be as transparent, unambiguous, and predictable as possible, and Title II would benefit from any rulemaking that makes the FDIC's authority clearer and more consistent. For this reason, we're pleased to read that the proposed rule's purpose "is to provide clarity and certainty to the financial industry and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of failing systemic financial companies." We worry, however, that despite the FDIC's efforts to enhance the orderly liquidation authority's transparency and predictability, the constructive ambiguity that accompanies the FDIC's discretion is likely to breed market uncertainty, which can add to financial volatility when market participants are forced to speculate on the FDIC's treatment of various similarly situated creditors. The potential for panics and runs in the face of such ambiguity could in turn impinge on the FDIC's decision making in the midst of a crisis. Greater

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156 *Oversight of Dodd Frank Implementation*, Hearings Before Senate Banking Committee (Feb. 17, 2011) *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=c43953db-0fd7-43c3-b6b8-97e2d0da3ef7. Various provisions of the DFA and its implementing rules, rather than discouraging bank retention of investments in complex securitization structures, expressly permit such investments and in some cases require it. *See, e.g*, D.F.A. § 619(g)(3); OCC, Federal Reserve Board, FDIC, SEC, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (Nov. 7, 2011).

157 *Improving Regulation and Regulatory Review*, Exec. Order No., at 3821 13563 (Jan. 18, 2011).

158 Letter from Jeffrey M. Lacker, President, Federal Reserve Bank of Richmond to FDIC (Jan. 18, 2011) *available at* http://www.fdic.gov/regulations/laws/federal/2010/10c35Orderliq.PDF.

transparency and predictability would help limit this adverse feedback loop.[159]

We think the best way to reduce the uncertainty created by the ambiguity in Title I is to make clear to investors and the public that Money Funds will ***not*** be designated for Board supervision under Title I of DFA or FDIC receivership under Title II. This can be done through a combination of revising the definition of "covered company" in the rules proposed by the NPR, formal statements on this point by the Board, FDIC, and Council, action by the Board on behalf of the Council pursuant to Section 170 of the DFA to exclude Money Funds from coverage, and actions consistent with that position over time by the Board, Council and FDIC.

We note in this regard that it is doubtful that *any* open-end investment company (*e.g.* a mutual fund), including a Money Fund, is within the definition of a "nonbank financial company" that is subject to designation under Title I or Title II of the DFA.[160] The Board has steadfastly refused for nearly six decades to interpret the provisions of Section 4 of the BHC Act that are incorporated into the DFA definition of a "nonbank financial company" to permit bank holding companies to control, be affiliated with, or be open-end investment companies (i.e. mutual funds), and has taken actions to prevent that from occurring.[161] Because the Board has not determined that being or controlling an open-end investment company or mutual funds is an eligible activity under those provisions, the activity of being an open end investment company is not a "financial" activity and thus mutual funds are not "nonbank financial companies" for purposes of Title I of Dodd Frank. The Board cannot have it both ways.[162] If Sections 4(c)(8) and 4(k) do not authorize a bank holding company to engage in the activity of being or controlling a mutual fund, then a mutual fund cannot be a nonbank financial company within the meaning of Title I.

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[159] Letter from Jeffrey M. Lacker, President, Federal Reserve Bank of Richmond to FDIC, at 2 (Jan. 18, 2011) *available at* http://www.fdic.gov/regulations/laws/federal/2010/10c35Orderliq.PDF.

[160] Section 102 of the D.F.A. defines the universe of "nonbank financial companies," that potentially are subject to designation under Title I, by reference to the financial powers of Section 4(k) of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. 1843(k). Section 4(k) in turn has its own list of activities, including those permitted under Section 4(c)(8) of the BHC Act and Regulation K, 12 C.F.R. § 211. Other parts of the BHC Act (Sections 4(c)(5), 4(c)(6) and 4(c)(7) of that Act) authorize investing in securities and in investment companies, and 4(c)(8) and Regulation K have been interpreted by the Board to include sponsoring, advising, administering and providing other services to open-end and closed end investment companies, as well as dealing and underwriting in securities (as contrasted to investing, reinvesting and trading in securities). But the Board has gone out of its way *not* to determine that being, or controlling, an open-end investment company is a permitted Section 4(c)(8) or 4(k) activity. Petition of the United States in *Board of Governors of the Federal Reserve System v Investment Company Institute* (in U.S. Supreme Court Docket No. 79-927, October Term, 1979), 450 U.S. 46 (1981).

[161] *See* 12 C.F.R. §§ 211.10(a)(11), 225.28(b)(6), 225.86(b)(3), 225.125.

[162] *Cf. Citicorp v Bd. of Governors*, 936 F.2d 66 (2d Cir. 1991), *cert. denied* 502 U.S. 1031 (1992) (Federal Reserve Board cannot simultaneously interpret the BHC Act in two different, conflicting ways).

Moreover, a primary purpose of designation of a nonbank financial company under Title I is to prepare it, and place it in line, for a potential FDIC receivership under Title II. Because the text, purpose and structure of Title II (and of Sections 165(d) & (g)) clearly establish that Title II receiverships are to address defaults by a nonbank financial company on its obligations, and Money Funds are financed entirely by shareholder equity and do not borrow or otherwise use leverage, they do not have the ability to default on their obligations in a way contemplated by Section 165(d) and Title II. If Money Funds do not have the kinds of debts and counterparty obligations that Titles I and II were intended to address, it makes no sense within the structure and purposes of Titles I and II to treat Money Funds as nonbank financial companies that are subject to designation under those Titles.

To the extent that there is any doubt on this question, it would be appropriate and in the public interest for the Board, acting in consultation with the FDIC and the Council, to exercise the mandatory exemptive authority in Section 170 of the DFA to exclude Money Funds from coverage under Titles I and II.

V. The Difference Between Causing Financial Instability and Being Immune From It.

Title I requires the Council to designate non-bank financial companies under Title I if the Council determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness or mix of the activities at the non-bank financial company could pose a threat to the financial stability of the United States. The task is to determine whether financial problems at a company could create a systemic problem, not whether the company is immune from losses in the event of a systemic financial problem that occurs in the economy.

This difference is important when considering the example cited for the need for additional regulation of Money Funds – the Reserve Primary Fund's "breaking a buck" on September 17, 2008, during the darkest days of the Financial Crisis. Before that event occurred, the U.S. economy had been in a deep recession for well over a year.

- After years of investing in risky subprime mortgages and related securities, Freddie Mac and Fannie Mae began scaling back their involvement in subprime mortgage lending in February 2007.
- Large participants in the subprime mortgage markets started failing, the first being New Century Financial Corporation in April 2007.
- In July 2007, two Bear Sterns controlled hedge funds heavily invested in collateralized debt obligations (CDOs) backed by subprime mortgages collapsed.
- The securitization markets dried up in the Summer of 2007.
- During August 2007, a series of mortgage lenders, including American Home Mortgage, Thornburg Mortgage Inc., and Capital One Financial Corp, either closed their doors or stopped funding new residential mortgages.

- The turmoil and freezing up of the credit markets prompted an unprecedented meeting on August 21, 2007 among then Senate Banking Committee Chair Dodd, then Treasury Secretary Paulson, and Federal Reserve Chairman Bernanke, in which Chairman Bernanke pledged to use all tools available to stem the credit crunch.
- The auction rate securities market dried up in February 2008.
- Fourteen FDIC-insured banks failed between January 1, 2007 and September 15, 2008.
- Bear Stearns had to be rescued in March 2008. Countrywide was forced to be sold in June 2008.
- IndyMac failed in July 2008.
- Fannie Mae and Freddie Mac were placed in conservatorship on September 7, 2008.
- Merrill Lynch was forced to sell to Bank of America to avoid insolvency during the second week of September 2008.
- Lehman Brothers went into bankruptcy on September 15, 2008.
- AIG was bailed out with an $85 billion loan from the Federal Reserve on September 16, 2008.
- Starting on September 16, 2008, both Washington Mutual Savings Bank and Wachovia Bank experienced massive runs on commercial deposits causing both institutions to become liquidity insolvent. Washington Mutual was closed and placed in receivership (the largest bank failure in U.S. history) and Wachovia was sold to Wells Fargo to avoid an even larger receivership.
- On September 16, 2008, roughly 20 months into the Financial Crisis, the Reserve Primary Fund broke a buck as a result of its Lehman commercial paper holdings, experienced a run on redemptions and suspended redemptions of its shares. Reserve Primary Fund Shareholders eventually recovered over 99 cents on the dollar in the liquidation of the fund.

The Reserve Primary Fund's breaking a buck did not cause the Financial Crisis to occur. The Financial Crisis, which had been raging for 20 months, was a key ingredient in the failure of many large institutions, including Lehman Brothers. The failure of Lehman caused the Reserve Primary Fund to break a buck. The Reserve Primary Fund situation was an effect, not a cause, of the Financial Crisis. As a formal part of the process for determining whether to designate a firm as systemically important under Title I, the rules proposed in the NPR should be amended to include a consideration of whether a firm is a likely cause of system financial instability, or a potential casualty of it. The final rules should specify that only the former type of firm should be considered for designation under Title I.

In addition, the AMLF financing program put in place by the Federal Reserve to lend to banks that bought commercial paper from Money Funds, while significant and very successful (and profitable to the Federal Reserve), was a very small part of a massive injection of liquidity into banks, GSEs and the financial markets by the Federal Reserve, FDIC and Treasury during the crisis, the vast majority of which had no relation to Money Funds. Most recently, the Federal Reserve disclosed that its total discount window loans to banks unrelated to Money Funds during the crisis aggregated to over $7.7 trillion dollars, of which $1.2 trillion was outstanding at its peak. All in, the emergency lending programs in place during the financial crisis aggregated over $30 trillion, although the net balance outstanding at any given time was much lower.[163]

VI. Do Not Aggregate Investment Company Balances to Reach $50 Million Threshold.

Certainly, Section 113 of the DFA does not authorize designation of an entire industry as being "systemically significant," and the NPR is consistent with the Act in this respect. Rather, under Section 113, designation is for individual companies. Money Funds are each separate entities, with separate investment portfolios. Even when two Money Funds share a single investment adviser, their investments are segregated, and typically have different specializations. Thus, they cannot be lumped together and designated *en masse* as systemically significant under Section 113.[164]

On the other hand, the NPR indicates that the FSOC is considering aggregating the holdings of mutual funds in a given investment fund family. The NPR states that, in the first stage of consideration in the designation process "[f]or purposes of applying these six thresholds [including the threshold of having $50 billion in consolidated assets] to investment funds managed by a nonbank financial company, the Council may consider the funds as a single entity if their investments are identical or highly similar."[165] We understand this to mean the Council will not consider funds to be a single entity if their investments are not identical or highly similar, but will if they are.

In the case of Money Funds, the same investment adviser typically advises many different Money Funds with different investment focuses. Broadly speaking, they fall into three general categories: U.S. government securities Money Funds; tax-exempt Money Funds, which invest in tax-exempt municipal securities; and prime Money Funds, which invest in a combination of different types of securities. Within each broad category, there are different Money Funds, each with a different investment specialization. For example, within the category of U.S. government securities Money Funds are funds that invest only in U.S. Treasury securities, and other funds that invest in

[163] *See* Federal Reserve Board, Usage of Federal Reserve Credit and Liquidity Facilities (Nov. 30, 2011), *data available at:* http://www.federalreserve.gov/newsevents/reform_transaction.htm; Press release, Department of the Treasury, Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008) *available at:* http://www.treasury.gov/press-center/press-releases/Pages/200897111172217483.aspx; Federal Reserve Bank of St. Louis, The Financial Crisis: A Timeline of Events and Policy Actions (Apr. 13, 2011), *available at* http://timeline.stlouisfed.org/

[164] We note press reports indicating that an unpublished draft FSOC staff report has reached the same conclusion. Rebecca Christie and Ian Katz, *Hedge Funds May Pose Systemic Risk in Crisis, U.S. Report Says* (Bloomberg, Feb. 17, 2011) *available at* http://noir.bloomberg.com/apps/news?pid=newsarchive&sid=aodA4jeoNSxE.

[165] FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64264, at n. 12.

a broader range of U.S. Treasury and agency securities. Within the broad category of tax-exempt Money Funds are funds that invest in municipal securities of a particular state and municipalities within that state and are offered primarily to taxpayers of that state (who get the most favorable tax treatment for the home state municipal securities), and Money Funds that invest in municipal securities from many states. Within the broad category of prime Money Funds similarly are different funds each with its own investment portfolio and maturity profile.

Regardless of what specific investments are in a particular Money Fund, each Money Fund portfolio stands alone. The liabilities (if any) and shareholder interests of one Money Fund do not have a claim on the portfolio assets of another Money Fund, even if they are invested in the same issuers. The portfolio of each Money Fund is diversified by issuer and maturity resulting in limited exposure to any one issuer or group of issuers, such that a default by any one (or several) issuers of underlying investments does not mean that either or both Money Funds will fail to maintain a stable net asset value.

Because Money Funds hold only very short term money market instruments, the portfolio composition of every fund is continuously changing, with the great majority of the assets turning over every two or three months. Two Money Funds may invest in many of the same issuers, but at different times with different maturity dates, such that the performance and payment on the two investments will differ and will not necessarily bear the same risks or market values. More broadly, two different Money Funds that invest in the same issuers may have very different maturity profiles to reflect the investment adviser's and board of directors' assessments of the different liquidity needs and redemption expectations of the shareholders of the two funds. As a result, similarity of the names of the issuers in two Money Funds on a given date does not mean the two Money Funds have the same risk profiles, investment returns or liquidity needs. Ultimately, the primary risk faced by Money Funds is liquidity risk, not credit risk.[166] A comparison of names of portfolio issuers is not very reflective of the different exposures they may face.

Money Fund investment advisers select portfolio investments for the funds through extensive and on-going credit review of issuers, which results in a list of permitted issuers and instruments, and the maximum portfolio investment in each. To this is applied a matrix of the maturity profile required to meet the liquidity and return objectives of the fund and other investment and diversification requirements. The portfolio manager and traders then select particular investments from the approved list that meet the requirements of the matrix as they become available, depending on price, market outlook on the issuers and instruments, and other considerations, seeking to pick

[166] A 2006 Paper in the FDIC Working Paper Series confirms that liquidity issues, rather than credit issues are the triggers behind banking runs and panics. Kathleen McDill and Kevin Sheehan, *Sources of Historical Banking Panics: A Markov Switching Approach*, Working Paper 2006–01 (Nov. 2006), *available at* www.fdic.gov/bank/analytical/working/wp2006.../wp2006_01.pdf.

the best of the available investments to optimize the Money Fund's performance within the criteria set forth in the matrix.

Aggregation by the FSOC of two Money Funds with the same investment adviser to reach the $50 billion size criteria based upon similarity of the names of the issuers held in the funds' respective portfolios would create a perverse incentive for the investment adviser to allocate the two Money Funds into different issuers, rather than selecting for each Money Fund the best portfolio of available money market instruments. Half the time, each Money Fund would get the second-best investment alternative, and the two Money Funds would not be invested in the same issuers. This type of differential allocation would not enhance the performance or reduce the risk of either Money Fund. It would, instead, be one additional investment constraint for which each portfolio would need to be optimized, without any resulting benefit to shareholders other than avoiding designation under Title I.

For these reasons, we believe that it is inappropriate and counterproductive for the NPR to include a provision in the guidelines for designation that would aggregate Mutual Funds with the same investment adviser for purposes of the $50 billion size criteria based upon the degree of overlap between the ultimate underlying issuers of money market instruments held in their separate portfolios.

VII. The Proposed Rule Is Part of an Integrated Statutory Program That Is Fundamentally Flawed

The statute and the various proposed rules that would implement the statute contain a number of other flaws and shortcomings, which are discussed in more detail in our previous comment letters, two of which are attached hereto and should be included in the comment file on the NPR. If applied to Money Funds, the NPR is subject to these same flaws. Due to the procedural and practical linkages and statutory intertwining of Titles I and II of the DFA with Title I of the DFA and the rules under both Titles, the NPR is made defective by the shortcomings in other parts of Titles I and II and the related implementing rules. Certain of these are highlighted below, and described more fully in our prior comment letters.

The interrelated provisions of Titles I and II concerning the designation of nonbank financial companies contain significant Constitutional defects that have not been addressed, or even mentioned, in the NPR or in the related rulemakings of the Board, the FDIC and the Council implementing Title I and Title II. In the context of this NPR to implement the designation process under Title I of the DFA, the judicial review provisions of Titles I and II of the DFA, which dramatically curtail judicial oversight of agency actions particularly those related to designation of firms under Titles I and II and resolution of firms, and the implementing rules, infringe inappropriately on the role of the Federal courts under Article III of the Constitution and the right of private parties to have access to Article III courts, rather than a federal agency, in the ultimate determination and disposition of their private property rights and interests.

The curtailment of the role and authority of Article III federal courts in the process of reviewing agency action associated with the designation of nonbank financial companies under Titles I and II of DFA, and in adjudicating private rights, violates the Constitution.[167]

Although the property interests and contractual rights of investors, counterparties and other private parties will be profoundly affected by a receivership under Title II of the DFA, and the decisions and determinations of the receiver, the stated purposes of Title II do not include protecting those private parties' interests and rights, as against one another, as against the failed institution or its management, as against the government, or as against the general good of the public. Instead, the prime directive in designating and liquidating companies under Title II is protecting the financial stability of the United States, and the priority of payments places the claims of the United States ahead of everyone (other than the administrative expenses of the receiver).[168]

Unlike banks, which choose to subject themselves to potential FDIC receivership when they apply for FDIC insurance, nonbank financial companies that are designated under Title I of the DFA and potentially subject to Title II FDIC receivership do not elect that treatment. Becoming subject to Title I and Title II is not a voluntary, consensual step undertaken by the subject company. It is instead thrust upon a nonbank financial company (and thus upon the company's creditors, counterparties, shareholders and employees and others whose private property and rights would be affected by a receivership) by virtue of engaging in any of a broad and ill-defined swath of activities deemed to be financial in nature. Banks voluntarily apply for and obtain FDIC insurance and thus opt into the federal receivership provisions that come along with FDIC insurance and have direct access to Federal Reserve Bank lending on a regular basis, enjoy a federal government-granted monopoly to subsidized deposit-taking as a means to finance their operations, and in the case of national banks and federal savings associations, are organized and exist under Federal law, and thus are both willing participants in, and direct beneficiaries of, a federal safety net that effectively subsidizes their costs of doing business. In contrast, nonbank financial entities are not voluntary participants in the DFA Title I and Title II designation process and receivership provisions, nor are they participants in the federal safety net on a regular and continuous basis. Whatever may or may not be the Constitutionality of limited judicial involvement in and oversight of the designation and receivership powers as applied to banks that voluntarily elect into a federal receivership system outside of the normal bankruptcy process, the analysis is very different in the case of nonbank financial services companies.

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167 *See N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982); Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?* The Federalist Society (Nov. 16, 2010) *available at* www.fed-soc.org; Federalist Society Panel Discussion on the Constitutionality of the Dodd-Frank Financial Services Reform Act (Nov. 19, 2010), webcast *available at* www.youtube.com/watch?v=qX2iDe1eox0; Cato Institute Policy Forum, *Is Dodd Frank Constitutional?* (Feb. 15, 2011), webcast *available at* http://www.cato.org/event.php?eventid=7732.

168 D.F.A. § 210(b), (codified at 12 U.S.C. § 5390(b)).

As part of the statutory program, judicial review of placement of a nonbank financial company into receivership is extraordinarily limited by Section 202 to a period of 24 hours, on an arbitrary and capricious standard, with no stay. Other provisions of Title II of the DFA, including Section 205(c), 208, 210(a)(4), 210(a)(8), 210(e), and 210(h)(6), further limit judicial participation in the process. Individual claims brought against the receivership, after initial determination by the FDIC as receiver, are subject to determination in the district court on a *de novo* standard, but the resolution or plan for resolution of the estate, payment of those claims, and the ultimate disposition of the assets of the estate, are determined by the FDIC as receiver subject only to very limited judicial review.[169]

Due to the extraordinary limitation on judicial review of the designation and actions taken under Title II of the DFA, the determination and resolution of the property rights and interests of private parties under Title II that follow from designation under Title I would violate due process requirements under the Fifth Amendment to the Constitution, and would otherwise conflict with the due process rights of private parties under the Constitution. Designation under Title I of the DFA places a nonbank financial company by definition and through the interrelated provisions of Title I and Title II at risk of a Title II receivership and thus shares the inherent Constitutional flaw that exists in Title II.

The Board and FDIC have an obligation in conducting a rulemaking to consider the Constitutional issues associated with these provisions.[170] This has not been done, and no effort has been made in the rulemaking to address or ameliorate these issues. If the Constitutional flaws in the statute can be fixed as part of the rulemaking, they must be fixed. If they are not fixable, then the rule cannot be validly adopted and must be withdrawn.

The breadth and vagueness of the authority granted under Titles I and II on such issues as who will be subject to designation and on what grounds, and the lack of clarity as to what agency is responsible, impermissibly delegates legislative authority, a flaw that is compounded by the failure of the regulators in their respective rulemakings to clarify and narrow these provisions. Under these circumstances, the rules and guidelines proposed in the NPR and other actions taken by the Board, the Council, the FDIC, and other federal agencies pursuant to Titles I and II are not subject to judicial deference under the standards of *Chevron* and its progeny[171] but instead under the less deferential judicial review standards of *Industrial Union Department, AFL-CIO*, and similar cases.[172]

[169] D.F.A. §§ 210(a)(2)-(4), (e)(4).

[170] *See Whitney Nat'l Bank v. Bank of New Orleans*, 379 U.S. 411, 418-25 (1965); *Iowa Indep. Bankers Ass'n v. Bd. of Governors*, 511 F.2d 1288, 1293 n.4 (D.C. Cir. 1975).

[171] *Chevron U.S.A., Inc. v. Natural Resources Def. Council*, 467 U.S. 837 (1984); *United States v. Mead Corp.*, 533 U.S. 218 (2001).

[172] *Indus. Union Dep't, AFL, CIO v. Am. Petroleum Inst.*, 448 U.S. 607 (1980); *City of N.Y. v. Clinton*, 985 F. Supp. 168 (D.D.C. 1998), *aff'd on other grounds, Clinton v. City of N.Y.*, 534 U.S. 417 (1998); *Whitman*

Footnote continued on next page

VIII. Paperwork Reduction Act Estimates Internally Inconsistent, Conflict With Representations Made to Congress

The Paperwork Reduction Act estimates in the NPR do not give a clear indication of the approximate numbers of firms that will be designated, but earlier proposals contained widely divergent estimates of how many companies will be designated under Title I of the DFA and how much work will be required by companies to comply with regulatory requirements. For example, the joint Board/FDIC resolution plan final rulemaking notice estimated that 104 firms will be required to submit resolution plans and reports of exposure.[173] Title I specifies that banking entities with $50 billion or more of consolidated assets shall be deemed to be systemically important and designated under Title I.[174] According to data posted on the FFIEC website, there are approximately 35 U.S. banking organizations with $50 billion or more in consolidated assets.[175] If there are a total of 104 firms designated under Title I, that suggests that approximately 69 foreign banks with U.S. branches and non-bank financial firms will be designated under Title I and required to submit resolution plans.

When Congress was considering Title I of the DFA, Board Chairman Ben Bernanke testified that a total of roughly 25 firms, "virtually all of" which were bank holding companies already regulated by the Board, would meet the test of systemic significance for designation under the Act.[176] In its paperwork estimate as of February 11, 2011, the Board suggested that only three nonbank financial firms will be designated under Title I.[177]

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v. Am. Trucking Co., 531 U.S. 457, 487 (2001) (concurring opinion of Justice Thomas). The normal cure for an overly broad delegation of legislative power is a narrow reading by the courts of the grant of authority in order to avoid the Constitutional issue. *See e.g., Almendarez-Torres v. United States*, 523 U.S. 224, 237-38 (1998); *Whitman*, 531 U.S. at 476 (concurring opinion of Justices Stevens and Souter).

[173] FDIC Notice of Final Rule, Resolution Plans Required, 76 Fed. Reg. 67,323, 67,333 (Nov. 1, 2011).

[174] Federal Reserve, Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

[175] National Information Center, Top 50 BHCs, http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx.

[176] Regulatory Perspectives on the Obama Administration's Regulatory Reform Proposals, Part II, Hearings before the Financial Services Committee, U.S. House of Representatives, 111th Cong., 1st Sess. July 24, 2009, H.R. 111-68 at 47-48 (testimony of Federal Reserve Board Chairman Ben Bernanke). Similar statements that only a very few firms were appropriate for designation under Title I were made on several occasions during consideration of the DFA. *See, e.g.* Written Statement of former Federal Reserve Board Chairman Paul A. Volcker to Senate Banking Committee (Feb. 2, 2010); Written Statement of former Federal Reserve Board Chairman Paul A Volcker to House Financial Services Committee (Sept. 24, 2009) (estimating number between 5 and 25 firms globally). Similarly, the Basel Committee on Banking Supervision has also stated that under its proposed rules, 28 global firms would be deemed systemically important. Press Release, Assessment Methodology and the Additional Loss Absorbency Requirement for Global Systemically Important Banks - Consultative Document Issued By The Basel Committee (July 19, 2011) *available at* http://www.bis.org/press/p110719.htm.

[177] Federal Reserve, Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 76 Fed. Reg. 7731, 7735-37 (Feb. 11, 2011).

The growing number of firms that are estimated to be subject to Title I designation in these other related rulemaking notices signals that the regulators may be planning to be overly inclusive in their designation of nonbank financial companies for supervision under Title I, in conflict with the intent of Congress, the terms of the statute, and the economic best interests of the American people.

IX. Money Funds Represent a Regulatory Success

(a) History and Importance of Money Funds

Approximately thirty million investors own shares of Money Funds. The utility of Money Funds and their popularity with citizens, as well as Money Funds' successful forty-year track record of operations, cannot be overlooked in the policy discussion involving whether Money Funds should be regulated like banks by the Board and FSOC.

Money Funds are leading investors in the short-term debt instruments that are issued and traded in the "money market," including Treasury bills, bankers' acceptances, certificates of deposit, federal funds and commercial paper.[178] The money market is the single most important source of liquidity funding for the global financial system. It permits large institutions to meet short-term borrowing needs and invest cash holdings for brief periods. Federal, state and local governments also use the money market to meet liquidity needs by issuing short-term paper, including municipal paper and Treasury bills.

Money Funds were first offered in the U.S. in 1971 as a way to preserve investor principal while earning a reasonable return – and for the first time made a market interest rate available to retail investors. They have become widely held by many types of investors and are subject to pervasive regulation and oversight by the SEC. Due in large part to SEC rules that require them to invest exclusively in specific high-quality, short-term instruments issued by financially stable entities, they also have enjoyed a high degree of success, greatly increasing in number and in assets under management. Thus, Money Funds are now among the most widely held, low-risk and liquid investments in the world.[179]

Banks and their trade associations viewed Money Funds in their early years as competitors for retail business, and supported efforts to subject Money Funds to "bank-

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[178] Commercial paper consists of short-term, promissory notes issued primarily by corporations with maturities of up to 270 days but averaging about 30 days. Companies use commercial paper to raise cash for current operations as it is often cheaper than securing a bank loan. Federal Reserve Board, *Commercial Paper, available at* http://www.federalreserve.gov/releases/cp/about.htm.

[179] Notwithstanding relatively low prevailing yields, according to the Investment Company Institute, as of December 8, 2011, Money Funds had over $2.6 trillion in assets under management. *See* Investment Company Institute, *Money Market Mutual Fund Assets*, Dec. 8, 2011, *available at* http://www.ici.org/research/stats/mmf/mm_12_08_11. Investment Company Institute historical weekly money market data show that assets under management have declined significantly since January 2009. As of January 7, 2009, Money Funds had over $3.8 trillion in assets. *See* Investment Company Institute, *Weekly Total Net Assets (TNA) and Number of Money Market Mutual Funds, available at* http://www.ici.org/research/stats/mmf/.

like" supervision.[180] Policy makers, however, recognized that bank-like regulation would effectively kill off what has become not only an important investment choice for millions of individuals and institutions,[181] but also a highly efficient and essential mechanism to fund the needs of business and government borrowers in the short-term market.[182]

For investors of all types, Money Funds offer numerous benefits. They come in several forms, including both taxable funds (which invest in securities such as Treasury bills and commercial paper) and tax-free funds (which generally invest in municipal securities), government funds (which invest only in U.S. government and agency securities and repurchase agreements on those securities), and "prime" funds (which

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[180] *See, e.g., Shooting at Money Market Funds*, Time, Mar. 23, 1981, *available at* http://www.time.com/time/magazine/article/0,9171,952946,00.html. The article states that banking and savings institutions had "undoubtedly been hurt by the Money Funds" and that "banks and savings and loans have launched drives to bring them down. . . .Last week the U.S. League of Savings Associations urged the Government to impose sharp restrictions on the money market funds and asked the Federal Savings and Loan Insurance Corporation to pledge up to $7 billion in low-cost loans." The article further notes that "Senate Banking Committee Chairman Jake Garn of Utah wants to prevent money market funds from offering check-writing privileges; Congressman James Leach of Iowa has introduced a bill that would diminish the funds' appeal by setting reserve requirements on them...The funds are also under heavy assault in several state legislatures." *See also* Karen W. Arenson, *Volcker Proposes Money Funds Be Subject to Rules on Reserves,* N.Y. TIMES, June 26, 1981 (noting that former Federal Reserve Chairman Paul A. Volcker testified before a Congressional subcommittee that money market funds should be subject to regulations that would make them more competitive with banking institutions and less attractive to investors. Mr. Volcker also testified that reserve requirements were a key part of monetary policy and because they could not be removed from banking institutions, also should apply to other investment vehicles); Beatson Wallace, *Money Funds Aren't Banks*, BOSTON GLOBE, May 21, 1981 (noting that "[m]oney market funds continue to be the whipping boy of the banking industry and the delight of the small sum investor."). The article explains that Treasury Secretary Donald T. Regan testified that "imposing new controls on our financial markets would be the wrong approach to assisting the thrift industry," but that nevertheless Senator Garn "persists in his effort to curry support for legislation to curb the funds' check-writing feature and make the funds maintain a percent of their assets in a reserve account."

[181] *See, e.g., Competition and Conditions in the Financial System,* Hearings Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, 97th Cong., 939 (1981) (statement of former SEC Commissioner John R. Evans, who testified that "we are very concerned with suggestions that legislation should be enacted which would impose bank-type regulation on money market funds to the detriment of [public] investors." Noting that "many depository institutions are having difficulty attracting savings during a period when money market funds are experiencing dramatic growth....We can understand why certain depository institutions might like their competitors to be restricted. We believe, however, that any consideration of legislation to impose bank-type regulatory burdens and limitations on money market funds should include an evaluation of the existing regulation of such funds, the present protection provided to investors, and the negative impact that such proposals would have on the millions of people who invest in money market funds." Further, "[i]t is the Commission's view that the harm to small investors, and the inconvenience to large investors, which could result from the imposition of bank-type regulations on money market funds may not be significantly offset by any benefit to banks and thrift institutions."

[182] *See* Phillip R. Mack, *Recent Trends in the Mutual Fund Industry,* 79 Fed. Res. Bull. 1001, 1005 (1993), *available at* http://findarticles.com/p/articles/mi_m4126/is_n11_v79/ai_14714669/pg_5/?tag=content;col1, stating that "[m]oney market mutual funds grew rapidly in the late 1970s and early 1980s, when interest rates on money market instruments exceeded regulatory ceilings that applied to depository institutions. Flows from depositories to money funds supported expansion of the commercial paper market, an important alternative to bank loans for businesses."

invest in short-term corporate and bank debt, but not government securities).[183] Investors can choose between and among funds that offer slightly higher yields, funds that offer less credit risk, and funds that offer tax advantages. For institutional investors, Money Funds offer low cost, convenient ways to invest cash in the short-term. Many institutional investors, including companies and governmental entities, have cash balances swept from their operating accounts into Money Funds on a nightly basis. For retail investors, Money Funds continue to offer a low-risk, low-expense way to diversify liquid holdings.

Based on Investment Company Institute data, as of December 2010, there were approximately 652 Money Funds.[184] As of December 7, 2011, Money Funds held over $2.6 trillion in assets under management.[185] These numbers reflect a decline in both the number of Money Funds and aggregate Money Fund assets reflecting industry consolidation and a shrinking in the overall size of Money Funds during the recession.[186] Money Funds account for investments in almost 40% of outstanding commercial paper, approximately two-thirds of short-term state and local government debt, and a substantial amount of outstanding short-term Treasury and federal agency securities.[187] During the more than 25 years since Rule 2a-7 was adopted in 1983, over $335 trillion has flowed in and out of Money Funds.[188]

(b) Comparison of Money Fund Stability to Bank Failures

Money Funds have enjoyed a superior safety record compared to insured depository institutions. In the forty years that money market funds have been in operation, only two Money Funds have "broken the buck" and returned shareholders less than 100 cents on the dollar.[189] Significantly, no taxpayer funds were used to bail out shareholders in either case.

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[183] *See* Sue Asci, *Prime Money Funds See Recent Inflows*, Investment News, Feb. 22, 2009.

[184] Investment Company Institute, *Money Market Mutual Fund Assets*, Jun. 9, 2011, *available at* http://www.ici.org/research/stats/mmf/mm_12_08_11.

[185] Of this amount, retail Money Funds held roughly one third of this sum, while institutional funds held over two-thirds – though this distinction is somewhat arbitrary. Investment Company Institute, *Money Market Mutual Fund Assets,* Dec. 8, 2011, *available at* http://www.ici.org/research/stats/mmf.

[186] In 2008, there were 807 Money Funds holding approximately $3.1 trillion in assets under management. Investment Company Institute, 2008 Investment Company Factbook, Table 34 (*available at* http://www.icifactbook.org/2008/).

[187] *See* REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS, 7 *available at* http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf.

[188] *See* Investment Company Institute, *Report of the Money Market Working Group*, Mar. 17, 2009 (hereinafter "ICI Money Market Working Group Report"), at 38, *available at* www.ici.org/pdf/ppr_09_mmwg.pdf.

[189] The Community Bankers U.S. Government Fund in 1994 repaid its investors 96 cents on the dollar. That Money Fund had only institutional investors, so individual investors were not directly harmed. *See* ICI Money Market Working Group Report, (Mar. 2009) at n. 47, *available at*

Footnote continued on next page

Money Funds achieved this success under the regulation and oversight of the SEC and its Division of Investment Management.[190] At the core of this regulatory program is SEC Rule 2a-7, which in thirteen pages imposes sound principals that are the secret of the stability and solvency of Money Funds: invest only in very short-term, high quality, marketable debt instruments in a diversified manner, and do not use any leverage. Rule 2a-7 is the Occam's Razor of financial regulation.

In comparison, the regulation of banks involves four (formerly five) federal regulators and over fifty regulators in states and other districts. The federal agencies alone require over 26,000 full-time employees.[191] The federal banking code – Title 12 of the United States Code and Title 12 of the Code of Federal Regulations – totals fourteen volumes and many thousands of pages of requirements and prohibitions. Yet, during the 40 years since the launch of the first Money Fund – a period during which the Money Fund industry experienced exactly two instances in which shareholders did not receive 100 cents on the dollar – some 2,898 depository institutions have failed, and an additional 592 were the subject of "assistance transactions" in which the government injected capital to keep them afloat.[192] From 1971 through 2011, total estimated FDIC losses incurred in connection with failed banks or assistance transactions amount to $188.5 billion.[193]

Even in times of greatest financial stress, Money Funds have proved to be more stable than depository institutions. Money Funds weathered the financial crisis far better than banks, brokers, insurance companies or government sponsored enterprises. Since January 2008, as a result of the financial crisis that followed the burst of the housing bubble and the collapse of mortgage-backed securities investments, at least 412 banks have failed,[194] and even more would have failed but for dozens of federal programs that infused banks with cash. The Board, Department of the Treasury, and FDIC spent

Footnote continued from previous page
www.ici.org/pdf/ppr_09_mmwg.pdf. *See* Saul S. Cohen, *The Challenge of Derivatives*, 63 Fordham L. Rev. 1993, 1995 n.15 (1995). The Reserve Primary Fund was forced to liquidate in September 2008 as a result of a run triggered by Lehman's bankruptcy and the fund's holdings of Lehman commercial paper. The Reserve Primary Fund has returned to shareholders more than 99 cents on the dollar. *See* Press Release, *Reserve Primary Fund to Distribute $215 Million* (July 15, 2010), *available at* http://www.reservefunds.com/pdfs/Primary%20Distribution_71510.pdf; *see also* SEC Press Release: Reserve Primary Fund Distributes Assets to Investors (Jan. 29, 2010), *available at* http://www.sec.gov/news/press/2010/2010-16.htm.

[190] We note that the SEC's program of regulating and supervising investment companies has been extraordinarily efficient and effective to date and that the SEC is appropriately seeking additional funding to carry out its new responsibilities under the DFA.

[191] FDIC 2009 Annual Report; FRB 2009 Annual Report; OCC 2009 Annual Report; OTS 2009 Annual Report.

[192] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[193] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[194] FDIC Failed Bank List, *available at* http://www.fdic.gov/bank/individual/failed/banklist.html.

approximately $2 trillion on an array of programs to infuse cash into the banking system.[195] In addition, the Board has kept interest rates close to zero, allowing banks to borrow at almost no cost and to lend at higher rates so as to practically guarantee risk-free profits. This is estimated to cost savers $350 billion each year as banks do not have to compete for depositors' funds, and therefore may offer only low interest rates on deposits.[196]

During the same period, only one Money Fund, the Reserve Primary Fund, failed to return investors' shares at less than 100 cents on the dollar.[197] The other 806 Money Funds in operation in 2008 did not break a buck and more than 95% of those funds did not receive any support from their sponsors. Nonetheless, the massive requests for redemptions by the Reserve Primary Fund shareholders beginning on September 15, 2008 when Lehman declared bankruptcy, and Reserve's announcement the following day that it would re-price its shares, triggered a run by investors in other prime Money Funds who feared that those funds' holdings of commercial paper of other financial institutions would decline in value. Numerous Money Funds liquidated assets and fewer than 50 Money Funds obtained support from their advisers or other affiliated persons.[198] As the PWG Report describes, the liquidation of Money Fund assets to meet redemptions led to a reduction of Money Fund holdings of commercial paper by about 25 percent.[199]

No Money Funds were "bailed out" by the government, but the extraordinary conditions in the market, including illiquidity in the secondary market for commercial

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[195] Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of Its Expiration*, at 145-46 (Sept. 16, 2010).

[196] Yalman Onaran and Alexis Leondis, *Bank Bailout Returns 8.2% Beating Treasury Yields*, Bloomberg (Oct. 20, 2010), *available at* http://www.bloomberg.com/news/2010-10-20/bailout-of-wall-street-returns-8-2-profit-to-taxpayers-beating-treasuries.html.

[197] On September 16, 2008, the Reserve Primary Fund's shares were priced at 97 cents after it wrote off debt issued by Lehman Brothers, which had declared bankruptcy the day before. Even so, this event was in large part due to misconduct by the Fund's management, as the SEC has alleged in a pending enforcement proceeding. *See* SEC Press Release: SEC Charges Operators of Reserve Primary Fund With Fraud , May 5, 2009, *available at* http://www.sec.gov/news/press/2009/2009-104.htm and related SEC Complaint, *available at* http://www.sec.gov/litigation/complaints/2009/comp21025.pdf, at 35. Moreover, Reserve Fund shareholders recovered more than 99 cents on the dollar after it closed. Press Release, Reserve Primary Fund to Distribute $215 Million (July 15, 2010), *available at* http://www.reservefunds.com/pdfs/Primary%20Distribution_71510.pdf; SEC Press Release: Reserve Primary Fund Distributes Assets to Investors (Jan. 29, 2010), *available at* http://www.sec.gov/news/press/2010/2010-16.htm.

[198] The SEC notes that with the exception of the Reserve Primary Fund, all of the funds that were exposed to losses during 2007-2008 from debt securities issued by structured investment vehicles or as a result of the default of debt securities issued by Lehman Brothers Holdings Inc. obtained support of some kind from their advisers or other affiliated persons, who absorbed the losses or provided a guarantee covering a sufficient amount of losses to prevent these funds from breaking the buck. *See* SEC, Money Market Fund Reform, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

[199] *See* REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS, 12 (2010) *available at* http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf.

paper, led to the adoption of special measures to restore confidence in the money markets and Money Funds and address the freeze-up in the commercial paper market. The Treasury Department implemented a limited "Temporary Guarantee Program for Money Market Funds" whereby Money Funds could, in exchange for a payment, receive insurance on investors' holdings such that if shares broke the buck, they would be restored to a $1 NAV.[200] The program expired about one year later, experienced no losses (because the insurance guarantee was never called upon), and earned the Treasury about $1.2 billion in participation fees.[201]

The Federal Reserve also created an "Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility" ("AMLF") to provide credit for banks and bank holding companies to finance their purchases of commercial paper from Money Funds.[202] This program lent $150 billion in its first 10 days of operation and was terminated with no credit losses.[203] All loans made under the AMLF were repaid in full, with interest, in accordance with the terms of the facility.[204] Indeed, the Federal Reserve Bank of Boston Statements of Income and Comprehensive Income for the years ended December 31, 2009 and December 31, 2008 show the total amount of interest income made on "other loans" (which refers to the AMLF program) during 2008 and 2009 was $543 million ($470 million and $73 million in 2008 and 2009, respectively).[205] Advances made under the AMLF were made at a rate equal to the primary credit rate offered by the Boston Federal Reserve Bank to depository institutions at the time the advance was made.[206] In sum, the program was extremely profitable to the government. Both programs were limited in scope and involved relatively low risk to taxpayers when compared to other steps taken by the government during the financial crisis.

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200 Press Release, Treasury Announces Guaranty Program for Money Market Funds (Sept. 19, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1147.aspx.

201 Press Release, Treasury Announces Expiration of Guarantee Program for Money Market Funds (Sept. 18, 2009), *available at* http://www.ustreas.gov/press/releases/tg293.htm.

202 Federal Reserve Board, *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, available at* http://www.federalreserve.gov/monetarypolicy/abcpmmmf.htm.

203 Burcu Duygan-Bump, Patrick M. Parkinson, Eric S. Rosengren, Gustavo A. Suarez, and Paul S. Willen, QAU Working Paper No. QAU10-3, *How Effective Were the Federal Reserve Emergency Liquidity Facilities? Evidence from the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility available at* http://www.bos.frb.org/bankinfo/qau/wp/2010/qau1003.htm. The program ceased operation in February, 2010. Federal Reserve Board Press Release, FOMC Statement (Jan. 27, 2010), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20100127a.htm.

204 Federal Reserve Board, *Monthly Report on Credit and Liquidity Programs and the Balance Sheet,* Appendix B at 31 (October 2010), *available at* http://www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201010.pdf.

205 *See* The Federal Reserve Bank of Boston, Financial Statements as of and for the Years Ended December 31, 2009 and 2008 and Independent Auditors' Report, *available at* http://www.federalreserve.gov/monetarypolicy/files/BSTBostonfinstmt2009.pdf.

206 *Id.*, at 19.

(c) What if Amended Rule 2a-7 Had Been in Place in 2008?

Going forward, other means must be used to address any future financial crisis. Although we note the uncertainty of predicting how the impact of the 2007-2009 Financial Crisis on Money Funds might have been different had new regulatory requirements been in place in 2008, it is nonetheless a useful exercise.[207] Had current rules been in place in 2008, it is doubtful that the Reserve Primary Fund situation would have occurred as it did, or that the Treasury and Federal Reserve Bank efforts would have been needed. First, it was the bankruptcy of Lehman Brothers that caused the Reserve Primary Fund to "break the buck." Had the Dodd-Frank Act been in effect in 2008, Lehman Brothers would have been quickly resolved by the FDIC under Title II of the DFA (assuming it would have been allowed to get in a financial predicament in the first place). The FDIC's recent analysis and report on how it would have resolved Lehman Brothers under Title II of DFA concludes it would have been able to do so quickly and at a far smaller loss to creditors than occurred under the bankruptcy court process.[208] If that is correct, the losses to the Reserve Primary Fund would have been much less (potentially preserving the dollar per share) and the investment in Lehman commercial paper repaid in cash by the FDIC as receiver at a discounted value very quickly.

Moreover, had the 2010 amended version of Rule 2a-7 and the SEC's new enhanced program of oversight of Money Funds been in place before 2008, including SEC staff's current program of analyzing the information submitted by Money Funds, the SEC Staff would have detected the unusually rapid growth and high yield of the Reserve Primary Fund as early as 2007 and flagged it as a problem fund for closer scrutiny and rapid supervisory action. The Reserve Primary Fund likely would not have been permitted to grow to the size that it did, or take on the portfolio risk that it did. SIVs and other low-credit quality or long maturity assets would not have been allowed in the Reserve Primary Fund portfolio under the SEC's 2010 amended version of Rule 2a-7, and consequently the illiquidity and risk associated with those positions would not have been in the Reserve Primary Fund in September 2008.

During the week of September 15, investors redeemed approximately 15% of prime Money Fund shares.[209] Had the SEC's 2010 amended rules been in place in 2008, the Reserve Primary Fund and every other Money Fund would have held at least 10% overnight cash and 30% seven day cash available to pay those redemptions, a cash holding roughly double the amount redeemed by investors during the worst week of the financial crisis for Money Funds. Given the other market events and investor skittishness

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[207] *Cf. The Orderly Liquidation of Lehman Brothers Holdings Inc. Under the Dodd-Frank Act*, 5 FDIC Quarterly (April 2011) (FDIC report describing how the FDIC could have structured a resolution of Lehman under the authority of Title II of the Dodd-Frank Act had the Act been in effect in 2008, concluding that an FDIC liquidation of Lehman would have recovered substantially more for creditors than bankruptcy proceedings with no cost to taxpayers).

[208] *Id.*

[209] SEC Chairman Mary L. Schapiro, Remarks at SIFMA's 2011 Annual Meeting, New York, New York (Nov. 7, 2011), *available at* www.sec.gov/news/speech/2011/spch110711mls.htm.

in the weeks and months prior to September 2008, Money Funds likely would have held far more liquidity than those 10%/30% levels due to the overarching requirements in the amended Rule 2a-7 that the Money Fund assess its reasonable cash needs to meet redemptions and hold sufficient liquidity to do so. Amended Rule 2a-7 now requires Money Funds to hold enough cash and very short-term assets to be able to meet investor withdrawal requests on a scale comparable to those seen in September 2008 without any government assistance or market intervention and without having to sell portfolio assets into an illiquid market. This much stronger cash position likely would have permitted the Reserve Primary Fund and other Money Funds to meet investor redemption requests as they occurred without needing to dump portfolio assets into the markets to raise cash. This could have helped prevent the commercial paper markets from seizing up that week, and would also have calmed investor skittishness, nipping the "run" on Money Funds before it began.

Moreover, under the SEC's new Money Fund portfolio reporting obligations, had they been in effect in 2008, the SEC and investors in other Money Funds would have a better understanding of what was (and was not) in the portfolios of other Money Funds, calming concerns that other Money Fund portfolios contained large positions in Lehman commercial paper or other similarly troubled issuers. Part of every financial panic is fear of the unknown. Better disclosure of Money Fund portfolios removes much of the uncertainty that investors had in September 2008 regarding the potential portfolio losses of other Money Funds which caused the Reserve Primary Fund's credit losses to trigger redemptions at other unrelated Money Funds that did not in fact have material loss exposure to Lehman or other troubled creditors.

Going forward, the type of intervention in which the Government may engage will be limited. Congress has forbidden the use of the Exchange Stabilization Fund to guarantee the obligations of Money Funds.[210] The Board's lending authority has been restricted by Section 1101 of the DFA, so that it is not permitted to lend to individual firms that are insolvent.[211] In addition, under Section 214 of the DFA, financial companies placed in receivership under Title II of the DFA cannot receive bailouts or taxpayer-funded expenditures to prevent their liquidation.[212] It is anticipated that these limitations will go a long way in promoting market discipline by eliminating expectations of a Government "bail out" – either of Money Funds or other institutions.

In addition, changes to accounting standards and commercial bank regulatory capital requirements on off-balance sheet treatment of commercial paper financing conduits, as well as changes to commercial paper market conditions (and to a lesser extent the 2010 amendments to Rule 2a-7) have resulted in a substantial decline (by roughly two-thirds) in Money Fund investments in ABCP. As a result, the category of

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[210] Economic Emergency Stabilization Act of 2008, Div. A of Pub. L. 110-343 (Oct. 3, 2008), §131(b).

[211] Pub. L. No. 111-203, 124 § 1101 (2010).

[212] Pub. L. No. 111-203, 124 § 214 (2010).

assets financed under the AMLF program no longer are held by Money Funds at anywhere near the dollar levels that existed at the time of the AMLF program.

Moreover, although the Board and the Council have just begun to consider the use of the Government's new tools under the DFA to identify and apply new layers of regulation to systemically significant nonbank institutions that, like Lehman, may rely heavily upon short term funding. The SEC, as discussed below, already has acted to substantially enhance the liquidity of Money Funds and further enhance their ability to withstand the potential failure of institutions in whose securities they invest. In addition, the SEC in September 2010 proposed new rules that will shed new light on a company's short-term borrowing practices, including balance sheet "window dressing."[213] The SEC's proposed rules require public companies to disclose additional information to investors about short-term borrowing arrangements, including commercial paper, repurchase agreements, letters of credit, promissory notes, and factoring, used to fund their operations.[214] These actions by the SEC, in combination with future actions by the Board and the Council to apply regulation to certain financial institutions that are issuers of the commercial paper purchased by Money Funds, should, in combination, prevent or mitigate the impact of future failures of systemically significant financial institutions and, in particular, mitigate the impact of their failures on investors, such as Money Funds, in the short-term markets.

(d) The 2010 Revisions to Money Fund Supervision Program Proved Effective in 2011 European Debt Crisis, US Budget Impasse

(i) Enhanced Liquidity and Credit Quality Standards

In 2010, the SEC acted decisively to enhance the stability and liquidity of Money Funds through amendments to Rule 2a-7 and related rules and reporting forms. These changes have included: a requirement to maintain liquidity sufficient to meet reasonably foreseeable redemptions,[215] a requirement that taxable money market funds hold at least

[213] *See*SEC, Short-Term Borrowings Disclosure, 75 Fed. Reg. 59,866 (Sept. 28, 2010). Currently, SEC rules require public companies to disclose short-term borrowings at the end of the reporting period, but generally there is no requirement to disclose information about the amount of short-term borrowings outstanding throughout the reporting period. The only exception is for bank holding companies, which must disclose annually the average and maximum amounts of short-term borrowings outstanding during the year.

[214] *Id.* The proposed rules distinguish between "financial companies" and other companies. Financial companies would be required to report data for the maximum daily amounts outstanding (meaning the largest amount outstanding at the end of any day in the reporting period) and the average amounts outstanding during the reporting period computed on a daily average basis (meaning the amount outstanding at the end of each day, averaged over the reporting period). All other companies would be permitted to calculate averages using an averaging period not to exceed a month and to disclose the maximum month-end amount during the period. *See also,* SEC, Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis, 75 Fed. Reg. 59894 (Sept. 28, 2010).

[215] 17 C.F.R. § 270.2a-7(c)(5); Investment Company Act, 15 U.S.C. § 80a-22(e).

10 percent of their assets in "daily liquid assets" and that all Money Funds hold at least 30 percent of their assets in "weekly liquid assets,"[216] and a new power for Money Funds to suspend redemptions in extreme circumstances, to ensure an orderly liquidation process.[217] These rules provide even greater assurance for Money Fund investors that they will remain liquid in times of financial turmoil.[218]

While Rule 2a-7 sets a 120-day limit on the weighted average life of a portfolio and a 60-day limit on weighted average portfolio maturity, Money Funds in fact have been operated much more conservatively. At year-end 2010, 93% of prime money funds had a weighted average life of 90 days or less, and 80% had a weighted average maturity of 50 days or less.[219]

As amended in 2010, Rule 2a-7 now requires Money Funds to hold very large amounts of available cash to resolve shareholder runs. Prime Money Funds now must hold at least 10% of their assets in overnight cash and all Money Funds must hold at least 30% of their portfolio in assets that mature within one week. In addition, the rule now requires Money Funds to consider potential redemption levels and hold even more cash if needed to meet anticipated redemption needs. Most Money Funds in fact hold cash and near-cash items well above the 10% and 30% minimums.

To put these ratios in perspective, Money Funds currently hold $2.6 trillion in assets. Of that amount, over $260 billion is in overnight cash and roughly $800 billion or more must have a maturity that permits it to be converted to cash within one week.

(ii) Enhanced Portfolio Disclosures on Money Funds

Money Funds are now required to publicly disclose more about their portfolios, including "shadow" NAVs and market-based values of each portfolio security and to do so on a more frequent and current basis.[220] Customers and others can now analyze a fund's liquidity and overall positions and move their cash or take other actions in response. The mysteries surrounding what securities are held by a Money Fund have been removed, and investors now know what exposures and risks are in a Money Fund's portfolios and what exposures and risks are not.

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216 *See* 17 C.F.R. §§ 270.2a-7(c)(5)(ii)-(iii), (a)(8), (a)(32).

217 17 C.F.R. § 270.22e-3.

218 SEC, Money Market Fund Reform, 75 Fed. Reg. 10060 (Mar. 4, 2010).

219 Money Fund Regulatory Changes Post Financial Crisis, 2011 Investment Company Institute Money Market Funds Summit (May 16, 2011) (*available at* www.ici.org/pdf/mmsummit11_panel3.pdf).

220 17 C.F.R. § 270.30b1-7. Form N-MFP.

(iii) Enhanced SEC Supervision of Money Funds

The amendments to Rule 2a-7 are only half the story on the new ways in which the SEC supervises and regulates Money Funds. In 2010, an article published by the staff of the Federal Reserve Bank of New York called upon the SEC to significantly enhance its monitoring of Money Fund portfolios and look for signs of future trouble, such as unusually high yields and fast growth, that in retrospect clearly could have foretold as early as 2007 the looming risks within the portfolio of the Reserve Primary Fund.[221] Behind the scenes, the SEC now does that, and more. Since 2010, the SEC has implemented enhanced regulatory oversight of Money Funds and added staff to monitor Money Funds.

Using data from the new Form N-MFP filings, the SEC has created a central database of Money Fund portfolio holdings. The database also allows the SEC staff to analyze and sort reported data in a variety of ways, so that it can evaluate any Money Fund's overall maturity, diversification, credit quality, credit enhancements and liquidity. This database allows SEC officials to identify each and every Money Fund that holds a particular issuer's commercial paper, and determine which funds may have exposure to an issuer that is experiencing difficulty. The SEC can also detect and review trends across Money Funds. The staff can also use reports of Money Funds to identify those that have experienced sudden growth in assets under management or high yields. Analysts within the SEC now sift through weekly portfolio data submitted each month electronically by all Money Funds, looking for risk. Using this data, the SEC Staff now follows up frequently with Money Fund managers, asking detailed questions about reported data, trends in yields and portfolios, growth, repo counterparties, general market conditions and other issues, and for explanations of adverse trends, portfolio red flags and potentially risky investments. The SEC is doing the types of portfolio reviews the federal banking regulators do in analyzing bank portfolios. Except that the SEC is using real-time information on Money Fund portfolios that is much deeper and more transparent than anything available to bank regulators in arrears on illiquid, unmarketable and very opaque bank assets.

(iv) Amended Rule 2a-7 Worked Well in Summer 2011 Greek Debt Crisis and Federal Budget Impasse

As noted above, Money Funds must hold specified percentages of their portfolios in daily and weekly liquid assets, and the overall maturity of their portfolios is strictly limited. This cash holdings requirement was proven effective in preventing runs. In 2011, at a time of extreme volatility in world markets caused by fear of major sovereign defaults and the potential for related contagion, Money Funds experienced dramatic

[221] *See* Patrick McCabe, *The Cross Section of Money Market Fund Risks and Financial Crises*, Federal Reserve Board Finance and Economics Discussion Series (Sept. 2010) *available at* http://www.federalreserve.gov/pubs/feds/2010/201051/201051pap.pdf. Note that the Reserve Primary Fund doubled in size during the first eight months of 2008. *Report of the Financial Crisis Inquiry Commission,* at 356 (2011) *available at* http://fcic.law.stanford.edu/.

shareholder redemptions in June and again in late July/early August. Investors reacted first to the Greek debt crisis and then to the U.S. federal budget deadlock. Money Funds handled redemption requests during both the Greek debt crisis and the U.S. federal debt ceiling impasse without disruptions.

As of June 22, 2011, "prime" money market money funds held about $1.6 trillion in assets, requiring daily liquid assets of at least $160 billion and weekly liquid assets of at least $480 billion. From June 22 to June 29, 2011, following reports of exposures to European banks and Greek debt, about $48 billion was redeemed from prime Money Funds.[222] Under Rule 2a-7's minimum standards, prime Money Funds had about ten times the weekly liquidity needed to cover actual withdrawals in this period. Consistent with Rule 2a-7's requirement for Money Funds to assess foreseeable redemptions and hold assets sufficiently liquid to meet them, actual amounts of daily and weekly liquid assets held by money funds exceeded these requirements.

As of late July, 2011, taxable Money Funds (Money Funds other than municipal securities Money Funds) held approximately $2.3 trillion in assets.[223] In the last week of July, 2011, when negotiations over the federal debt-ceiling reached an impasse, almost $120 billion in share value was redeemed from taxable Money Funds.[224] In the week ending August 3, net outflows from taxable Money Funds totaled $69 billion, apparently due to concerns about the U.S. debt ceiling negotiations and Eurozone debt.[225] Thus, under Rule 2a-7's minimum requirements, taxable Money Funds held weekly liquid assets of at least 5.7 times the amounts redeemed in late July and 10 times the amounts redeemed in early August. In fact, the minimum daily liquid asset requirement would have been more than sufficient to cover the heaviest week of withdrawals. Again, liquidity did not dry up.

From the end of May until August 3, 2011, investors redeemed over 10% of their prime (taxable non-government) Money Fund investments, totaling over $169 billion in redemptions.[226] Some prime Money Funds experienced redemptions of between 20% and 45% of their assets.[227] Much of the redemption activity was in short bursts around the key events of each financial episode. Yet no Money Fund broke a buck. None

[222] Investment Company Institute, *Historical Weekly Money Market Data available at* http://www.ici.org/research/stats.

[223] *Id.*

[224] Mark Jewell, *With Risk of Debt Default Allayed, Money Funds Remain Safe Bet*, Associated Press (Aug. 7, 2011) *available at* http://articles.boston.com/2011-08-07/business/29862085_1_money-funds-crane-data-money-market; *see* Appendix E: Daily Change In Money Market Fund Assets (July 22 - August 4, 2011) (Source: Crane Data).

[225] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[226] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[227] Based on analyses by Federated Investors using data derived from IMoneyNet (Sept. 30, 2011).

faltered or was unable to meet redemption requests. Everything went smoothly. The key reforms adopted by the SEC in 2010, which shortened Money Fund maturities, increased cash holdings and portfolio diversification, and improved credit quality, worked exactly as intended.

Conclusion

Money Funds have been a success story in U.S. financial regulation. Using a very simple, common sense approach, which permits investment only in short term, high quality money market instruments, the SEC has succeeded in supervising an efficient and effective program by which investors' cash balances provide financing for American businesses and governmental units. Money Funds are an efficient and low-risk way to hold short-term liquidity and have been essential to development of a wide variety of automated commercial applications that have shortened processing times and settlement cycles facilitated by predictable $1 per share values and same day processing that are made possible through the use by Money Funds of amortized cost instead of forward pricing of shares using daily mark-to-market portfolio valuations. Money Funds are very popular with consumers, government and business investors, and very useful to the economy.

The enhancements made since 2010 by the SEC to their oversight and supervision of Money Funds, as well as to the liquidity and credit quality requirements applicable to Money Funds have been substantial and have further reduced the risks associated with Money Funds. These changes have not been without cost to investors in Money Funds, who are paying for these amendments through lower yields associated with shorter-term, higher credit quality portfolios that Money Funds now hold.

We respectfully suggest that the rules and guidelines to implement the designation process under Title I of the DFA that are proposed in the NPR be revised before they are adopted in final form to include:

(1) a formal and thorough consideration of the direct and indirect impact of designation of a firm on the financial system and the economy;

(2) a process for formal and thorough consideration of whether the direct and indirect consequence of designation of a firm will reduce or increase economic risk associated with "too big to fail" institutions, protect the American taxpayer by ending bailouts or instead expand exposure to federal bailouts, and result in an increase or a decrease in the federal safety net as contemplated by the preamble to the DFA;

(3) greater weighting of an existing program of comprehensive supervision and regulation by a primary federal regulator of the firm being considered for Title I designation;

(4) an analysis of what is sought to be accomplished through designation of the firm and how designation is a better means to that end than allowing the firm's existing primary federal regulator to continue its supervision of the firm; and

(5) a clear statement pursuant to Section 170 of the DFA that Money Funds will not be designated under Title I.

Even if Money Funds were within the statutory criteria for designation under Title I of DFA (which they are not), under an appropriate consideration of the potential damage and lack of benefit to the economic system from such a designation, Money Funds should never be designated under Title I of the DFA. We request that the final rules or the release that will accompany the final rules provide more clarity on this point and state that due to the comprehensive SEC regulation and supervision of Money Funds, in light of the definitions and criteria in the statute, Money Funds will not be designated under Title I.

In an era of constrained federal budgets and severe limits on the ability of the federal government to finance future bail-outs or pay for a massive federal regulatory oversight staff, the simple and very conservative model used by the SEC in regulating and supervising Money Funds should serve as a model for the way to proceed. Money Funds are able to maintain their stable net asset value of $1 per share not because of an accounting rule, but because they are allowed to invest only in very short term, very high quality debt securities. Money Funds do not use leverage, and are instead financed 100% by shareholder equity. Fundamental changes to this program of regulation would increase risk, not reduce it. Applying the failed model of federal bank regulation to Money Funds is simply the wrong way to go.

Although we recognize that there continue to be some critics of Money Funds who continue to espouse the view that Money Funds should be regulated like banks, the reality is that the SEC's regulation of Money Funds has been far more effective than the federal banking agencies' regulation of banks. In the past 40 years only two Money Funds have broken the buck, and both were liquidated with relatively minimal losses to investors on a percentage basis and zero cost to the federal government. During that same period, more than 2,800 depository institutions failed, and almost 600 were kept afloat with government infusions of capital, at a total cost to the government of more than $188 billion. There is nothing in the historical record to suggest that imposing "bank like" regulatory, resolution or receivership requirements on Money Funds will make Money Funds, or the American economy, safer. The prudent course is to continue to build upon what has worked and to refine the current program of regulation of Money Funds under the supervision of the SEC.

Appendix B

Shadow NAVs of Sample Years
2002, 2005, 2008, and 2011

Date	Acronym	NAV	Rounded to 3rd Decimal	# weeks
1/3/2002	POF	1.000869	1.001	1
1/10/2002	POF	1.000748	1.001	2
1/17/2002	POF	1.000803	1.001	3
1/24/2002	POF	1.000686	1.001	4
1/31/2002	POF	1.000591	1.001	5
2/7/2002	POF	1.000567	1.001	6
2/14/2002	POF	1.000459	1.000	7
2/21/2002	POF	1.000409	1.000	8
2/28/2002	POF	1.000419	1.000	9
3/7/2002	POF	1.000286	1.000	10
3/14/2002	POF	1.000095	1.000	11
3/21/2002	POF	0.999957	1.000	12
3/28/2002	POF	0.999886	1.000	13
4/4/2002	POF	1.000025	1.000	14
4/11/2002	POF	1.000126	1.000	15
4/18/2002	POF	1.000234	1.000	16
4/25/2002	POF	1.000381	1.000	17
5/2/2002	POF	1.000303	1.000	18
5/9/2002	POF	1.000280	1.000	19
5/16/2002	POF	1.000223	1.000	20
5/23/2002	POF	1.000242	1.000	21
5/30/2002	POF	1.000201	1.000	22
6/6/2002	POF	1.000261	1.000	23
6/13/2002	POF	1.000323	1.000	24
6/20/2002	POF	1.000373	1.000	25
6/27/2002	POF	1.000440	1.000	26
7/3/2002	POF	1.000400	1.000	27
7/11/2002	POF	1.000441	1.000	28
7/18/2002	POF	1.000368	1.000	29
7/25/2002	POF	1.000423	1.000	30
8/1/2002	POF	1.000358	1.000	31
8/8/2002	POF	1.000489	1.000	32
8/15/2002	POF	1.000405	1.000	33
8/22/2002	POF	1.000346	1.000	34
8/29/2002	POF	1.000352	1.000	35
9/5/2002	POF	1.000392	1.000	36
9/12/2002	POF	1.000289	1.000	37
9/19/2002	POF	1.000326	1.000	38
9/26/2002	POF	1.000408	1.000	39
10/3/2002	POF	1.000469	1.000	40
10/10/2002	POF	1.000373	1.000	41
10/17/2002	POF	1.000250	1.000	42
10/24/2002	POF	1.000237	1.000	43
10/31/2002	POF	1.000550	1.001	44
11/7/2002	POF	1.000574	1.001	45
11/14/2002	POF	1.000560	1.001	46
11/21/2002	POF	1.000486	1.000	47
11/27/2002	POF	1.000496	1.000	48
12/5/2002	POF	1.000438	1.000	49
12/12/2002	POF	1.000423	1.000	50
12/19/2002	POF	1.000456	1.000	51
12/26/2002	POF	1.000446	1.000	52

Acronym	Date	NAV	Rounded to 3rd Decimal	# weeks
PCOF	1/3/2002	1.000832	1.001	1
PCOF	1/10/2002	1.000744	1.001	2
PCOF	1/17/2002	1.000786	1.001	3
PCOF	1/24/2002	1.000611	1.001	4
PCOF	1/31/2002	1.000490	1.000	5
PCOF	2/7/2002	1.000513	1.001	6
PCOF	2/14/2002	1.000390	1.000	7
PCOF	2/21/2002	1.000322	1.000	8
PCOF	2/28/2002	1.000330	1.000	9
PCOF	3/7/2002	1.000249	1.000	10
PCOF	3/14/2002	1.000086	1.000	11
PCOF	3/21/2002	0.999942	1.000	12
PCOF	3/28/2002	0.999908	1.000	13
PCOF	4/4/2002	1.000065	1.000	14
PCOF	4/11/2002	1.000172	1.000	15
PCOF	4/18/2002	1.000268	1.000	16
PCOF	4/25/2002	1.000461	1.000	17
PCOF	5/2/2002	1.000362	1.000	18
PCOF	5/9/2002	1.000332	1.000	19
PCOF	5/16/2002	1.000287	1.000	20
PCOF	5/23/2002	1.000280	1.000	21
PCOF	5/30/2002	1.000243	1.000	22
PCOF	6/6/2002	1.000294	1.000	23
PCOF	6/13/2002	1.000321	1.000	24
PCOF	6/20/2002	1.000355	1.000	25
PCOF	6/27/2002	1.000442	1.000	26
PCOF	7/3/2002	1.000376	1.000	27
PCOF	7/11/2002	1.000383	1.000	28
PCOF	7/18/2002	1.000310	1.000	29
PCOF	7/25/2002	1.000364	1.000	30
PCOF	8/1/2002	1.000282	1.000	31
PCOF	8/8/2002	1.000383	1.000	32
PCOF	8/15/2002	1.000292	1.000	33
PCOF	8/22/2002	1.000236	1.000	34
PCOF	8/29/2002	1.000264	1.000	35
PCOF	9/5/2002	1.000318	1.000	36
PCOF	9/12/2002	1.000225	1.000	37
PCOF	9/19/2002	1.000255	1.000	38
PCOF	9/26/2002	1.000320	1.000	39
PCOF	10/3/2002	1.000370	1.000	40
PCOF	10/10/2002	1.000265	1.000	41
PCOF	10/17/2002	1.000170	1.000	42
PCOF	10/24/2002	1.000199	1.000	43
PCOF	10/31/2002	1.000430	1.000	44
PCOF	11/7/2002	1.000468	1.000	45
PCOF	11/14/2002	1.000445	1.000	46
PCOF	11/21/2002	1.000352	1.000	47
PCOF	11/27/2002	1.000377	1.000	48
PCOF	12/5/2002	1.000371	1.000	49
PCOF	12/12/2002	1.000321	1.000	50
PCOF	12/19/2002	1.000380	1.000	51
PCOF	12/26/2002	1.000414	1.000	52

Shadow NAVs of Sample Years
2002, 2005, 2008, and 2011

Date	Acronym	NAV	Rounded to 3rd Decimal	# weeks
1/6/2005	POF	0.999803	1.000	53
1/13/2005	POF	0.999815	1.000	54
1/20/2005	POF	0.999826	1.000	55
1/27/2005	POF	0.999829	1.000	56
2/3/2005	POF	0.999852	1.000	57
2/10/2005	POF	0.999869	1.000	58
2/17/2005	POF	0.999881	1.000	59
2/24/2005	POF	0.999875	1.000	60
3/3/2005	POF	0.999932	1.000	61
3/10/2005	POF	0.999895	1.000	62
3/17/2005	POF	0.999864	1.000	63
3/24/2005	POF	0.999840	1.000	64
3/31/2005	POF	0.999912	1.000	65
4/7/2005	POF	0.999925	1.000	66
4/14/2005	POF	0.999922	1.000	67
4/21/2005	POF	0.999941	1.000	68
4/28/2005	POF	0.999961	1.000	69
5/5/2005	POF	0.999966	1.000	70
5/12/2005	POF	0.999964	1.000	71
5/19/2005	POF	0.999968	1.000	72
5/26/2005	POF	0.999965	1.000	73
6/2/2005	POF	0.999979	1.000	74
6/9/2005	POF	0.999963	1.000	75
6/16/2005	POF	0.999963	1.000	76
6/23/2005	POF	0.999942	1.000	77
6/30/2005	POF	0.999943	1.000	78
7/7/2005	POF	0.999961	1.000	79
7/14/2005	POF	0.999914	1.000	80
7/21/2005	POF	0.999901	1.000	81
7/28/2005	POF	0.999922	1.000	82
8/4/2005	POF	0.999916	1.000	83
8/11/2005	POF	0.999911	1.000	84
8/18/2005	POF	0.999906	1.000	85
8/25/2005	POF	0.999918	1.000	86
9/1/2005	POF	0.999976	1.000	87
9/8/2005	POF	0.999997	1.000	88
9/15/2005	POF	0.999961	1.000	89
9/22/2005	POF	0.999931	1.000	90
9/29/2005	POF	0.999878	1.000	91
10/6/2005	POF	0.999873	1.000	92
10/13/2005	POF	0.999856	1.000	93
10/20/2005	POF	0.999843	1.000	94
10/27/2005	POF	0.999830	1.000	95
11/3/2005	POF	0.999822	1.000	96
11/10/2005	POF	0.999886	1.000	97
11/17/2005	POF	0.999816	1.000	98
11/23/2005	POF	0.999837	1.000	99
12/1/2005	POF	0.999846	1.000	100
12/8/2005	POF	0.999823	1.000	101
12/15/2005	POF	0.999811	1.000	102
12/22/2005	POF	0.999816	1.000	103
12/29/2005	POF	0.999850	1.000	104

Acronym	Date	NAV	Rounded to 3rd Decimal	# weeks
PCOF	1/6/2005	0.999808	1.000	53
PCOF	1/13/2005	0.999780	1.000	54
PCOF	1/20/2005	0.999791	1.000	55
PCOF	1/27/2005	0.999834	1.000	56
PCOF	2/3/2005	0.999857	1.000	57
PCOF	2/10/2005	0.999877	1.000	58
PCOF	2/17/2005	0.999907	1.000	59
PCOF	2/24/2005	0.999828	1.000	60
PCOF	3/3/2005	0.999971	1.000	61
PCOF	3/10/2005	0.999901	1.000	62
PCOF	3/17/2005	0.999897	1.000	63
PCOF	3/24/2005	0.999844	1.000	64
PCOF	3/31/2005	0.999914	1.000	65
PCOF	4/7/2005	0.999931	1.000	66
PCOF	4/14/2005	0.999927	1.000	67
PCOF	4/21/2005	0.999958	1.000	68
PCOF	4/28/2005	0.999973	1.000	69
PCOF	5/5/2005	0.999983	1.000	70
PCOF	5/12/2005	0.999985	1.000	71
PCOF	5/19/2005	0.999987	1.000	72
PCOF	5/26/2005	0.999993	1.000	73
PCOF	6/2/2005	0.999995	1.000	74
PCOF	6/9/2005	0.999986	1.000	75
PCOF	6/16/2005	0.999998	1.000	76
PCOF	6/23/2005	0.999977	1.000	77
PCOF	6/30/2005	0.999956	1.000	78
PCOF	7/7/2005	0.999966	1.000	79
PCOF	7/14/2005	0.999924	1.000	80
PCOF	7/21/2005	0.999917	1.000	81
PCOF	7/28/2005	0.999959	1.000	82
PCOF	8/4/2005	0.999950	1.000	83
PCOF	8/11/2005	0.999947	1.000	84
PCOF	8/18/2005	0.999949	1.000	85
PCOF	8/25/2005	0.999955	1.000	86
PCOF	9/1/2005	1.000009	1.000	87
PCOF	9/8/2005	1.000027	1.000	88
PCOF	9/15/2005	0.999989	1.000	89
PCOF	9/22/2005	0.999956	1.000	90
PCOF	9/29/2005	0.999909	1.000	91
PCOF	10/6/2005	0.999898	1.000	92
PCOF	10/13/2005	0.999877	1.000	93
PCOF	10/20/2005	0.999849	1.000	94
PCOF	10/27/2005	0.999841	1.000	95
PCOF	11/3/2005	0.999847	1.000	96
PCOF	11/10/2005	0.999910	1.000	97
PCOF	11/17/2005	0.999821	1.000	98
PCOF	11/23/2005	0.999849	1.000	99
PCOF	12/1/2005	0.999843	1.000	100
PCOF	12/8/2005	0.999852	1.000	101
PCOF	12/15/2005	0.999853	1.000	102
PCOF	12/22/2005	0.999862	1.000	103
PCOF	12/29/2005	0.999901	1.000	104

Shadow NAVs of Sample Years
2002, 2005, 2008, and 2011

Date	Acronym	NAV	Rounded to 3rd Decimal	# weeks	Acronym	Date	NAV	Rounded to 3rd Decimal	# weeks
1/3/2008	POF	0.999234	0.999	105	PCOF	1/3/2008	0.999527	1.000	105
1/10/2008	POF	0.999251	0.999	106	PCOF	1/10/2008	0.999641	1.000	106
1/17/2008	POF	0.999404	0.999	107	PCOF	1/17/2008	0.999405	0.999	107
1/24/2008	POF	0.999987	1.000	108	PCOF	1/24/2008	1.000480	1.000	108
1/31/2008	POF	1.000021	1.000	109	PCOF	1/31/2008	1.000572	1.001	109
2/7/2008	POF	0.999918	1.000	110	PCOF	2/7/2008	1.000403	1.000	110
2/14/2008	POF	0.999971	1.000	111	PCOF	2/14/2008	1.000345	1.000	111
2/21/2008	POF	0.999801	1.000	112	PCOF	2/21/2008	1.000102	1.000	112
2/28/2008	POF	0.999791	1.000	113	PCOF	2/28/2008	1.000087	1.000	113
3/6/2008	POF	0.999667	1.000	114	PCOF	3/6/2008	0.999970	1.000	114
3/13/2008	POF	0.999716	1.000	115	PCOF	3/13/2008	1.000037	1.000	115
3/20/2008	POF	0.999577	1.000	116	PCOF	3/20/2008	0.999957	1.000	116
3/27/2008	POF	0.999679	1.000	117	PCOF	3/27/2008	0.999966	1.000	117
4/3/2008	POF	0.999368	0.999	118	PCOF	4/3/2008	0.999721	1.000	118
4/10/2008	POF	0.999387	0.999	119	PCOF	4/10/2008	0.999712	1.000	119
4/17/2008	POF	0.999257	0.999	120	PCOF	4/17/2008	0.999574	1.000	120
4/24/2008	POF	0.999265	0.999	121	PCOF	4/24/2008	0.999517	1.000	121
5/1/2008	POF	0.999363	0.999	122	PCOF	5/1/2008	0.999633	1.000	122
5/8/2008	POF	0.999345	0.999	123	PCOF	5/8/2008	0.999735	1.000	123
5/15/2008	POF	0.999082	0.999	124	PCOF	5/15/2008	0.999243	0.999	124
5/22/2008	POF	0.999133	0.999	125	PCOF	5/22/2008	0.999305	0.999	125
5/29/2008	POF	0.999370	0.999	126	PCOF	5/29/2008	0.999723	1.000	126
6/5/2008	POF	0.999314	0.999	127	PCOF	6/5/2008	0.999700	1.000	127
6/12/2008	POF	0.999183	0.999	128	PCOF	6/12/2008	0.999479	0.999	128
6/19/2008	POF	0.999197	0.999	129	PCOF	6/19/2008	0.999406	0.999	129
6/26/2008	POF	0.999228	0.999	130	PCOF	6/26/2008	0.999416	0.999	130
7/3/2008	POF	0.999297	0.999	131	PCOF	7/3/2008	0.999487	0.999	131
7/10/2008	POF	0.999433	0.999	132	PCOF	7/10/2008	0.999568	1.000	132
7/17/2008	POF	0.999469	0.999	133	PCOF	7/17/2008	0.999583	1.000	133
7/24/2008	POF	0.999541	1.000	134	PCOF	7/24/2008	0.999616	1.000	134
7/31/2008	POF	0.999572	1.000	135	PCOF	7/31/2008	0.999665	1.000	135
8/7/2008	POF	0.999645	1.000	136	PCOF	8/7/2008	0.999730	1.000	136
8/14/2008	POF	0.999673	1.000	137	PCOF	8/14/2008	0.999722	1.000	137
8/21/2008	POF	0.999695	1.000	138	PCOF	8/21/2008	0.999689	1.000	138
8/28/2008	POF	0.999706	1.000	139	PCOF	8/28/2008	0.999796	1.000	139
9/4/2008	POF	0.999772	1.000	140	PCOF	9/4/2008	0.999847	1.000	140
9/11/2008	POF	0.999723	1.000	141	PCOF	9/11/2008	0.999823	1.000	141
9/18/2008	POF	0.998130	0.998	142	PCOF	9/18/2008	0.998565	0.999	142
9/25/2008	POF	0.997817	0.998	143	PCOF	9/25/2008	0.997764	0.998	143
10/2/2008	POF	0.997423	0.997	144	PCOF	10/2/2008	0.997533	0.998	144
10/9/2008	POF	0.998202	0.998	145	PCOF	10/9/2008	0.997436	0.997	145
10/16/2008	POF	0.998498	0.998	146	PCOF	10/16/2008	0.998035	0.998	146
10/23/2008	POF	0.999241	0.999	147	PCOF	10/23/2008	0.998872	0.999	147
10/30/2008	POF	0.998920	0.999	148	PCOF	10/30/2008	0.998552	0.999	148
11/6/2008	POF	0.999631	1.000	149	PCOF	11/6/2008	0.999454	0.999	149
11/13/2008	POF	0.999562	1.000	150	PCOF	11/13/2008	0.999174	0.999	150
11/20/2008	POF	0.999452	0.999	151	PCOF	11/20/2008	0.999427	0.999	151
11/26/2008	POF	0.999222	0.999	152	PCOF	11/26/2008	0.999307	0.999	152
12/4/2008	POF	0.999447	0.999	153	PCOF	12/4/2008	0.999735	1.000	153
12/11/2008	POF	0.999551	1.000	154	PCOF	12/11/2008	0.999856	1.000	154
12/18/2008	POF	0.999939	1.000	155	PCOF	12/18/2008	1.000307	1.000	155
12/24/2008	POF	0.999833	1.000	156	PCOF	12/24/2008	1.000284	1.000	156
12/31/2008	POF	0.999765	1.000	157	PCOF	12/31/2008	1.000291	1.000	157

Shadow NAVs of Sample Years
2002, 2005, 2008, and 2011

Date	Acronym	NAV	Rounded to 3rd Decimal	# weeks
1/6/2011	POF	1.000362	1.000	158
1/13/2011	POF	1.000381	1.000	159
1/20/2011	POF	1.000382	1.000	160
1/27/2011	POF	1.000388	1.000	161
2/3/2011	POF	1.000414	1.000	162
2/10/2011	POF	1.000381	1.000	163
2/17/2011	POF	1.000380	1.000	164
2/24/2011	POF	1.000373	1.000	165
3/3/2011	POF	1.000407	1.000	166
3/10/2011	POF	1.000388	1.000	167
03/17/11	POF	1.000396	1.000	168
3/24/2011	POF	1.000391	1.000	169
03/31/11	POF	1.000383	1.000	170
4/7/2011	POF	1.000407	1.000	171
4/14/2011	POF	1.000429	1.000	172
4/21/2011	POF	1.000431	1.000	173
4/28/2011	POF	1.000442	1.000	174
5/5/2011	POF	1.000439	1.000	175
5/12/2011	POF	1.000437	1.000	176
5/19/2011	POF	1.000435	1.000	177
5/26/2011	POF	1.000418	1.000	178
6/2/2011	POF	1.000423	1.000	179
6/9/2011	POF	1.000410	1.000	180
6/16/2011	POF	1.000416	1.000	181
6/23/2011	POF	1.000424	1.000	182
6/30/2011	POF	1.000440	1.000	183
7/7/2011	POF	1.000451	1.000	184
7/14/2011	POF	1.000435	1.000	185
7/21/2011	POF	1.000414	1.000	186
7/28/2011	POF	1.000404	1.000	187
8/4/2011	POF	1.000427	1.000	188
8/11/2011	POF	1.000337	1.000	189
8/18/2011	POF	1.000313	1.000	190
8/25/2011	POF	1.000304	1.000	191
9/1/2011	POF	1.000332	1.000	192
9/8/2011	POF	1.000305	1.000	193
9/15/2011	POF	1.000328	1.000	194
9/22/2011	POF	1.000285	1.000	195
9/29/2011	POF	1.000302	1.000	196
10/6/2011	POF	1.000305	1.000	197
10/13/2011	POF	1.000301	1.000	198
10/20/2011	POF	1.000318	1.000	199
10/27/2011	POF	1.000373	1.000	200
11/3/2011	POF	1.000351	1.000	201
11/10/2011	POF	1.000323	1.000	202
11/17/2011	POF	1.000302	1.000	203
11/23/2011	POF	1.000267	1.000	204
12/1/2011	POF	1.000367	1.000	205
12/8/2011	POF	1.000350	1.000	206
12/15/2011	POF	1.000347	1.000	207
12/22/2011	POF	1.000342	1.000	208
12/29/2011	POF	1.000336	1.000	209
		209.000700		

Acronym	Date	NAV	Rounded to 3rd Decimal	# weeks
PCOF	1/6/2011	1.000052	1.000	158
PCOF	1/13/2011	1.000090	1.000	159
PCOF	1/20/2011	1.000087	1.000	160
PCOF	1/27/2011	1.000086	1.000	161
PCOF	2/3/2011	1.000088	1.000	162
PCOF	2/10/2011	1.000059	1.000	163
PCOF	2/17/2011	1.000069	1.000	164
PCOF	2/24/2011	1.000070	1.000	165
PCOF	3/3/2011	1.000103	1.000	166
PCOF	3/10/2011	1.000093	1.000	167
PCOF	3/17/2011	1.000092	1.000	168
PCOF	3/24/2011	1.000084	1.000	169
PCOF	03/31/2011	1.000084	1.000	170
PCOF	4/7/2011	1.000122	1.000	171
PCOF	4/14/2011	1.000129	1.000	172
PCOF	4/21/2011	1.000125	1.000	173
PCOF	4/28/2011	1.000143	1.000	174
PCOF	5/5/2011	1.000137	1.000	175
PCOF	5/12/2011	1.000133	1.000	176
PCOF	5/19/2011	1.000128	1.000	177
PCOF	5/26/2011	1.000106	1.000	178
PCOF	6/2/2011	1.000123	1.000	179
PCOF	6/9/2011	1.000116	1.000	180
PCOF	6/16/2011	1.000062	1.000	181
PCOF	6/23/2011	1.000109	1.000	182
PCOF	6/30/2011	1.000092	1.000	183
PCOF	7/7/2011	1.000110	1.000	184
PCOF	7/14/2011	1.000086	1.000	185
PCOF	7/21/2011	1.000072	1.000	186
PCOF	7/28/2011	1.000055	1.000	187
PCOF	8/4/2011	1.000077	1.000	188
PCOF	8/11/2011	1.000017	1.000	189
PCOF	8/18/2011	0.999986	1.000	190
PCOF	8/25/2011	0.999985	1.000	191
PCOF	9/1/2011	1.000008	1.000	192
PCOF	9/8/2011	1.000001	1.000	193
PCOF	9/15/2011	0.999994	1.000	194
PCOF	9/22/2011	0.999978	1.000	195
PCOF	9/29/2011	0.999966	1.000	196
PCOF	10/6/2011	0.999979	1.000	197
PCOF	10/13/2011	0.999965	1.000	198
PCOF	10/20/2011	0.999959	1.000	199
PCOF	10/27/2011	0.999924	1.000	200
PCOF	11/3/2011	1.000008	1.000	201
PCOF	11/10/2011	0.999988	1.000	202
PCOF	11/17/2011	0.999959	1.000	203
PCOF	11/23/2011	0.999939	1.000	204
PCOF	12/1/2011	0.999982	1.000	205
PCOF	12/8/2011	0.999931	1.000	206
PCOF	12/15/2011	0.999941	1.000	207
PCOF	12/22/2011	0.999946	1.000	208
PCOF	12/29/2011	0.999942	1.000	209
		208.991326		

Shadow NAVs of Sample Years
2002, 2005, 2008, and 2011

Date	Acronym	NAV	Rounded to 3rd Decimal	# weeks
Avg Shadow NAV		**1.0000033**	**1.000**	

Acronym	Date	NAV	Rounded to 3rd Decimal	# weeks
Avg Shadow NAV		**0.999958**	**1.000**	

Appendix C

Daily Change in Money Market Fund Assets (millions of dollars)

07/22/11 Institutional & Retail Assets: 2,243,804
08/04/11 Institutional & Retail Assets: 2,147,872

	1-Day Change		
Date	Taxable Institutional	Taxable Retail	Total
07/22/11	-4,049	477	-3,572
07/25/11	-10,347	984	-9,364
07/26/11	-9,187	292	-8,896
07/27/11	-13,870	-924	-14,794
07/28/11	-14,534	-1,764	-16,298
07/29/11	-39,862	-975	-40,837
08/01/11	-37,200	-1,734	-38,934
08/02/11	1,740	2,474	4,214
08/03/11	5,717	752	6,469
08/04/11	25,573	-252	25,320
Cumulative Change	-39,862	-1,764	-40,837

Note: This data contains only taxable funds. Crane data will not correspond to ICI's weekly MMF figures.

Appendix D

Illustration of Smaller Governmental and
Non-Profit Entities
That Would Be Affected By
Application Of The Proposed Rules To Money Funds.

Local Port Authorities

Airport and Aviation Authorities

Public Utilities (Power, Water and Sewage)

Transportation Authorities

County, City, Town and Village Treasurers

Local Development Finance Agencies

Infrastructure Financing Authorities

Local Park and Recreation Systems

County Managers

Local Housing Finance Agencies

Health and Educational Facilities Finance Authorities

Charitable Hospitals

Non-Profit Health Organizations and Initiatives

Public School Boards and School Systems

Independent and Public Colleges and Universities

Community Colleges

College Savings Plans

Fine Arts Commissions and Charities

Preservation and Development Authorities and Charities