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May 25, 2012

Mr. Mohamed Ben Salem
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Money Market Systemic Risk Analysis and Reform Options

Dear Mr. Ben Salem:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries (Federated) on IOSCO's Consultation Report on Money Market Fund Systemic Risk Analysis and Reform Options (IOSCO Report). Federated is one of the largest investment management firms in the United States, managing $369.7 billion in assets as of December 31, 2011. Federated manages $285.1 billion in money market assets, of which $249.3 billion is in U.S. registered money market funds (MMFs) and $6.5 billion is in short-term MMFs domiciled in Ireland and the United Kingdom. In addition, Federated manages $29.3 billion in separate account and sub-advised money market portfolios. Federated provides comprehensive investment management to approximately 4,700 institutions and intermediaries, including corporations, government entities, insurance companies, foundations and endowments, banks and broker dealers.

Federated appreciates the effort made in the IOSCO Report to provide an assessment of the proposed reforms and Federated continues to support prudent regulation that strengthens and enhances MMFs. Federated participated in developing industry recommendations as part of the rulemaking process followed by the United States Securities and Exchange Commission (SEC) in its 2010 amendments to Rule 2a-7 (2010 Amendments) and Federated is ready to play an equally active role in supporting additional MMF reform measures globally. In order to permit preparation of more complete and thoughtful comments on these important issues from a broad cross-section of market participants and the public, we respectfully suggest a longer period be provided for public comment on the IOSCO Report.

Federated, as a participant in the money markets and a sponsor of the Federated MMFs, is interested in the policy discussions in Europe, the United States and elsewhere around the globe on the status and regulation of MMFs. Adoption in 2009 of the revised "Undertakings for Collective Investment in Transferrable Securities" (UCITS), which put in place a more comprehensive framework for the regulation of investment companies within Europe, has been a significant development.[1] The continuing work of the European Securities and Markets Authority (ESMA) and its predecessor, the Committee of European Securities Regulators (CESR), to develop and implement common definitions, standards and requirements for MMFs in Europe has been a major step forward in the

[1] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.

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regulation of MMFs. Federated supports those efforts to further improve the global framework for regulation of MMFs.

Attention should be paid to additional safeguards that have been implemented in trade association practice codes, and in the U.S. as part of the 2010 Amendments, which serve as models for potential further enhancements to the European and global program of MMF regulation. We note as an initial matter that addressing liquidity is the most important area for consideration as part of further reforms to European and global MMF regulation. The 2007-2009 financial crisis was fundamentally a liquidity crisis. Although MMFs did not cause the financial crisis or the liquidity issues associated with the crisis, and were one of the last market sectors to feel the effects of the crisis, strengthening the liquidity of European and global MMFs is in our view the most important remaining agenda item for MMFs reform globally. In the U.S., the 2010 Amendments were swiftly implemented and directly addressed MMF liquidity. Although significant and highly beneficial reforms were also adopted in Europe, those reforms have not as directly addressed liquidity issues as did the 2010 Amendments. Federated believes that broader adoption globally of many of the measures implemented by the SEC as part of the 2010 Amendments would greatly enhance the global MMF industry.

In considering any further reforms, IOSCO should evaluate the effectiveness of: (1) the value of the many changes which have occurred in the global MMF industry since the liquidity crisis, including (i) the 2009 revisions to the UCITS Directive; (ii) the requirements placed upon MMFs and Short-Term MMFs by the May 2010 CESR (now ESMA) guidelines on a "Common Definition of European Money Funds" (ref. CESR/10-049) that went into effect in 2011 (CESR/ESMA Guidelines) that established a common definition of MMFs; (iii) enhanced portfolio requirements required by the Institutional Money Market Fund Association (IMMFA); and (iv) the global impact of the SEC's 2010 Amendments which are followed voluntarily by many MMFs around the world as a "best practice," (2) existing structural mandates requiring distressed constant net asset value (C-NAV) MMFs to float their NAV, and (3) existing disclosures to investors and investors' knowledge of the risks associated with investing in MMFs.

The implementation of reforms addressing liquidity coupled with the changes previously implemented in the global MMF industry since the 2007-2009 financial crisis, address the key risks that regulators are looking to mitigate. Federated also believes that investors are aware, probably now more than ever, that MMFs are in fact "investments" that have risk. Finally, it should be emphasized that C-NAV MMFs in the United States and UCITS C-NAV MMFs are prohibited from using amortized cost when such use fails to fairly reflect the market-based net asset value per share, and have a regulatory mandate to cease the use of amortized cost in such instances and convert to a variable net asset value (V-NAV).

Given all of the above, IOSCO should not recommend any other radical untested reforms that would fundamentally alter and undermine the global MMF industry. In particular, imposing the "reforms" being advocated for MMFs by bank regulators, such as bank-like capital structures and regulatory frameworks, mandatory use of V-NAV, liquidity fees, and hold-back requirements on redemptions of MMF shares, would be particularly damaging to MMFs globally and all who rely upon them. To do so could risk tremendous disruption in short term markets globally, increase assets held in already "too big to fail" banks, increase borrowing costs of businesses and governments and further slow economic recovery, cause movements of liquidity balances to separately managed accounts, repurchase agreements, unregulated fund products, and trigger a host of other unintended consequences.

We note that the issues associated with further changes to MMF regulation are sufficiently complex and in need of detailed economic analysis as to both the efficacy of existing and potential further

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reforms and the direct and indirect effects on the economy of further changes that a majority of the Commissioners of the SEC recently have gone on record to withdraw SEC support of publication of the IOSCO report in its current form.[2]

RESPONSE OUTLINE

We have highlighted below key points on MMF reform for your consideration, in addition to specific responses to each of the questions posed by IOSCO. We are available to discuss any particular response or provide any additional market information upon request.

MONEY MARKET FUNDS

The Big Picture

MMFs have attracted trillions of dollars globally because of the benefits they provide to their shareholders and to the entities they help to finance. MMFs are an important source of funding for the global economy, providing critical, cost effective, financing to every sector of the short term credit markets. MMFs also provide an important and efficient means by which investor liquidity balances are recycled into short-term credit for businesses and governments. MMFs are one of several means by which this process occurs, including repurchase agreements, individually managed portfolios of investments in short-term credit instruments, private and offshore investment funds offered as MMF substitutes, short-term bond funds, and deposits in banks, but in our view MMFs are the most cost-effective and stable means by which this process occurs. Over the past 25 years in the United States alone, we estimate that MMFs higher yields have added over $500 Billion in returns to investors over bank deposits.[3] Because of substantially lower operating costs per dollar of assets (of 200 basis points or more per year), the cost of obtaining financing through MMFs is much lower than is available from commercial banks. The collateral effects of these benefits are improved capital formation and more efficient capital markets, and greater potential for economic growth.

In an era of constrained governmental budgets and severe limits on governments' ability to finance future bail-outs, the simple and very conservative model currently in place in the U.S. to govern MMFs, as enhanced by the 2010 Amendments, should serve as a global model for future regulatory action. MMFs are able to maintain their C-NAV not because of an arbitrary accounting rule, but because their investments are limited to only very short term, very high quality, debt securities. MMFs do not use leverage, and are instead financed 100% by shareholder equity.

Fundamental changes to MMF structure and regulation that make MMFs less attractive and useful will increase systemic risk, not reduce it, and will stifle economic recovery, rather than foster it.

Use of Constant NAV and Amortized Cost

MMFs (we use the term here to refer to both European "short-term" MMFs that operate under the CESR/ESMA Guidelines and U.S. MMFs that must operate under SEC rule 2a-7, as well as other regulated global MMFs that are required to conform to analogous standards for credit quality, short-term portfolio maturity and asset maturity limits) are able to operate using C-NAV due to the very short-term, high quality, diversified investment portfolios, which do not fluctuate to any material

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[2] Statement concerning publication by IOSCO on April 27, 2012 of the "Consultation Report of the IOSCO Standing Committee 5 on Money Market Funds: Money Market Fund Systemic Risk Analysis and Reform Options." (May 11, 2012) available online at http://www.sec.gov/news/speech/2012/spch051112laatapdmg.pdf.

[3] This is a conservative estimate, as it is unlikely that yields on bank deposits would have been as high without competitive pressure from MMFs.

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degree in market value. MMFs in the U.S. and Europe are required to calculate and report share values using market values of portfolio assets (called "shadow prices," essentially a V-NAV used for benchmarking purposes to determine whether C-NAV continues to be an appropriate method of determining share prices), in addition to the amortized cost-based C-NAV.

Use of amortized cost accounting is a part of maintaining a C-NAV. An assumption underlying use of amortized cost accounting is that the portfolio assets will not need to be sold into the market but instead will be held to maturity. Amortized cost accounting takes the historical cost of each portfolio asset, subtracts it from the par value at maturity, divides that difference by the number of days remaining to maturity to find a daily imputed interest amount, and adds to the value each day a daily amount of imputed interest until the maturity date. With very short-term assets, and substantial natural liquidity within the portfolio, cash is available to pay redeeming investors through the normal maturity of portfolio investments, and there is not a need to sell assets into the secondary markets to pay redeeming shareholders, and therefore any minor difference between the amortized cost of the asset and its current "market" price will never be realized. Amortized cost accounting is not unique to MMFs, and commonly is used by banks to account for the values of their loan portfolios. Maintaining sufficient portfolio liquidity is an important aspect of a MMF using amortized cost accounting and a C-NAV.

If the amortized cost C-NAV of shares does not track the market value V-NAV within less than half a cent per share, the board of directors of a U.S. MMF must determine what action to take, which may include movement to market values to calculate NAV and purchase and redemption prices of shares. The CESR/ESMA Guidelines do not contain clear guidance on use and publication of a shadow price based on mark-to-market valuations. Part V of the IMMFA Code of Practice requires its members to perform weekly mark-to-market shadow pricing of portfolios to validate the continued appropriateness of unit and portfolio values that are determined using amortized cost accounting. Part V also requires a process of escalation and board involvement and action when Money Fund unit values determined using mark-to-market portfolio valuations depart by 10 basis points, 20 basis points and 30 basis points from the amortized cost values.

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 MMF's sponsor. A review of these U.S. MMF shadow price calculations shows that C-NAV using amortized cost closely tracks V-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.[4] To put this in perspective, a deviation of a hundredth of one percent is equal to $100 on a million dollars worth of MMF shares. Unless the MMF 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 U.S. MMFs are required to hold under amended SEC Rule 2a-7, and MMFs that comply with IMMFA's Code of Practice, it is now even less likely that either a U.S. MMF or an IMMFA member MMF 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 U.S. MMFs' $1 per share C-NAV is not an accounting trick, but instead reflects the stable market values of the assets owned by a U.S. MMF. A recent study of U.S. MMF shadow prices published by the Investment Company Institute (ICI), shows that, due to the portfolio restrictions in SEC Rule 2a-7, MMF NAVs maintain their values in the face

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

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of credit events, interest rate changes and extraordinary market changes.[5] Even in September 2008, in the worst days of the financial crisis, average U.S. MMF shadow share prices stayed above 99.8 cents per share, and returned to an average NAV of 100.0000 cents within a very short period.[6]

The stability of MMF NAVs is driven by the stable market value of the underlying assets of MMFs. This is why, in 2008, during the worst financial crisis since the 1930s, only one U.S. MMF "broke a buck" (the Reserve Primary Fund which returned to shareholders over 99 cents per dollar) and over 800 U.S. MMFs did not "break a buck," and the overwhelming majority of those did not require any sponsor support to maintain C-NAV of $1 per share.

The 2010 Amendments to SEC Rule 2a-7 have further reduced price movements from MMF portfolios. As of year-end 2010, for example, 50% of "prime" U.S. MMFs' reported shadow prices were 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. U.S. MMF "shadow prices" must move below 99.5 cents per share or above 100.5 cents per share to cause the MMF to "break a buck."[7] Nonetheless, U.S. MMFs continue to warn investors that a MMF may not always be able to maintain a C-NAV. Similarly, the CESR/ESMA Guidelines require specific disclosures to investors in European MMFs of the differences between a MMF investment and a bank deposit, and that the fund's objective to preserve capital is not a capital guarantee, as well as certain other disclosures regarding the risk profile and maturity of the MMF's portfolio.

Nor is there a lack of transparency of the valuation methods used by U.S. MMFs. MMFs 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 MMF'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 MMF investors. Moreover, if the C-NAV of MMF shares calculated using the amortized cost method departs materially (0.50 cents per share or more) from the "shadow price" V-NAV calculated using mark-to-market values, the MMF is required to notify the SEC and its Board must take appropriate action.

Requiring all MMFs to float their NAV, when C-NAV no longer is an appropriate reflection of the value of the fund shares, is not a novel approach. In fact, not only is it not novel, it has been a regulatory requirement for over forty years. All MMFs, whether UCITS short-term MMFs or MMFs in the United States subject to Rule 2a-7, are essentially required to float the NAV when there is a material discrepancy between the market value of the instruments held by the MMF and the value calculated according to the amortized cost method, whether at the individual or at the fund level.

Notwithstanding the existing requirement for MMFs to float their NAV in certain circumstances when C-NAV no longer appropriately represents the value of shares, the IOSCO Report appears to assume that a market in which all MMFs have a V-NAV would continue to exist in any material form. In Federated's view, this assumption is not accurate. From the investing public's perspective, a MMFs utility is in its provision of daily liquidity at par and, as evidenced by asset levels, investors do not consider V-NAV MMFs to be a viable global alternative to C-NAV MMFs. With this in mind, it becomes apparent that requiring C-NAV MMFs to convert to V-NAV MMFs would essentially entail the elimination of the MMF market as it exists today.

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[5] ICI Research Report, Pricing of U.S. Money Market Funds (Jan. 2011).
[6] Money Fund Regulatory Changes Post Financial Crisis, 2011 ICI Money Market Funds Summit (May 16, 2011) (slides available on ICI website).
[7] *Id.*

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Changes on par with the 2010 Amendments should be adopted to enhance and strengthen MMFs globally.

The cumulative effect of the 2010 Amendments has been to improve the safety and liquidity of MMFs in the United States. The 2010 Amendments require MMFs to have procedures for assuring that they maintain adequate liquidity to meet reasonably anticipated redemptions. These procedures must include "know your customer" measures for gauging the liquidity risks posed by individual shareholders or types of shareholders. To assure adequate liquidity, ten percent of a MMF's portfolio must consist of Daily Liquid Assets (Treasury securities and securities that may be repaid within one business day) and another twenty percent must consist of Weekly Liquid Assets (short-term government agency discount notes and securities that may be repaid within five business days). Further, a MMF may not invest more than five percent of its portfolio in Illiquid Securities.

The 2010 Amendments also reduced the weighted average maturity (WAM) permitted by Rule 2a-7 from 90 to 60 days and imposed a 120-day limit on a MMF's weighted average life (WAL). Additionally, all MMFs now are subject to a uniform limit of three percent on the acquisition of Second Tier Securities, with not more than one half of a percent of Total Assets permitted in any issuer of Second Tier Securities. The SEC also reinstituted diversification requirements for all repurchase agreements not secured by Government Securities and requires funds to determine the creditworthiness of every counterparty.

The 2010 Amendments went on to require funds to conduct periodic stress tests and report the results to their board of directors. These stress tests quantify the changes in interest rates, spreads, credit ratings and redemptions that could cause a MMF to no longer maintain a stable share price. The stress tests improve the directors' ability to oversee and manage the risks taken by their fund.

The SEC increased the transparency of MMFs by requiring them to provide updated portfolio information on their websites as of the end of each month. Finally, the SEC adopted Rule 22e-3, which allows the board of directors of a liquidating fund to suspend redemptions. This rule assures a fair and orderly resolution of any fund that can no longer maintain a stable NAV. Shareholders in a liquidating fund will receive pro rata distributions of cash as rapidly as the portfolio can be liquidated. Even in adverse market conditions, this should not be an extended period, given the limitations on a fund's WAM and WAL and the required levels of Daily and Weekly Liquid Assets.

Many of the changes included in the 2010 Amendments have been put in place either through (i) the revised Undertaking for Collective Investment in Transferable Securities (UCITS IV) implemented in July of 2011[8] or (ii) requirements for fund management implemented by industry trade associations, in particular IMMFA's Revised Code of Practice.[9]

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[8] The UCITS IV directive was implemented effective 1 July 2011 and the CESR Guidelines provided a "transitional period" for existing funds to comply by 31 December 2011. This means that most MMFs have only been required to operate under the new rules for a very short time period. We believe that the benefits of these new requirements have not been properly assessed, and additional time is needed to evaluate the effectiveness of these changes.

[9] In June of 2011 IMMFA approved wide ranging revisions to its Code of Practice which closely tracked the 2010 Amendments. IMMFA funds are now required to maintain daily liquid assets of ten percent and weekly liquid assets of twenty percent. Additionally, funds are required to maintain liquidity policies designed to address a fund's specific liquidity needs. The IMMFA revisions to its Code of Practice also indirectly increased a fund's liquidity by shortening a fund's WAM and WAL and provided greater transparency through the provision of better and more timely portfolio information to investors.

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There are many reforms that can be implemented to strengthen and enhance MMFs that will not severely increase the risks to the financial markets. Given that it was a liquidity crisis in 2008, IOSCO should first and foremost consider recommending the implementation of liquidity minimums on par with the 2010 Amendments. Secondly, IOSCO should consider recommending reforms to better align the global MMF market with the SEC's 2010 Amendments. The 2010 Amendments have been tested and have proven to increase the safety and stability of MMFs and changes to better align the global market to revised 2a-7 would strengthen and enhance the global MMF industry. It has only been a year since implementation of UCITS IV. More time is needed to gather information and analyze the effectiveness of existing reforms before further changes are considered.

Serious Risks of Imprudent MMF Reform

Imprudent reform to the MMF industry entails not only the risk of serious unintended consequences, but also potentially systemic risk to the financial markets generally. We highlight a few of the key risks below and further expand on the risks of imprudent MMF reform in response to Questions 3, 5, 6, 10, 11, 12, 13, 15, 18, 19, 23, and 24.

The Elimination of MMFs would create a credit crunch in the short-term funding markets. A wholesale shift of cash from MMFs to banks would require banks to raise tremendous amounts of capital. To attract this capital, banks would have to make more profitable investments than the short-term obligations typically held by MMFs. This means that borrowers will find it harder to obtain short-term financing from banks than they currently do from MMFs and that short-term interest rates will rise. In other words, eliminating MMFs would create a "credit crunch" for high quality short-term borrowers while increasing the propensity of systemically significant banks to make riskier investments. This is scarcely the formula for an economic recovery or for financial stability.

The elimination of MMFs will increase the level of risk in the financial system. Cash that was not shifted to bank deposits after the elimination of MMFs would likely flow into unregulated alternative constant value products. Institutions would lose the benefit of professional management and diversification of the cash investments.

The elimination of MMFs would make systemically significant banks even more significant. Investors leaving MMFs would look primarily for other constant value investments. This means that a substantial portion of the cash currently held in MMFs would flood into banks as deposits. If MMFs are eliminated via regulation, these banks are unlikely to redirect this cash into financial products they do not control. Elimination of MMF will therefore increase the size of banks already found to pose systemic risks to the global financial system.

FEDERATED'S RESPONSES TO IOSCO QUESTIONS

Question 1: *Do you agree with the proposed definition of money market funds? Does this definition delimit an appropriate scope of funds to be potentially subject to the regulatory reform that the FSB could require to put in place, with an objective to avoid circumvention and regulatory arbitrage?*

Response 1:

Federated believes that the proposed definition of MMFs does not adequately reflect the importance of a constant value. The allusion to "preservation of capital" does not capture the absolute character

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of this objective for MMFs: namely, that a MMF seeks to preserve capital by maintaining a constant value. MMFs do not seek any degree of capital appreciation, other than through the accretion of income, or loss. In Federated's view, the term MMF should be limited to funds that meet stringent requirements for portfolio credit quality, diversification, very short maturity and liquidity that are appropriate to maintaining a constant value. For example, U.S. ultra-short bond funds should not be considered MMFs, and European MMFs that are not "short term" MMFs under the CSER/ESMA Guidelines, in Federated's view, should not be brought within the definition of MMF. To do so muddles both investor understanding of the product and the policy debate over regulation of MMFs.

The essential importance of a C-NAV has been demonstrated in the U.S. market, where recent investor surveys show that all types of investors would stop using or significantly curtail their use of MMFs if they had a V-NAV. Federated realizes that V-NAV funds comprise a substantial part of the European market. In competing with V-NAV funds, however, Federated has found that most investors do not expect V-NAV funds to actually fluctuate. The significant redemptions from V-NAV MMF during 2007-2009 financial crisis are consistent with such expectations. This evidence demonstrates that investors do not view truly V-NAV funds as substitutes for C-NAV MMFs.

IOSCO's use of an overly broad definition of MMFs creates an unduly broad range of policy options. Once it is understood that principle stability under normal market conditions is an essential feature of MMFs, proposals to "float" the NAV can be properly understood as proposals to ban, rather than reform, MMFs. This is not a legitimate policy option for anyone who would purport to preserve the tremendous benefits of MMFs. It also provides a bright line for determining whether a competing product is circumventing MMF regulations.

Question 2: *Do you agree with the description of money market funds' susceptibility to runs? What do you see as the main reasons for this susceptibility?*

Response 2:

Federated does not agree with the characterization of MMFs as being susceptible to runs. In over forty years, there has been only one run on U.S. prime MMFs. It was a consequence of a general flight to quality at the height of the 2007-2009 financial crisis. It occurred 20 months into the crisis, and long after many other trading markets had experienced illiquidity events and a large number of prominent financial institutions had become insolvent.

There have been only two instances of a U.S. MMF breaking a dollar. The first, in 1994, did not produce a run on MMFs, and generally was not noticed by the markets. The second, involving the Reserve Primary Fund, coincided with the redemption of approximately 15% of the assets held by U.S. prime MMFs during the week of September 15, 2008. One MMF breaking a dollar in 1994 had no impact on other MMFs, while prime MMFs experienced substantial redemptions at the time the Reserve Primary Fund broke a dollar in 2008. Some commentators have assumed that, because the redemptions from prime MMFs coincided with the Reserve Primary Fund breaking a dollar, the Reserve Primary Fund "caused" the broader redemptions. A comparison of the market conditions in 1994 and 2008 undercuts this assumption. In 1994, the Community Bankers MMF broke a dollar because it held derivative securities that were later found by the SEC to violate Rule 2a-7. Although other MMFs had held similar derivative securities, their managers had cleared these securities from the MMFs' portfolios before Community Bankers broke a dollar. The market therefore viewed Community Bankers as an isolated incident, with no implications for other MMFs or for the market in general. Shareholders did not run from other MMFs because they had no reason to suspect that another MMF would break a dollar.

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In contrast, the 2007-2009 financial crisis was marked by a complete loss of confidence in the financial system. The large redemptions from MMFs coincided with the rescue of AIG, the failure of Lehman Brothers, the arranged merger of Merrill Lynch with Bank of America and many other financial shocks. At the same time, there was a run on many U.S. banks, including Washington Mutual and Wachovia. Many investors were uncertain as to whether other financial institutions would fail and whether they would receive government support. Rather than risk a default, these investors sought to shift their cash to government securities, draining liquidity from the credit markets. Thus, the credit markets were completely frozen before the Reserve Primary Fund tried to liquidate its portfolio.

Other MMFs were not immune to this market turmoil. Their shareholders also fled to government securities, as evidenced by the fact that nearly two-thirds of the assets redeemed from prime MMFs were reinvested in government MMFs. Redemptions were motivated by concerns regarding the issuers of securities held by prime MMFs and not MMFs themselves. This suggests that the shareholders redeemed shares from prime MMFs in order to eliminate credit risk by shifting their cash to government securities.

Thus, the record over the past forty years includes one U.S. MMF that broke a dollar without causing a run, and one run that, although it coincided with a fund breaking a dollar, was caused by a general investor flight to quality in response to the unprecedented financial crisis that was not caused by MMFs and was not limited to MMFs. It does not indicate that MMFs are susceptible to runs.

Federated also does not agree with the suggestion that that use of C-NAV causes MMFs to be subject to runs. Poor construction and management of investment portfolios, and insufficient liquidity, can cause a MMF to break a buck in difficult market conditions and lead to shareholder redemptions from that MMF. Appropriate portfolio construction and management, and robust natural liquidity, can protect a MMF from being subject to, or harmed by, substantial shareholder redemptions. In over forty years, there has been only one run on U.S. prime MMFs, and it occurred during a general flight to quality at the height of the 2007-2009 financial crisis, and prior to the SEC's 2010 Amendments which strengthened portfolio liquidity requirements, maturity limits and credit quality at U.S. MMFs.

During the 2007-2009 financial crisis, V-NAV MMFs in Europe experienced investor withdrawals roughly equivalent to withdrawals from European C-NAV MMFs.[10] Similarly, in the U.S., MMFs (which are analogous to Short-Term MMFs under the CESR/ESMA Guidelines) 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 must use a V-NAV. U.S. ultra-short bond funds are analogous to European MMFs under the CESR/ESMA Guidelines, and similarly are required to use V-NAV to price fund shares. U.S. ultra-short bond funds are not subject to the tight investment and credit quality restrictions, maturity limits or liquidity requirements that apply to U.S. MMFs under SEC Rule 2a-7. The weighted average maturity of ultra-short bond funds is

[10] J. Fisch, & E. Roiter, "*A Floating NAV for Money Market Funds: Fix or Fantasy?*" at n.183 (2011)("Fisch & Roiter") ("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. 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).

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approximately 12 months, as compared to 60 days or less for a U.S. MMF.[11] Although they have a higher yield than U.S. MMFs, ultra-short bond funds are not as popular with U.S. investors or with commercial users of MMFs, with only $36 billion in assets as of year-end 2010,[12] as compared to $2.6 trillion invested in U.S. MMFs. Significantly, despite using V-NAV to set share prices for purchases and redemptions, U.S. ultra-short bond funds faced investor redemptions in the Fall of 2008 at levels higher than those experienced by MMFs.[13] Certain ultra-short funds reported significant reductions in the NAVs during the crisis. One ultra-short fund suffered such heavy redemptions during a one-week period that it was forced to liquidate with support from its adviser; another ultra-short bond fund's net assets fell from $13.5 billion to $1.8 billion in an eight-month period; and a limited duration fund was forced to sell 50% of its assets over a one-week period to cover expected redemptions. [14]

History illustrates that there is no real difference between C-NAV MMFs and V-NAV MMFs when it comes to shareholder behavior.[15] Cash investors run when they are convinced that by selling today they will avoid losses tomorrow, or if they think they will not be able to get their cash out when needed in the near term. Their expectation becomes self-fulfilling as selling drives down prices and buyers stay on the sidelines waiting for the market to bottom. This happened repeatedly during the financial crisis (e.g., to SIVs, CDOs and auction rate securities). MMFs attracted more attention because of their size, but they proved more resilient during the crisis than any other financial institution (including banks).

Whether V-NAV prevents runs is an empirical question, and the data shows overwhelmingly that it does not. What stops a run is liquidity. The objective of reducing runs on MMFs, and thereby reducing systemic risk, would not be met by requiring MMFs to use V-NAV.

Under the 2010 Amendments, a U.S. MMF is required to have a minimum percentage of its assets in highly liquid securities so that it can meet reasonably foreseeable shareholder redemptions.[16] Under

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[11] Fisch, & Roiter, supra at n.183 ("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.

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

[13] Fisch & Roiter, supra 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." (c*iting* 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).

[14] See In the Matter of Evergreen Investment Management Company, LLC and Evergreen Investment Services, Inc., Administrative Proceeding File No. 3-13507 (June 8, 2009); In the Matter of Charles Schwab Investment Management; Charles Schwab & Co., Inc.; and Schwab Investments, Administrative Proceeding File No. 3-14184 (Jan. 11, 2011); and In the Matter of State Street Bank and Trust Company, Administrative Proceeding File No. 3-13776 (Feb. 4, 2010)

[15] According to information provided by Strategic Insight, when measured as a percentage of net assets, total net redemptions from V-NAV money market funds in Europe in September and October 2008 were only 1% less than total net redemptions from stable NAV money market funds during the same period.

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

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new minimum daily liquidity requirements applicable to all taxable U.S. MMFs, 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 MMFs, 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). Prior to the 2010 Amendments, Rule 2a-7 did not include any minimum liquidity requirements.

The minimum of 30% 7-day liquidity required to be held by U.S. MMFs under revised rule SEC 2a-7 is double the percentage of assets redeemed from U.S. MMFs during the worst week in the 2007-2009 financial crisis -- the week that Lehman Brothers failed and the Reserve Primary Fund "broke the buck." During the market turmoil in the Summer of 2011, involving European debt and U.S. government budget impasse, U.S. MMFs had more than sufficient liquidity to meet substantial investor redemptions, without running into cash shortfalls or "breaking the buck."

Similar to SEC Rule 2a-7, Part VI of the IMMFA Code of Practice requires MMFs managed by its members to maintain not less than 10% of portfolio assets in overnight liquid assets and not less than 20% of portfolio assets which mature within five business days. As under SEC Rule 2a-7, the IMMFA Code of Practice allows sovereign debt that the member determines is traded in a liquid market to be treated as meeting this standard, even though it may have a maturity date more than five business days away. During the market turmoil in the Summer of 2011, European MMF subject to the IMMFA Code of Practice, like U.S. MMFs, had more than sufficient liquidity to meet substantial investor redemptions, without running into cash shortfalls or "breaking the buck."

CESR/ESMA Guidelines require Short-Term MMFs to take into account the liquidity considerations when making portfolio investments, and require stress-testing of portfolios taking into consideration liquidity needs, but currently do not include a clear numerical requirement for minimum liquidity.

In considering areas for further enhancements to the current program of MMF regulation for Europe and globally, the Rule 2a-7 liquidity requirements introduced in 2010 by the SEC, and those in place under the IMMFA Code of Practice, should be reviewed. This high level of liquidity provides two key protections for MMFs during a crisis. First, what stops a run is liquidity.[17] When investors who request a redemption are quickly paid in full, no redemption queue forms, and investors do not panic and all suddenly demand to redeem shares at once. Second, when a MMF has liquidity available from normal portfolio maturities to meet redemptions, it does not need to sell portfolio assets prior to maturity to raise liquidity (which is a key assumption that underpins the use of amortized cost accounting to value portfolio assets). This, in turn, protects the MMF from having to incur losses from sales of performing notes into an illiquid money market, and protects the money market from being locked up by a large amount of paper being sold into the market.

Question 3: *Do you agree with the description of the role of money market funds in short-term money markets? To what extent this role may create risks for short-term funding markets and their participants? Are there changes to be taken into account since the 2007-2008 experience? What are the interdependencies between banks and MMFs and the risks that are associated?*

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[17] 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.

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Response 3:

Federated agrees that MMFs are very important participants in the short-term funding market. Federated does not, however, agree with the suggestion that MMFs cause or exacerbate instability in the short-term funding markets.

First, it should be noted that a run on an individual fund or even a fund complex does not present a systemic risk to the broader financial market. There are many MMFs participating in the short-term funding markets, and many other types of institutional investors in these markets, and the issuers in these markets normally have other sources of funding that can be drawn upon when needed. So long as investors are withdrawing from a MMF that broke a dollar, rather than from the general short-term credit market, other market participants should be able to provide the needed liquidity.

Second, the key to preventing runs at MMFs is requiring them to maintain robust levels of natural liquidity. With sufficient liquidity, MMFs are less susceptible to being caught up in or contributing to the expansion of a financial panic in the short-term funding markets.

Third, short-term funding markets experienced liquidity crises from time to time long before MMFs existed or were a significant participants in the money markets. The existence of MMFs did not create the potential for illiquidity in short-term funding markets, and doing away with MMFs as we currently know them will not protect the short-term funding markets from illiquidity during a future financial crisis. Instead, investors will invest liquidity balances into short-term credit markets through other alternative means, such as separately managed accounts investing directly in commercial paper and other money market instruments, repurchase agreements, bank deposits, private investment funds, and ultra-short bond funds. In a financial crisis, investors will still "flee to quality" and withdraw funding from markets they perceive as involving higher risks. The concern that, in a crisis, MMFs withdraw funding from the underlying money markets by choosing not to roll over investments in commercial paper, is equally applicable to each of these other alternatives by which investors hold liquid assets, whose managers — bound by fiduciary duties and contractual obligations — liquidate positions and stop rolling over investments in commercial paper and other money market instruments to meet client directions, investor redemptions, reduce the risk exposure, and curtail possible portfolio losses. By imposing untested structural "reforms" on MMFs, regulators may simply cause the large-scale diversion of liquidity balances from MMFs into other less transparent investment vehicles, increasing the likelihood of dislocations in short-term funding markets.

The example often cited for MMFs having a destabilizing impact on short-term markets has been the Reserve Primary Fund's "breaking a buck" on September 17, 2008, during the financial crisis. Before that event occurred, the global economy had been in a deep recession for 20 months, and confidence of market participants was deeply shaken by failures and forced mergers in the days, weeks and months preceding that event. Liquidity dried up across many markets well in advance of the Reserve Primary Fund breaking the buck, and banks and other issuers were experiencing silent runs on funding well before trouble hit the Reserve Primary Fund. MMFs did not cause the financial crisis, and did not cause the sharp contraction of liquidity that occurred during the crisis.

During the 2007-2009 financial crisis, the U.S. Federal Reserve Board, Department of the Treasury, and FDIC invested or extended credit through an array of programs to infuse cash into the banking system and various businesses and markets.[18] The portion that related to MMFs was short in duration, highly profitable to the U.S. government, and a small part of a massive injection of liquidity into

[18] Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of Its Expiration*, at 145-146 (Sept. 16, 2010).

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banks, Government Sponsored Enterprises and the financial markets by the U.S. government during the crisis, the vast majority of which had no relation to MMFs. The Federal Reserve disclosed that its total discount window loans to banks unrelated to MMFs during the crisis aggregated to over $7.7 trillion dollars, of which $1.2 trillion was outstanding at its peak. All in, the U.S. 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.[19] These programs were designed to provide liquidity to a broad range of institutions and markets due to extraordinary market conditions, and the part involving MMFs was a very small part of these programs.

There should be no disputing that MMFs strengthen our credit markets. We believe that the track record of MMF managers surpasses that of every other financial institution in terms of the quality of their credit analysis. Certainly a smaller percentage of MMFs had a much smaller exposure to defaulted securities during the financial crisis than banks, investment banks or insurance companies. In February 2007 Federated and many other major mangers reviewed their MMFs' exposures to subprime mortgages (primarily indirect exposures to issuers engaged in subprime lending activities) and reduced these exposures to the greatest practical extent. The rating agencies did not start to place subprime securities on credit watch until July 2007, at which point most market participants started to conduct reviews that MMFs had completed months earlier.

MMF managers also maintained liquidity in their funds well beyond normal levels going into September 2008. Although no one could have foreseen the depth of the crisis that followed Lehman's bankruptcy, MMF managers were better prepared for it than other market participants.

Reducing the assets managed through MMF, which will be a necessary consequence of a mandatory V-NAV, will certainly weaken the credit markets and increase systemic risk. As the investor representatives indicated during the President's Working Group Roundtable, they are not equipped to engage in the in-depth credit analysis performed by MMF managers, and will be forced to concentrate their investments in fewer issuers. It is also reasonable to assume that direct investors will rely more heavily on credit ratings. The increased concentration will increase the systemic importance of large financial institutions and the consequences of errors made by the rating agencies. Finally, over half of the industry's current assets are managed by subsidiaries of bank holding companies already deemed systemically important by the Dodd-Frank Act. Most of these assets will probably shift to bank deposits, common and collective trust funds and other stable value products, which will increase the systemic risks posed by these institutions.

Question 4: *What is the importance of sponsor support for MMFs? What is the respective percentage of banks versus non-bank sponsors in the MMF industry? Are there differences among MMFs depending on their sponsors? What are the potential systemic risks of support or protection against losses by sponsors?*

Response 4:

MMF shares are investments. Sponsor support should not be assumed or relied upon by investors or required by regulatory policy. In limited, extraordinary circumstances a sponsor may voluntarily

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[19] *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/20089711172217483.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/

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choose to provide support to a MMF in several ways, such as, for example, through purchase by the sponsor of an illiquid or troubled security out of a fund's portfolio. The SEC has cited a number of incidences of sponsor support during the 2007-2009 financial crisis, but the vast majority of MMFs did not receive such support. While sponsor support has provided benefits for fund investors, some regulators have referred to incidences of sponsor support of MMFs as a risk, because of the perceived danger that investors may rely on such support when it in fact is not guaranteed.[20] Federated believes that investors (and as discussed below in response to Question 8, rating agencies) should not make decisions based upon the MMF sponsor or the potential for sponsor support, but instead should consider the quality of the investment portfolio of the MMF. The assumption that investors do not understand that MMFs have investment risks is simply incorrect. Disclosures on MMF prospectuses in the U.S. are required to make clear that:

> 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.

The CESR/ESMA Guidelines for European MMFs similarly require disclosures to MMF investors of the differences between a MMF investment and a bank deposit, and that the MMF's objective to preserve capital is not a capital guarantee, as well as other disclosures regarding the risk profile and maturity of the MMF's portfolio.

Question 5: *Do you agree with the description of MMF benefits? Are there other benefits of MMFs for investors than those outlined in this presentation? What are the alternatives to MMFs for investors? How has investor demand for MMFs recently evolved? What would lead investors to move away from MMFs to other financial products?*

Response 5:

In addition to the benefits of MMFs noted earlier in our response, we note the following contributions made by MMFs cannot be seriously disputed:

- MMFs have increased the returns to retail cash investors in the U.S. by at least $225 billion since 1985, when the ICI first started tracking MMF assets and yields. This estimate is based on the additional yield paid by the average retail MMF[21] over the rate paid on the average money market deposit account by banks, times the assets held in such MMF. It actually underestimates the contributions of retail MMFs, because (a) without competition from MMFs, interest rates on money management accounts would have been lower and (b) not all retail cash investors had sufficient balances to qualify for interest bearing bank accounts or for accounts paying the interest rate used in our calculations.

- It is reasonable to assume that MMFs have had a comparable positive effect on institutional cash investors, although this is more difficult to quantify because some (although by no means all) institutional investors have access to cash investments

[20] *See* Letter from Federal Reserve Board Chairman Ben S. Bernanke to Anthony J. Carfang, Treasury Strategies, Inc. (Dec. 9, 2010); Letter from Acting Comptroller of the Currency John Walsh to U.S. Congressman Gregory W. Meeks (Feb. 17, 2011).

[21] The ICI did not track assets separately for retail and institution money market funds until 1996. In 1996, over 63% of money market fund assets were held in retail funds. For the period from 1985 through 1995, we made the conservative assumption that 70% of money market fund assets were held in retail funds.

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other than money market deposit accounts. The fact that so many institutions have used MMFs so consistently demonstrates, however, that the returns provided by MMFs exceeded those provided by any of these alternatives. This is not surprising—direct investment in money market instruments (other than bank instruments) requires personnel to analyze, select and trade the instruments, custodians to hold the instruments and a substantial amount of bookkeeping. Furthermore, institutions that are not "qualified institutional buyers" cannot participate in the market for Rule 144A securities, which typically provide better returns than other types of money market instruments. Also, it is likely that many institutional investors lack the operational infrastructure and expertise to participate in the repo markets. Finally, few institutions manage cash positions large enough to obtain the level of diversification or the same price and quality of execution as a professional manager with tens, if not hundreds, of billions of dollars of cash assets under management. Therefore, it is reasonable to assume that the total benefit of MMFs to investors, both retail and institutional, since 1985 was on the order of $500 billion in the U.S. alone.

- MMFs have substantially lower overhead and operating costs per dollar of balance sheet assets than do banks, by 200 - 300 basis points per annum. This permits MMFs to invest in lower-risk portfolio assets that return lower interest rates than banks are profitably capable of investing. This lower cost structure makes funding available to high credit quality issuers in the short-term markets at a much lower interest rate than is available from banks.

- MMFs have lowered the average cost of funding for companies, states, municipalities and governments. Moreover, MMFs have been instrumental in the growth of the commercial paper market over the last forty years. This impact is also hard to quantify, but here again, companies would not issue commercial paper if it were not advantageous relative to bank loans or other funding sources.

- MMFs would seem to have had an even bigger impact on state and municipal issuers. Prior to the advent of MMFs, these issuers typically obtained short-term financing through banks at less advantageous rates. Institutional demand for short-term tax exempt obligations is limited[22] and retail distribution is prohibitively expensive.

- MMFs historically provide between a quarter to a third of the funding available in the tri-party repo market.[23] Repo is used primarily to finance securities held in inventory by dealers, and thereby contributes directly to the efficiency of the capital markets. In particular, repo contributes to the unparalleled efficiency and liquidity of the market for U.S. Treasury and agency securities, which significantly reduces borrowing costs.

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[22] Corporations cannot deduct expenses incurred to carry tax exempt obligations beyond a 1% "de minimis" amount. Historically, those corporations that have invested directly in tax exempt obligations have not exceeded this amount, so they could not replace the funding provided by tax exempt money market funds. Other institutional investors (such a pensions, charities and foreign institutions) are exempt from taxation and do not invest in tax-exempt obligations. Insurance companies typically invest in longer term tax exempt obligations.

[23] New York Federal Reserve Staff Report No. 477, "The Tri-party Repo Market before the 2010 Reforms," (Nov. 2010).

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- MMFs provide an efficient, alternative to banks for investors as a means of intermediating liquidity balances. The existence of MMFs makes the short-term funding market more robust and deep, and serves as a counterbalance to limit further growth in size of the largest systemically important banks that depend upon government support to maintain their solvency.

- Historically, MMFs have been a gateway to other mutual funds. Most individuals save money before they begin to invest. MMFs allow individuals to use a mutual fund as a savings vehicle, by providing ready liquidity and a stable price under most market conditions. Individuals who invest in MMFs are exposed to the advisers' other mutual funds, and may become more comfortable moving to these funds once they have achieved their targeted savings. They may also be more inclined to invest directly in stock markets than individuals that never venture beyond their bank account and certificates of deposit. In addition, individuals investing in MMFs gain access to the general investor education materials provided by the funds' investment advisers.

All of these factors have contributed significantly to capital formation, improved returns for investors, encouraged savings, and lowered rates for borrowers. Dynamic, efficient and transparent markets improve the allocation of capital and increase economic growth. In light of all this, it seems certain that MMFs have contributed, and continue to contribute, in a meaningful way to the growth of the global economy.

A mandatory change to a V-NAV would lead investors to move away from MMFs.

Federated believes that there is ample direct evidence of the likely effect of a V-NAV on the demand for MMFs. From January 2009 (which was the high point for MMF assets) through October 2010, investors redeemed nearly $1.1 trillion from US MMFs.[24] The primary reason for these redemptions is obvious—this year the average MMF will return only 4 basis points.[25]

At this time, when compared to other mutual funds, MMFs' primary value to investors is diversification and their maintaining a C-NAV. There is no more plausible explanation for why globally investors maintained approximately $4.69 trillion in MMFs than the paramount importance of a C-NAV to these investors. It is unlikely that investors would continue to invest these cash balances in a mutual fund that did not offer a C-NAV. A recent survey of corporate treasurers conducted by Treasury Strategies Inc. indicates that a shift to a mandatory V-NAV for MMFs will result in a large percentage of institutional investors shifting investments out of MMFs and into other means of holding liquidity balances.[26]

This means that nearly all of the approximately $4.69 trillion currently invested in MMFs globally would move to other stable value investments if MMFs were eliminated. In other words, requiring MMFs to float their NAVs would substantially eliminate the current demand for the funds.

It may be suggested that investors who have been redeeming their shares since January 2009 have shown a willingness to take market risks and, under normal market conditions, would continue to invest in MMFs with V-NAVs. The data suggests, however, that much of this money was moved to

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[24] Investment Company Institute Money Market Fund Assets Historical Data (Dec. 9, 2010), available at http://www.ici.org/info/mm_data_2010.xls.
[25] Money Fund Intelligence at 2 (Dec. 2010).
[26] Treasury Strategies, Inc, "Money Market Fund Regulations: The Voice of the Treasurer" (April 2012), available online at: http://www.ici.org/pdf/rpt_12_tsi_voice_treasurer.pdf.

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bank deposits. A survey by the Association of Financial Professions shows that bank deposits and MMFs have traded places over the last two years. In 2008, surveyed professionals allocated 39.4% of their short-term investments to MMFs and 25% to bank deposits; in the 2010 survey, bank deposits garnered 41.5% of short-term investments as compared to 25.1% for MMFs.[27] This may account for some of the $668 billion increase in commercial bank deposits from January 2009 through October 2010.[28] Therefore, it would probably be optimistic to assume that, under normal market conditions, demand for MMFs without C-NAVs would reach even $500 billion, which is less than 15% of the assets held in MMFs at the beginning of 2009.

Question 6: *Do you agree with the proposed framework comparing money market funds and bank deposits? Are there other aspects to consider?*

Response 6:

Federated does not believe MMFs are similar to banks. Federated agrees that MMFs are dissimilar to banks in that MMFs do not use leverage, and that investors in MMFs are shareholders, not creditors, of the MMF. MMFs are financed with 100% equity capital and do not use leverage. Unlike bank depositors, MMF shareholders do not have a contractual right to obtain a set principal amount upon redemption, they do not have a right to "put" shares back to the fund at a guaranteed price, and no one guarantees or insures the value of their investment in a MMF. MMFs seek to maintain a constant net asset value per share by very conservative investment in a diverse portfolio of high quality, very short-term investments that are highly liquid, have known values, and are marketable. MMFs maintain liquidity by holding natural liquidity within the portfolio of the fund of cash, overnight assets and very short-term assets.

Banks, in contrast, are financed almost exclusively by debt in one form or another (deposits and other borrowings), with a very small tranche of capital. Banks invest medium and long term, primarily in illiquid, hard to value, unmarketable assets. Banks maintain their liquidity by government support in three forms: (1) government-sponsored deposit insurance which keeps smaller depositors from "running" in a crisis and helps stabilize funding of the bank; (2) access to the central bank lending window and other specialized government lending and liquidity programs; and (3) occasional government injections of capital or other support in a crisis, particularly for large "too big to fail" institutions.

MMFs are not banks or "bank-like." The suggestion that MMFs are banks or "bank-like" reflects a fundamental misconception of MMFs and the role they play in the financial markets.

Federated also notes that a transformation of MMFs from their current structure, to a "bank like" capital structure and regulatory framework, would fundamentally alter the rights and obligations of MMF shareholders and could not be effected without their consent. As discussed below in response to Question 13, there is no reason to believe such a transformation could successfully be accomplished.

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[27] 2008 AFP Liquidity Survey at 15 (June 2008), http://www.afponline.org/pub/pdf/2008_AFP_Liquidity_Survey.pdf, and 2010 AFP Liquidity Survey at 15 (June 2010), http://www.afponline.org/pub/pdf/2010_AFP_Liquidity_Survey.pdf.

[28] Federal Reserve Report H8 Assets and Liabilities of Commercial Banks in the United States (Dec. 20, 2010), available at https://www.federalreserve.gov/releases/H8/default.htm.

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Question 7: *Are there other similarities or differences between CNAV and VNAV funds which would be useful for the analysis? Is there evidence (based on representative samples) showing differences in the fluctuation of the funds' NAV depending on their model? What is the extent of the use of amortized cost accounting by VNAV funds? Has this practice evolved over time?*

Response 7:

Other than as discussed elsewhere in response to the other questions, Federated does not have additional information comparing V-NAV and C-NAV funds that is responsive to Question 7.

Question 8: *What is the importance of ratings in the MMF industry? What is the impact of the monitoring function of credit rating agencies for MMFs? What are the potential systemic risks associated with ratings in the MMF industry?*

Response 8:

Credit rating agencies affect MMFs in two ways: through ratings of the MMFs themselves, which are used by some investors to decide in which MMFs to invest, and ratings of individual portfolio assets, which have historically been factored in to the investment decisions made by MMF managers in selecting investments for a MMF's portfolio. Although rating agencies play a useful service in providing an external benchmarking of investments for credit quality, Federated believes that credit ratings have in many cases played too central a role in both investment decision contexts related to MMFs, and reliance upon ratings should be reduced. Investors and portfolio managers of money market investments should conduct their own rigorous, independent analysis of the credit quality of an investment, without undue reliance on external ratings. Federated conducts very detailed credit analyses of all portfolio investments, and does not place undue reliance upon any one external factor or favorable rating as part of that process to determine whether an investment is sound.

Federated is particularly concerned about the reliance of some rating agencies on "sponsor support" of an MMF as a criteria for assigning investment ratings. In our view, a MMF rating should turn upon an objective review of the investment portfolio of the MMF, with its manager and other servicing infrastructure serving at most only as a secondary, qualitative factor in rating agency review. Investor and rating agency reliance on sponsor support, which is not and should not be guaranteed, in setting a rating of the MMF and deciding to invest can create the risk of rapid redemptions from a MMF based upon a change in view regarding the manager and its willingness or ability to provide support to the MMF.[29] We note as an example of this effect, that in early December 2011, Fitch downgraded the Prime Rate Capital Management (PRCM) MMFs based solely on Fitch's perception of the ability of those funds' manager to provide sponsor support, and not on the content of the MMFs investment portfolios or the credit review process.[30] The Fitch ratings downgrade was followed by a series of redemptions from those MMFs of almost 60% of PRCM MMF assets, which redemptions stopped and

[29] Letter from Federal Reserve Board Chairman Ben S. Bernanke to Anthony J. Carfang, Treasury Strategies, Inc. (Dec. 9, 2010); Letter from Acting Comptroller of the Currency John Walsh to U.S. Congressman Gregory W. Meeks (Feb. 17, 2011).

[30] Room151, "Fitch puts 3 PRCM liquidity funds on rating watch negative" (Dec. 8, 2011); available online at: http://www.room151.co.uk/latest/fitch-puts-3-prcm-liquidity-funds-on-rating-watch-negative/.

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were reversed only when the manager announced its sale to Federated, and Fitch reaffirmed its earlier ratings on that basis.[31]

For a further discussion on the role of ratings in the portfolio investment context, see response below to Question 29.

Question 9: *Are existing rules adequately addressing risks regarding the management of collateral from money market funds? What are the risk management processes currently in place with regard to repo and securities lending transactions? Do MMFs present unique issues with regard to their use of repo markets or would general policy recommendations that the FSB may issue regarding repo markets be applicable?*

Response 9:

The 2010 Amendments included the following reforms with respect to repurchase agreements (repos) held by MMFs:

- Only repos collateralized by Government Securities or cash instruments can receive "look through" treatment for diversification purposes. Previously, securities with the highest rating and unrated securities of comparable quality were also eligible; and

- A MMF's board (or the board's delegate) is required to evaluate the repo counterparty's creditworthiness in order for a MMF to "look through" for diversification purposes.

In the United States, in addition to the repo collateral reform referenced above, the Tri-Party Repo Infrastructure Reform Task Force (formed in Sept 2009 under the auspices of the Payments Risk Committee, a private sector body sponsored by the Federal Reserve Bank of New York) has instituted the following additional reforms:

- Mandatory three-way confirmations between Dealer, MMF (Cash Investor) and Clearing Bank were fully implemented across the tri-party market by the end of 2011. Previously the Dealer provided Clearing Bank with the trade confirmation. Accordingly, the Clearing Bank did not receive any independent confirmation from the cash investor. The revised process improves transparency and therefore potentially reduces fails in the market;
- Clearing Banks implemented automated collateral substitution capabilities which enables the Clearing Banks to be able to unwind the repo later in the day (previously repo trades were generally unwound in the morning) and thereby reduce the amount of intra-day credit extended by the Clearing Banks;
- The settlement window is now generally between 3:30 p.m. and 6:00 p.m. which reduces the intra-day credit extended by the Clearing Banks to Dealers; and
- Cash investors have discussed and generally undertaken additional contingency planning associated with potential Dealer defaults.[32]

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[31] CCLA Investment Management Limited, PSDF(12)P07, The Public Sector Deposit Fund Advisory Board, "Rating Action on Prime Rate Capital Management" (Dec. 2011), available online at http://www.psdf.co.uk/wp-content/uploads/2011/05/12-01-16-P07-Prime-Rate-Capital-Management.pdf.

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Industry participants continue to work to to further strengthen the repo industry.

Question 10: *Are the above-mentioned changes in the environment of MMFs relevant factors to take into consideration? What are some of the implications for regulatory options? Are there other aspects to consider?*

Response 10:

Since the 2007-2009 financial crisis, important improvements have been made in Europe and in the U.S. that have enhanced the stability of MMFs. These include enhanced credit quality requirements and shorter portfolio maturity limits. In the U.S., this has also included a very substantial increase in mandatory liquidity requirements, to include at least 10% overnight liquidity, 30% 7-day liquidity, and a requirement that MMFs make a continuing assessment of their investors' investment horizons and maintain additional portfolio liquidity as needed to meet reasonably anticipated cash flows, and much greater transparency concerning portfolio content and valuations. During the summer of 2011 market crisis, these enhancements proved very effective in maintaining the stability of MMFs in the face of substantial redemptions and market uncertainty.

In addition, broader reforms in the financial markets are being implemented that are designed to insulate the financial markets from shocks at individual large financial institutions and market utilities. Among other aspects of these broader enhancements are requirements for less risky investment portfolios, stronger capital, more liquidity, less reliance on short-term funding, and enhanced contingency planning, at financial institutions. These improvements, once fully implemented, are expected to contribute to greater financial stability, which in turn should help contribute to a more stable and less volatile short-term credit market. Added stability in the underlying asset classes in which MMF invest, the markets in which those assets are issued and traded, and at the issuers of those assets, should further enhance the overall stability and liquidity of MMFs.

Before further major changes in the structure and regulation of MMFs are proposed, particularly untested changes that may make MMFs less useful to investors and the economy, it is important first to assess the effectiveness of the existing MMF regulatory enhancements that have been put in place since 2009.

Question 11: *Do you agree with the systemic risk analysis and the rationale for reform presented in this section? Are there other factors to consider?*

Response 11:

Federated disagrees with the focus of this section on "run" risk without a discussion of the central role of liquidity in addressing that risk. First, as previously discussed, MMFs are not susceptible to runs. Second, what prevents a run -- or resolves it before it causes a panic -- is liquidity. Using V-NAV rather than C-NAV, imposing holdbacks or other redemption limits, a two-tiered capital structure, or "bank like" regulations, does not address this core issue. In the U.S., the SEC addressed the "run" risk issue very effectively in the 2010 Amendments to Rule 2a-7 by requiring MMFs to maintain very high levels of natural, near-term liquidity in their portfolios. Serious consideration should be given in other jurisdictions to enhancements of mandatory liquidity requirements in MMFs.

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[32] *See* ICI checklist for dealer default: http://www.ici.org/policy/current_issues/11_mmf_repo_checklist.

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MMFs' transition from a C-NAV to V-NAVs might itself be systemically risky.

Use of a mandatory V-NAV, or a process for conversion to V-NAV will not itself reduce run risk. The problem with the conversion process is that, while trying to prevent future runs, it would produce market conditions that could prompt shareholders to run from MMFs before the conversion takes effect. MMF shareholders will face an immediate prospect that their funds could "break a dollar" after they convert to a V-NAV, so they are incented to redeem before the conversion date. Responsible managers will raise liquidity to meet these redemptions, either by selling holdings or refusing to roll investments. Selling pressure would lower prices and not rolling investments would cut off funding to issuers, which will increase the risk that converted funds will break a dollar. This would encourage more redemptions from the funds and would lead to the cycle repeating itself.

Converting funds in phases (which would be one way to design the process) will just make the disruption to the capital markets more protracted. Shareholders will still have the same incentive to redeem before their fund converts, so fund managers will have the same incentive to increase liquidity by selling and not buying. Knowledge that converting funds will be withdrawing liquidity from the capital markets will deter non-converting funds and other institutions from buying money market instruments. Moreover, cash from converting funds may be shifted to non-converting funds, making each phase of the conversion process larger and more disruptive. In summary, Federated does not see how a conversion process can be designed to avoid creating its own systemic risk.

Risk management practices in a V-NAV MMF industry might deteriorate without the discipline required to maintain a $1 share price.

Assuming for this point that unregulated MMF substitutes could be eliminated, investors who are unwilling to hold their cash in a fund with a V-NAV will either move their cash to banks or invest directly in commercial paper and other money market instruments. Neither banks nor institutions managing their own cash are likely to manage risks with the same discipline as MMFs.

Regulations allow banks to take greater risks than MMFs, and they must do so in order to attract the capital necessary for their growth. Banks can lend money for any term to any borrower they deem creditworthy, and may engage in a broad array of related businesses posing various degrees of risk. Thus, it is certain that money shifted from MMFs to banks will be invested for longer terms, and also may be invested in obligations with lower credit quality, than are held within current MMF portfolios. This would increase the overall level of risk in the financial system.

With respect to other institutional investors, they cannot afford to dedicate the same personnel and resources to cash management as do MMFs. Institutional investors are more likely to rely on ratings rather than perform their own credit analysis. In addition, they generally cannot attain the same degree of diversification through direct investment as they do through MMFs. Thus, a complete disintermediation of the institutional cash market through the elimination of MMFs would also result in an increase in the overall level of risk in the financial system.

Eliminating C-NAV MMFs will not serve the objective of reducing systemic risk

The elimination of C-NAV MMFs would not accomplish the objective of reducing systemic risk, as the implementation of mandatory V-NAV will not reduce the credit market's vulnerability to "freezing." Federated believes that investors who redeemed out of MMFs in September 2008 were running from what the funds held in their portfolios, rather than the funds themselves. During that period, investors lost confidence in the market's ability to evaluate credit risks. Their flight to government securities (including government MMFs), to such a degree that on several occasions

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Treasury bills were bid up beyond their face values, provides evidence of an overwhelming lack of investor confidence.

Even if MMFs had not existed, these investors would not have been willing to hold commercial paper or other credit instruments during this period. They would have stopped rolling their investments and would have tried to sell holdings regardless of price. The credit markets still would have frozen solid and issuers would have been cut-off from funding. In short, if market freezes are a result of cash investors' unwillingness to extend credit rather than their concerns about MMFs, then eliminating MMFs will not serve the objective of reducing this risk.

Question 12: *Do you agree with the benefits of imposing a mandatory move from CNAV to VNAV, which would amount to prohibiting the use of amortized cost valuation for any securities held by a MMF? Are the challenges identified in the US context valid in other jurisdictions currently authorizing CNAV funds? How could these challenges be overcome?*

Response 12:

We do not agree with the benefits of imposing a mandatory V-NAV requirement. V-NAV funds during the crisis faced redemptions at an equal or higher rate than C-NAV MMFs. The data does not support the premise that C-NAV Funds are less stable or more subject to runs than V-NAV MMFs. Please see our response to Question 2.

Additionally, the operational challenges below apply to not only U.S. investors, but investors globally. Different investors use MMFs for different purposes. Many corporate users do not want and will not use a V-NAV MMF. This is not simply risk aversion. For technical reasons, $1, 1 Euro, or 1 pound per share pricing is critical to the usefulness of MMFs to a variety of business applications involving automated accounting and settlement systems.

Use of C-NAV MMFs to hold short-term liquidity is incorporated into many automated systems and the interfaces used in these systems. Examples include bank trust accounting systems, corporate payroll processing, corporate and institutional operating cash balances, government cash balances, bond trustee cash management systems, consumer receivable securitization cash processing, escrow processing, custody cash balances and investment manager cash balances, 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 systems 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 C-NAV MMFs to hold short-term liquidity in connection with settlement of transactions. The features of C-NAV MMFs 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 of the exact dollar amounts that are being processed between different counterparty accounting systems so that the

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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 C-NAV MMFs, (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.

MMFs, 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 C-NAV MMF 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 V-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 mandatory V-NAV would make MMFs 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 V-NAV requirements on MMFs would require these systems to be redesigned and re-programmed on a wide scale, involving substantial effort from many people and years to complete.

Question 13*: What would be the main effects of establishing a NAV-buffer? What would be the most practical ways to implement such buffers? Should various forms of NAV-buffers be allowed or should regulators favor a single option? What would be a realistic size of the NAV-buffer and what would be the impact in terms of costs for running MMFs? In the case of subordinated shares, could the option be seen as creating a securitization position, with associated requirements in terms of retention?*

Response 13:

In Federated's view, the capital buffer concept would not have the desired effect of reducing run risk. The concept of establishing a capital "buffer" has been put forward as a means of absorbing portfolio credit losses without a decline in share value. The options under discussion include a slow build up of capital through retained earnings, purchase of a new subordinated class of equity by the fund manager, or sale of subordinated equity to third party investors. Any of these options would be a departure from the concept of what a mutual fund fundamentally is-- a mutually-owned pool of equity owned by a single class of shareholders, who share equally in the profits or losses of the fund. In its place, there would be created a two-tiered equity structure, introducing a form of leverage into MMFs for the first time. This brings with it several problems.[33]

First, it is not clear how much capital would be needed to cause the main shareholder group to feel so secure against losses that they would not feel compelled to redeem shares in a financial panic. What the subordinated equity would provide, however, is a short "head start" after the first loss announcement to put in a redemption request to get out ahead of other investors before the subordinated capital is exhausted. This will make runs more likely, not less.

Second, the existence of a subordinated equity layer will cause the main shareholders to think of themselves like creditors or depositors, and make them less likely to consider the risks in the MMFs

[33] *See*, ICI, *The Implications of Capital Buffer Proposals for Money Market Funds* (May 16, 2012), available online at: http://www.ici.org/pdf/ppr_12_mmfs_capital_buffer.pdf.

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investment portfolio before investing. It will lull them into a sense of complacency about the risk of loss until there is a financial crisis.

Third, due to the very low yields on money market investments that have persisted over a period of several years and are likely to continue for the foreseeable future, currently there is insufficient portfolio yield to generate returns that could be used to create a meaningful capital buffer through retained earnings. In the current rate environment, a subordinated capital layer would take many years to built up to any significant level through retained earnings, will cause adverse tax consequences to the MMF and its investors, and further reduce yields in an already very low yield environment. If provided by the investment manager, it would be expensive for the manager to provide and would be difficult or impossible to finance. It is doubtful that third-party investors would be willing to purchase subordinated capital of a MMF under economic terms that would make sense for the main shareholders of the MMF. The subordinated class of investors would expect a yield on their more risky class commensurate with that risk, which would be a further reduction to yields to the other investors.

Fourth, the amounts required would be very large. At even a half percent on over $4 trillion in global MMF balances, subordinated capital of roughly $20 billion would be required. Where would that investment come from?

Fifth, MMF investors are shareholders. It is not clear why they should be protected by a second, more junior layer of equity capital.

Finally, a capital buffer does not prevent runs or stop them once they have begun. Available cash to pay investors, not a capital buffer, is what prevents or resolves a run.[34]

While a buffer (assuming the fund has built one) will help absorb market losses incurred on sales of portfolio securities, the fund must first be able to find buyers for the securities. We found few bidders for many classes of portfolio securities during September 2008. It may be dangerous to adopt a reform that presumes that every fund will be able to do so.

Capital requirements will drive most shareholders out of MMFs and into banks or alternative (often unregulated) cash products by making it impractical for shareholders to use the funds for cash management or by taking away the advantages of using MMFs. Any reform that has the effect of forcing trillions of dollars out of MMFs will produce the same adverse economic effects as floating the share price.

Shareholders Cannot Easily Switch MMFs.

Some capital proposals would require MMFs to stop selling shares or even liquidate if they could not meet the capital requirement. This would have extremely disruptive consequences for shareholders. There is no means of instantaneously notifying shareholders that a fund has been shut off, so some shareholders will be left with uninvested cash balances. It can take days for a shareholder to open an account at another fund. Moreover, for many shareholders, operating with multiple accounts is simply not practical.

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

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This would be a particularly serious problem for shareholders with automated deposits or withdrawals. Brokers and trusts that automatically sweep their clients' uninvested cash balances will not use a product that may reject purchase orders without sufficient notice. A company that uses a MMF to cover payroll will not want to deal with the possibility that checks or wire transfers may have to be issued from multiple funds. Constantly shifting money from the one fund to another invites errors which can injure a company's reputation for financial responsibility. Thus, any reform that would arbitrarily shut off a fund will seriously undermine the utility of MMFs.

Capital May Not Always Be Available.

Proposed capital requirements seem to presume that funds or investment managers will always be able to obtain capital, at least at some price. The 2007-2009 financial crisis contradicts this presumption. In the aftermath of Lehman's failure, many sound financial institutions could not obtain funding at any price. Central banks were forced to intervene in order to avoid a cascade of financial failures. Making MMFs dependent on capital will only add them to the list of institutions that may need central bank support during a financial crisis.

Funds and investment managers also cannot afford to pay "any price" for capital. Under normal market conditions, the spread between fund yields and short-term government securities is narrow. Any serious reduction in the spread will drive investors out of the funds and reduce the amount of funding available to the private sector. Regardless of whether the funds pay for capital directly, through higher advisory fees or by retaining a portion of their earnings, a capital requirement will have the effect of reducing the spread. If the price of capital rises too high, the spread will be eliminated and the funds with it. If advisers are forced to provide capital, high capital costs will likely drive advisers out of the business of managing MMFs.

Finally, we are currently in an unprecedented period of exceptionally low interest rates. Neither funds nor their investment managers have any income from which to pay for capital, no matter how cheap. Even if regulators delay capital requirements until market conditions become more favorable, they cannot be sure that rates will not fall again to levels where MMFs or their investment managers cannot afford to meet the requirements.

Shareholder May Not Be Willing to Invest in a Product They Cannot Understand.

Shareholder attitudes to capital requirements and redemption restrictions are entirely untested. Although shareholders might be expected to support capital in principle, they may reject funds that have complicated capital structures or terms. Attempts to work out detailed proposals for third party capital are instructive, insofar as they could never be explained in term an average investor could understand.

MMFs May Have to Pay Taxes.

Under U.S. tax laws, investment companies must pay corporate taxes on undistributed net income. Consequently, a requirement that funds retain earnings in order to build a capital buffer will trigger substantial tax payments. In the U.S., approximately half of the retained earnings may need to be paid as federal and state corporate taxes. This will greatly reduce the benefit of the capital requirement. This assumes that only a small fraction of the earnings are retained. In the U.S., an investment company must pay an excise taxes if it fails to distribute 98% of its earnings. If distributions fall below 90% of earnings, then all of the earnings (distributed as well as undistributed) become subject to corporate taxes.

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MMFs May Have to Report Taxable Income.

In the U.S., investment companies must report to each shareholder (with a copy to the tax authorities) the dividends paid to, and the gains and losses realized by, the shareholder during the year. These reports are relatively simple for MMFs, because (unless the fund breaks a dollar) the only information to report is the dividends paid. A redemption requirement may affect the amount or timing of redemption payments, however, which may produce real or apparent losses for tax reporting purposes. Modifying tax reporting systems to account for redemption restrictions will increase their costs.

Providers of Capital May Have to Include MMFs in their Consolidated Financial Statements.

Any external capital requirement will create a class of MMF investors who will bear a disproportionate share of fund losses as compared to the common equity. Current accounting rules may require certain of these investors to consolidate any fund in which they invest into their financial statements. This will inflate the investor's consolidated assets and obscure its financial performance. The prospect of consolidation will deter potential investors and increase the cost of external capital, such that it may not be feasible for funds to raise the required capital.

Providers of Capital May Have to Mark their Investments to Market.

Even if an investor is not required to consolidate the fund, current accounting rules may require the provider of subordinate capital to a MMF to carry the capital at its current market value. Given the high degree of leverage implicit in external capital proposals (*e.g.*, a 2% capital requirement implies 50 times leverage), a small change in the value of the fund's portfolio can produce a large fluctuation in the market value of the capital. Federated estimates that normal fluctuations in a large ($10 billion) fund's portfolio could add or subtract tens of millions from a capital provider's quarterly financial results. So long as the fund does not break a dollar, these swings would be meaningless to the capital provider's financial results. This kind of financial "noise" could also deter potential investors and increase the cost of capital.

Capital Requirements Create Barriers to Entry.

Assuming for purposes of argument that a capital requirement is feasible, this will result in a market where all MMFs provide a shareholders with a capital buffer against breaking a dollar. Any new MMF will have to match this buffer in order to compete with funds that already have one. Thus, even if the requirement theoretically allows funds to create a buffer by retaining earnings, as a practical matter the sponsor of any new fund will have to advance (or raise from third parties) sufficient capital to match the buffers maintained by competing funds. Thus, a capital requirement will create a substantial barrier to entry in the market for sponsors or promoters of MMFs.

Capital Requirements Increase Concentration.

Capital requirements will favor managers who already have, or have access to, capital. Even if the requirement allows funds to create a buffer by retaining earnings, managers with capital can afford to waive their fees or reimburse expenses and thus absorb more of the cost of building capital. Capital requirements will therefore increase concentration in the MMF industry, either because other manager will not be able to raise the required capital or will not be able to meet the capital requirement as quickly or cheaply.

Capital Requirements Change the Basis for Competition.

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Currently, because shareholders have no assurance that the fund sponsor, promoter or investment manager will support its funds, shareholders have some interest in monitoring the risks taken by their funds. If capital becomes the primary means of protecting MMF shareholders from losses, they will focus on the amount and availability of capital for a fund, rather than its management of portfolio risks. Even if funds are permitted to obtain external capital, so long as managers can also provide capital, the managers will be able to takes more risk without driving away shareholders. Thus shareholders will be attracted to the funds taking the greatest risk (so as to produce the highest yield) so long as the fund can maintain the required capital. This will increase the overall level of risk in the financial system.

Corporate Governance and Investment Structure of MMFs Requires Shareholder Approval of Material Changes to MMF Capital Structure and Shareholder Rights

An additional complicating factor in fundamentally altering the capital structure and redemption rights of MMFs arises from the existing corporate and governance structure of MMFs. Shareholders of MMFs are not customers or creditors, they are the owners of MMFs. Unlike a bank in its dealings with depositors, a MMF cannot simply impose changes to the terms of the investment. Shares of a MMF represent undivided ownership interests in the fund's net assets. The fund's constitutional documents govern the terms, priorities, rights and obligations of its shareholders. Articles of association, trust deeds, or their equivalent generally cannot be amended without the consent or approval of shareholders. These cannot simply be changed without first obtaining shareholder approval by vote. This has the following implications for proposed changes to the capital structure and redemption rights of MMFs.

The Allocation of Losses Must Be Uniform.

The shares within any class are homogenous insofar as each share is entitled to the same votes, dividends and distributions as any other share in that class.

In order to allocate a larger share of any losses to the restricted shares (so as to maintain the same division of losses among shareholders without regard to redemptions), the fund must convert the restricted shares into another class that is subordinated to the common equity. If permitted under the corporate law of the fund's home jurisdiction, this would require significant amendments to the fund's constitutional documents and would make the fund inordinately complicated.

The Fund's Constitutional Documents Must Authorize the Issuance of a Subordinated Class of Shares.

If MMFs are required to maintain a separate layer of capital to protect the common shareholders, their constitutional documents will need to authorize the directors or trustees to designate a subordinated class of shares. These funds would have to obtain shareholder approval to amend the constitutional documents to permit the issuance of such shares. Corporate and company regulations in the European Union may also need to be amended to accommodate the use of subordinated share classes.

MMF Shares Are Held through Nominee Accounts and Securities Clearance Systems.

MMF shares are securities that financial intermediaries hold for the account of their clients. These shareholders are entitled to all of the rights and benefits of, and as subject to all of the restrictions on, the securities held by the intermediary on their behalf. The MMF, however, cannot tell if trades in an intermediary's omnibus or nominee account relate to one or several underlying shareholders. Due to netting of purchases and sales, an omnibus account may not even reflect trading by underlying

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shareholders. (For example, if two shareholders maintain accounts at the same intermediary, and one redeems $1,000 while the other purchases $1,000, the fund has no way of knowing that these trades took place because there would be no change in the intermediary's omnibus account holdings on the fund's share register.)

Consequently, any required redemption restriction will require operational and systems changes not only by the MMFs and their transfer agents, but by every intermediary or fund distributor that holds shares on behalf of the fund's shareholders. This will greatly increase the cost of any redemption requirement and the difficulty of verifying compliance with the requirement.

MMFs Cannot Easily Alter the Terms of their Shares.

Banks generally reserve the right to change the terms of demand deposit accounts (*e.g.*, to change the amount or impose additional fees or limitations) with notice to the depositor. If the depositor objects to the change, he or she would presumably withdraw the deposit and move it to another bank.

MMF shares are investments. As with most investments, material terms cannot be altered after the fact without the consent of the shareholder. Moreover, laws or regulations may require shareholder approval of fundamental changes. For example, under the U.S. Investment Company Act, a fund may not increase its advisory fee or distributions charges without shareholder consent. Under UCITS regulations, changes that would materially alter the risk profile, credit quality, or rights of shareholders would also require shareholder approval and prior notice of implementation

This makes it difficult to impose new redemption restrictions on shares issued before the requirement takes effect. If MMFs' offering documents promised unrestricted access to a shareholder's investment, the fund cannot unilaterally restrict such access without risking liability. Although it is theoretically possible to impose restrictions only on newly issued shares, the expense of separately tracking old and new shares will increase the cost of a redemption requirement and may confuse shareholders.

Question 14: *Do you agree with the description of the challenges associated with the establishment of private insurance? Are there ways to address them?*

Response 14:

Although Federated remains open to the possibility of MMF insurance, our experience suggests that this will not be a fruitful approach to reform. In the 1990s, Federated worked with an insurance company to develop a proprietary default insurance policy for its MMFs. Although we maintained the policy for several years, we were never able to obtain enough coverage for a large default such as the one suffered by the Reserve Primary Fund. The insurance company withdrew from the market, along with other companies offering similar policies, after the American General default. We suspect that there is no private business model that will prove viable for the long term.

Question 15: *Do you agree with the description of the challenges and potential second-round effects of a conversion of MMFs into special purpose banks? Are there ways to circumvent those effects?*

Response 15:

Federated does not believe that regulating MMFs like banks is a workable approach to MMF regulation. We agree that there are substantial challenges and second-round effects of this approach, to such a degree that the imposition of bank-like regulation on MMFs should not be viewed as an approach that has merit.

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The premise that bank regulators have done a better job of regulating banks than securities regulators have done in regulated MMFs is not consistent with the record. In the U.S., for example, during the 40 years that MMFs have existed, only two MMFs have "broken the buck" and failed to repay investors 100 cents on the dollar. One of the MMFs repaid its investors 96 cents on the dollar, and the other repaid its investors over 99 cents on the dollar, at no cost to the government. During the same period, over 2800 U.S. banks failed and more than 500 other U.S. banks were kept afloat by government assistance, at a total cost of approximately $188 billion. In an era of limited government resources, a bank regulatory model built around a very large regulatory infrastructure and substantial government financial support to maintain the stability of regulated entities, is ill-conceived, particularly where the results have been so unimpressive to date.

Nor have U.S. bank regulators done a good job at regulating stable value investment funds. In 2008, a bank-sponsored "short term investment fund" for pension plans that was marketed as an alternative to a MMF, and was regulated and supervised by the Federal Reserve rather than the SEC, broke a buck and incurred substantial losses for its investors. In the wake of this debacle, the bank regulators have proposed to modify their rules governing bank-sponsored short term investment funds to include elements drawn from SEC Rule 2a-7.

MMFs arose in the U.S. 1970s and 1980s because banks simply were not meeting the needs of the public. Banks then, as now, were not efficient at rechanneling liquidity balances of customers into a financing for borrowers, which resulted in higher-than necessary costs to borrowers and lower than appropriate returns to saver/investors. In addition, the risk of loss on bank failure for bank deposit amounts above the government insurance limits was, and remains, unacceptably high. MMFs arose and have continued to flourish for over forty years not because of "regulatory arbitrage" but due to the high operating costs, inefficiency and high risks of the banking industry. Applying a bank regulatory capital structure and regulatory model to MMF will not stabilize MMFs, it will eliminate them, and deny the public and the economy the benefits associated with the highly efficient means of intermediating liquidity balances into financing for government and business that is provided by MMFs.

Question 16: *What are the main advantages and drawbacks of two-tier system(s)? Would it be sufficient to address the risks identified? What could be the conditions applicable to CNAV funds? What could be the potential impact on investor demand? Should certain funds be exempted from certain risk limiting conditions due to their holdings?*

Response 16:

Federated notes that we already have a two-tier system, with some funds allowed to use C-NAV (MMFs in the U.S., Short-Term MMFs in Europe) and others using V-NAV (MMFs in Europe, ultra-short bond funds and enhanced cash funds in U.S.). The difference between the permitted share valuation methods for the two types of funds is due to much stricter portfolio requirement that apply to C-NAV funds, rather than external liquidity support or bank-like regulations.

Moreover, all MMFs, whether UCITS short term MMFs or MMFs in the United States subject to Rule 2a-7, are required to float the NAV when there is a material discrepancy between the market value of the instruments held by the MMF and the value calculated according to the amortized cost method, whether at the individual or at the fund level.

Federated suggests that additional enhancements to portfolio liquidity requirements to global MMFs, similar to those adopted by the SEC as part of its 2010 Amendments, would help address the issues associated with investors moving during a crisis out of particular funds.

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Question 17: *Do you agree with the suggestion that reserving CNAV funds for only certain investors (i.e. retail or institutional investors) would face practical challenges and would not be sufficient to address the risks identified?*

Response 17:

Federated agrees with the observation that the distinction between institutional and retail investors is not clear cut in all cases, particularly in the context of omnibus accounts held through broker-dealers, banks and other portals. Federated also agrees that institutional shareholders in 2008 generally were more likely to move liquidity balances than were retail investors, although in general the movements were to more conservatively managed MMF from less conservatively managed MMFs. With enhanced transparency of MMF portfolios and "shadow prices" mandated by SEC rules, and significantly increased institutional diligence on MMFs (and diligence by MMFs on their investors' cash flow needs), Federated anticipates that in the future, institutional shareholders will be less prone to sudden action than was the case in 2008. Federated does not support the reservation of different categories of MMFs only for retail or institutional investors.

Question 18: *Regarding the different structural alternatives described in Section 1, what are the benefits and drawbacks of the different options described above? How could they be prioritized? What are the necessary conditions for their implementation?*

Response 18:

Federated does not believe that the structural alternatives proposed in Section 1 of the paper should be pursued. These structural alternatives include mandatory use of V-NAV, variations on a two-tier capital structure or "capital buffer" similar to banks, or insurance programs. The drawbacks of these approaches are that: (i) they do not address the key issue of MMF liquidity; (ii) they will make MMFs less efficient, less useful and therefore less attractive to investors, who will move their investments out of MMFs; and (iii) they are expensive to implement, to the extent they can be implemented at all. Killing off MMFs will not benefit the public and will not make the financial system more stable.

Insufficient attention has been paid to the effectiveness of the recent revisions adopted in the U.S. and in Europe to the regulation of MMFs, which have demonstrated over the past two years by the resiliency of MMFs in the face of turbulent market conditions. Operating under the amended rules, MMFs 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. Further enhancement of liquidity requirements for MMFs outside the U.S. may be appropriate. Before other radical changes are made to the program of regulation of MMFs, greater consideration should be given to evaluating the effectiveness of the existing regulatory program. In our view, the greater liquidity, together with robust surveillance 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 MMFs that led to the 2008 problem at the Reserve Primary Fund – would provide significant safeguards.

Question 19: *What are the main benefits and drawbacks of imposing the use of marked-to-market accounting for all the instruments held by MMFs? What is the availability of market prices for securities commonly held by money market funds? Are there situations where this general principle could not be applied?*

Response 19:

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Federated does not see any benefit to requiring marked-to-market accounting and V-NAV to set share prices for MMFs. Federated does see a benefit to using marked-to-market accounting and V-NAV to establish "shadow prices" for shares as a disclosure matter and as part of an internal control program to test the continued appropriateness of the use of amortized cost and C-NAV to price portfolio assets and shares.

As discussed in the responses to Questions 2 and 12, for a diverse portfolio of high credit quality, liquid, very short term investments, the use of amortized cost to value portfolio assets and establish share prices, is appropriate. Where the MMF maintains robust natural portfolio liquidity such that it is highly unlikely to be required to sell portfolio assets in the secondary market in order to raise cash, amortized cost valuations accurately reflect the value in the portfolio. In this context, the deviations between share prices calculated using amortized cost methods of accounting and marked-to-market valuations are far too small to be material to investors. Imposing the mandatory use of marked-to-market accounting and V-NAV valuation achieves spurious precision in share pricing, at the cost of (i) a delay in settlement of MMF share purchases and redemptions by at least one business day; (ii) making MMFs unusable for a variety of automated accounting systems used in various commercial applications such as payroll processing, escrow, bank, trust and brokerage cash sweep systems, and bond trustees; and (iii) imposing adverse tax consequences on investors in some jurisdictions.

Question 20: *Should the use of amortized cost accounting be limited, and, if so, how? Are general restrictions on funds' WAM or WAL preferable? Are there practical impediments (e.g. availability of prices) to imposing stricter requirements on the use of amortized cost accounting than current existing regimes? What would be the potential effects on MMFs' investment allocation and short-term funding markets? What monitoring should be implemented? What conditions are advisable? In particular, please describe the rationale, feasibility and effects of limiting the residual maturity of instruments to [30-60-90-other] days. What materiality threshold could be proposed?*

Response 20:

Federated believes that the use of amortized cost accounting and C-NAV should be limited to MMFs that adhere to strict portfolio standards established by regulations that include diversification requirements, credit quality standards, portfolio maturity requirements (both WAL and WAM as well as outside limits on maturities of individual positions), robust natural liquidity standards, and a process for continuing benchmarking and evaluation of the appropriateness of the continued use of amortized cost and C-NAV for valuing MMF shares, and enhanced transparency to investors of portfolio assets and values. All of these elements currently are incorporated into SEC Rule 2a-7 and related SEC requirements for MMFs. Many of these requirements are also incorporated into the CESR/ESMA Guidelines and IMMFA Code of Practice.

Question 21: *What are the main benefits and drawbacks of imposing global liquidity restrictions? Should there be restrictions regarding (daily/weekly) liquid assets as well as regarding illiquid assets? Are global definitions of (daily, weekly) liquid and illiquid assets practical? Are there other conditions to consider (e.g. regarding the concentration of assets)?*

Response 21:

Federated supports the inclusion of robust liquidity requirements for MMFs, in addition to WAM, WAL, and other portfolio requirements. Liquidity requirements have several benefits, including (i) the ability to meet shareholder redemption requests as they occur, including in difficult market conditions, and (ii) provides greater assurance that the use of amortized cost accounting is appropriate for the MMF by sharply reducing the possibility that portfolio assets will need to be sold at a loss to

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raise cash to meet investor redemptions. Federated believes that it is appropriate to establish a floor for overnight liquid assets, as well as for 7-day liquid assets, but also to require the MMF to assess likely investor redemptions and hold higher levels of liquidity to meet anticipated redemptions and to address market conditions. Federated believes that a central challenge facing MMFs globally is the ability to address shareholder redemptions, and that this is addressed only by maintaining robust levels of near-term liquidity.

Question 22: *To what extent are managers able to "know their customers" and anticipate redemptions? Are there practical obstacles for managers to "know their customers" (e.g., in the case of platforms, omnibus accounts) and how could they be addressed? What are the main features of the funds' investor base to take into consideration from a liquidity risk management point of view? Should conditions, e.g., regarding the concentration of the investor base be considered? Would this requirement allow fund managers to better understand and manage the risks to which the fund is exposed?*

Response 22:

In Federated's experience, managers are able to gather information on their investors' purchases and redemptions that are very useful in establishing portfolio liquidity. Institutional investors invest large liquidity balances that often are associated with very specific and known time horizons, such as payroll, pension plan contributions, tax payments, payment of bond coupons or share dividends, and escrow settlements. With appropriate effort, this information can be collected, understood and used to meet the liquidity needs of investors and the MMF.

Under SEC Rule 2a-7 as amended in 2010, U.S. MMFs must hold securities portfolios that are sufficiently liquid to meet reasonably foreseeable redemptions. To satisfy this new requirement, a MMF must adopt policies and procedures to identify the risk characteristics of large shareholders and anticipate the likelihood of large redemptions.[35]

Large U.S. MMF complexes 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.[36]

Federated devotes a significant effort to gathering information on the larger shareholders of its MMFs, and to analyzing, understanding and anticipating large purchases and redemptions of MMF shares. Federated has a department devoted to this effort. The information generated is used by portfolio managers of the Federated MMFs to establish and maintain appropriate portfolio liquidity and maturity structure to address anticipated net cash inflows and outflows. In Federated's experience, large shareholders, and various portals and intermediaries through which investor funds are channeled, have been cooperative in this effort. These efforts include both extensive questionnaires completed with the assistance of the shareholder or their intermediaries, meetings with and conversations with investors to determine their plans, investment time horizons, and liquidity needs,

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

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

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and tracking and modeling actual purchase and redemption history conducted by Federated and its transfer agent.

Federated does not believe specific regulatory restrictions should be placed on concentration of investor bases, but does take concentrations into account in setting portfolio liquidity, and imposes internal limits and caps on amounts that given investors can hold of a particular MMF to address, in part, liquidity considerations.

Question 23: *Would such a liquidity fee generate a pre-emptive run? If so, when and are there ways that pre-emptive run risk could be reduced? How would shareholders react to the liquidity fee? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm? Would MMF board directors be able to impose a liquidity restriction despite potential unpopularity with investors and competitive disadvantage imposed on the fund? At what level such a liquidity trigger should be set?*

Response 23:

Federated believes that liquidity fees, from the investors' perspective, are simply a different way to break the dollar (and would be far more likely to occur than breaking a dollar based on NAV), and would generate large preemptive redemptions from MMFs. Investors that would be able to avoid the fee by redeeming shares early, or subject to a waiting period, would do so. Moreover, the existence of redemption fees would be inherently flawed because it would undermine the very utility that MMFs provide -- a simple, stable, low cost means of holding liquidity. Redemption fees and delays would cause the rapid, wide-scale shareholder redemptions that they are intended to deter.

Investors would not react well to a liquidity fee. Investors would either use other investment products that are not subject to a liquidity fee (resulting in a slow run on MMFs as investors switched to other products), or would remain invested in MMFs but at the first hint of financial trouble would attempt to redeem their shares in order to avoid the fee, triggering the very run the fee was intended to prevent. A liquidity fee is just another version of breaking a dollar: investors would receive less money than they invested. This would deter investors from investing in a MMF at least as much as a V-NAV, and probably more, because the loss is certain rather than probable. Federated anticipates that many investors will choose not to invest in MMFs that are subject to liquidity fees, and will redeem existing investments in MMFs that impose a liquidity fee.[37]

Shareholder attitudes to redemption fees on MMFs are untested. There is no evidence that MMF shareholders will accept the imposition of fees on redemption of their shares. The more difficult it is for shareholders to understand the fees or when the fees will apply, the greater the deterrent to their use of the MMFs.

Question 24: *How would shareholders react to a minimum balance requirement? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm?*

Response 24:

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[37] *See,* Treasury Strategies, Inc, "Money Market Fund Regulations: The Voice of the Treasurer" (April 2012), available online at: http://www.ici.org/pdf/rpt_12_tsi_voice_treasurer.pdf.

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Shareholders would not react favorably to a minimum balance requirement. A minimum balance requirement (or a holdback variant of the same basic concept) would eliminate the very liquidity of MMFs that has been central to their widespread use in a variety of applications, including corporate payroll processing, escrow balances, storing corporate and institutional operating cash balances, pension and employee benefit plan processing, and holding broker-dealer customer cash balances. Same-day settlement of the entirety of a transaction amount is a crucial feature of MMFs that underpins their widespread use to hold short-term cash balances. Imposition of a minimum balance or holdback requirement—no matter the amount—for any number of days would destroy the ability of companies and individuals to use MMFs as a liquid investment that can be readily redeployed, on a same-day basis, towards other uses. The net result of a minimum balance or holdback requirement would be to make MMFs impractical to hold the large, short-term cash balances used in transaction processing systems across a wide variety of businesses and applications. This, in turn, will result in many existing institutional investors choosing not to continue to invest in MMFs if such requirements are imposed.[38]

Question 25: *What are the benefits of using bid price for valuing the funds? Are there other options (such as anti-dilution levy) which could be explored to reduce shareholders' incentive to redeem?*

Response 25:

Federated does not believe that reducing the incentive to redeem is an appropriate policy objective in itself. For markets to operate efficiently, investors must have the right to sell as well as buy, even in times of financial crisis. This is particularly true of MMFs, for which daily liquidity is an essential element of the product. Unless IOSCO is proposing to prohibit all holders of commercial paper, for example, from selling their paper during certain market events, there is no justification for constraining redemptions by shareholders of funds that hold such paper.

Federated believes that the legitimate regulatory concern is preventing redemptions from causing excessive dilution or other unfair results to the remaining shareholders. Safeguards against such dilution or unfair results may have the consequence of reducing the incentive to redeem, but that is not their objective. From this perspective, if a MMF can no longer maintain a constant NAV and is in the process of liquidating generally the MMF will stop accepting new investments, and instead will conduct an orderly liquidation of its portfolio and use the cash to pay out shareholders pro rata.

Question 26: *What are the benefits and drawbacks of allowing redemptions-in-kind? Are there practical impediments to implementing this option (e.g. some portfolio securities cannot easily be divided)?*

Response 26:

Federated welcomes further discussion on the issues associated with redemptions-in-kind. The impediments to effective redemptions in-kind are largely a consequence of securities and tax regulations. MMF portfolios are not infinitely divisible and contain securities that are probably not suitable for all shareholders to hold directly.

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[38] Comment letters discussing this topic in more detail were submitted on behalf of Federated Investors to the SEC on December 15, 2011, February 24, 2012, March 16, 2012, and March 19 2012, and are available online at: http://www.sec.gov/comments/4-619/4619-112.pdf, http://www.sec.gov/comments/4-619/4619-122.pdf; http://www.sec.gov/comments/4-619/4619-143.pdf; http://www.sec.gov/comments/4-619/4619-140.pdf

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Question 27: *What are the benefits and drawbacks of requiring gates in some circumstances? Which situations should trigger gates to be imposed to redeeming investors? Would it be enough to permit gates in some jurisdictions? Would there be a risk of regulatory arbitrage?*

Response 27:

A holdback requirement would be very unpopular with investors and would make MMFs impractical to hold the large, short-term cash balances used in transaction processing systems across a wide variety of businesses and applications. See response to Question 24 above. Redemption restrictions will drive most shareholders out of MMFs and into banks or alternative (often unregulated) cash products by making it impractical for shareholders to use the funds for cash management or by taking away the advantages of using MMFs. Any reform that has the effect of forcing trillions of dollars out of MMFs will produce the same adverse economic effects as floating the share price.

Shareholders rely on MMFs not only to return each dollar they invest, but also to do so on a same-day basis. Any loss of this daily liquidity will have the same impact on shareholders as the loss of a stable share price—they will move their cash to other investment or deposit accounts that offer daily liquidity. Just as funds will be unable to maintain a stable price under exceptional circumstances, funds may on rare occasions be unable to provide daily liquidity to their shareholders. In that context, the MMF must conduct an orderly liquidation process.

Shareholder attitudes to redemption restrictions are entirely untested. There is no evidence that MMF shareholders will accept restrictions on the redemption of their shares. The more difficult it is for shareholders to understand the restrictions or when the restrictions will apply, the greater the deterrent to their use of the funds.

Question 28: *Do you agree with the suggestion that the establishment of a private liquidity facility faces challenges that make the option unworkable or do you see ways to circumvent these challenges?*

Response 28:

We agree that designing, organizing and capitalizing a captive liquidity bank will be difficult to accomplish under the best of circumstances. Banking and tax regulations are making this even more difficult, however, insofar as they do not allow for the unique purpose of the bank and the extremely limited risks that would be posed by its activities.

Question 29: *What are the main benefits and drawbacks of the provisions included in current regimes referring to external CRA ratings? Are there alternative to credit ratings that reasonably can be substituted?*

Response 29:

Until someone has answered the second question, Federated would urge IOSCO to proceed cautiously in removing rating requirements from MMF regulations. Although Federated agrees that CRAs have a lamentable record in many respects, Federated is not aware of a better external gauge of credit risk. To paraphrase Churchill's remark about democracy, credit ratings are the worse means of measuring credit risk except for all the others that have been proposed.

The benefit of rating requirements is that they provide an objective limit on credit risk. Rule 2a-7 definition of "Requisite NRSROs" and "Rated Security" exemplify the difficulty of incorporating potentially inconsistent ratings from a fluid set of CRAs into regulations. Apart from burdening the board of directors with unwarranted responsibilities, Federated believes that the introduction of

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"Designated NRSROs" in the 2010 reforms to Rule 2a-7 was a step in the right direction. IOSCO might be better advised to promote a more sophisticated use of credit ratings in regulations rather than trying to remove them altogether.

Federated continues to be of the view, however, that managers of MMFs must conduct their own detailed internal independent credit analysis of all portfolio investments, and not rely upon credit rating agencies or other external sources to perform this critical function for MMFs.

Question 30: *What are the benefits of MMF ratings? Should a greater differentiation between MMF ratings be encouraged? To what extent are investors restricted in their investments to 'Triple-A' rated funds? What alternatives could there be (e.g. from other third parties)? What initiatives could be proposed to educate investors about MMF ratings?*

Response 30:

Many investors are restricted, or choose to restrict themselves, to the most highly rated investments. There are various reasons for this restriction, including the need to control the degree of credit risk taken with the investor's money. Thus, for some investors, ratings restrictions serve the same purpose as they do in MMF regulations—providing a convenient standard for limiting permissible credit risk.

The inability of investors to find an alternative standard for credit risk suggests that IOSCO is unlikely to find one as well. In any event, Federated does not see what would be gained by prohibiting investors from using an imperfect standard is the absence of a better alternative. IOSCO should let the markets continue to work on this problem and assure that regulations do not interfere with development of new credit standards.

Federated also does not believe that IOSCO should "encourage" particular rating categories. Unless regulators undertake to hire appropriate professionals and attempt to analyze and classify credits themselves, Federated does not see how regulators can have a sufficiently informed view to weigh in on the subject. Ultimately, investors will be better judges of whether rating categories are too broad or too narrow.

Question 31: *In addition to the options explored in the four sections above, do you see other areas to consider which could contribute to reinforcing the robustness of MMFs?*

Response 31:

As noted above in our general response, we believe that the cumulative effect of the 2010 Rule Amendments has been to improve the safety and liquidity of MMFs and that the global MMF industry would be well served to adopted similar reforms, specifically relating to (i) more specific requirements for portfolio liquidity including a "know your investor" requirement, (ii) more specificity on portfolio diversification requirements, (iii) increased transparency on portfolio assets and their current market values, and (iv) a more defined process for moving from a constant net asset value (C-NAV) to a variable net asset value (V-NAV) in those unusual circumstances when such a change is needed due to economic conditions. In addition, enhanced supervisory analysis and follow-up on MMF portfolio risk, particularly consideration of red flags such as unusual growth or portfolio returns, and portfolio exposure to particular issuers, may be in order. Further enhancement of transparency to subaccounts would be beneficial.

Question 32: *Do differences between jurisdictions require different policy approaches or would a global solution be preferable, notably to ensure a global level playing field?*

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Response 32:

Federated believes that, broadly speaking, similar policy approaches should be followed in different jurisdictions, because the practical and operational needs of MMFs in different countries are in many respects similar, and the practical solutions to the issues faced by MMFs are often workable in different jurisdictions. These must, however, be tailored to the situation and context of each jurisdiction.

By way of example, in the U.S., a significant part of MMF internal portfolio liquidity is held in short-term U.S. Treasury securities, due to the extraordinary market depth, liquidity and high credit quality of this asset class. That solution may not be as workable in other jurisdictions, with a smaller, less liquid market for government securities, or less stable prices for government securities. Other solutions to holding liquidity balances may be more workable in other jurisdictions.

As noted above, the issues associated with further changes to MMF regulation are sufficiently complex and in need of further detailed economic analysis that a majority of SEC Commissioners have gone on record to withdraw SEC support from publication of the IOSCO report in its current form.[39]

CONCLUSION & NEXT STEPS

MMFs are important participants the financial markets because they efficiently intermediate investor's shareholdings with short-term funding of governments, businesses and financial institutions. MMFs have been successful by using a very simple, common sense approach, which permits investment only in short term, high quality money market instruments, and maintaining a very liquid investment portfolio sufficient to meet investor redemption requests out of normal cash flows from maturing portfolio investments.

MMFs should not be labeled as a type of "shadow bank," and should not be subjected to a banking-style capital structure and regulatory program. Instead, MMFs should continue to be treated as what they actually are -- highly liquid investment funds by which investor cash is pooled and invested in money market assets -- and regulated by securities regulators in a manner consistent with their actual structure and purpose.

Rather than imposing dramatic and potentially dislocative changes on the regulation of MMFs by imposing bank-like capital structures and regulations, it would be more prudent to continue the careful fine-tuning of regulatory programs for MMFs developed by securities regulators that have included the revised UCITS Directive in 2009 and the CSER/ESMA Guidelines in 2010, as well as SEC Rule 2a-7. There remain areas for further improvement in the regulation and supervision of MMFs globally that are appropriate for consideration.

These further enhancements to MMF regulation were adopted by the SEC in 2010 after the financial crisis, and have shown the capacity to further stabilize share values, increase investor awareness, and stave off "runs" by shareholders of MMFs. Serious consideration should be given to adopting additional standards for global MMFs similar to those adopted in 2010 for U.S. MMFs.

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[39] Statement concerning publication by IOSCO on April 27, 2012 of the "Consultation Report of the IOSCO Standing Committee 5 on Money Market Funds: Money Market Fund Systemic Risk Analysis and Reform Options." (May 11, 2012) available online at http://www.sec.gov/news/speech/2012/spch051112laatapdmg.pdf.

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We remain committed to avoiding any recurrence of liquidity events similar to those experienced in September 2008. We are equally committed to the continuation of MMFs as an important sector of the global financial markets. We will be happy to continue to work with the IOSCO and its member nations regulators on reforms that are consistent with both of these objectives.

Please feel free to contact us if you have any questions or require additional information relating to our comments.

Respectfully,

/s/

Gregory P. Dulski
Corporate Counsel