Dreyfus

THE DREYFUS CORPORATION

J. Charles Cardona
President

April 23, 2014

Via Electronic Submission on www.sec.gov

U.S. Securities and Exchange Commission
Attn: Ms. Elizabeth M. Murphy, Secretary
100 F Street, NE
Washington, D.C. 20549-1090

RE: Money Market Fund Reform Proposals: Staff Analyses of Data and Academic Literature Related to Money Market Reform (SEC File Number S7-03-13)

Dear Ms. Murphy:

The Dreyfus Corporation ("Dreyfus") appreciates the opportunity to comment on the ***"Analyses of Data and Academic Literature Related to Money Market Reform"*** (the "Analyses") that were prepared by the Staff (the "Staff") of the U.S. Securities and Exchange Commission's (the "Commission") Division of Economic and Risk Analysis, which were published for public comment on March 24, 2013 and which supplement the Commission's June 2013 money market fund ("MMF") reform proposals (the "Proposals" and the "Proposing Release," as applicable).

Our comments on the four Analyses, listed below, are set forth in the subsequent sections of this letter.

1. Analysis of Liquidity Cost During Crisis Periods
2. Analysis of Government Money Market Fund Exposure to Non-Government Securities
3. Analysis of Demand and Supply of Safe Assets in the Economy
4. Analysis of Municipal Money Market Funds Exposure to Parents of Guarantors

Overall, Dreyfus welcomes the Staff's analysis of each of these various, important aspects of MMF reform, but we are concerned generally with the conclusions reached in these respective Analyses and with how these conclusions might inform final rulemaking.

This letter follows Dreyfus' comment letter dated September 17, 2013 filed in response to the Proposals and Dreyfus' supplemental comment letter dated March 5, 2014, which provided additional information to support Dreyfus' view that Municipal MMFs should be excluded from any structural MMF reforms the Commission may adopt.

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A. <u>Analysis of Liquidity Costs During Crisis Periods</u>
(the "Liquidity Cost Analysis")

The Staff indicated that the Liquidity Cost Analysis is intended, in part, to inform decision-making in connection with establishing a standby liquidity fee ("SLF"). The Commission sought comment in the Proposing Release on the reasonableness of applying a 2% SLF automatically (the "Default SLF") on MMF shareholders who redeem when the fund's Weekly Liquid Assets ("WLA") decline below 15% (the "Objective Trigger") unless a MMF board determines differently. In our September 17th comment letter, Dreyfus supported setting any Default SLF rate at 1% rather than 2% but also supported with that providing MMF boards with broader and more meaningful discretion to impose SLFs prior to the operation of any Objective Trigger. We believe our comments in this regard are consistent with the Commission's stated policy goals for this rulemaking (the "Policy Goals).[1]

We believe the substance of the Liquidity Cost Analysis is consistent with the views Dreyfus expressed in its September 17th comment letter. We read the Liquidity Cost Analysis and interpret the average spread calculations contained therein to support a Default SLF of 1% and not 2%, as proposed. As we noted in our September 17th letter, a Default SLF that is too high poses significant hurdles for the MMF and for their respective boards. If the Default SLF is too high the fund will over-withhold on a shareholder's redemption proceeds, which might unjustly enrich the fund and non-redeeming shareholders as well as create an overly large pool of unused capital that might negatively impact fund management. This issue is compounded by statements in the Proposing Release that will place a heavy burden on MMF boards that might seek to set a SLF rate that is lower than the Default SLF.

More importantly, though, in our view, the Liquidity Cost Analysis reaffirms our view that, if the Commission adopts the "Fees and Gates" alternative as a stand-alone option. MMF boards must be empowered to act in the best interest of shareholders. In our September 17th letter, we supported an Objective Trigger only as a "floor" for MMFs and their boards to act upon. We believe that MMF boards cannot adequately exercise their fiduciary responsibility and oversee the imposition of a Fees and Gates structure unless boards can act to protect shareholders to the fullest extent practicable. As previously stated in our September 17th comment letter, Dreyfus supports boards having the flexibility to apply an SLF and define the applicable SLF rate pursuant to the board's general fiduciary standard, protected by the business judgment rule, and before any Objective Trigger is activated.

We continue to support these broader powers for MMF boards to act in order to increase the effectiveness of Fees and Gates as a stand-alone option for reducing systemic risk, consistent with the Policy Goals.[2] To illustrate, consider that, with a 30% minimum WLA requirement (pursuant to Rule 2a-7), a MMF's liquidity can decline to under 15% rapidly during a severe market crisis. A MMF board, in our view, cannot effectively protect shareholder interests without the authority to be able to impose SLFs earlier than any Objective Trigger otherwise will require. Stated another way, boards cannot reasonably be charged with overseeing a Fees and Gates structure without having the commensurate flexibility and power to manage it.

[1] Our September 17th comment letter noted the following Policy Goals: (a) lessening MMFs' sensitivity to excess redemption activity (b) increasing MMFs' ability to manage through and mitigate potential contagion from high levels of redemptions; (c) imposing transparency and risk management overlays; and (d) preserving, as much as possible, the utility of MMFs.

[2] In our September 17th comment letter, we set forth reasons why we believe our view for how Fees and Gates should be structured answers the criticism that a Fees and Gates structure in fact increases run risk.

Moreover, we believe the acknowledged deficiencies in the data underlying the Liquidity Cost Analysis[3] argue for the inappropriateness of imposing a Default Fee requirement (and, in particular, an overly high Default SLF) without supplementing it with board flexibility to act during a financial crisis. We can expect that the next crisis will come upon us with as much uncertainly as the recent one came upon us, and so optimal foresight dictates allowing MMF boards to be armed with the appropriate flexibility to implement the tools and measures that the regulator otherwise supports, in the best interests of fund shareholders.

B. **Analysis of Government MMF Exposure to Non-Government Securities**
(the "Government MMFs Analysis")

We recognize that the Government MMF Analysis is intended to help define the "Government MMF" exclusion from any proposed structural reforms that may be adopted.[4] However, for the reasons discussed below, we caution that the focus in the Government MMF Analysis on current allocations to "Other Securities" in Government MMFs could lead to unnecessary or misdirected conclusions.

In proposing the Government MMF exclusion, the Commission noted that a Government MMF invests at least 80% of its assets in U.S. Government securities. However, we read the Government MMF Analysis to (1) suggest that a constant net asset value ("CNAV") Government MMF should not, or does not need to, have the flexibility to invest up to 20% of its assets in "Other Securities" simply because Government MMFs currently do not take full advantage of that flexibility and (2) conclude that a 95%/5% "name test" requirement for a CNAV Government MMF is appropriate. Without agreeing or disagreeing with the Staff on this point, we offer the following information to provide context for further deliberation on this issue.

Dreyfus would not have expected that the Government MMF Analysis would have revealed significant investment by Government[5] MMFs in non-Government securities. We acknowledge that the typical Government MMF tends to stay at or near fully invested in Government securities (including, in some cases, repurchase agreements collateralized by Government securities), but the Government MMF Analysis misses the critical reason why this is the case. In some cases, Government MMFs serve a specific client investment mandate for a Government-only or a Government and Repo-only[6] MMF). In other cases, Government-only MMFs are desirable for certain investors because they generate dividends that are exempt from state income tax. In still other cases, Government MMF investments represent an investor's decision to seek the highest level of credit safety in a stable value investment. In the current CNAV MMF environment, a "hybrid"[7] Government/Prime MMF does not correspond with this intolerance for credit risk (and would draw little investor interest when distributed side-by-side with Prime MMFs). The common element in each case is meeting investor demand, which remains the core principle for product development in the MMF cash management/ savings vehicle investment space.

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[3] For example, the Staff indicates that *"....our sample differs from what MMFs hold"* (p.2) and that *"...TRACE did not cover many of these types of instruments in 2008 and 2009"* (referring to the several instruments that constitute approximately two-thirds of aggregate MMF holdings) (p.2).

[4] Dreyfus continues to support excluding Government MMFs from any structural reforms that might be adopted.

[5] Unless otherwise indicated, reference to "Government" MMFs includes those that invest predominantly in U.S. Government securities or those that are further limited to U.S. Treasury securities.

[6] In this circumstance, Repo collateral would be limited to Government securities.

[7] While there are many factors that ultimately determine what the structure of such a product might look like, we would expect that a 95%/5% hybrid Government/Prime MMF would not provide enough incremental yield pick-up to generate sufficient investor demand for the product-type to gain broader investor acceptance.

If the Commission adopts a variable net asset value ("VNAV") for Prime MMFs, the investor's decision-making process will change dramatically. MMF providers can be expected to offer products that meet investor demand as well as close products that no longer meet investor demand. So, in a dual CNAV/VNAV MMF universe, we cannot say with certainly that investor's would not consider a hybrid CNAV Government/Prime MMF for investment just because they do not consider such a fund for investment currently. The Government MMF Analysis is inadequate, in our view, because it should have focused on assessing the potential systemic risk posed by a hybrid fund and pursued a related economic analysis that addresses the cost-benefit of preserving a hybrid CNAV Government/Prime MMF. This would seem the appropriate course in light of the Policy Goals, rather than only relying on current allocations to "Other Securities" in such funds to decide on how to define funds in a new CNAV/VNAV MMF universe.

C. <u>Analysis of Demand and Supply of Safe Assets in the Economy</u>.
(the "Safe Assets Analysis")

We believe the Safe Assets Analysis has numerous shortcomings and should not be relied on by the Commission to justify adopting a VNAV structure. We believe the definition of "safe assets" put forth in the Safe Assets Analysis is inadequate. We also believe the Safe Assets Analysis relies too heavily on opinion and supposition and does not provide the requisite quantitative evidence to demonstrate that the U.S. Treasury market will not suffer substantial and long-term harm from the permanent migration of assets from Prime MMFs to Government MMFs if a VNAV for Prime MMFs is adopted. The Safe Assets Analysis also seems to ignore that Prime MMF investors rely on MMFs as their cash management vehicle of choice, meaning that the vast majority of the universe of "safe assets" are not alternatives for Prime MMF investors. The Analysis should have acknowledged that the alternative for Prime MMF investors (if subject to a VNAV) principally will be limited to CNAV Government MMFs and bank deposit sweep vehicles. Currently, there are no other products or services that can provide the cash management services institutions require and have come to depend on from MMFs. Finally, the Safe Assets Analysis also fails to recognize that the vast majority of Safe Assets are not eligible investments for U.S. Government MMFs, meaning that the ability of such funds to absorb net inflows is more limited than estimated.

A "safe asset" is defined as *"any debt asset that promises a fixed amount of money in the future with virtually no default risk."* The Analysis also includes the statement that *"any asset can be rendered safe by an implicit or explicit promise from a central bank or credit-worthy institution to buy it if its price falls below a certain level."* We find this definition perplexing and question the extent to which it compromises the Analysis. While we agree generally with the assertion in the Analysis that *"historically, bank deposits and Treasuries constitute the vast majority of domestic safe assets,"*[8] we are not aware of the degree to which "creditworthy institutions" offer investment products with a promise to buy them back if the price of the product falls below a certain level, as the Analysis contemplates. We believe the Analysis should have presented a clearer case for what seems contrary to current practice.

We also believe the Safe Assets Analysis inappropriately presumes that each component within the global universe of "safe assets" is substitutable for Prime MMFs. This is simply not the case. The Analysis ignores the fact that MMFs serve as the cash management vehicle of choice for millions of investors. The demand for cash management services will not be eliminated if a VNAV structure is adopted for Prime MMFs. This is why industry commenters, including Dreyfus, focused so heavily on

[8] These excerpts are drawn from pages 1 and 2 of the Safe Assets Analysis.

the substantial, long-term harm that a VNAV structure poses to the U.S. Treasury market, particularly in the current "zero-yield" rate environment. The Safe Assets Analysis does not address this near universal industry concern over implementation of a VNAV structure and fails to recognize that there are only two alternatives for VNAV Prime MMF cash management clients: Government MMFs and bank deposit sweep products.

Further, the assertion in the Safe Assets Analysis that the "global economy" offers the capacity to provide an adequate supply of Safe Assets is based on supposition and conjecture only and, in our view, is inadequate for its intended purpose.[9] The Analysis also fails to acknowledge the most basic fact that, historically, U.S. Treasuries have been the safe asset of choice globally, meaning that investors globally do not utilize the "universe" of safe assets to the extent implied by the Analysis.

In addition, we believe this Safe Assets Analysis fails to adequately answer the critical issue of the direct, long-term, negative impact that a VNAV structure will have on the U.S. Treasury market (which was the narrow focus of numerous commenters, including Dreyfus). We note, for instance, on page 5 of the Analysis that "$357 billion" is provided as an estimate for the amount that will redeem Prime MMFs and re-invest in Government MMFs. Regardless of the reasonableness of this estimate,[10] the Staff then answers this concern by concluding that since the *"global market for safe assets is estimated to be $74 trillion, it is difficult to envision such flows would create a problem."* This conclusion is overly simplistic and ignores the most basic fact that the vast majority of the world's safe assets are not eligible investments for U.S. Government or Treasury MMFs.

There is a statement in the Safe Assets Analysis that the 2008 financial crisis provided evidence that Government MMFs *"can absorb large inflows, especially if they occur over a period of time."* This assertion, however, also ignores basic facts. It ignores how supply and demand conditions during this period drove U.S. Treasury yields to zero, which threatened the stability of Government MMFs. The statement also ignores that on multiple occasions Government MMFs had to close to new investors to prevent additional net inflows which, if accommodated, might have resulted in a "negative yield" being generated for certain Government MMFs. Under such a circumstance, absent the option of a return of principal to investors, the MMF is forced to liquidate and distribute its proceeds. Finally, the Safe Assets Analysis fails to adequately address how $374 billion in flows will be absorbed into a U.S. Government/Treasury market that already is a zero-yielding environment (compared with 2008, where there was a nominal Treasury yield curve in existence before the net flows from Prime into Government funds began).

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[9] For example, we note the following unsubstantiated assertions (see page 4 of the Analysis, emphasis added):

- *".....sustained excess demand for safe assets should increase the price of safe assets and lower rates."*
- *These higher prices should attract new private-label safe assets to the market."*
- *"As prices rise, the supply of safe assets should increase.*
- *"Other adjustments might transpire as well: Regulators, for example, may choose to alter regulatory requirements that affect the demand and supply of safe assets and collateral over time."*
- *Central banks may provide guarantees or 'monetary backstops" for private-label securities, thereby transforming them into safe assets."*
- *Alternatively, they may...."rent" good collateral to strong counterparties."*

[10] To emphasize, our concern here is not with the size of this estimate but with the conclusion drawn from the assumption. For example, in our September 17th comment letter, we estimated that, based on client feedback, approximately 25% of the assets in Dreyfus' Institutional Prime MMFs would transfer permanently into Government MMFs.

Overall, we are not persuaded that these unsubstantiated opinions justify adopting a VNAV structure for Prime MMFs on a cost-benefit basis, nor are we persuaded that the Safe Assets Analysis fairly addresses the likelihood that the global supply of safe assets in fact will provide reasonable alternatives for Prime MMF investors. Accordingly, Dreyfus cannot support an economic analysis on this issue that does not recognize the capacity constraints and performance impact (from a supply and yield perspective) on U.S. Government/Treasury MMFs that are posed by the VNAV alternative.

D. <u>Analysis of Municipal MMF Exposure to Parents of Guarantors.</u>
(the "Guarantors Analysis")

The Commission has proposed eliminating the "25% Basket" under Rule 2a-7, which allows for up to 25% of the value of a MMF's portfolio securities to be subject to guarantees or demand features from a single guarantor (with the remaining 75% of the portfolio subject to a 10% cap per guarantor). Dreyfus opposed eliminating the 25% basket in its September 17th comment letter and continues to believe that eliminating the 25% basket, particularly with respect to state-specific Municipal MMFs, is unnecessary, will not materially advance the Policy Goals, and will harm certain MMFs that rely on this flexibility for efficient portfolio management. As more fully discussed below, Dreyfus believes that the Guarantors Analysis does not adequately address these issues.

We agree with the data provided in the Guarantors Analysis suggesting that state-specific Municipal MMFs utilize the 25% basket most. We would expect that the Guarantors Analysis would make this finding because the flexibility afforded by the 25% basket is most important to managing these types of funds. Of greater concern, though, are the assertions made and conclusion drawn in the "Average Guarantor Exposure" section of the Analysis, where the Analysis notes that *"any increase in guarantor diversification should not lead to a deterioration in guarantor credit quality."*[11]

We presume the above-noted conclusion is designed to provide support for the proposed eliminate of the 25% basket. However, numerous critical factors relevant to this issue are overlooked in the Analysis, most important of which is that the credit quality of the various "other guarantors" listed in the Analysis is not the relevant consideration underlying our comment or the cost-benefit analysis appropriate to this issue. Regardless of the credit quality of these guarantors,[12] these guarantors have not provided, and are not expected to provide, the supply of Rule 2a-7 eligible securities that will compensate for the loss of supply to state-specific Municipal MMFs that would occur if the 25% basket is eliminated.

In addition, the Guarantors Analysis does not adequately reflect how Municipal MMFs currently use the 25% basket, in order to assess the potential impact on such funds. Currently, many Municipal MMFs (and again, particularly state-specific MMFs) will rely on the 25% basket for flexibility to exposure to two different guarantors. While monitoring against a 10% limitation even for these two guarantors, the 25% basket allows for flexibility in the event of supply shortages or sharp net asset outflows without impacting efficient portfolio management. Eliminating the 25% basket will cap all guarantor exposures

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[11] See page 15 of the Guarantors Analysis.

[12] We note, however, that the Analysis, in our view, inappropriately reaches conclusions about the credit quality of the various guarantors listed. That, however, is a task for fund management to determine pursuant to its "minimal credit risk" obligation under Rule 2a-7, and so we believe that the Analysis inappropriately relies on this factor in reaching its conclusion about the impact on MMFs if the 25% basket is eliminated.

at 10% and will eliminate this necessary flexibility required to maintain orderly portfolio management, particularly for State-specific Municipal MMFs.[13]

Further, the Guarantors Analysis ignores the fact that virtually all of the securities that are subject to these guarantees and that may reside within the 25% basket are variable rate demand securities with 1- or 7-day reset periods. These are highly liquid securities that do not pose systemic concerns for Municipal MMFs. Correspondingly, we believe the need to diversity guarantor exposure from 75% to 100% of a Municipal MMF's assets is unwarranted given the certain negative consequences on supply that will ensue from such action.

We appreciate the Staff providing the opportunity for public comment on these Analyses. If you have questions in regard to this comment letter, you can reach me directly at (212) 922-6680 or, in my absence, please contact John B. Hammalian, Senior Managing Counsel, at (212) 922-6794.

Very truly yours,

J. Charles Cardona

J. Charles Cardona
President

With copies to:

The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
Norman B. Champ, III, Director, Division of Investment Management

[13] We believe reducing the 25% basket to a 15% basket, for example, would be counterproductive. Such a move would eliminate flexibility with respect to one guarantor and drive concentrations higher in another guarantor (from just under 10% to up to 15%). We cannot see how that change will further the Commission's stated policy goals.