FannieMae

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September 3, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, DC 05749-1090

RE: Comments of Federal National Mortgage Association ("Fannie Mae") on Proposed Money Market Fund Reform, Release No. IC-28807; SEC File Number S7-11-09 (June 30, 2009) (the "Release")

Dear Ms. Murphy:

Fannie Mae appreciates the opportunity to comment on the proposal of the Securities and Exchange Commission (the "SEC" or the "Commission") of amendments to the rules governing money market funds (the "Proposed Rules").

We commend the SEC for its action on the Proposed Rules, which we believe will improve the risk profile of money market funds and offer greater protections and information to investors in money market funds.

This letter comments on two changes in the Proposed Rules, the addition of the "weighted average life" test and the shortening of the "weighted average maturity" test, both of which we believe could have adverse consequences for active daily issuers of short and long-term debt securities such as Fannie Mae that outweigh the anticipated incremental increase in the protections for investors in money market funds.

Background

Fannie Mae is an active daily issuer of both short and long-term debt securities. Fannie Mae uses the proceeds from these daily issuances to fulfill its Congressionally-chartered mission to support liquidity and stability in the secondary mortgage market.

During the first half of 2009, we purchased or guaranteed an estimated $415.2 billion in new business, measured by unpaid principal balance, which provided financing for approximately 1,737,000 conventional single-family loans and approximately 193,000 multifamily units.[1] The $415.2 billion in new business consisted of $255.8 billion in Fannie MBS that were issued, and $159.4 billion in mortgage loans and mortgage-related securities that we purchased for our mortgage investment portfolio.[2] As of June 30, 2009, Fannie Mae had approximately $260 billion in short-term debt securities outstanding and $573 billion in long-term debt securities outstanding.[3]

[1] Fannie Mae Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2009, page 15.
[2] Id.
[3] Id. at page 70-71.

As a leading investor in mortgage assets, we closely monitor the prepayment and duration risk inherent in mortgage investments. This risk is present because each mortgage borrower has the option of prepaying its mortgage at any time (via refinance or sale of the property) or of continuing to pay its mortgage to its stated maturity (usually 15 or 30 years). Our overall goal is to manage interest rate risk by maintaining a close match between the duration of our assets and our liabilities.[4] We historically have actively managed this risk through a variety of techniques, including (i) asset selection and structuring, (ii) issuance of a broad range of callable and non-callable debt instruments, and (iii) use of LIBOR-based interest-rate derivatives.[5]

It is critical to our ability to further our mission to provide liquidity and stability to the secondary mortgage market that we maintain adequate liquidity to fund our operations.[6] Our primary source of funds is proceeds from the issuance of short-term and long-term debt securities, and our liquidity depends on our ability to issue our debt in the capital markets.[7] Money market funds, as active investors in debt securities, are a key provider of liquidity in the capital markets.

As demonstrated on *Appendix A* to this letter, money market funds have been a valuable source of liquidity for Fannie Mae, especially in times of market distress. In 2008, Fannie Mae sold over $48 billion in variable rate securities with a maturity of two years or less, offerings that we believe were purchased almost exclusively by money market funds. For the period from January 1, 2009 through June 30, 2009, Fannie Mae sold over $23 billion of such securities. This compares with only $3.75 billion of variable rate securities with a maturity of two years or less that were sold in 2007, $2 billion in 2006, and approximately $17 billion in 2005.

We believe the chart in *Appendix A* can be explained by a confluence of two factors that occur in times of market disruption. First, in times of market distress, investors such as money market funds seek to invest in highly-rated, highly liquid assets such as those offered by issuers of "government securities" such as Fannie Mae. Second, in such times, active issuers of short and long-term debt securities may find certain sources of funding or markets (*e.g.*, the long-term debt markets) not operating efficiently, and may seek to achieve their funding needs by accessing other markets, such as the variable-rate debt markets preferred by money market funds.

Proposed Rule Changes

We would like to comment on two of the changes in the Proposed Rules, the addition of the new "weighted average life" test and the shortening of the "weighted average maturity" test from 90 to 60 days.

A. "Weighted Average Life" Test

Our first comment with respect to the Proposed Rule relates to the new 120 day "weighted average life" test for money market funds.[8] This new test requires a money market fund to (i) calculate the stated contractual maturity of its portfolio assets without regard to the interest rate

[4] Fannie Mae Second Quarter 2009 10-Q, page 106.
[5] Id.
[6] Id. at page 66.
[7] Id.
[8] Release, beginning on page 45.

readjustment maturity-shortening provisions in Rule 2a-7(d), and (ii) limit the "weighted average life" of its portfolio assets to an average of 120 days.[9]

As noted in the Release, the maturity shortening provisions currently set forth in Rule 2a-7(d) allow money market funds to treat floating rate government securities as having a maturity of one day, and to treat variable rate government securities (*e.g.*, securities with interest rates that reset weekly, monthly, quarterly, *etc.*) as having a maturity equal to the period remaining until the next interest rate reset date.[10] Variable rate securities that are not "government securities" under Rule 2a-7 only receive this treatment if they have a final maturity of 397 days or less.[11]

In the Release, the SEC staff requests comment on whether the Proposed Rule should restrict a money market fund's ability to use the maturity shortening provisions of the rule to those adjustable-rate securities, including government securities, with maximum final maturities of no more than two years, three years, or four years.[12] The Release indicates that the SEC is concerned that the traditional weighted average maturity measurement (including the maturity shortening provisions in Rule 2a-7(d)) does not limit adequately a money market fund's exposure to credit spread risk and interest rate spread risk appurtenant to securities with longer maturities.[13] While we concur with this assessment to a degree, we believe that the solution set forth in the Proposed Rule – to eliminate all maturity shortening provisions and require a weighted average life of 120 days for all portfolio assets – will have an adverse impact on the overall market disproportionate to the anticipated benefit.

We endorse the application of the weighted average life test set forth in the Proposed Rule to government securities with maturities of more than two years. We submit, however, that preserving the interest rate reset maturity shortening provisions for government securities that have a maturity of 731 days or less will both minimize market disruption and enable issuers of government securities to continue to meet critical internal funding needs. As demonstrated in *Appendix A*, during times of market disruption, active daily issuers of debt securities such as Fannie Mae have benefitted from money market fund's appetite for variable rate securities with a maturity of two years and under. We are concerned that the Proposed Rule, as currently drafted, would unnecessarily cut-off active daily issuers of debt securities from a valuable source of liquidity.

B. "Weighted Average Maturity" Test

Our next comment with respect to the Proposed Rule relates to the proposed shortening of the "weighted average maturity" test for money market funds from 90 days to 60 days.[14] The Release cites concerns about interest rate risk and credit spread risk inherent in longer-dated securities and statistics that taxable funds on average maintain a weighted average maturity of under 60 days as justification for modifying the rule.[15] The Release also notes that the recommendation in the ICI Report was to reduce the maximum weighted average maturity for money market fund portfolios from 90 to 75 days.[16]

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[9] Id.
[10] Rule 2a-7(d)(1).
[11] Rule 2a-7(d)(2).
[12] Release, page 50.
[13] Id. at 47.
[14] Id., beginning on page 42.
[15] Id. at 42-44.
[16] Id. at 43.

We concur that shortening the "weighted average maturity" of money market funds from 90 to 60 days in the Proposed Rule will provide some improvement to the risk profile of those funds; however, we are concerned that such changes will result in heightened "roll-over" or refinancing risk. Issuers that fund their business and operations through the issuance of debt, such as Fannie Mae, face heightened roll-over risk if there is an increase in the amount of short-term debt as a percentage of total debt outstanding. We believe the Proposed Rule could be modified to better balance the incremental improvement in the risk profile of the money market funds against the increased roll-over risk that would result from a shortened "weighted average maturity" test.

As noted in the Release, money market funds do not typically manage their portfolios up to the maturity limits set forth in Rule 2a-7.[17] Although the current Rule 2a-7(c)(2)(iii) allows money market funds to maintain a dollar-weighted average portfolio that does not exceed 90 days, the Commission notes that the average weighted average maturity of taxable money market funds (as a group) has not exceeded 58 days in the last twenty years.[18] Since money market funds seem to be already managing to a "weighted average maturity" of less than 60 days, we are concerned that a reduction in Rule 2a-7 from 90 to 60 days will result in a significant further decrease in the weighted average maturity of such funds as they attempt to stay well within the new limit.

Also, as noted above, during the upheaval in the capital markets in 2008 and into 2009, money market funds became a more significant source of liquidity for active daily issuers such as Fannie Mae. We believe these purchases of Fannie Mae securities by money market funds, especially in a time of market disruption, were beneficial not only for Fannie Mae and the money market funds, but for the market as a whole. We are concerned that if a similar market environment were to occur at a time when money market funds were subject to the new 60 day rule, that rather than being a valuable source of liquidity for active daily issuers of debt securities, a money market fund's needs for shorter-term debt securities could exacerbate tumultuous market conditions by subjecting active issuers such as Fannie Mae to increased short-term roll-over risk.

We propose that in order to balance the interests of money market funds and active issuers of debt securities, that the Commission consider bifurcation of the "weighted average maturity" test. We propose that money market funds that are "Retail Funds" under the Proposed Rule, given their anticipated customer base, be limited to a weighted average portfolio maturity not to exceed 60 days. We further propose that money market funds that are "Institutional Funds" under the Proposed Rule, with their institutional customer base, be allowed to maintain the current standard of a weighted average portfolio maturity not to exceed 90 days. We believe this solution (i) protects consumers from investing in money market funds with a higher risk profile, (ii) allows funds with a sophisticated institutional investor base the freedom to opportunistically extend the average maturity of their portfolios and (iii) helps protects active issuers of short-term securities from increased roll-over risk due to decreases in money market fund interest in longer duration securities.

Conclusion

We appreciate the opportunity afforded by the SEC to comment on the Proposed Rules. We believe that the new requirements for money market funds set forth in the Proposed Rule achieve the Commission's goals of improving the risk profile of money market funds and improving the information available to investors in those funds.

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[17] Release at 43-44.
[18] Id.

Our comments in this letter are intended to highlight two provisions in the Proposed Rules that we believe could be modified to lessen the impact of the Proposed Rules on active daily issuers of short and long-term debt securities while at the same time not materially impacting the Commission's goals of reducing the risk profile of money market funds. We remain mindful of our Congressionally-mandated mission to provide liquidity and stability in the secondary mortgage market and the importance of maintaining access to all significant sources of capital to help us fulfill that mission.

For the "weighted average life" test, we believe that allowing maturity shortening mechanisms for government securities with a maturity of two years or under will minimize market disruptions for both money market funds and issuers of government securities such as Fannie Mae. Such an exception would prohibit money market funds from investing in longer-maturity government securities, which can subject such funds to increased credit spread and interest rate spread risk, while maintaining money market fund access to a deep, highly liquid market for variable rate government securities with a maturity of two years and under.

For the "weighted average maturity" test, we believe that allowing money market funds that meet the definition of an "Institutional Fund" under the Proposed Rules to continue to maintain a weighted average portfolio of 90 days, while limiting "Retail Funds" to 60 days, will help to protect the average consumer while at the same time allow funds with a sophisticated institutional investor base to continue to invest in longer maturity securities that also help protect active issuers of short-term securities from increased roll-over risk.

In closing, we also would comment that given the anticipated effects that the Proposed Rules may have on money market funds and active issuers of debt securities, that the implementation of the final rules be done over a 90 to 180 day period to minimize any market disruption.

Sincerely,

Stephen H. McElhennon
Vice President & Deputy General Counsel

APPENDIX A

FANNIE MAE ISSUANCES OF VARIABLE RATE SECURITIES WITH A MATURITY OF TWO YEARS OR LESS