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September 14, 2009

Ms. Elizabeth M. Murphy
Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Mr. David A. Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Harmonization of Regulation, File Number 4-588: Harmonizing the Regulation of Allowable Investments for Segregated Customer Funds of SEC Broker-Dealers and CFTC Futures Commission Merchants.

Dear Ms. Murphy and Mr. Stawick:

We submit these comments on behalf of Federated Investors, Inc. ("Federated") regarding the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission's ("CFTC") request for comment regarding the harmonization of these agencies' rules.[1] In responding to a call by the White House for the SEC and CFTC to make recommendations to Congress for changes to statutes and regulations that would harmonize the regulation of futures and securities, the SEC and CFTC held joint public meetings to discuss recommendations for changes and asked for public comment on harmonization.

Federated is a Pittsburgh-based financial services holding company and a major sponsor of money market funds regulated under SEC Rule 2a-7 of the Investment Company Act of 1940. Federated money market funds have aggregate assets in excess of

[1] See Joint Meetings on Harmonization of Regulation, SEC Release No. 34-60539 (Aug. 19, 2009); see also CFTC/SEC to Hold Joint Meeting on Regulation Harmonization (Aug. 20, 2009), Press Release available at http://cftc.gov/newsroom/generalpressreleases/2009/pr5696-09.html.

$350 billion. Federated's money market funds are designed for use by regulated entities where a statute, rule or instrument limits an investment to high-quality, liquid, short-term investments. Federated money market funds meet the requirements of CFTC Regulation 1.25 and are used by Futures Commission Merchants ("FCMs") as investments on behalf of their customers. We estimate that at any given time FCMs invest approximately three billion dollars into Federated money market funds, which successfully serve the needs of FCMs in meeting their customer segregated fund requirement under CFTC Regulations.

## Our Recommendation for Harmonization

For the reasons set forth below, we believe that the harmonization of SEC's Rule 15c3-3(a)(6) ("qualified securities") by including money market mutual funds so as to be consistent with CFTC's Regulation 1.25 ("permitted investments") (both agencies' regulations pertain to investment options for segregated customer funds), is a relatively simple and easily defined modification which would accomplish the twofold purpose of coordinating the regulatory regimes of the SEC and CFTC and further benefitting broker-dealers and their customers by conferring operational flexibility, reduced costs and avoidance of concentration risks (i.e., segregated customer funds concentrated in a few large banks).

There does not appear to be any customer protection justification that allows FCMs to use money market funds for segregated customer funds purposes, but denies broker-dealers the authority to use money market funds as an investment option for segregated customer funds in an analogous function, especially when the SEC itself regulates money market funds.

To harmonize the use of money market mutual funds as an investment option for segregated customer funds under both regulatory regimes, the SEC would need only to amend Rule 15c3-3(a)(6) to include money market funds as an investment option like those allowed under CFTC's Regulation 1.25.

### I. Both the SEC and the CFTC regulatory regimes have established requirements for the segregation of customer funds, however, they differ only in the availability of investment options for those funds.

Both the SEC and the CFTC regulatory regimes have established requirements for the segregation of customer funds held by a broker-dealer or FCM, and both regulatory regimes permit the broker-dealer or FCM to place customer funds into specific investment options. Nevertheless while the CFTC has expanded its list of permitted investments over the years to include, among others, interests in money market mutual funds, the SEC has failed to expand its list of investment options.

SEC Rule 15c3-3 requires broker-dealers to account for all customer funds held by the broker-dealer. The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of insolvency. The required amount of customer funds to be segregated is calculated pursuant to a formula

set forth in Exhibit A to Rule 15c3-3. If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash or "qualified securities" in that net amount in a Special Reserve Bank Account for the Exclusive Benefit of Customers (the "Reserve Account"). SEC Rule 15c3-3(a) provides that a broker-dealer may maintain customer funds in cash and/or qualified securities. Rule 15c3-3(a)(6) defines the term "qualified security" as meaning "a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States."

Similarly, CFTC Regulation 1.20 requires FCMs to treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer and separately account for such customer funds. CFTC Regulation 1.20(c) provides that an FCM may maintain customer funds in permitted investments as described in Regulation 1.25. Regulation 1.25 defines the term "permitted investments" to include, among others, "obligations of the United States and obligations fully guaranteed as to principal and interest by the United States." However, unlike the SEC's segregation of customer funds rule, CFTC Regulation 1.25 also permits customer funds to be invested in "interests in money market mutual funds."

As noted above, SEC Rule 15c3-3(a)(6)'s "qualified securities" does not include money market funds.

The CFTC first allowed FCMs to use certain money market funds for purposes of "permitted investments" for customer segregated funds in 2000. In its release, the CFTC stated that it was allowing FCMs to invest customer funds in money market funds based upon, in part, its conclusion that "an expanded list of permitted investments could enhance the yield available to FCMs, clearing organizations and their customers without compromising the safety of customer funds."[2] At that time, the CFTC also noted that the expansion of Regulation 1.25 and the safeguards therein, would become a part of the broad set of protections built into the system intended to guard against financial risk at FCMs.

After several years of favorable experience, the CFTC amended its rule and allowed FCMs to use any Rule 2a-7 money market fund.[3] In consideration of, among other things, (1) the risk-limiting standards imposed by Regulation 1.25(c) (to be discussed below), (2) the existence of extensive investor protections of SEC Rule 2a-7 that imposes strict portfolio quality, diversification, and maturity standards, which greatly limit the possibility of significant deviation between the share price of a fund and its per share net asset value, and (3) the board oversight imposed on money market funds

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[2] 65 Fed. Reg. 39008, 39014 (June 22, 2000) (rule proposal); 65 Fed. Reg. 77993 (Dec. 13, 2000) (rule adoption).

[3] See 68 Fed. Reg. 38654 (June 30, 2003); 70 Fed. Reg. 28190, 28194-95 (May 17, 2005).

regarding credit quality requirements and investment procedures, the CFTC expanded Regulation 1.25 to allow FCMs to use any Rule 2a-7 money market fund.[4]

Although the SEC has not yet allowed broker-dealers to use money market funds for purposes of "qualified securities" for customer segregated funds, the SEC has proposed to expand the definition of "qualified securities" to include certain money market funds.[5] In that release, the SEC stated that expanding the definition of "qualified securities" to include money market funds could provide greater operational flexibility to broker-dealers in meeting their Rule 15c3-3 customer protection requirements.[6] In the following two and a half years, the SEC has not acted on this rule proposal.

## II. The harmonization of money market fund use by broker-dealers and FCMs for segregated customer fund requirements is beneficial to the SEC and CFTC regulated entities and their customers.

In addition to fulfilling the goal of harmonizing SEC and CFTC regulations, the inclusion of money market funds for SEC Rule 15c3-3 segregated customer fund requirements will be beneficial to both broker-dealers and their customers. As discussed below, money market funds provide liquidity and safety to customer money through a comprehensive regulatory regime of the Investment Company Act of 1940, SEC Rule 2a-7 and CFTC Regulation 1.25. Furthermore, federal and state regulators, FCMs and broker-dealers endorse the use of money market funds.

### A. Money market funds are subject to a comprehensive regulatory scheme under the Investment Company Act of 1940, SEC Rule 2a-7 and CFTC Regulation 1.25, which collectively provides liquidity and safety to customer money.

Money market funds holding customer money are subject to all four of the major federal securities laws administered by the Securities and Exchange Commission, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 and, most importantly, the Investment Company Act of 1940. Beyond the broad general protections of the Investment Company Act, money market funds must meet the exacting requirements of Rule 2a-7. Moreover, the requirements of CFTC Regulation 1.25 provide further protections to customer money committed to money market funds.

The Investment Company Act places substantive requirements or restrictions on a fund's governance and structure; its issuance of debt and senior securities; its

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[4] See 70 Fed. Reg. 28190, 28195 (May 17, 2005).

[5] See Amendments to Financial Responsibility Rules for Broker-Dealers, 72 Fed. Reg. 12862, 12865 (Mar. 19, 2007) (hereinafter the "March 2007 Proposal").

[6] See March 2007 Proposal, 72 Fed. Reg. at 12865.

investments, sales and redemptions of its shares; and its dealings with service providers and other affiliates.[7] Some of the important requirements of the Investment Company Act's comprehensive regulatory program include the following:

- A money market fund is subject to both internal board oversight and external SEC oversight,
- A money market fund is required to disclose all material aspects to investors and the market place,
- A money market fund is required to maintain strict custody of its assets, and
- A money market fund is required to maintain highly liquid investments as investors may redeem fund shares each business day.

As a second layer of regulation, the SEC established a specific regulatory program for money market funds under Rule 2a-7 of the Investment Company Act, to further enhance the usefulness and safety of money market funds. Rule 2a-7, adopted in 1983, has been an unqualified success, and has been revised and strengthened periodically in light of money market funds' response to economic conditions.[8] The primary objective of every money market fund is to maintain a stable value per share. In order to maintain a stable value per share, a money market fund's exposure to credit risk (the risk that the fund will not receive timely payment on an investment) and market risk (the risk of significant changes in value due to changes in prevailing interest rates) must be limited. Rule 2a-7 sets forth provisions, including portfolio maturity provisions, portfolio quality provisions, and portfolio diversification provisions, which are specifically designed to reduce such risks by limiting the composition of a money market fund's portfolio. These requirements also enhance liquidity, providing a strong investor protection foundation.[9]

In addition to the layers of protection noted above, CFTC Regulation 1.25 also requires, among others, that the net asset value of the money market fund be computed by 9 a.m. of the business day following each business day and made available to the FCM by

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[7] See Paul Roye, Director, Division of Investment Management, Speech by SEC Staff: The Genius of the Investment Company Act – A Framework for Adaptation to Change, June 15, 2005, available at http://www.sec.gov/news/speech/spch382.htm.

[8] See Release No. IC-13380 (July 11, 1983), 48 Fed. Reg. 32555 (July 18, 1983) ("Rule 2a-7 Adopting Release); Release No. IC-21837 (Mar. 21, 1996), 61 Fed. Reg. 13956 (Mar. 28, 1996).

[9] On June 30, 2009, the SEC released for comment proposed comprehensive money market reforms to further tighten the risk-limiting conditions of Rule 2a-7 and other potential changes in the regulation of money market funds. See Investment Company Act Release No. IC-28807. These reforms would increase protections on money market funds by further constraining the maturity and credit quality of their portfolios. They would also safeguard the liquidity of money market funds by requiring investment of a substantial portion of the portfolio in the most liquid or shortest-term securities. In addition, the reforms would increase oversight through stress testing and more frequent disclosures. Given the SEC's reform efforts, it would be reasonable to anticipate that the protections and liquidity of money market funds will increase in the near future, making them even more appropriate investments for customer segregated funds.

that time and, with noted exceptions, the money market fund must be legally obligated to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request.

This multi-layered, comprehensive regulatory framework has been an overall success in permitting FCMs to use money market funds to meet their regulatory requirements concerning customer money.

**B. The financial industry's use of money market funds confirms their value and usefulness.**

Unsurprisingly, under the broad protections of the Investment Company Act of 1940, institutional investors began to use money market funds during the 1970s. Their confidence in money market funds grew after the SEC adopted Rule 2a-7 in 1983. In the last ten years, money market funds' assets under management have increased significantly. In 1998, $1.4 trillion was invested in money market funds and by the end of 2008, approximately $3.8 trillion was invested in money market funds.[10]

Federal and state regulators have also helped expand the use of money market funds. For example money market funds have been approved as investments for national banks by the Office of the Comptroller of the Currency; for state-chartered banks by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation; for federal credit unions by the National Credit Union Administration; and for state and municipal entities.[11] Further, in addition to having been approved by the CFTC as an investment vehicle for customer funds held in custody by FCMs, money market funds have been approved for margin collateral by the Clearing Corporation, the New York Mercantile Exchange, the Chicago Mercantile Exchange, and the Options Clearing Corporation.

As a practical matter, the disclosures and reporting requirements, noted above, provide FCMs and other users with a clear mechanism to evaluate their appropriate use of money market funds in terms of credit, liquidity and other factors in contrast with the investment products with which money market funds compete. Indeed, FCMs have found money market mutual funds to involve significantly less concentration, credit and operational risk, i.e., obviating the need to assemble a portfolio of individual securities,

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[10] See Statements by Chairman Shapiro and Commissioners Walter and Aguilar, Money Market Fund Reform, Securities and Exchange Commission Open Meeting, June 24, 2009, available at http://sec.gov/news/speech/2009/spch062409mls.htm, http://sec.gov/news/speech/2009/spch062409ebw.htm, and http://sec.gov/news/speech/2009/spch062409laa.htm, respectively.

[11] See Appendix D of the Report of the Money Market Working Group submitted to the Board of Governors of the Investment Company Institute, March 17, 2009, for a review of state regulations identifying money market funds and other stable NAV investments that are permissible investments.

while at the same time benefiting from the diversification requirements of SEC Rule 2a-7. As short-term investment vehicles, they contribute liquidity and safety to their users.

Further, broker-dealers have advised that they are highly interested in the possibility of investing segregated customer funds into money market funds and have indicated that the option of being able to use money market funds would alleviate credit and operational risks.[12] Further, the additional investment option of money market funds would minimize the need of broker-dealers having to put customer funds at risk of the balance sheets of banks where the cash deposits exceed the FDIC level of insurability. Banks are not required to hold the cash separately from their other assets. Therefore, customer funds held at banks become subject to the same risks as any other bank obligation. This is particularly true in the instance of large cash deposits being made in accounts that are held at a limited number of major banks. With aggregate deposits being made by broker-dealers under Rule 15c3-3 reaching an estimated $150 to $180 billion, a substantial portion of customer fund cash is backed by the balance sheets of these banks rather than FDIC insured. Of additional concern is the concentration of customer fund cash deposits in a few large banks. The failure of such banks could effectively eliminate most customer funds properly on deposit under Rule 15c3-3.

## III. Conclusion.

For all of the reasons noted above, we submit that that the harmonization of SEC's Rule 15c3-3(a)(6) ("qualified securities") by including money market mutual funds so as to be consistent with CFTC's Regulation 1.25 ("permitted investments"), is a relatively simple and easily defined modification which would accomplish the twofold purpose of coordinating the regulatory regimes of the SEC and CFTC and further benefitting broker-dealers and their customers by conferring operational flexibility, reduced costs and avoidance of concentration risks.[13]

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[12] Federated, at the request of the senior staff of the Division of Trading and Markets, scheduled and participated in meetings between the senior staff and major broker-dealer firms to discuss those firms' methods of meeting Rule 15c3-3 segregated customer fund requirements and their need of money market funds to meet those requirements.

[13] As noted above on March 19, 2007, the SEC proposed certain amendments to the financial responsibility rules for broker-dealers, including expanding "qualified securities" under SEC Rule 15c3-3(a)(6) to include certain money market funds. We understand that harmonizing the SEC and CFTC rules is a difficult task, and therefore, the SEC may find that as a first step toward harmonization it may be appropriate to initially limit "qualified securities" to U.S. government money market funds. Thus, for example, Rule 15c3-3(a)(6) could be amended modestly to define "qualified securities" as "a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States, *or a redeemable security of an investment company registered under the Investment Company Act of 1940 and described in 17 C.F.R. § 270.2a-7, unaffiliated with the broker dealer and which limits its investment to securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions).*" (proposed amendment in italics)

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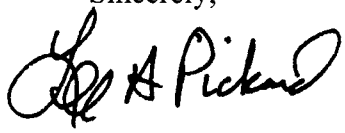
If you have any questions, please call Lee A. Pickard or Peter E. McLeod at 202-223-4418. On behalf of Federated Investors, Inc., we appreciate your consideration of our comments.

Sincerely,



Lee A. Pickard

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