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August 17, 2012

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC Authority to Address Threats to Money Market Mutual Funds or Related Market Disruptions[1]

Dear Chairman Schapiro:

As the Commission considers whether to impose new restrictions on money market mutual funds (MMFs) and their shareholders, for the stated purpose of reducing potential systemic risks related to MMFs, one of the justifications given for taking such action is that, "[t]he tools that were used to stop the run on money market funds in 2008 are either no longer available or unlikely to be effective in preventing a similar run today."[2] As discussed below, while one of the tools used by the government in 2008 is no longer available, the government has a wide range of tools to address a future crisis in the financial markets, including a crisis that may impact one or more MMFs. These tools include, among others:

- the Federal Reserve's authority and responsibility to provide liquidity to the markets;
- the Commission's broad authority to act summarily by emergency order with respect to any matter or action under its jurisdiction;
- directives under the Commission's 2010 amendments that MMF boards identify and take specified actions to reduce MMF risks;
- requirements under the 2010 amendments for enhanced asset quality and liquidity, enabling MMFs to withstand periods of high redemptions; and
- new monitoring tools for the Commission to identify and address MMF risks.

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[1] We write this letter on behalf of our client, Federated Investors, Inc.

[2] *Perspectives on Money Market Mutual Fund Reform: Hearing Before the U.S. Senate Comm. on Banking, Housing and Urban Affairs*, 112th Cong. at 7 (June 21, 2012) (statement of Mary L. Schapiro, Chairman, SEC) (*available at*: http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=66f4ddb5-4823-4341-bad9-8f99cdf5fe9a).

MMFs and their investors do not want or need a federal insurance backstop. While it is true, as Chairman Schapiro recently testified, that the Department of the Treasury can no longer use the Exchange Stabilization Fund to support a program to guarantee MMF shareholders as it did in the financial crisis in 2008,[3] MMF investors do not want or need federal insurance or a guarantee:

- The MMF guarantee program created by the Treasury in 2008 was never called upon, had no losses, and made a $1.2 billion profit for taxpayers.[4]
- During the last several months of 2008, during the height of the financial crisis, over $170 billion in *uninsured* MMF assets flowed into prime MMFs, reflecting decisions by millions of MMF investors to put their money in MMFs *without* a federal guarantee.[5]
- The Treasury's MMF guarantee program ended promptly;[6] its termination had no impact on investors' willingness to invest in MMFs; and there were no calls for extending the program – either by the MMF industry or investors.

By comparison:

- The Transaction Account Guarantee (TAG) program, which was implemented during the financial crisis to provide unlimited deposit insurance for banks, has resulted in losses of approximately $2.5 billion to date.[7]
- The TAG program has been in effect for more than three and one-half years and will continue through the end of 2012.[8]
- Even so, there have been calls to extend the TAG program beyond its expiration date at year end for the stated purpose of preventing outflows from smaller banks to too-big-to

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[3] *Id. See also* Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 131, 122 Stat. 3765, 3797-98 (2008). In addition, the Dodd-Frank Act restricted government lending to individual insolvent institutions, although the Federal Reserve is still authorized to make discount loans to individual participants in broad-based programs for the purpose of providing liquidity to the financial system. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, §§ 214, 1101, 1501 (2010).

[4] Press Release, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009), http://www.treasury.gov/press-center/press-releases/Pages/tg293.aspx.

[5] Treasury Strategies, *Dissecting the Financial Collapse of 2007-2009*, http://www.sec.gov/comments/4-619/4619-188.pdf (filed as a comment letter with SEC June 1, 2012).

[6] Press Release, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009), http://www.treasury.gov/press-center/press-releases/Pages/tg293.aspx.

[7] Letter from Martin J. Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation to Hon. Shelley Moore Capito (Jun. 29, 2012), http://www.aba.com/Issues/Index/Documents/FDICResponsetoCapitoonTAG.pdf.

[8] *Id.*

fail banks,[9] or preventing outflows from all banks to MMFs, which are viewed as offering important safety advantages relative to bank deposits.[10]

Banks and their depositors want federal insurance; MMFs and their investors do not. The fact that the Treasury's temporary insurance program for MMFs cannot be resurrected in the future does not put MMF investors or the financial system at greater risk, nor does it justify the imposition of harsh penalties on MMF investors for redeeming their shares, as certain proposals under consideration by the Commission would require.

The Federal Reserve has the authority and obligation to provide liquidity in a financial crisis. Chairman Schapiro also recently testified that, since the asset-backed commercial paper market has shrunk dramatically, there would be "little benefit" in a future financial crisis in reopening the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) – a special Federal Reserve liquidity program that enabled banks to buy asset backed commercial (ABCP) paper from MMFs during the period of extreme stress in the credit markets.[11] But this does not mean that the government is without tools to supply liquidity if the commercial paper market freezes up again as it did in 2008. As we discussed at length in a separate filing with the Commission, the Federal Reserve not only has the authority but has the obligation (as one of its purposes under the Federal Reserve Act of 1913), to provide liquidity to the short-term credit markets in times of extreme stress, as it did when it took similar action to unfreeze the commercial paper market during the 1970 Penn Central crisis, long before the events of 2008 and long before MMFs even existed.[12] It is simply wrong to suggest the Federal Reserve would be without appropriate tools to provide liquidity to the financial markets in any future financial crisis.

The Commission has emergency authority to act summarily by order to address any matter under its jurisdiction. The Commission has wide-ranging authority to address market emergencies, including any emergency impacting MMFs. This authority is found in Section 12(k)(2) of the Securities Exchange Act of 1934, which provides, in part –

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9 *See* Evan Weinberger, *State Regulators Want FDIC Guarantee Program Extended*, LAW360, Aug. 3, 2012, http://www.law360.com/banking/articles/366685/state-regulators-want-fdic-guarantee-program-extended.

10 FEDERAL RESERVE BANK OF NEW YORK STAFF REPORT, *The Minimum Balance at Risk: A Proposal to Mitigate the Systemic Risks Posed by Money Market Funds* at 52 (July 2012), *available at* http://www.federalreserve.gov/pubs/feds/2012/201247/201247pap.pdf.

11 *Perspectives on Money Market Mutual Fund Reform: Hearing Before the U.S. Senate Comm. on Banking, Housing and Urban Affairs*, 112th Cong. at 7 (June 21, 2012) (statement of Mary L. Schapiro, Chairman, SEC) (*available at*: http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=66f4ddb5-4823-4341-bad9-8f99cdf5fe9a).

12 *See* Letter from John D. Hawke to Mary L. Schapiro (July 12, 2012), http://www.sec.gov/comments/4-619/4619-212.pdf.

> (A) The Commission, in an emergency, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the Commission or a self-regulatory organization under the securities laws, as the Commission determines is necessary in the public interest and for the protection of investors –
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> . . .
>
> (iii) to reduce, eliminate, or prevent the substantial disruption by the emergency of –
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> (I) securities markets (other than markets in exempted securities) *investment companies*, or any other significant portion or segment of such markets . . . .[13]

The Commission's emergency authority is derived from its long-standing authority under Section 12(k) of the Exchange Act to institute market-wide trading halts, subject to Presidential approval. The authority was expanded under the Market Reform Act of 1990 to authorize the Commission to take broader emergency actions under the Exchange Act, provided the President does not object.[14] It was further expanded following the events of September 11, 2001 to include its current language, which, among other things, specifies that the Commission is authorized to take emergency action with respect to any matter or action subject to its regulation, including to reduce, eliminate, or prevent the substantial disruption by the emergency of securities markets, *investment companies* or a substantial segment or portion of the markets.[15]

The Commission used this authority to issue numerous emergency orders during the financial crisis, beginning with a July 15, 2008 emergency order to impose pre-borrow requirements on short sales of the securities of 19 financial institutions.[16] The Commission at the time described its emergency order as necessary to address "rumors" in the financial markets that could lead to "panic selling," which could be exacerbated by "naked" short selling, that could lead to price declines and a "chain of events" that could threaten disruption of the market – an unproven and speculative scenario but nonetheless sufficient to justify the Commission's use of its emergency powers.[17] In a series of orders issued and extended during the period September 17 through October 2, 2008, the Commission took additional emergency actions, including

[13] 15 U.S.C.A. § 78(k)(a)(2)(A) (West 2012) (emphasis added).

[14] Market Reform Act of 1990, Pub. L. No. 101-432, § 2 (1990).

[15] Emergency Securities Response Act of 2004, Pub. L. No. 108-458, § 7803, 118 Stat. 3638, 3862 (2004).

[16] Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Securities Act Release No. 34-58166, 2008 WL 2743880 (July 15, 2008).

[17] *Id.*

issuing orders imposing restrictions on short selling of the securities of more than 1000 "financial" issuers, on the basis that these issuers were subject to "artificial price movements based on unfounded rumors regarding [their] stability . . . exacerbated by short selling."[18] Although then-Commission Chair Christopher Cox later said that the biggest mistake of his tenure was agreeing to the ban on short selling and that he took the action while under intense pressure from the Chairman of the Federal Reserve and Secretary of the Treasury,[19] the various emergency orders issued during the period July-October 2008 demonstrate the breadth of Commission authority and its ability to act rapidly during an emergency.[20]

Indeed, there are very few limits on the Commission's emergency authority – which allows the Commission to act without the delay of notice and comment required for other actions. The term "emergency" is broadly defined to include, among other things, "a major disturbance that substantially disrupts, *or threatens to substantially disrupt* . . . the function of securities markets, investment companies, or any other significant portion or segment of the securities markets . . . ."[21] In such an emergency, the Commission may issue summarily an order to alter, supplement, suspend, or impose requirements or restrictions with respect to *any* matters or actions subject to its regulation.[22] The Commission must notify the President of its decision and the President must notify the Commission that the President does not disapprove. There is limited court review. The order may stay in effect for 10 days and may be extended for a total period of 30 calendar days.[23]

Therefore, pursuant to this authority, the Commission could take action in an emergency to alter, supplement, or suspend any current requirements, or impose new requirements or

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[18] Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Release No. 34-58592, 2008 WL 4287187 (Sept. 18, 2008). *See also* Amendment to Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Release No. 34-58611, 2008 WL 4299750 (Sept. 21, 2008). The Commission released an initial list of financial companies and subsequently permitted the exchanges to add to the list.

[19] Amit R. Paley and David S. Hilzenrath, *SEC Chief Defends His Restraint During Financial Crisis*, WASH. POST, December 24, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/12/23/AR2008122302765.html?sid=ST2008122302866.

[20] The Commission issued additional orders during the crisis regarding short sale reporting and issuer share repurchases. Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Release No. 58591, 2008 WL 4287186 (Sept. 18, 2008); Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Release No. 58588, 2008 WL 4287183 (Sept. 18, 2008).

[21] 15 U.S.C.A. § 78l(k)(7) (West 2012) (emphasis added).

[22] 15 U.S.C.A. § 78l(k)(2) (West 2012).

[23] 15 U.S.C.A. §§ 78l(k)(2)-(5) (West 2012).

restrictions, with respect to all MMFs, a group of funds, or even one MMF in order to reduce, eliminate, or prevent broader disruption. It is doubtful, however, that the Commission would need to call upon this authority, in light of its extensive regulatory authority and oversight over MMFs and the significant enhancements to MMFs under the Commission's 2010 amendments.

The Commission has broad regulatory and enforcement authority to address MMF risks and investor protection. As we and others have addressed in detail in previous comments to the Commission, MMFs are subject to regulation under each of the four major securities laws, as well as comprehensive and detailed rules specific to MMFs, designed to limit risks and protect investors. Each MMF has its own board of directors, which is charged by statute and Commission rules with specific risk management and investor protection responsibilities. Many of these are new requirements – they were not in place in 2008. Thus, any discussion of the "tools . . . that are no longer available" that were used in 2008 is incomplete without an acknowledgement of the many *new* tools that are available to the Commission and MMF boards today to (1) prevent the occurrence of problems at a MMF in the first instance and (2) to specify actions that must be taken by a MMF board in the event that problems occur. The Commission has broad powers to enforce these requirements under a range of authorities, including through its cease-and-desist powers under Section 9(f) of the Investment Company Act,[24] its power to obtain injunctive relief under Sections 36 and 42(d) of the Act,[25] and its power to impose civil money penalties on MMFs and their related persons under Sections 9(d) and 42(e) of the Act.[26] The Commission also has the ability to intervene in reorganizations and liquidations of a MMF.[27]

These requirements, authorities and tools– all designed to limit MMF risks and/or to specify actions to address and limit risks as they emerge – include the following: [28]

- Requirements that MMFs file detailed reports, in electronic sortable form, regarding each portfolio security, its valuation and other information, including each fund's "shadow NAV," enabling shareholders and the Commission to carefully monitor MMFs in 2012 much more effectively than was possible in 2008;[29]

[24] 15 U.S.C.A. § 80b-3(k) (West 2012).

[25] 15 U.S.C.A. § 80a-35 (West 2012); 15 U.S.C.A. § 80a-41(d) (West 2012).

[26] 15 U.S.C.A. § 80b-3(i)(1)(B) (West 2012); 15 U.S.C.A. § 80a-41(e) (West 2012).

[27] *See, e.g.*, 11 U.S.C.A. § 1109 (West 2012) (granting the SEC the power to intervene in any Chapter 11 bankruptcy).

[28] Unless otherwise noted, the authority for these requirements, authorities, and tools is found in 17 C.F.R. § 270.2a-7 (2011).

[29] From Form N-MFP filings, the SEC has created a central database that allows SEC staff to identify each and every money fund that holds exposure to a particular issuer. The staff can also use these reports to identify funds

Footnote continued on next page

- Minimum liquidity requirements and further requirements that MMFs must hold securities portfolios that are sufficiently liquid to meet reasonably foreseeable redemptions;

- Credit quality, maturity limits, and diversification requirements applicable to MMF portfolio holdings;

- Requirements for periodic stress testing of MMF portfolios, including, requirements to examine a MMF's ability to maintain a stable NAV per share based upon certain hypothetical events;

- Requirements that MMFs must "shadow price" the amortized cost net asset value of the fund's portfolio against its mark-to-market net asset value. If there is a deviation of more than ½ of 1 percent, the fund's board of directors must promptly consider what action, if any, it should take, including whether the fund should discontinue using the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share;

- Regardless of the extent of the deviation of a MMF's mark-to-market net asset value and $1.00 per share, the board of a MMF must take action whenever it believes any deviation may result in material dilution or other unfair results to investors;

- A MMF must have the capacity to redeem and sell its securities at a price based on its current NAV, even if the MMF's current net asset value does not correspond to the fund's stable net asset value or price per share;

- MMFs must follow specified procedures if a portfolio investment is downgraded or is subject to a default or other event, including disposing of the instrument under certain circumstances;

- If securities accounting for 1/2 of 1% or more of a MMF's total assets default (other than an immaterial default unrelated to the issuer's financial condition)

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that have experienced sudden growth in assets under management or high yields, which, as shown by a report by Federal Reserve Board staff, can be a signal of future difficulties. *See* Patrick McCabe, *The Cross Section of Money Market Fund Risks and Financial Crises*, Federal Reserve Board Finance and Economics Discussion Series (Sept. 2010) (available at http://www.federalreserve.gov/pubs/feds/2010/201051/201051pap.pdf).

or become subject to certain events of insolvency, the MMF must promptly notify the SEC and state the actions the Money Fund intends to take in response to such event. If an affiliate of the fund purchases a security from the fund in reliance on Rule 17a-9, the SEC must be notified of the identity of the security, its amortized cost, the sale price, and the reasons for such purchase; and

- Rule 22e-3 permits a MMF board of directors to suspend redemptions and postpone payment of redemption proceeds if the fund is about to break the buck and the board decides to liquidate the fund.[30] This is designed to facilitate an orderly liquidation of fund assets in the event of a threatened run on the fund.

Of course, the Commission is well aware of the above and other requirements and is well aware of its broad and pervasive authorities with respect to MMFs.

MMFs and their investors do not want or need federal insurance or a guarantee, and the lack of such insurance or guarantee does not justify the imposition of new restrictions on MMFs and their investors. Indeed, the enhanced credit quality, liquidity, and transparency of MMFs after the Commission's 2010 amendments, together with robust regulation and oversight by the Commission, have made MMFs a product preferred by many investors even during a period of unlimited deposit insurance for banks.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

cc: Hon. Luis A. Aguilar
Commissioner

Hon. Daniel Gallagher
Commissioner

Hon. Troy A. Paredes
Commissioner

Hon. Elisse B. Walter
Commissioner

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[30] 17 C.F.R. § 270.22e-3.