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The Honorable Mary Jo White
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Proposed Rule on Money Market Fund Reform, Amendments to Form PF; File No. S7-03-13; Overview of Federated's Planned Comment Letters

Dear Chair White:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), to provide initial comments in response to the Securities and Exchange Commission's (the "Commission's") proposed rules on money market fund ("MMF") reform (the "Release").[1] We appreciate the Commission's work in re-claiming jurisdiction over MMF reform efforts from the Financial Stability Oversight Council ("FSOC"), which has attempted to usurp the Commission's jurisdiction through its legally questionable initiation of the Dodd-Frank Section 120 process.[2] We also

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[1] *Money Market Fund Reform; Amendments to Form PF*, 78 Fed. Reg. 36834 (June 19, 2013) (the "Release").

[2] FSOC, Proposed Recommendations on Money Market Fund Reform, 77 Fed. Reg. 69445 (Nov. 19, 2012). Federated submitted comments on the FSOC's Section 120 proposal noting the substantive flaws in the FSOC proposal as well as limits on the FSOC's authority to dictate changes to the regulation of MMFs. Letters from John D. Hawke, Jr. on behalf of Federated to FSOC on Proposed Recommendations Regarding Money Market Mutual Fund Reform (Dec. 17, 2012, Jan. 25, Jan. 25, Jan. 25, and Feb. 15, 2013): Letter from Stephen Keen to FSOC on behalf of Federated (Nov. 26, 2012), Letter from Michael Granito and Stephen Keen on behalf of Federated to FSOC (Jan. 30, 2013) (each available in File No. FSOC-2012-0003). Federated also submitted comments raising similar issues on other FSOC and Federal Reserve Board rulemakings that led to the adoption of Regulation PP. Letter from John D. Hawke, Jr. on behalf of Federated (Feb. 24, 2011) on FSOC Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, available in File No. FSOC-2011-0001; Letter from John D. Hawke, Jr. on behalf of Federated (Dec. 15, 2011) on FSOC

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appreciate the efforts of the Commissioners and staff in developing a Release that explains the Commission's goals and that acknowledges what the Commission knows and does not know about the impact of the alternatives proposed. This is an initial letter on behalf of Federated, intended to inform the Commission of our overall analysis while we and others continue to develop more detailed comments responsive to specific issues raised by the Release. Federated will be filing additional comment letters during the next few days.

We note that the Release is 698 pages long and includes well over 1000 questions and requests for data. In view of the very large number of questions posed in the Release and the amount and complexity of the cost data and other information requested, we renew our previously filed request that the Commission extend the comment period so that Federated and others may complete efforts to assemble data to respond more fully to the questions and information requests in the Release.

Federated has almost 40 years of experience in the business of managing MMFs and, during that period, has participated actively in the money market as it has developed over the years.[3] Through its MMFs and related services, Federated has served the cash management and investment needs of millions of individual and institutional investors of all sizes, including thousands of intermediaries who, through omnibus accounts, provide Federated-sponsored MMFs to millions of their individual and institutional investors.[4]

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Rulemaking Proposal "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies", available in File No. FSOC-2011-0001, and also available in SEC File No. 4-619; Letter from John D. Hawke, Jr. on behalf of Federated (June 10, 2011) on Federal Reserve Proposed Rulemaking on Resolution Plans and Credit Exposure Reports Required, available in Federal Reserve Docket No. R-1414; Letter from John D. Hawke, Jr. on behalf of Federated (Mar. 30, 2011) on Federal Reserve Proposed Rulemaking Regarding Definitions of ''Predominantly Engaged in Financial Activities'' and ''Significant'' Nonbank Financial Company and Bank Holding Company; 12 C.F.R. Part 225, Regulation Y; available in Federal Reserve Docket No. R–1405; Letter from John D. Hawke, Jr. on behalf of Federated (May 24, 2012), on Federal Reserve Proposed Rule on Definition of "Predominantly Engaged in Financial Activities"; available in Federal Reserve Docket No. R-1405.

[3] The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating MMF to use the amortized cost method of accounting. Federated also received one of the initial exemptive orders permitting use of the amortized cost method of accounting in 1979.

[4] These include corporations using MMFs for operating cash balances and payroll; broker-dealers offering sweep accounts to optimize returns for their customers; bank trust departments safeguarding funds for

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Federated also serves as investment adviser to several local government investment pools ("LGIPs") that hold liquid assets for state and local governments.

Federated has spent the weeks following the issuance of the Commission's release assessing how these investors would be affected by the Commission's proposals, the impact of the proposals on the utility of MMFs for investors, the implementation costs that must be borne by intermediaries and investors, and whether investors will continue to use MMFs subject to the limitations proposed in the Release.

Federated believes MMFs do not require dramatic regulatory change that would restructure the product and undermine its utility for investors. The 2010 amendments to Rule 2a-7, augmented by industry practices, have made MMFs substantially more resilient and transparent. We believe any further MMF reform should be designed to preserve the utility of MMFs for investors and be targeted to address very narrow circumstances, such as the type of once-in-a generation scenario experienced in 2008, or where one or more individual MMFs experiences a large credit event or other event likely to cause an unusual rush to redeem.[5] Based upon the Commission's own statements, these types of circumstances, which have the potential to result in material dilution or unfair treatment of shareholders or a risk of contagion for the broader financial markets, appear to be the Commission's concerns as well.[6] However, as discussed briefly below and as will be discussed in more detail in forthcoming comments:

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individuals and institutions through omnibus accounts at MMFs; state and local governments; pension plan administrators; escrow agents; securities and commodity exchanges; and a range of other investors who rely upon the stable value, transparency, efficiency, returns and low risk of MMFs. We have previously described the range of MMF investors and the functions MMFs perform for these investors in letters filed with the Commission. *See* Letter from John D. Hawke, Jr. on behalf of Federated to SEC (Nov. 2, 2012) (available in File No. 4-619); Letter from John D. Hawke, Jr. on behalf of Federated to SEC (Feb. 24, 2012) (available in File No. 4-619).

[5] As stated by Senator Pat Toomey, "it should not be the goal of government regulators to over-regulate for the sake of trying to prevent any and all risks. Regulation should instead focus on limiting systemic risk and providing adequate disclosure to investors, while allowing individual investors to make their own choices about where to invest their money and the risk they want to assume." Press Release: Sen. Toomey Criticizes FSOC Recommendations On Money Market Funds (Tuesday, Nov 13, 2012), avail. online: http://www.toomey.senate.gov/?p=press_release&id=744.

[6] Release at 36837-38 ("Each alternative seeks to preserve the ability of money market funds to function as an effective and efficient cash management tool for investors, but also address certain features in money

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1) Imposing a floating NAV requirement on a large subset of MMFs, as proposed in "Alternative One," would destroy key operational features that make MMFs useful to investors and would be enormously costly to investors and the economy, without furthering the Commission's goal of preventing or reducing the risk of large shareholder redemptions in a crisis. Indeed, it appears that the primary purpose of the floating NAV proposal is to increase awareness among sophisticated institutional investors in prime MMFs of trivial fluctuations in estimated "market-based" valuations of the MMFs' portfolios by forcing them to transact in prime MMF shares at these minutely fluctuating valuations. The resulting operational, accounting, tax, legal and other burdens associated with a floating NAV, which have not been addressed in the current proposal, will drive away users and lead to a dramatic shrinkage of MMFs. The delays in transactions resulting from the requirement for "market-based" pricing will further undermine the utility of MMFs and introduce new risks. These issues would need to be completely resolved and the resolutions implemented – not merely discussed – before a floating NAV could be imposed, unless the regulatory goal is to eliminate, or dramatically shrink investors' use of, MMFs.

2) The proposed exemptions in Alternative One do not alleviate the disruptive effects of the proposal. For example, the proposed "retail" exemption from the floating NAV requirement for MMFs that limits redemptions to no more than $1 million per day, which is included in Alternative One to narrow its application and thereby lessen its impact, creates its own set of complex operational and compliance problems that would make the exemption difficult or impossible to implement. The exemption for government MMFs, intended to provide investors with a stable value option, also is problematic, as further discussed below. Thus, Alternative One, if adopted, will have an even broader practical impact than may have been intended by the Commission. Meeting the requirements of the exemptions would impose restrictions and burdens upon a MMF and its shareholders every day, rather than only in times of economic uncertainty. These restrictions would limit MMF shareholders' access to their liquid assets and disrupt their normal use of MMFs on a daily basis.

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market funds that can make them susceptible to heavy redemptions, provide them with better tools to manage and mitigate potential contagion from high levels of redemptions, and increase the transparency of their risks.").

3) The elimination of the amortized cost method of accounting to price shares of stable value MMFs, and its replacement with the "penny rounding" method, would be very costly to implement and would cause severe operational problems for MMFs, create settlement bottlenecks and delays for investors and intermediaries, introduce new risks from potential technology breakdowns and systems failures at pricing vendors, and potentially impose systemic risks on payment systems and markets. For retail and government MMFs, these costs would be incurred to show minute, irrelevant fluctuations in "market-based" estimates of MMF share NAVs that are rounded to the nearest penny, thus adding immense costs to get to a result that is identical to the current calculation – $1.00. Disclosure of an amortized cost method MMF's shadow price would inform shareholders of the same minute fluctuations in the estimated value of its portfolio as disclosure of the unrounded penny rounding price, for a fraction of the cost and less risk and inconvenience for shareholders.

4) While Federated does not believe that further structural MMF reforms are necessary, Alternative Two is the only current alternative that would address the policy concerns identified by the Commission, while preserving the utility of MMFs for investors and the short-term financing provided to corporate and governmental issuers. It provides tools MMF directors may use if necessary to protect investors from material dilution and prevent "fire sales" of MMF portfolio holdings if a MMF comes under extraordinary redemption pressure.

The Commission needs to make critical modifications to Alternative Two, however, in order for these additional tools to operate effectively and to minimize their potential impact on shareholders. Specifically, Alternative Two should be modified to (a) permit directors to implement a liquidity fee or suspend redemptions temporarily *before* the end of the business day, so the board can respond whenever the directors find that unimpeded redemptions could result in material dilution or other unfair results to investors and shareholders, (b) reduce the maximum period that redemptions may be suspended to ten calendar days, and subject liquidity fees to the same limitation, and (c) include tax exempt funds in the exemption proposed in paragraph (c)(2)(iii). Federated also urges the Commission to make it clear that the purpose of the provision is to protect, and not to penalize, shareholders and that it therefore is to be used only in extreme circumstances that could result in unfair results for shareholders.

5) The direct and indirect costs of implementing the proposals – particularly the floating NAV imposed under Alternative One and the elimination of the amortized

cost method of valuing shares contained in both Alternatives – on investors, on corporate, state and local government issuers, on financial institutions, and on the economy, will be staggering, with no offsetting benefits. A final rule containing these elements cannot meet the cost/benefit and statutory considerations required for a Commission rulemaking, particularly when there are alternatives that meet the Commission's goals with far less disruption and costs. A targeted provision authorizing temporary suspension of redemptions, under the circumstances described above, would fulfill the Commission's statutory obligations.

6) The disclosure and reporting proposals in the Release contain many useful elements, but also other elements that would be excessively costly and burdensome without a corresponding benefit to investors or systemic stability. The Commission's definition of sponsor financial support is overly broad and would capture many routine transactions that are not indicative of stress. Daily disclosure of current weekly liquid assets and flows in conjunction with Alternative Two has the potential to be destabilizing, because it could result in reactionary redemptions that are not based on the MMF's true liquidity levels. The lot level reporting contemplated under Form N-MFP would be a wasteful, inefficient and inequitable means of evaluating pricing in the money markets, and could be used by other market participants to trade to their advantage and the MMF's disadvantage. These proposals must be more carefully tailored before any final rules are adopted.

7) While aggregating parents and subsidiaries for purposes of diversification reflects a practice already followed by Federated and many other MMF managers, the other proposed changes to the diversification requirements would seriously impair the operations of MMFs or create arbitrary restrictions without contributing to the goal of investor protection. Although clarification of the current stress testing requirements would be helpful to MMFs and their directors, the proposed wholesale expansion of stress testing would be a waste of resources and of the directors' limited time.

8) Regardless of what reforms the Commission decides to impose on prime MMFs, tax exempt funds[7] should (a) be excluded from both Alternative One and Alternative Two, because tax exempt funds resemble government MMFs more closely than prime MMFs, (b) retain the ability to rely on the so-called "25% basket"

[7] As defined in Rule 2a-7(a)(26), including single state funds defined in Rule 2a-7(b)(25).

when diversifying guarantees and demand features, which is essential to their operations, and (c) remain exempt from the 10% daily liquid asset requirement.

9) The proposed amendments, if adopted, will not directly affect LGIPs that operate within the governmental fund exclusion in Section 2(b) of the Investment Company Act. Adoption of the proposals as currently drafted (particularly Alternative One) would, however, impose a large burden on state and local governments and the Government Accounting Standards Board ("GASB") to address and resolve the relationship between the amendments and the use of the amortized cost method of accounting by external pools that operate as "2a7-like" LGIPs. We do *not* anticipate that the end result would be a transformation of LGIPs to floating NAV funds.

(1) Operational, Accounting, Tax, Legal and other Burdens Associated with a Floating NAV MMF will Drive Away Users, for the Primary Purpose of Requiring Investors to Transact at Insignificant Fluctuations in Estimated Valuations.

Federated and others have provided extensive analyses of the operational, accounting, tax, legal and other burdens associated with a floating NAV, as well as the issues associated with arriving at "market-based" estimated valuations to derive a floating NAV.[8] While the Release asks for comments on the various problems associated with a floating NAV, it does not solve for them.[9] In a more detailed forthcoming comment letter on the specific proposals in the Release, we will provide further analyses, based on

[8] Letter from Federated Investors to SEC (May 17, 2013) (SEC File No. for 2012 Special Studies); Letter from John D. Hawke, Jr. on behalf of Federated to FSOC (Jan. 25, 2013) (available in File No. FSOC-2012-0003 and SEC File No. for 2012 Special Studies); Letter from John D. Hawke, Jr. on behalf of Federated to SEC (Nov. 2, 2012) (available in File No. 4-619); Letter from John D. Hawke, Jr. on behalf of Federated to SEC (July 17, 2012) (available in File No. 4-619).

[9] The only issue the Release attempts to address is how a floating NAV would impact the current GAAP treatment of MMFs as a cash equivalent. But the Release's statement hardly solves the issue. It states only, "We believe the adoption of floating NAV alone would not preclude shareholders from classifying their investments in [MMFs] as cash equivalents because fluctuations in the amount of cash received upon redemption would likely be insignificant and would be consistent with the [GAAP] concept of a 'known' amount of cash." Release at 36869. This is a strange statement in a Release that, at the same time, emphasizes the importance of adopting a floating NAV to the fourth decimal point in order to "mak[e] gains and losses a more regular and observable occurrence" in MMFs. Release at 36851.

recent discussions with various MMF investors and further surveys and analyses. In brief:

- The tax, accounting, and legal burdens of a floating NAV stem from the fact that deviations as small as 1/100th of a penny per share require record-keeping, must be accounted for, produce taxable gains and losses, and will disqualify the MMF from being used where there are statutory or contractual requirements for stability of principal.[10] For example, bank intermediaries performing corporate and institutional trust services have told us a floating NAV MMF will not be a qualified investment; they will turn to government MMFs or, more likely, will take assets onto the bank's own balance sheet. The bank intermediaries expressed concerns about the impact of a large flow of prime MMF assets into government MMFs or onto their own balance sheets.

- The operational burdens stem from (1) the need for wholesale retooling throughout the user community and intermediaries, as well as MMFs, of systems built specifically on the basis of a $1.00 per share MMF; (2) the fact that many functions, such as sweeps, cannot be performed with a floating NAV fund; and (3) pricing at a floating NAV will make it impossible to use many automated

[10] Letter from Federated Investors to SEC (May 17, 2013) (SEC File No. for 2012 Special Studies); Letter from John D. Hawke, Jr. on behalf of Federated to FSOC (Jan. 25, 2013) (available in File No. FSOC-2012-0003 and SEC File No. for 2012 Special Studies); Letter from John D. Hawke, Jr. on behalf of Federated to SEC (Nov. 2, 2012) (available in File No. 4-619); Letter from John D. Hawke, Jr. on behalf of Federated to SEC (July 17, 2012) (available in File No. 4-619); Letter from Allegheny Conference on Community Development and Greater Pittsburgh Chamber of Commerce to SEC (April 24, 2012) (available in File No. 4-619); Letter from Association for Financial Professionals, Benefit Resource, Inc., Blue Cross Blue Shield of Massachusetts, CacheMatrix, Catholic Health Initiatives, California ISO, CareSource, Centerline Capital Group, Crawford & Company, Grass Valley USA LLC, Miami-Dade County Public Schools, Solix, Inc., University of Colorado – Treasurer's Office, WellCare Health Plans, Inc. to SEC (Apr. 4, 2012) (available in File No. 4-619); Letter from Texas Municipal League to SEC (Jan. 21, 2011) (available in File No. 4-619). The Release's statement that fluctuating NAV funds will be considered cash equivalent (Release at 36869) and the IRS statement regarding wash sales (*Application of Wash Sale Rules to Money Market Fund Shares*, Internal Revenue Service, Notice 2013-48, available at http://www.irs.gov/pub/irs-drop/n-13-48.pdf) do not solve for the fact that gains and losses nonetheless must be tracked and accounted for, and statutory and contractual requirements relating to stable value requirements cannot be preempted by a statement in a Commission release.

systems and will push back settlement times by hours, if not overnight, depending upon how often a NAV is struck for each individual MMF.

The above impediments negatively impact investors' willingness to use floating NAV funds, as is apparent from hundreds of comment letters and surveys already on file with the Commission, confirmed through numerous recent discussions Federated and we have had with investors and intermediaries. For example, large banks offering prime MMFs through their corporate and institutional trust services tell us they would simply take floating NAV funds off their platforms and offer clients either government MMFs or the banks' own money market deposit accounts. Many institutions are not taking the time to cost out systems changes in a floating NAV environment but have candidly said that if Alternative One of the Commission's proposal is adopted, they will stop using prime MMFs. Financial institutions offering prime MMFs as part of cash sweeps have told us they cannot use floating NAV funds for this function and will shift to FDIC-insured sweeps vehicles, or stop offering sweeps altogether.

While a stable NAV permits purchases and redemptions to be conducted seamlessly throughout the day, often through automated entries from the ultimate investor via the intermediary's platform, and through automated entries from the intermediary to the MMF's electronic systems, transactions using a floating NAV must be delayed until the next price is struck by a MMF using model portfolio price estimates supplied by an outside pricing vendor. We have spent considerable time discussing these issues with Federated's accounting service provider and the independent pricing service retained by the fund accountant to determine (1) the time it takes the pricing service to value the individual assets in a MMF portfolio (many of which the Commission acknowledges, do not actively trade and, therefore, do not have market prices, and therefore must be individually valued based upon comparisons to other assets and their location on the relevant curves and other aspects of a pricing matrix) and (2) the time thereafter for the MMF accounting provider to review and validate the valuations received and to calculate an NAV for the MMF (based on the valuations of individual assets provided, valuations of newly purchased assets that must be obtained, expenses and income of the fund, number of shares outstanding, and other factors) on a basis other than amortized cost, and (3) the time for senior personnel of the MMF to conduct their own review of the valuations and calculations. At this time, it appears that it will take a minimum of three to four hours to strike a "market-based" price (assuming there are no technology disruptions), based on a given portfolio – a price that varies, if at all, within a narrow range of hundredths of a penny per share. If MMFs and their service providers, in an effort to meet investor demands for intra-day redemptions, attempt to decrease the time the pricing service spends reaching valuations and the time the accounting service provider spends reviewing and validating those valuations and calculating the final NAV, the cost of producing the valuations and calculating NAVs will increase due to increased staffing requirements, and the risk of errors in the NAVs produced will increase.

These delays and new risks serve no purpose. The current amortized cost method of valuing MMF portfolios is simple, accurate, and allows MMFs to sell and redeem securities throughout the day, in response to investor needs, based upon a known $1.00 per share value. MMFs are permitted to use amortized cost only if it fairly reflects market value. The Release acknowledges that "the amortized cost method of valuation and the penny-rounding method of pricing . . . provide[] a close approximation to market value under normal market conditions . . . ."[11] Publically available data prove this point.[12]

In order to ensure the integrity and fairness of their stable $1.00 per share, MMFs have rigorous procedures to obtain valuations for their portfolio assets and to measure deviations between the MMF's amortized cost price per share and the "current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) . . . ."[13] – the "shadow price." But, although market-based valuations for purposes of MMF shadow pricing are a critical benchmark against which to measure the fairness of stable value MMFs using amortized cost, they are not "mark-to-market" based on observable market trades. Elimination of amortized cost valuation will create insignificant fluctuations for the sake of creating fluctuations, at great cost, with substantial delays, creating new risks, and undermining the utility of MMFs for investors.

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[11] Release at 36837.

[12] *See, Perspectives on Money Market Mutual Fund Reform: Hearing Before the U.S. Senate Committee on Banking, Housing and Urban Affairs*, 112th Cong. at 29-30 (Jun. 21, 2012) (testimony of Paul Schott Stevens, President, Investment Company Institute), http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=bba4146c-6b7f-47d0-93bc-ebc73189c9c0) ("[U]sing publicly available data from Form N-MFP reports that require money market funds to disclose their underlying mark-to-market share price, without using amortized cost pricing, ICI calculated changes in prime fund share prices on a monthly basis for January 2011 to March 2012. Nearly all (96 percent) of the prime money market funds had an average absolute monthly change in their mark-to-market share prices of 1 basis point [(one hundredth of one penny per share)] or less and all had an average absolute monthly change of less than 2 basis points.").

[13] 17 C.F.R. § 270.2a-7(c)(8)(ii)(A).

As the Release acknowledges, the assertion by advocates of the floating NAV that it provides investors with a "mark-to-market" price for MMFs [14] is not true:

> [T]he vast majority of money market fund portfolio securities are not valued based on market prices obtained through secondary market trading because the secondary markets for most portfolio securities such as commercial paper, repos, and certificates of deposit are not actively traded. Accordingly, most money market fund portfolio securities are valued largely through "mark-to-model" or "matrix pricing" estimates.[15]

But, while the Release states this critical fact, it ignores its significance. The Release fails to analyze or explain the mechanics of matrix pricing, the judgments, estimates and assumptions involved, and how the process – while providing an important benchmark against which the amortized cost valuation of short-term instruments can be measured – certainly does not offer the level of precision that carrying a MMF NAV to the fourth decimal point would suggest.

For purposes of "shadow price" comparisons, MMFs typically use independent pricing vendors to obtain "market-based" valuations for individual instruments held in the MMF portfolios. For instruments for which there are no market quotations, the pricing service generally compares each instrument or security to a homogenous set of instruments in the market (e.g., because they have similar ratings, interest rates, maturities) to derive a valuation the pricing service believes reflects current market conditions. Valuations for individual instruments are dependent upon how the pricing vendor's evaluators group portfolio instruments, where they are placed on a curve, and a variety of factors, many of which involve estimates and judgments.[16] The pricing service

[14] *See, e.g.*, Mary Schapiro, *Statement on Money Market Fund Reform* (Aug. 22, 2012), http://www.sec.gov/news/press/2012/1012-166htm (MMFs should "float the NAV and use mark-to-market valuation like every other mutual fund."); Letter from Timothy F. Geithner to FSOC (Sept. 27, 2012) (Under the FSOC's proposed recommendations, "MMFs would be required to use mark-to-market valuation to set share prices, like other mutual funds. This would allow the value of investors' shares to track more closely the values of the underlying instruments held by MMFs and eliminate the significance of share price variation in the future.").

[15] Release at 36837.

[16] Of course, the most important factors in valuing highly rated money market instruments are the number of days to maturity and the coupon or discount – the same factors that are used in amortized cost valuation.

then forwards to the MMF's accounting service provider the valuations determined for the various instruments requested. The accounting service provider must obtain valuations for any instruments purchased by the MMF during the day or others for which the pricing service does not provide a valuation. It then derives a NAV per share, which senior analysts at the MMF review along with valuations of certain individual portfolio instruments for any deviations from certain parameters. [17] The Commission is well aware of both the importance of this process of fair valuation as a benchmark, as well as the differences between this derived price versus a traditional market quote for most other asset classes.[18]

The proposals in the Release would introduce the delays, costs, imprecision and burdens associated with the above process, which is currently used for MMF "shadow price" comparison, into the actual pricing of MMF shares for transaction purposes, creating odd results, new risks, and in some cases insurmountable burdens, all for purpose of showing estimated fluctuations in prices as small as a hundredth of a penny.

For example, for prime institutional MMFs,[19] Alternative One of the proposal permits the continued use of amortized cost accounting to value instruments of 60 days or less (consistent with GAAP)[20] but prohibits either amortized cost accounting or penny

[17] Each MMF board has the ultimate responsibility to assure that valuation methods used are appropriate. Federated views this valuation process as critical to meeting the board's obligation to assure that the stable NAV of its funds, derived from amortized cost valuation, "fairly reflects the market-based net asset value per share," as required by Rule 2a-7(c)(1). 17 C.F.R. § 270.2a-7(c)(1).

[18] The Commission has long acknowledged that there is no single "correct" fair value and that "[t]he same security held in the portfolios of different funds can be given different fair value prices at any one time, all of which can be reasonable estimates meeting the statutory standard." Letter from Fisch & Roiter to SEC at 6 (Dec. 2, 2011) (available in File No. 4-619). However, astonishingly, the Release makes the claim that a fluctuating price based on "mark to model" or "matrix pricing," carried out to the fourth decimal point, is superior to amortized cost valuation, because it will "allow funds to reflect gains and losses more precisely." Release at 36853.

[19] Under the proposal, a prime institutional MMF is any registered investment company holding itself out as an MMF that is not operating pursuant to the exemptions of proposed § 270.2a-7(c)(2) (exemption for funds investing primarily in government securities) or (c)(3) (exemption for retail MMFs limiting redemptions by any single shareholder of record to no more than $1,000,000 in any one business day).

[20] Release at 36849 ("Money market funds would only be able to use amortized cost valuation to the extent other mutual funds are able to do so – where the fund's board of directors determines, in good faith, that the fair value of debt securities with remaining maturities of 60 days or less is their amortized cost, unless the

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rounding for instruments in portfolio of longer duration; for these it requires the market-based valuations calculated as described above. Apart from the operational, tax, accounting, and legal problems created by a floating NAV, the proposal creates an absurd situation in which approximately 70% or more of the instruments in a prime institutional MMF – those of 60 days or less in duration – will be valued at amortized cost,[21] while approximately 30% will be valued using matrix-derived prices, the latter for the sole purpose of creating a NAV fluctuation of, perhaps, hundredths of a cent.[22]

For retail[23] and government[24] MMFs, as discussed in Section 3, below, Alternative One would permit continued use of amortized cost valuation for instruments of less than 60 days duration, but require use of market-based matrix or mark-to-model pricing for the remainder of the portfolio, using penny rounding to achieve the stable NAV[25] – introducing substantial costs and delays to achieve the same exact result.

There also will be unintended consequences that may flow from changing the role of pricing services from providers of benchmarks for portfolio valuation to enable MMF

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particular circumstances warrant otherwise."); Accounting for Certain Investments in Debt and Equity Securities, Statement of Fin. Accounting Standards No. 115, § 7 (Fin. Accounting Standards Bd. 1993).

[21] According to SEC form N-MFP filings compiled by ICI, in June 2012, approximately 72% of prime MMF assets had maturities of less than 60 days. Sean Collins et al., *Money Market Mutual Funds, Risk, and Financial Stability in the Wake of the 2010 Reforms*, 19 ICI Research Perspective 1, Fig. 5 at 11 (Jan. 2013).

[22] We note here that Federated, in fulfilling its obligations under Rule 2a-7(c)(1) to assure that the stable NAV of its funds, derived from amortized cost valuation, "fairly reflects the market-based net asset value per share," obtains market-based valuations for all instruments in fund portfolios, except those of 7 days or less duration, which are priced at par.

[23] Under the proposal, a retail MMF is an MMF that does not permit any shareholder of record to redeem more than $1,000,000 of redeemable securities on any one business day. Release at 37000.

[24] Under the proposal, a government MMF is an MMF investing at least eighty percent of its total assets in cash, government securities, and/or repurchase agreements that are collateralized fully by such securities. Release at 37000.

[25] Release at 36855 ("Under the proposal, funds taking advantage of the government fund exemption (as well as funds using the retail exemption discussed in the next section) would no longer be permitted to use the amortized cost method of valuation to facilitate a stable NAV, but would continue to be able to use the penny rounding method of pricing.").

directors to assure the fairness of MMF share prices, into final arbiters of MMF share prices. Pricing services will gain authority and increased fee income for providing what amounts to a market-based calculation provided by a pricing vendor on the valuation of a security, multiple times a day, with no additional discernible benefit to investors. Giving price vendors the type of *de facto* power held by rating agencies before the Financial Crisis could have a material impact on the markets and investors. The small number of vendors will compound their influence and the potential for operational risks, technology breakdowns and systems failures at a vendor. Systems problems at price vendors, of the types that have surfaced unexpectedly at other major market utilities and participants in recent months, could suddenly prevent MMFs from processing transactions, putting additional stress on the payment and settlement systems and financial markets.

We want to underscore that Federated views the process of obtaining "market-based" valuations as important to assure that a MMF's stable NAV fairly reflects the value of its portfolio holdings. Indeed, a MMF board is obligated to take action if it does not.[26] Federated, like many other fund advisers, has gone further than any statutory or regulatory requirement by posting daily shadow NAVs, based on market factors, for five of its prime MMFs. But the fact is that the Commission is proposing fluctuating NAV funds to the fourth decimal point, simply to create fluctuations for the sake of showing minute fluctuations in a highly stable product. It has no bearing upon accuracy or precision. It is a penalty, not a policy. Requiring investors to transact based on a fluctuation of one hundredth of a penny has no educational value for investors. It has no bearing upon whether investors, responding to market stress or a default in a portfolio security will engage in large-scale redemptions from a MMF. Yet, the costs to investors and to the economy of requiring purchases and redemptions of MMF shares to be made based upon these so-called "precise" estimated values will be staggering.

[26] Rule 2a-7 requires that MMFs monitor the "extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) from the money market fund's amortized cost price per share . . . ." 17 C.F.R. § 270.2a-7(c)(8)(ii)(A). In the event the deviation exceeds 1/2 of 1 percent, the board of directors must promptly consider what action, if any, should be initiated. 17 C.F.R. § 270.2a-7(c)(8)(ii)(B). In the event the board believes the deviation "may result in material dilution or other unfair results to investors or existing shareholders," the board *must* "cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results." 17 C.F.R. § 270.2a-7(c)(8)(ii)(C).

(2) The Proposed Exemptions in Alternative One do not Alleviate the Problems and would be Costly and Difficult or Impossible to Implement.

Throughout the Release, the Commission seeks to minimize the disruptive effects of its floating NAV and other proposals on investors and on the economy by pointing to the various exceptions and/or proposed exceptions to the proposals. But, the exceptions are limited, costly to implement, introduce more complexity and limit the efficiencies of MMFs for many investors. For example:

- The $1 million redemption limit for "retail funds" exempted from the floating NAV will not be available to many investors and will be extremely difficult and costly to implement (the Commission itself estimates that the costs of simply implementing the exemption will be enormous).[27] Thus, even routine business transactions for larger accounts, not driven by an effort to redeem ahead of a declining share value, such as sweeps, 401(k) plan transactions, meeting corporate payrolls, or payments of cash from escrow accounts, would not have the convenience of a stable NAV MMF even in normal market conditions when there is no threat to the stability of a MMF's share value. The Commission should not arbitrarily treat such routine redemptions as redemptions based on investors "running" to redeem or attempting to exert a "first mover" advantage.

- Retail funds in any event under the Release will be subject to the delays inherent in obtaining "market-based" estimates prior to rounding to the nearest penny to achieve a stable $1.00 per share – delays serving no purpose whatsoever, since the end price will be the same.

- The Release's assumption that tax exempt funds inevitably will qualify for the retail exemption, based on their investor base – is not accurate.[28]

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[27] Release at 36854-66.

[28] Release at 36855 ("We also note that our proposed retail money market fund exemption discussed in the next section would likely cover most municipal (or tax exempt) funds, because the tax advantages that these funds offer are only enjoyed by individuals and thus most of these funds could continue to offer a stable share price."). The impact of the proposal on tax exempt MMFs will be addressed in a separate letter.

- The Release's suggestion that omnibus accounts can utilize the retail exemption on a "look through" basis reflects a lack of appreciation for the enormous technical difficulties that would make it extremely difficult to implement and monitor. Many intermediaries simply would not undertake the costly systems retooling required. MMFs may be unwilling to rely upon the intermediaries (whether bound by contract or otherwise) to undertake this compliance obligation, for which MMFs ultimately would be responsible.[29]

- The exemption for government MMFs as an option for investors who need a stable value cash management vehicle is problematic on several fronts. While investors in these funds may have the convenience of stable value, they will have the inconvenience of delays of up to three to four hours in redemptions (to accommodate the valuation process described in section one, above, before rounding to the nearest penny). This would significantly hamper the liquidity of the same-day markets for Treasury and agency securities and repos and have a destabilizing impact at the end of the day prior to Fedwire closing, increasing the risk of fails in the payment systems. Government MMFs, now holding an estimated $917.6 billion in investor funds[30] may be called upon to absorb (if capacity exists) more investments, if institutional investors seeking stable value do in fact reallocate from prime to government funds – a loss of yield to investors, and a loss of credit to the private economy, resulting in higher financing costs to the private and state and municipal government sector. Promoting the ability of the federal government to borrow at the expense of state and local governments and private issuers is contrary to the Commission's consideration of competition, market efficiency and capital formation.

To the extent that the Commission is concerned about the potential for "first mover" institutional investors to take advantage of retail investors, it should consider other alternatives that would address this issue while retaining the utility of MMFs for all. While we believe it is extremely difficult to define and separate "retail" and "institutional" MMFs, one possibility is to continue to permit the use of the amortized cost method to provide stable value MMFs for all investors, but provide for types of

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[29] Release at 36860. Federated will address these issues in more detail in a separate comment letter.

[30] *Money Market Mutual Fund Assets as of July 31, 2013*, Investment Company Institute (Aug. 1, 2013), http://www.ici.org/research/stats/mmf/mm_08_01_13.

MMFs that, either by limitations on redemptions or limitations on balances, would be available to investors assumed to be "retail," and thereby permit those investors to separate themselves from investors who require larger redemptions or who have larger balances. Of course, another alternative would be to rely upon a carefully crafted mechanism for temporary suspension of redemptions from a MMF under stress, as discussed in section 4, below.

The staggering costs associated with Alternative One will be incurred for no identifiable benefit. The Release points to no evidence or data suggesting that a floating NAV for institutional prime MMFs will prevent or reduce runs in a crisis, nor does the Release provide support for the theory that institutional investors must be forced to transact MMF purchases and redemptions at a floating NAV in order to understand what they already know – that the portfolio holdings of MMFs may fluctuate (however minutely) in value and that MMFs are not insured and may lose value. Likewise, elimination of the amortized cost method of valuation for all MMFs, including those MMFs permitted under the proposal to use penny rounding to maintain a stable NAV, serves no purpose in either preventing or reducing runs or informing investors of a MMF's risk and fluctuating value, particularly in light of the current practices of many MMFs to disclose their daily shadow NAVs.

(3) The Elimination of Amortized Cost Accounting for Stable Value MMFs Will Add Costs and Create Delays and New Risks, Solely for the Purpose of Showing Insignificant Fluctuations in MMF NAVs, Without Providing any Benefits to Shareholders.

As discussed in Section 1, above, under either Alternative One or Alternative Two, MMFs would be prohibited from using amortized cost to value portfolio assets with a maturity in excess of 60 days. Other portfolio assets would have to be valued at an estimated value using a method other than the amortized cost, and rounded to the nearest penny (unless the MMF is an institutional fund under Alternative One, in which case penny rounding would not be permitted). Even for those MMFs for which "penny rounding" would be permitted, amortized cost provides critical operational efficiencies that would be lost under either Alternative. Given that the "shadow price" of a MMF using the amortized cost method of accounting is the same as the unrounded NAV of a MMF using the penny rounding method of establishing share prices, this proposal would only serve to increase the processing time for purchase and redemption transactions, as well as the costs and risks of operating a stable value MMF.

Specifically, for retail and government MMFs, Alternative One would permit continued use of amortized cost valuation for instruments of less than 60 days duration, but require use of "market-based" valuation for the other portfolio assets, using penny rounding to achieve the stable NAV.[31] For these MMFs, the Release rationalizes that since the Commission also is proposing that all MMFs be required to disclose daily their share price with portfolios valued using market factors and applying basis point rounding, stable value funds in any event would have to value their portfolio assets using market factors each day.[32] The Release posits that since "penny rounding alone [is] an equal method of achieving price stability in MMFs," government and retail MMFs will have the benefit of a stable NAV under these circumstances.[33] This is the entirety of the Commission's justification for the proposal – that eliminating the amortized cost method of valuation and permitting only penny rounding will make no difference to stable value MMFs. Although it makes no difference in the resulting share valuations, it will be more expensive and operationally difficult to use model pricing, at the least, and it quite likely will change the nature of flows in the entire liquidity markets due to settlement and processing delays.

The Commission could address this by permitting stable value MMFs to rely on the prior day's price, derived using market-based factors and penny rounding, to transact throughout the subsequent business day, absent action by the MMF board. Otherwise, stable value MMFs will need to go through the process described in Section 1, above, to obtain estimated market values throughout the day for each individual portfolio instrument, even though the penny-rounded NAV of the fund will inevitably be a stable $1 per share. MMFs will not be able to meet shareholder redemption requests throughout the day, as they do now, but will need to batch redemptions at periodic intervals, with prices struck using model portfolio price estimates supplied by an outside pricing vendor at some point following a shareholder's request and with the delivery of funds to the investor perhaps three or four hours later, or longer. Fund pricing services and fund

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[31] Release at 36855 ("Under the proposal, funds taking advantage of the government fund exemption (as well as funds using the retail exemption discussed in the next section) would no longer be permitted to use the amortized cost method of valuation to facilitate a stable NAV, but would continue to be able to use the penny rounding method of pricing.").

[32] *Id.*

[33] Release at 36855.

accountants tell us this will require multiples of current staff and introduce greater risk of errors and, in the end, meaningless variations – if any – in valuations.

This process described above under the current version of Rule 2a-7 produces a "shadow price" of the fund's shares based on current estimates of the market value of the MMF's portfolio. The shadow price is the same as the unrounded NAV of a penny rounding fund, except that the shadow price uses vendor calculated values for the entire portfolio, not just assets with maturities in excess of 60 days. Disclosing the shadow price to a MMF's shareholders allows them to confirm that there have been only trivial fluctuations in the MMF's estimated asset values. Therefore, continued use of the amortized cost method to maintain a stable value would not have any effect on the information available to shareholders.

An amortized cost MMF can calculate its NAV without first obtaining estimates of its market value from third-party pricing vendors, whereas a penny rounding MMF must obtain vendor prices before calculating its NAV. This has tremendous operational implications. Use of the amortized cost method allows a MMF to calculate its NAV quickly and frequently throughout the day, while use of the penny rounding method necessarily entails the lengthy and expensive process described above. There is a substantial risk of error at every stage in the penny rounding process, which may lead to substantial delays in payments to the MMF's shareholders.

Eliminating the amortized cost method and mandating the penny rounding process will only disadvantage shareholders. It will not affect the price of their transaction. It will lengthen, however, the time shareholders must wait for payments (possibly to the next business day), subject them to unpredictable payment delays resulting from pricing errors and systems failures and increase their MMF's expenses. The slower settlement times would force earlier deadlines for order submission, compress processing and settlement of share purchase and redemption transactions into fewer windows, create a large payment queue immediately before the close of Fedwire around 6 p.m. each business day, cause more transactions to settle the next business day, and make it even harder for a shareholder to coordinate its MMF settlements with the cash transactions to or from which those MMF cash settlement amounts are moving. The delay serves no purpose. It is highly unlikely that the market-based estimate from which stable value funds are penny-rounded will deviate from the amortized cost valuation by more than .0001 throughout the day, if at all, and in any event the redemption price always will be $1.00 per share. The elimination of the amortized cost method to value MMF shares will create pointless "make work," which will be costly, delay- and risk-creating, for no purpose whatsoever. It is not, as the Commission states, an "equal method" of achieving price stability.

(4) Alternative Two Preserves MMFs Utility for Investors While Providing a Tool to be Used by Directors if Necessary to Protect Investors from Material Dilution.

Alternative Two offers two new ways, redemption fees or a temporary suspension of redemptions, for MMF boards of directors to address circumstances that threaten a MMF's ability to continue redeeming its shares at a stable value, in order to protect shareholders against the potentially dilutive effect or other unfair results, and to protect markets against the potential contagion effect of "fire sales" to meet such redemptions. While Alternative Two builds upon existing concepts for mutual funds[34] and MMFs,[35] many MMF investors have expressed concerns regarding the impact of these proposals on their access to their money. For this reason, it is critical that Alternative Two be targeted to the narrowest of circumstances.

Given the very rare circumstances in which Alternative Two would apply, and the proven beneficial effects of the Commission's 2010 amendments, Federated does not believe that this additional reform is necessary. Nevertheless, Federated would welcome a rule permitting a MMF board to suspend redemptions temporarily in extraordinary circumstances, without being forced to liquidate the MMF, as Commission rules now require.[36] This grant of authority would be in addition to an obligation to impose a liquidity fee or take other action based on the level of weekly liquid assets. For the reasons further discussed below, we are proposing that the level of weekly liquid assets that triggers the obligation be set at 10%.

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[34] *See* 17 C.F.R. § 270.22c-2 (providing, as a method to reduce the short-term trading of mutual fund shares, that if a fund redeems shares within seven days of purchase, its board must consider whether to impose a fee of up to two percent of the value of shares redeemed).

[35] *See* 17 C.F.R. § 270.22e-3 (permitting a MMF board to suspend redemptions if it determines that the deviation between a MMF's cost per share using amortized cost versus its share price calculated to reflect current market conditions may result in material dilution or unfair results to investors, and imposing certain other conditions).

[36] *Id.*

Federated separately will submit a comment letter with recommendations to improve Alternative Two by broadening the board of directors authority to suspend redemptions or impose a liquidity fee, while shortening to ten days the maximum period for which liquidity fees and redemption deferrals could be imposed. MMF directors have an absolute obligation to act to avoid any material dilution or unfair results to investors and shareholders. Alternative Two should be focused on enhancing the tools available to directors to meet that obligation, without penalizing investors or causing unnecessary panic. Federated also urges the Commission to make a clear statement in the adopting release that liquidity fees and gates are to be imposed very rarely, in extreme circumstances, to protect shareholders.

For Alternative Two to be effective, the directors must be able to use these tools whenever unrestricted redemptions could produce unfair results for their shareholders, in the directors' judgment. Tying the ability of directors to impose liquidity fees or temporarily suspend redemptions to the amount of weekly liquid assets held at the end of a business day will not give the directors the flexibility to respond to the circumstances in which prompt action is needed to protect shareholders. The Reserve Primary Fund illustrates how a MMF holding a defaulted security can start the day with ample liquidity and, if redemptions are not restricted, totally exhaust its cash before 10:30 a.m. Directors must have the ability to respond to events that are likely to lead to large-scale redemptions, before the redemptions get underway and potentially harm the remaining shareholders.

We therefore recommend that the Commission give directors the power to impose a liquidity fee or suspend redemptions temporarily whenever they determine it would be in the interest of the MMF's shareholders in order to prevent material dilution or other unfair results to investors or existing shareholders. This has been the standard for breaking a dollar since the adoption of Rule 2a-7 thirty years ago. Given the potential impact of a liquidity fee or suspension of redemptions on shareholders, the Commission should not invent a different (and certainly not a lower) standard for the directors to take these actions.

If the Commission nevertheless finds that greater specificity is required for when the board may take these actions, then it at least should add defaults, acts of insolvency, significant downgrades or determinations that a portfolio security no longer presents minimum credit risk to the situations in which directors may suspend redemptions or impose liquidity fees. Moreover, if the Commission retains a weekly liquid asset threshold as a basis for imposing liquidity fees or suspending redemptions, it should lower the threshold from 15% to 10%.

The Release indicates that during the past three years, five MMFs, none of which was in jeopardy of breaking a dollar or failing to meet redemptions, had weekly liquid assets below 15% of their total assets. If Alternative Two had been in effect at the time, it would have required these funds to call needless board meetings and make unnecessarily alarming disclosures to their shareholders. Setting a threshold known to produce such false positives is not in the interest of shareholders or market stability. If the Commission used a 10% threshold, there would have been only one false positive.

Federated also believes that the proposed 30-calendar day maximum period for suspending redemptions is too long. Discussions with intermediaries and investors have led us to conclude that denying investors access to their cash for more than a brief period will create serious hardships. We doubt that it will take directors much more than a week to resolve what course of action would best serve the interest of their shareholders. We therefore expect that directors would not need to suspend redemptions for more than 10-calendar days, and we would limit Alternative Two accordingly. We also recommend similar time limits on the imposition of a liquidity fee.

If properly tailored, Alternative Two offers substantial benefits over Alternative One:

- The ability to impose a liquidity fee or temporarily suspend redemptions in rare and extraordinary circumstances would not disrupt the day-to-day utility, stability, and liquidity of MMFs for investors.[37] Indeed, because of the substantial liquidity carried by MMFs since the 2010 reforms, it is unlikely that the vast majority of MMF investors will ever experience a liquidity fee or a suspension of redemptions. The potential for imposition of these actions should be as rare (as we believe the Commission intends) as the potential for a MMF to break a dollar.

- Empowering MMF boards to suspend redemptions temporarily in extraordinary circumstances to protect investors is the only one among the proposals in either

[37] However, if Alternative Two were imposed together with the elimination of the amortized cost method of valuation, even if penny rounding is permitted, intraday liquidity would be substantially hindered and same-day settlement would incur substantial delays.

> alternative that has been demonstrated to address runs in a crisis and preserve customer assets in a troubled MMF.[38] In the highly unlikely event that MMFs are faced with the type of once-in-a-generation scenario they experienced in 2008, or that an individual MMF experiences a significant credit event or other event likely to cause a rush to redeem, temporarily suspending redemptions will, as Commissioner Gallagher observed, "stop a run in its tracks."[39]

Alternative Two is the only alternative consistent with the Chairman's pledge to preserve the value of MMFs for investors.[40]

(5) Alternative One would be Costly to Investors and the Economy, Without Furthering the Commission's Goals.

The floating NAV proposal in Alternative One would impose unjustified (but not yet fully calculated) costs and disruption to millions of investors in MMFs, with consequences that are not fully known but which likely will drive investors away from MMFs and toward products that are less transparent, less efficient, and more costly, and that carry greater risk, and/or which will distort the funding markets by pushing more investors into government MMFs or to systemically important banks. The extraordinary costs to investors, municipal and corporate borrowers and MMF sponsors, and the burdens on the economy as a whole that would result from Alternative One, when weighed against the inability – acknowledged by the Commission – of Alternative One to achieve the intended systemic benefit of preventing or stopping widespread redemptions from MMFs in a future crisis, cannot satisfy the legal and policy standards that the

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[38] *See* Letter from Peter E. Madden to SEC (Feb. 13, 2013) (available in SEC file for 2012 Special Studies) (discussing the suspension of redemptions by the Putnam Prime Money Market Fund in September 2008 which permitted the fund to protect customer assets while arranging a sale to Federated). *See also* Release at 36881, n. 360 (citing examples of "successful" gating by European enhanced cash funds during the financial crisis to preserve shareholder assets).

[39] Daniel M. Gallagher, *Statement at the SEC Open Meeting on Money Market Fund Reform* (June 5, 2013), http://www.sec.gov/news/speech/2013/spch060513dmg.htm.

[40] *See Oversight of the SEC's Agenda, Operations, and FY 2014 Budget Request*: *Hearing Before the H. Comm. on Fin. Services*, 113th Cong. 15 (May 16, 2013) (statement of Mary Jo White); *Nomination Hearing of Mary Jo White: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs* (Mar. 12, 2013) (statement of Mary Jo White).

Commission must uphold in its rulemaking, especially when other, more effective, efficient, less disruptive and less burdensome regulatory solutions have been identified.

For the floating NAV proposals, the costs are wholly unwarranted. The billions in implementation costs and broader economic costs will be imposed on investors and the economy, not because the floating NAV will have any effect on investor redemptions during periods of stress and not because it has an educational benefit for investors, but because the Commission seems to believe that eliminating the amortized cost method of valuing MMFs to create insignificant fluctuations for the sake of showing fluctuations in an inherently stable product is a legitimate public policy goal.

The Commission has attempted to provide various "pin estimates" of the costs of implementing its floating NAV and other proposals.[41] The Release estimates various other costs for shareholder communications, disclosures, training and related costs. It also estimates the costs of systems modifications to impose a liquidity fee and various other proposals. We have not attempted to multiply the Commission's estimated costs by the number of entities affected, but clearly the costs of implementing the proposals, using only the Commission's preliminary estimates, will be enormous, in the billions of dollars. Federated has undertaken its own cost estimates and has encouraged its investors to do the same. We are hopeful of proving relevant data to the Commission in future comments. An extension of the comment period would assist Federated and other commenters in more fully developing information responsive to the information requests in the Release.

The consulting firm Treasury Strategies conducted its own preliminary survey of various MMF institutional shareholders and intermediaries and estimated that total up-front costs for U.S. MMF institutional investors to modify operations in order to comply with a floating NAV will be between $1.8 and $2.0 billion, with new imposed annual

[41] It suggests, for example, the costs of systems modifications to process transactions in a floating NAV of up to $2.3 million per fund, transfer agent, or intermediary, depending upon the extent of modifications needed, and ongoing additional costs of up to $345,000 annually per entity. Release at 36871. The Commission estimates that, even taking advantage of the "retail" exemption would cost up to $1,500,000 per fund to implement and up to $450,000 additional annual costs. Release at 36865-66.

operating costs of between $2.0 and $2.5 billion.[42] But these costs “do not include opportunity costs related to lower returns and higher financing costs” of a floating NAV, which, according to Treasury Strategies, “will be considerable and will impact investors' decisions to use MMFs.”[43] Federated currently is working to complete its assessment of the potential costs of the proposal and anticipates that the initial and on-going costs may be even higher than suggested in the Treasury Strategies survey.

The Commission admits that it has no idea whatsoever about the overall impact of the proposal on the economy:

> We currently do not have a basis for estimating under either reform alternative the number of investors that might reallocate assets, the magnitude of the assets that might shift, or the likely investment alternatives because we do not know how investors will weigh the tradeoffs involved in reallocating their investments to alternatives.[44]

While we appreciate that the Commission has sought to minimize the disruptive effects and costs of its floating NAV and other proposals on investors and on the economy by proposing various exceptions to the proposals, the assumptions underlying the exemptions do not bear out, such as its assumption that operational concerns about the floating NAV are satisfied in the exemptions for government and retail funds discussed above,[45] the Release's assumption that tax exempt funds will qualify for the retail exemption, based on their investor base – which is not accurate,[46] the Release's assumption that the retail exemption can be easily applied to omnibus accounts on a “look through” basis – which in fact will create huge operational and compliance

[42] Letter from Center for Capital Markets Competitiveness to SEC (Aug. 1, 2013) (available in File No. S7-13-03) (enclosing a report by Treasury Strategies titled *Operational Implications of a Floating NAV Across Money Market Fund Industry Key Stakeholders*).

[43] *Id.*

[44] Release at 36915.

[45] Release at 36854-66.

[46] Release at 36855 (“We also note that our proposed retail money market fund exemption discussed in the next section would likely cover most municipal (or tax exempt) funds, because the tax advantages that these funds offer are only enjoyed by individuals and thus most of these funds could continue to offer a stable share price.”).

burdens, if workable at all,[47] and the Release's assumption that the "range of options" for investors that are unable or unwilling to invest in a MMF subject to its proposals will leave investors with acceptable alternatives to MMFs.[48]

On this last point, none of the non-MMF "cash investment alternatives" in the chart presented in the Release[49] provide the combination of stability, transparency, low risk, liquidity, yield and level of regulation provided by prime MMFs. For example, prominent among the alternatives are bank demand deposits, which above the $250,000 insurance limit carry more credit risk than MMFs,[50] with a lower yield and less liquidity.

Indeed, the Release's presentation of the various investor alternatives for investors who cannot or will not tolerate the Commission's proposals suggests a lack of appreciation for the important historic, current, and potential future role of MMFs for investors – which should be the Commission's fundamental concern. MMFs developed as an investor-led phenomenon in which savers and investors found a better diversified and higher yielding cash management vehicle, whose construction as a mutual fund gave the protection of the securities laws that were as or more effective than bank regulation. Investors experienced higher returns, lower fees, and fund providers who found ways to promote transactional convenience and efficiency. Borrowers found a way to issue high quality paper directly to funds without having to pay much higher rates to banks. Using data from the Investment Company Institute, iMoneyNet and the Bank Rate Monitor, Federated estimates that during the period from 1985 through 2008, taxable MMFs increased investor returns by over $450 billion, as compared to what the same assets

[47] Release at 36860. Federated currently is engaged in the process of assessing whether the omnibus look through would be feasible.

[48] Release at 36916.

[49] Release at 36917.

[50] Letter from John D. Hawke, Jr. on behalf of Federated to SEC (Aug. 9, 2012) (available in File No. 4-619) (quoting the Federal Reserve Bank of New York's *Minimum Balance at Risk* paper as follows: "Even bank deposits have safety disadvantages for large institutional investors whose cash holdings typically exceed by orders of magnitude the caps on deposit insurance coverage; for these investors, deposits are effectively large, unsecured exposures to a bank. MMF shares – which represent claims on diversified, transparent, tightly regulated portfolios – would continue to offer important safety advantages relative to bank deposits.").

would have earned in money market deposit accounts.[51] The extraordinarily low short-term interest rates established by the Federal Reserve in response to the financial crisis have temporarily suppressed MMF yields and reduced this investor benefit. But the investor earnings benefit from MMFs will return in the future, as rates inevitably will climb after the Federal Reserve pulls back from its five-year quantitative easing.

In any case, the Release makes clear that there can be no confidence that Alternative One will either preserve MMFs as a valid investment and cash management product or that it will address the likelihood of high-volume redemptions. Nor can the Release assure that Alternative One will not impede economic growth. A careful cost-benefit analysis leads inexorably to the conclusion that more targeted reforms would be most effective.

(6) The Release's Proposals for New Disclosure Requirements and Investment Restrictions will Promote Transparency and Shareholder Understanding, but Should be More Tailored in Certain Areas.

The Release includes disclosure-related amendments to Rule 2a-7, Rule 482 under the Securities Act of 1933, and Form N-1A. Federated supports a majority of such amendments, and believes that they generally would promote transparency and facilitate shareholder understanding of MMFs. However, Federated has substantial concerns about certain of the amendments, as described herein, on the basis that the requested information (i) is unnecessary or overly duplicative of information already available shareholders, or (ii) is of a sensitive nature, and may be misused or misinterpreted by shareholders. Federated's concerns about other amendments are based solely on the period within which the information must be made publicly available.

The Release would require MMFs to disclose current and historical instances on which the fund has received sponsor financial support. Such disclosure would appear in various venues, including in Form N-CR and the SAI, and on the MMF's website. The Commission's definition of financial support is ambiguous and overly broad, and would capture many routine, ordinary course-of-business transactions. Accordingly, Federated recommends that the Commission tailor its definition of financial support to the following: (i) purchase of a security from a MMF in reliance on Rule 17a-9; (ii) capital

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[51] Letter from Federated Investors to SEC at 13 (May 13, 2013) (available in SEC file for 2012 Special Studies).

support agreement or other conditional credit arrangement; and (iii) capital contributions, but only to the extent that the shadow price of the MMF would have deviated from $1.00 by more than ½ of 1% in the absence of such contribution. Federated would further propose to limit SAI disclosure regarding sponsor financial support to those instances of financial support that occur subsequent to the effective date of the amendments to Form N-1A, and for a five-year look-back period.

The Release also would require website disclosure of daily liquid assets, weekly liquid assets, and inflows and outflows; and would require that such disclosure be updated on a daily basis. Federated believes the weekly liquid asset information disclosure should be disclosed on the first business day of each week, reflecting information from the close of the last business day of the prior week. Based on input from its client base, Federated believes that delayed disclosure of weekly liquid asset information would not impact the Commission's goal of promoting transparency to "permit investors to make more efficient and informed investment decisions"[52] and would offer the significant advantage of deterring reactionary shareholder redemptions based on transient liquidity fluctuations. Federated also believes the provision of inflow and outflow information is potentially confusing and should not be required. Certain of Federated's MMFs, particularly institutional MMFs, experience very large flows and are in fact structured to be able to accommodate such flows. Shareholders may misinterpret a sizeable outflow from a MMF as a sign that the MMF is experiencing stress.

The Release significantly amends the content of Form N-MFP, and solicits comments as to the frequency of the filing of Form N-MFP and the period within which Form N-MFP is made public. As a preliminary matter, Federated believes that a weekly filing of Form N-MFP would be tremendously burdensome, and that monthly filings of Form N-MFP should be retained. Federated additionally recommends that there be a five-business day delay in the public availability of Form N-MFP.

With respect to the content of Form N-MFP, Federated strenuously objects to the changes to Part C of Form N-MFP (Items C.17 and C. 25) that would require lot level reporting with respect to portfolio securities; and questions the efficacy of the Commission's statement that such information "would have the incidental benefit of facilitating price discovery and would enable the Commission and others to evaluate

[52] Release at 36927.

pricing consistency across funds (and identify potential outliers)."[53] Federated believes that this requirement is a wasteful, inefficient and inequitable means of evaluating pricing in the money markets. The Release would place on MMFs the entire burden of "facilitating price discovery" in the money markets, when MMFs do not represent a majority of trading therein. Federated does not believe that shareholders would be at all concerned with historical trading information, and that other market participants may use it to trade to their advantage and the MMF's disadvantage.

While Federated agrees with the Commission's amendments to Item 4 of Form N-1A regarding the disclosure of fees and gates, it disagrees with the additional disclosures with respect to which the Commission seeks guidance in the Release. Federated also would propose to limit SAI disclosure regarding historic instances of fees and gates to a five-year look-back period.

Federated supports the Commission's proposals regarding disclosure of MMD shadow NAVs, but does not believe that reporting thereof should be required on Part D of Form N-CR in those instances where the fund's current NAV per share deviates downward from its intended stable price per share by more than ¼ of 1%. This reporting trigger is arbitrary, and there are no other implications under Rule 2a-7 for a MMF that has a 25 basis point deviation; accordingly, Federated does not view such deviation as a material event that necessitates a separate reporting. Moreover, under the Release, such information would already be readily available on the MMF's website.

(7) Current Diversification and Stress-Testing Requirements Should be Modified to Reflect Existing Best Practices.

The Release includes some proposed changes to Rule 2a-7 that would reflect current practices of Federated and other major MMF managers. For example, the Commission proposes to require MMFs to consolidate parents and majority owned subsidiaries for purposes of complying with the rule's diversification limits. Federated's minimum credit risk procedures would already comply with this requirement. The Commission would also require MMFs to conduct stress tests combining concurrent hypothetical stress events. Federated currently combines redemptions with each other category of event (e.g., interest rate changes or defaults) in conducting its stress tests. We would not object to adding a

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[53] Release at 36942.

small number of stress tests that realistically combine stress events, provided that only significant testing results would need to be reported to the fund's directors.

Federated opposes the other proposed changes to the current diversification and stress testing requirements. This includes the proposal to treat sponsors of asset-backed securities as guarantors of the securities, even if the sponsor has no legal obligation to make payments on the securities. The proposal appears to be based on a misunderstanding of current practices. While it is true that MMFs cannot typically review information about the particular assets underlying an asset-backed security, they nevertheless base their credit decisions on a multitude of factors other than the sponsor's financial strength. Federated reviews a wide range of information, including pool level information about the underlying assets, and bases its minimum credit risk determination solely on the legal obligations of the parties. Federated has never purchased an asset-backed security based upon an "implicit" guarantee by the sponsor, and should not be required by Rule 2a-7 to act as though it has done so.

Federated believes that the other proposed changes to the stress testing requirements are excessive, costly and will unduly burden MMF directors with meaningless results. For example, one stress testing proposal would require a MMF to determine what change in general interest rates would *cause* the MMF's weekly liquid assets to fall below 15% of its total assets. This proposal presupposes a non-existent causal relationship between interest rates and the amount of weekly liquid assets maintained by a MMF. A MMF could not comply with the proposed requirement.

Proposed Rule 2a-7 would also include two new requirements to conduct an unspecified number of stress tests based on "non-parallel" shifts in the yield curve and other hypothetical events an adviser deems relevant. The proposal is unclear about what events must be tested or how many tests must be included. Federated does not believe it could ever tell if it had conducted the kind of tests, or enough tests, necessary to comply with the proposed requirements. We also do not believe such a welter of tests would be of any use to the MMF's directors.

(8) Tax Exempt Funds Should Have the Same Exemptions as U.S. Government MMFs and Retain Their Ability to Operate Using a "25% Basket" and without a Daily Liquid Asset Floor.

Tax exempt MMFs are the single largest group of investors in short-term obligations of state and local governments. Alternative One, if applied to tax exempt MMFs, will lead to an exodus of investors from those MMFs. This would reduce the funding available to state and local governments for short-term financing and significantly drive up the cost to state and local governments of their short-term borrowings.[54]

The Commission assumes in its release that investors in tax exempt MMFs are primarily retail investors, and thus that tax exempt MMFs could readily avail themselves of the "retail" exemption from the floating NAV requirement in the Commission's Alternative One. However, a significant portion of the balances in tax exempt MMFs is invested by institutional investors whose balances and daily transactions are too high to fit within a fund operating within the proposed "retail fund" exemption. Federated estimates that two-thirds of the assets held in its tax exempt MMFs are attributable to such investors. Moreover, "institutional" assets have historically comprised 40% of the industry's tax exempt MMF assets. Alternative One could result in many investors leaving tax exempt funds. This would lead to shrinkage of tax exempt MMFs, to the significant detriment to state and local governments and their citizens. It may also lead to the wholesale elimination of many single state funds, reducing investment options for shareholders and raising short-term funding costs within those states. Tax exempt MMFs have been very stable through many market cycles and did not experience large redemptions during the 2008 Financial Crisis. It

[54] *See* Letter from 33 Members of Congress to SEC (May 1, 2012), http://www.preservemoneymarketfunds.org/wp-content/uploads/2012/05/Congress_Letter_to_SEC_5-1-12_13359658511.pdf (warning that any alterations to the structure of MMFs that would lead to a reduction in demand for MMFs, including a floating NAV, "would reduce demand for the securities issued by state and local governments and purchased by MMFs. As a result, states and municipalities would be deprived of a critical funding source and would be faced with increasing debt issuance costs."). The following Members of Congress signed the letter: Congressman Richard E. Neal (D-MA), Congressman Tom Reed (R-NY), Congressman James P. Moran (D-VA), Congressman Frank C. Guinta (R-NH), Congressman Gerald E. Connolly (D-VA), Congressman David Schweikert (R-AZ), Congressman Michael E. Capuano (D-MA), Congressman Steve Chabot (R-OH), Congressman Gary Peters (D-MI), Congressman Aaron Schock (R-IL), Congressman Jim Himes (D-CT), Congressman Phil Roe, MD (R-TN), Congressman David Cicilline (D-RI), Congressman Mike Coffman (R-CO), Congressman Henry Cuellar (D-TX), Congresswoman Lynn Jenkins (R-KS), Congressman John Carney (D-DE), Congresswoman Cynthia Lummis (R-WY), Congressman Brian Higgins (D-NY), Congressman James B. Renacci (R-OH), Congressman Martin Heinrich (D-NM), Congressman Adam Kinzinger (R-IL), Congressman Albio Sires (D-NJ), Congressman Kenny Marchant (R-TX), Congressman Bill Pascrell (D-NJ), Congressman Steve Stivers (R-OH), Congressman John Larson (D-CT), Congressman Bill Posey (R-FL), Congressman Sam Farr (D-CA), Congressman Jeff Fortenberry (R-NE), Congressman Todd Rokita (R-IN), Congressman Mike Fitzpatrick (D-PA), and Congressman Mike Kelly (R-PA).

certainly is not necessary to impose a floating NAV upon them as a means to address large-scale investor redemptions.

Federated strongly urges the Commission not to impose a floating NAV requirement or daily redemption caps on tax exempt MMFs. Federated also recommends excluding tax exempt MMFs from Alternative Two. Federated's tax exempt MMFs have historically maintained 80% of their total assets in weekly liquid assets, which is consistent with industry practice. The probability of weekly liquid assets falling below a 10% or 15% threshold would be exceedingly remote and the imposition of liquidity fees or suspension of redemptions at that point would provide less protection to the remaining shareholders. These high levels of weekly liquid assets, and the corresponding ability to recover most of the portfolio's value through the exercise of demand features rather than through open market transactions, makes tax exempt MMFs more like government MMFs than prime MMFs, which is why tax exempt funds should be given the same exemption from Alternative Two as government MMFs.

The Commission also proposes to eliminate the so-called "25% basket." Rule 2a-7 permits the credit of portfolio assets to be enhanced to meet investment quality and liquidity requirements through credit enhancements and demand features issued by third party highly-rated companies (usually banks and insurance companies). Rule 2a-7(c)(4)(iii) currently imposes a ten percent cap – applicable to 75% of a MMF's portfolio – on investments that are permitted to be supplemented by demand features or guarantees from any one company. The ten percent limit does not apply to the other 25% of a MMF's portfolio, which is referred to as the "25% basket."

Contrary to the analysis in the Release, tax exempt MMFs regularly rely on the 25% basket during the course of their operations. Three-quarters of Federated's tax exempt MMFs, and all but two of Federated's 14 single state funds, currently hold securities in their 25% basket. Federated believes the basket is widely used by other tax exempt funds, particularly single state funds, in the industry. The number of eligible demand feature providers in the municipal market is limited, so tax exempt MMFs rarely have the opportunity to substitute securities in the 25% basket for securities that would comply with the 10% limit on demand feature providers. Thus, the consequence of eliminating the 25% basket for tax exempt MMFs would be a combination of (a) decreased liquidity, as funds are forced to replace securities subject to demand features with securities that do not have demand features, and (b) increased risk, as funds are forced to increase their reliance on demand feature providers outside the 25% basket, even if those providers present marginally greater credit risks.

The Release attempts to justify elimination of the 25% basket by referring to significant disruptions that occurred in the municipal market during the financial crisis. However, this ignores the fact that tax exempt MMFs weathered these disruptions without an influx of redemptions or support from their sponsors. The Release does not cite a circumstance in which the 25% basket had an adverse impact on tax exempt MMFs or their shareholders.

Prime MMFs rely less frequently on the 25% basket, as they have a broader range of eligible securities available in their market. As the Release notes, however, this will change if the Commission adopts its ill-advised proposal to treat sponsors as guarantors of their asset backed securities. Regardless of whether the Commission adopts this proposal, Federated would still urge the Commission to retain the 25% basket for all types of MMFs. Uniformity facilitates compliance with Rule 2a-7, and the Release does not provide any justification for returning to the pre-1997 version of the rule, when the 25% basket was available only to tax exempt MMFs. The 25% basket has been available to prime MMFs for fifteen years and throughout the worst economic crisis since the Great Depression, without any instances of inappropriate use. The Commission should continue to allow all MMFs the flexibility to use the 25% basket for their strongest credit providers.

Federated also urges the Commission to stay the course on its decision not to require tax exempt MMFs to comply with the 10% daily liquid asset requirement. Contrary to the superficial analysis in the Release, the municipal market does not provide a sufficient supply of daily liquid assets to allow tax exempt funds to comply with this requirement. Since the 10% daily liquid asset requirement was first imposed on other MMFs in 2010, there were only two weeks when daily liquid assets exceeded 10% of the total assets held in Federated’s tax exempt MMFs. The asset-weighted average of daily liquid assets held in our tax exempt funds during this period was only 7.7%. Imposition of the 10% daily liquid asset requirement would force Federated to substantially curtail its tax exempt MMF offerings, and probably drive small managers out of the tax exempt MMF industry. As noted throughout Federated’s comments, tax exempt MMFs did not experience problems during the financial crisis, so the Commission does not have any basis for reducing competition in this manner.

(9) LGIP requirements do not automatically follow Rule 2a-7 Amendments.

The proposed amendments to the Commission’s MMF rules, if adopted, will not directly affect LGIPs that operate within the governmental fund exclusion in Section 2(b) of the Investment Company Act. LGIPs are not subject to Commission regulation or to registration under or the requirements of the Investment Company Act. The decision of whether an LGIP will follow the requirements of Rule 2a-7 is up to the states and GASB, not the Commission.

Many LGIPs voluntarily follow most of the requirements of Rule 2a-7 in order to qualify as “2a7-like” external pools that are permitted to value all of their assets at amortized cost. Changes to the Commission’s MMF rules do not automatically or necessarily apply to “2a7-like” LGIPs. It does not appear that “2a7-like” external pool LGIPs must comply with requirements that are contained in the Investment Company Act itself, or in other Commission rules or guidance applicable to MMFs that are not part of Rule 2a-7. Whether the proposed changes to Rule 2a-7, if adopted by the Commission, must be followed by a 2a7-like LGIP remains to be determined by GASB and the States.

State and local governments in respect of their direct holdings, and “internal pool” LGIPs (those owned by a single state or local reporting entity), are permitted to use amortized cost for assets with up to a year maturity. External pool LGIPs, even if not “2a7-like” are permitted to use amortized cost for assets with remaining maturities of up to 90 days, as well as for non-participating investments (non-tradable debt instruments that do not have an early redemption feature with a market price adjustment – for example bank time deposits).

Adoption of the Commission’s proposals as currently drafted (particularly Alternative One) would, however, impose a large burden on state and local governments and GASB to address and resolve the relationship between the amendments and the use of the amortized cost method of accounting by external pools that operate as “2a7-like” LGIPs. We do *not* anticipate that the end result would be a transformation of LGIPs to floating NAV funds. A more likely result would be that GASB and the States would de-couple the accounting treatment of external pool LGIPs from Rule 2a-7, and continue to operate them using amortized cost accounting and a stable NAV of $1 per share.

Conclusion

We continue to believe that no further structural changes to MMF regulation and structure are necessary at this time. In our view, however, Alternative Two could work to help stabilize MMFs in a future crisis, while Alternative One would not stabilize MMFs but would instead be enormously harmful and result in departures of institutional investors, including and state and local government investors, from MMFs and a significant shrinkage in MMFs.

Alternative Two, if adopted, would be improved by modifications to (a) permit directors to implement a liquidity fee or suspend redemptions temporarily *before* the end of the business day, so the board can respond to circumstances where the board in its judgment believes such action could prevent material dilution or other unfair results to investors or shareholders, (b) reduce the maximum period that redemptions may be suspended to ten calendar days, and subject liquidity fees to the same limitation, and (c) include tax exempt funds in the exemption proposed in paragraph (c)(2)(iii). Federated also urges the Commission to make it clear that the purpose of the provision is to protect, and not to penalize, shareholders and that it therefore is to be used only in the most extreme circumstances that could result in unfair results for shareholders.

Prohibiting MMFs' use of the amortized cost method of pricing shares would create severe operational issues and settlement delays, with adverse payment system and systemic risk implications, without improving the precision of valuations, enhancing investor protections, or addressing in any way the risk of large sustained redemptions in a financial panic. This measure also fails any reasonable cost/benefit analysis as being bereft of any benefit and replete with operational risks and costs.

While we support many aspects of the proposed disclosure and reporting requirements, they should be scaled back in amount, level of detail, and frequency of reporting, in order to more appropriately balance the costs and burdens of the new requirements with the usefulness of the information to investors.

Due to the length of the Release, the complex issues raised by the proposals, and the large number of questions and information requests contain in the Release, we respectfully renew our request that the time period for response be extended so that Federated and others can more fully develop and submit information responsive to the questions and issues posed by the Release.

We appreciate the opportunity to provide comments on the Release. In the coming weeks, we will be following up with additional comment letters providing more information and detail on these issues.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.