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July 16, 2014

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: **Money Market Fund Reform; Amendments to Form PF; File Number
S7-03-13 – Proposed Alternatives Raised by Commenters**

Dear Chair White:

On May 14, 2014, on behalf of our client, Federated Investors, Inc. and its subsidiaries (“Federated”), we filed a letter in the above-captioned money market mutual fund (“MMF”) rulemaking,¹ providing what we described as concluding comments on the Securities and Exchange Commission’s (“Commission’s”) record. However, information that a Wall Street Journal reporter apparently obtained from within the Commission and reported last week has prompted this further letter.² The reporter’s story, if true, suggests that the Commission soon may adopt new MMF rules that would impose on MMF investors and MMFs an onerous regulatory alternative that would destroy the utility of MMFs for a large segment of investors, with further adverse consequences for issuers who rely upon MMFs as an important alternative to bank financing. This is particularly troubling when the Commission has before it less burdensome alternatives that would achieve its regulatory goals of reducing run risk and potential first movers, as well as enhancing the transparency of MMFs for investors.

¹ *Money Market Fund Reform; Amendments to Form PF*, 78 Fed. Reg. 36834 (June 19, 2013) (“Release”). This letter supplements earlier letters filed by and on behalf of Federated. Those prior letters are available in the Commission’s File No. S7-03-13.

² See Andrew Ackerman, *SEC to Vote on Money-Fund Reforms July 23*, Wall St. J. (July 11, 2014), available at <http://blogs.wsj.com/moneybeat/2014/07/11/sec-to-vote-on-money-fund-reforms-july-23/?KEYWORDS=money+market+funds>.

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As the Commission is aware, as it moves forward to a decision as to whether to act on final rules and the content of those rules –

- The Commission must “respond to substantial problems raised by commenters”³ and is obligated under the APA, where commenters present “facially reasonable alternatives” to the agency’s approach, to consider those alternatives or provide a reason for declining to do so.⁴ In the current rulemaking, the Commission must address the overwhelming rejection by commenters of Alternative One (because a floating net asset value (“NAV”) will impose enormous costs on investors and affected issuers with no benefit in terms of curbing run risk) and further rejection of the combination of Alternatives One and Two (because the resulting product will not be viable for investors and the alternative of gates/fees can address potential run risk and potential first movers). The Commission must address, as well, comments on its current formulation of Alternative Two, which Federated and other commenters have suggested can and should be strengthened to give MMF boards additional authorities and flexibility to protect shareholders from potential first movers and enhance investor acceptance.
- The Commission must, under the APA and under the Investment Company Act of 1940 (“1940 Act”), consider whether its rules “*promote* efficiency, competition, and capital formation.”⁵ This requires more than simply checking the box on economic studies but mandates a real weighing of the economic impact of rules. In the current rulemaking, this requires the Commission to choose a regulatory alternative that best “preserve[s] the ability of money market funds to function as an effective and efficient cash management tool for investors,” as the Release states,⁶ while furthering the Commission’s goal of preventing or mitigating large-scale redemptions during market stress. As the Commission itself has acknowledged, the gates and fees alternative maintains the day-to-day utility of MMFs; the floating NAV alternative does not.

³ *Business Roundtable v. S.E.C.*, 647 F.3d 1144, 1149 (D.C. Cir. July 22, 2011).

⁴ *Chamber of Commerce of the United States v. S.E.C.*, 412 F.3d 133, 145 (D.C. Cir. 2005) (citing *Laclede Gas Co. v. FERC*, 873 F.2d 1494, 1498 (D.C. Cir. 1989)).

⁵ 15 U.S.C. § 80a-2(c) (emphasis supplied).

⁶ Release at 36836.

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- The Commission also must act consistent with its published Guidance on Economic Analysis in Commission Rulemakings, which requires, among other things, consideration of whether alternatives to a proposed rule are “better or worse . . . in terms of achieving the regulatory purpose in a cost-effective manner” when measured against the proposed rule.⁷ As the record demonstrates, an enhanced gates and fees proposal (modified as Federated and others have proposed), together with enhanced disclosures of MMF “market-based” NAVs, best achieves the Commission’s objectives of curbing run risk and enhancing transparency in the most cost-effective manner.
- The Commission must, under the Administrative Procedure Act (“APA”), articulate a “rational connection” between the facts found and the regulatory choice made.⁸ A final rule cannot rest merely on the Commission’s “predictive judgments,” but must be supported by the rulemaking record.⁹ In particular, speculation that a floating NAV for MMFs “*could* alter investor expectations” and therefore investors “*should* become more accustomed” to MMF NAV fluctuations and investors “thus *may be* less likely to redeem shares in times of stress,”¹⁰ without credible support for this proposition in the record (of which there is none) cannot possibly support the Commission’s floating NAV proposal. Limiting the floating NAV to provide additional exemptions for retail and tax-exempt funds does not cure these flaws.

The Commission’s MMF rulemaking has brought the statutory requirements for Commission rulemaking into sharp focus. We reiterate, as we did in our May 14th letter, that there is no justification in the Commission’s extensive rulemaking record for requiring a large segment of MMFs to convert to floating NAV, where the Commission has the alternative of fully informing investors of minute fluctuations in MMF valuations through enhanced disclosure, and where the Commission has a further alternative – gates and fees – that best addresses run risk. There is no justification to require MMFs to

⁷ *Current Guidance on Economic Analysis in Commission Rulemakings*, at 8 (Mar. 16, 2012), available at http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

⁸ *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

⁹ *Business Roundtable v. S.E.C.*, 647 F.3d 1144, 1149 (D.C. Cir. July 22, 2011).

¹⁰ Release at 36851 (emphasis added).

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abandon the amortized cost method for valuing high-quality short term money market instruments for MMFs that are subject to all of the other constraints of Rule 2a7,¹¹ and force MMFs to utilize another type of “level two” fair valuation, based upon the “good faith opinions” of pricing vendors’ mark-to-model valuations to yield a floating NAV.¹² Indeed, if the Commission were to choose a regulatory option that would destroy a product for a large segment of investors, when a far less disruptive alternative is available that better achieves its regulatory goals, better protects investors, and preserves the product, the Commission would violate its obligations under the Administrative Procedure Act and the Investment Company Act.

We address below the major alternatives to be considered by the Commission in determining whether alternatives to the proposed rule are “better or worse . . . in terms of achieving the regulatory purpose in a cost-effective manner” when measured against the proposed rule. These include:

- The Commission’s choice among its three proposed structural reforms: the floating NAV; gates and fees; and a combination of the two
- Other major alternatives: investor choice among types of funds and/or separation of institutional and retail funds
- Alternatives to the floating NAV proposal; principally, a penny rounding proposal applicable to all MMFs
- Disclosure alternatives

¹¹ Importantly, these include the requirement that a MMF may use the amortized cost method “only so long as the board of directors believes that it fairly reflects the market-based net asset value per share.” 17 C.F.R. 270-2a-7(c)(1). As the Commission is aware, the stable value pricing of MMFs using the amortized cost method closely tracks “market-based” valuations derived from pricing services’ mark-to-model valuations. Neither of these valuation methods represents “mark-to-market” pricing, but the use of the two methods together streamlines and facilitates cash management, while providing an important “market” benchmark. This promotes efficiency while protecting investors.

¹² Interactive Data, *FundRun*SM (last visited July 7, 2014), available at http://www.interactivedata.com/Assets/DevIDSite/PDF/Interactive%20Data_FundRun.pdf. This widely-used pricing vendor describes its valuations as follows: “Our evaluations represent our good faith opinion as to what a buyer in the marketplace would pay for a security (typically in an institutional round lot position) in a current sale.” *Id.*

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**I. The Commission's Choice Among its Three Proposed Structural Reforms:
Floating NAV; Gates/Fees; Combination**

The Commission has described its own proposal in terms of alternatives: “Alternative One,” a floating NAV for MMFs that are not “retail” or “government” MMFs; “Alternative Two,” liquidity fees and gates applicable to all MMFs except government MMFs; and a third alternative, which would combine the first two alternatives.¹³ In weighing the costs and benefits of the Commission’s rulemaking, these alternatives must be measured against each other as well as against various alternatives proposed by commenters.

The Commission must consider that commenters, as well as the Commission itself, nearly uniformly state that a floating NAV would not prevent or mitigate large-scale redemptions in a crisis and that gates are the “one regulatory reform discussed” that will.¹⁴ Indeed, we are hard pressed to find support in the extensive rulemaking record even for the weak proposition that MMF shareholders are incentivized to redeem fund shares in times of market stress “*based on* the fund’s valuation and pricing methods,” as the Release suggests.¹⁵ In fact, the record contains extensive commentary showing that, at periods during the financial crisis, shareholders in floating NAV short-term funds were incentivized to redeem shares at rates comparable to shareholders in stable value MMFs, demonstrating that shareholders redeemed for reasons other than the structural characteristics of MMFs.

Similarly, the Commission’s statements in the Release that a floating NAV for MMFs “*could* alter investor expectations” and therefore investors “*should* become more accustomed” to MMF NAV fluctuations and investors “*thus may be* less likely to redeem shares in times of stress”¹⁶ remain pure speculation, unsupported by the record or any

¹³ Release at 36834. The Commission also proposed a number of enhanced disclosure rules and other regulatory changes. Federated has commented on those proposals in a previous letter. *See, e.g.*, Letter from Federated to Commission (Sept. 17, 2013) (Available in File No. S7-03-13) (letter titled “Comments Regarding Amendments to Disclosure Requirements for Money Market Funds and Current Requirements of Rule 2a-7”) (stating that certain aspects of the Commission’s disclosure proposals are costly and of limited utility).

¹⁴ Release at 36880.

¹⁵ Release at 36849 (emphasis added).

¹⁶ Release at 36851 (emphasis added).

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other data. In any event, the Commission, if it chooses to impose a floating NAV on a large segment of MMFs, will need to explain why it believes investors, intermediaries, and issuers to affected funds should bear the enormous costs of a floating NAV (restructuring, retooling and accounting for a floating NAV in the case of investors and intermediaries; higher financing costs for affected issuers)¹⁷ when disclosure of underlying NAV fluctuations, particularly for institutional investors, could achieve the same informational result, and gates/fees could achieve a better result in terms of curbing run risk. If the Commission, as proposed, adopts a floating NAV for institutional, but not retail, prime MMFs, it also will need to explain why institutions need the informational benefit of a floating NAV, while retail investors do not – which is a ridiculous proposition.

The Commission is obligated to consider whether the gates and fees proposal as compared to the floating NAV proposal (or any proposed modification thereto) is more effective in achieving the proposed rule's goal of deterring runs and protecting investors against first movers with lower costs than the floating NAV approach. The Commission itself acknowledged that "gates are the one regulatory reform in this Release . . . that definitely stops a run on a fund (by blocking all redemptions),"¹⁸ a position strongly supported by the record. The Commission also has acknowledged that gates and fees would be less detrimental to MMF investors because they would preserve the day to day utility of the product.¹⁹ Thus, the gates and fees proposal is better in achieving the Commission's regulatory purpose in a cost-effective manner, when measured against the floating NAV.

Only a small number of commenters raised concerns about the effectiveness of the gates/fee proposal, suggesting that it could lead to preemptive runs by investors who closely monitored a MMF as it approached a gate or fee trigger.²⁰ As the Commission is aware, this concern can be addressed through modifying the proposal, as Federated and

¹⁷ Federated and others have submitted numerous comment letters discussing the costs associated with implementing Alternative One. *See, e.g.*, Arnold & Porter LLP on behalf of Federated (Sept. 17, 2013) (letter titled "Costs of Implementing the Proposals").

¹⁸ Release at 36880.

¹⁹ Release at 36915.

²⁰ *See* our discussion of these issues in Arnold & Porter LLP on behalf of Federated at 11-12 (May 14, 2014).

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other commenters have suggested, to give MMF boards greater flexibility to intervene to protect shareholders and avoid the potential adverse effects of a hard “trigger” for gates and fees.²¹ Specifically, Federated recommended: (1) reducing the 15% threshold to 10% (to avoid “false positives”); (2) reducing the maximum temporary suspension period to 10 days (which is a sufficient period for a MMF board to take appropriate action); and (3) permitting a board to implement a liquidity fee or redemption suspension before the end of the business day if it determines there is a risk that weekly liquid assets will be reduced to less than 10% or it determines that action is appropriate to avoid material dilution or other unfair results to shareholders (to head off preemptive redemptions and to protect shareholders against any potential first movers).²²

The record does not justify the Commission’s third alternative – the imposition of both a floating NAV and gates and fees on a large segment of MMFs. There is substantial evidence in the record that a floating NAV MMF with gates and fees simply will not be viable – creating “a uniquely undesirable product that no rational investor would select.”²³ This will completely deprive affected investors of the use of prime MMFs, and prime MMFs’ shrinking capacity will, in turn, diminish the market for commercial paper issuers. The Commission and commenters agree that gates and fees will address redemption pressures. Adding a floating NAV in combination with gates

²¹ Federated (Sept. 16, 2013) (letter titled “Comments Regarding Proposed Alternative 2”). *See also* J.P. Morgan (Sept. 17, 2013), Dreyfus (Sept. 17, 2013), Center for Capital Markets Competitiveness (Sept. 17, 2013), ICI (Sept. 17, 2013), Letter from Mercatus Center to Commission (Apr. 8, 2014). Researchers from the George Mason University Mercatus Center proposed allowing MMF boards to halt redemptions at any time and for any length of time, without any conditions other than an affirmative board vote (including the affirmative vote of a majority of the fund’s disinterested directors) that doing so is in the best interests of the fund, and is necessary to protect the fund’s stable NAV and to ensure the equitable treatment of shareholders. According to the commenters, “The ability to gate would afford a fund time to act to avert runs before they imperil the fund and its remaining shareholders and to dispose of illiquid securities in an orderly manner in the event of market distress. . . . Boards would be able to prevent first movers from benefiting at the expense of a fund’s remaining shareholders.”

²² Federated (Sept. 16, 2013) (letter titled “Comments Regarding Proposed Alternative 2”). Federated also recommended stating in any adopting release that the Commission expects boards will impose fees or redemption suspensions rarely and for only so long as necessary to protect shareholders; and further recommended exempting tax exempt MMFs from these provisions, as the proposal does for government MMFs.

²³ Invesco (Sept. 17, 2013). Unless otherwise stated, all references to comment letters are available in the Commission comment file number S7-03-13. Letters are referred to by commenter and date.

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and fees is a wholly unnecessary and destructive means of informing institutional investors of MMF risk, when, as stated above, enhanced disclosure, combined with gates and fees, achieves that goal in a far less costly manner.

II. Other Less Onerous Alternatives

Commenters have proposed other alternatives that would require a reconfiguration of MMFs but have a much less onerous impact on investors and issuers.

Investor Choice. For example, comments filed by the Mutual Fund Directors Forum and several asset managers have suggested allowing prime MMFs to choose which alternative (floating NAV or fees and gates) to adopt as a way of allowing investors to select which type of MMF best fits their investment needs.²⁴ One member of the Commission, Commissioner Piwowar, has suggested that MMF investors should be given the option of whether to invest in funds that have a floating NAV or those with a stable NAV and the authority to suspend redemptions during periods of market stress.²⁵ These alternatives are within the scope of the current rulemaking and, if implemented, would have the benefit of allowing the Commission to better gauge investor “incentives,” which currently are the subject of mere speculation in the Commission’s Release. Although implementing these alternatives would still involve significant administrative costs associated with reorganizing funds into floating and stable NAV MMFs, they also would preserve the benefits of MMFs for investors and avoid the downstream consequences to issuers and the broader economy of a greatly reduced prime MMF industry.²⁶

Separate Retail from Institutional. Since the proposed alternatives in the Release attempt to differentiate between institutional and retail funds (for purposes of imposing the floating NAV requirement), the Commission also might consider within the scope of

²⁴ Mutual Fund Directors Forum (Sept. 17, 2013); Legg Mason (Sept. 17, 2013); Dreyfus (Sept. 17, 2013). See also SPARK Institute (Sept. 16, 2013).

²⁵ See Andrew Ackerman, *SEC’s Piwowar: Give Investors Money-Fund Choices*, Wall St. J. (Feb. 28, 2014), available at <http://blogs.wsj.com/moneybeat/2014/02/28/secs-piwowar-give-investors-money-fund-choices/>.

²⁶ Deutsche Wealth & Asset Management also proposed dividing MMFs into stable and floating NAV MMFs. Deutsche Wealth & Asset Management (Sept. 17, 2013).

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its current rulemaking an alternative proposed earlier, which would separate institutional and retail MMFs, while preserving the stable value structure for all funds.²⁷ While this alternative also would involve the administrative costs associated with reorganizing funds (into institutional and retail), it also would address any Commission concerns about institutional investors redeeming from a MMF ahead of individuals.

III. Other Alternatives to the Floating NAV Proposal

Numerous commenters proposed variations in the Commission's floating NAV proposal – primarily to carve out larger or more streamlined exemptions. However, exemptions from the floating NAV do not diminish the enormous costs (tax, accounting, and operational costs, as well as increased risks due to the disruption of same-day settlement, among others) to be borne by institutional prime MMFs and their investors, the costs to those investors seeking other options, or the collateral consequences to issuers accessing the commercial paper market if institutional investor assets leave prime MMFs because of regulatory burdens imposed by the Commission. In terms of the Commission's cost/benefit analysis, various alternatives for exemptions from the floating NAV may make a bad proposal less bad for some MMFs and investors, but they cannot cure the arbitrariness of imposing upon a large segment of MMFs and their investors an alternative that continues to be the highest cost and least effective option.

Penny-Rounding Proposal. Federated offered as an alternative to the floating NAV proposal an alternative that would permit all MMFs to attempt to maintain a stable NAV using the penny rounding method, if the amortized cost method were no longer permitted by the Commission. MMFs would be permitted to calculate an unrounded NAV once each business day, and to continue to use the resulting portfolio valuation for any interim NAV calculations, unless an intervening significant market event has materially affected the portfolio's estimated value (as determined by existing procedures for identifying such significant events).²⁸ In the event a significant market event has

²⁷ Letter from Robert Comment to FSOC (Dec. 31, 2012) (available in File No. FSOC-2012-0003) (letter titled "Do Money Market Funds Require Further Reform?") (cited by the Commission for other purposes in the Release at footnote 67).

²⁸ See Federated (Nov. 6, 2013) (letter titled "Comments Regarding Penny Rounding Alternative"). Federated's proposal is similar to a proposal advanced by Capital Advisors Group in the Commission's comment file. See Capital Advisors Group (Sept. 3, 2013).

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occurred, the MMF would be required to update its estimates of the fair values of portfolio securities issued by affected companies.²⁹

Permitting MMFs to use the previous day's portfolio valuation as the basis for penny rounding absent a significant market event would retain the efficiencies inherent in the amortized cost method (which allows portfolio valuations to be determined at any point throughout the day through a simple calculation) which are absent from the Commission's floating NAV proposal and the current penny rounding method (both of which require obtaining valuations from a pricing vendor, slowing settlement times, raising costs to funds and reducing yields to shareholders, and inhibiting MMFs' same-day settlement capability).

IV. Disclosure Alternatives

Some commenters suggested that; instead of imposing further structural changes on MMFs, the Commission should consider requiring additional disclosures to achieve the Commission's regulatory objectives.³⁰ The Commission has stated that the floating NAV proposal is designed to increase transparency and investor awareness of the fact that money fund portfolios can fluctuate in value.³¹ There is no question that daily

²⁹ In addition, to protect shareholders from material dilution or other unfair results which may occur if a MMF's NAV drops, Federated recommended that the Commission incorporate the board responsibilities currently applicable to MMFs that use the amortized cost method to boards of MMFs that use the revised penny rounding method (adopting written supervisory procedures, which should include procedures for responding to significant events; monitoring the deviation between the unrounded NAV and the stable \$1 share price; and taking action if necessary to prevent such a deviation from resulting in material dilution or other unfair results to investors and existing shareholders). Federated (Nov. 6, 2013) (letter titled "Comments Regarding Penny Rounding Alternative").

³⁰ *See, e.g.*, OFI Global Asset Management (Sept. 17, 2013) (recommending monthly disclosure of funds' portfolio holdings and other characteristics, combined with the daily disclosure of funds' mark-to-market share prices instead of structural changes); American Bankers Association (Sept. 17, 2013) (arguing that disclosure of daily shadow NAV information, certain portfolio data, daily and weekly liquid asset levels, as well as any material events would accomplish the Commission's reform goals); Virginia Treasurer (Sept. 17, 2013) (arguing that daily portfolio disclosures by funds would permit investors to decide whether to continue to invest based on near real-time credit, yield and maturity information). *See also* J.P. Morgan (Sept. 17, 2013) (pointing out that many of the benefits of a floating NAV can be achieved through disclosure).

³¹ Release at 36850.

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“market-based” NAV disclosure is more cost-effective in informing investors of the underlying NAV fluctuations of MMFs. Thus, a tailored gates and fees proposal – which addresses run risk and any potential first mover risk – coupled with disclosure of daily market-based NAV – which addresses any transparency concerns, completely addresses the Commission’s rulemaking goals, in the most cost-effective way.

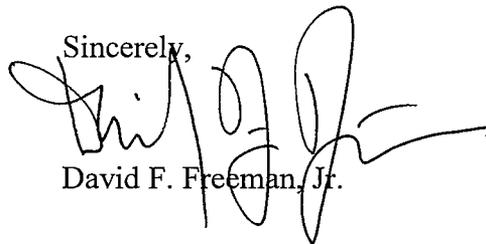
Conclusion

We appreciate the fact that the Commission and its staff have devoted many years and enormous resources to the issues put forward in its MMF reform proposal, and that the Commission would like to bring this rulemaking to a conclusion. Affected MMFs and investors who utilize them would as well. As we previously wrote the Commission, the data, studies, and commentary in the Commission’s extensive comment file point to a clear answer: Give due consideration to the comments, follow the facts, and insist upon a data-driven, cost-effective rule that best provides the benefits the Commission seeks to achieve.

There is no question that authorizing MMF boards in rare and limited circumstances to temporarily halt redemptions for periods of short duration will stop a run. The Commission’s gates and fees proposal, modified as Federated and others have recommended and coupled with enhanced disclosure, will fully address the Commission’s regulatory goals. Adding a floating NAV requirement for prime institutional funds serves no purpose, other than to destroy the utility of those funds for affected investors.

We appreciate the opportunity to provide these further comments.

Sincerely,

A handwritten signature in black ink, appearing to read "David F. Freeman, Jr.", written in a cursive style.

David F. Freeman, Jr.