



FAF ADVISORS™

Charles R. Manzoni, Jr.
General Counsel

May 23, 2007

SUBMITTED ELECTRONICALLY

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: Request for Comments Pursuant to Release No. 34-55431, File No. S7-08-07,
Relating to Amendments to Financial Responsibility Rules for Broker-Dealers
(the "Release")

Dear Ms. Morris:

FAF Advisors, Inc. ("FAF Advisors") is a registered investment adviser with the Commission, with over \$100 billion in assets under management, including approximately \$74 billion held by the First American Funds, a family of registered open-end and closed-end management investment companies ("mutual funds"). Among the mutual funds included in the family of First American Funds, are several money market funds representing approximately \$46.5 billion of assets under management. As the investment adviser to several billion dollars of money market fund assets, we are pleased to comment on the proposals in the Release relating to the status of shares of money market funds constituting "qualified securities" under Rule 15c3-3.

The family of First American Funds include: (i) one money market fund that invests only in U.S. Treasury Securities; (ii) one money market fund that invests only in U.S. Treasury Securities and repurchase agreements relating to U.S. Treasury Securities; (iii) one money market fund that invests only in U.S. Government and Agency securities and repurchase agreements relating to such securities; and (iv) one money market fund that invests in U.S. Government and Agency securities, commercial paper, bank obligations, repurchase agreements relating to such securities and other short term money market fund instruments (collectively, the "First American Money Market Funds"). Each of the First American Money Market Funds are rated AAAM by Standard & Poor's and Aaa by Moody's (each a "nationally recognized statistical rating organization" (an "NRSRO"), the highest ratings given by those organizations for money market funds. NRSRO ratings are independent opinions regarding a money market fund's ability to maintain principal stability and to limit exposure to losses due to credit, market, and/or liquidity risks.

The Release proposes amendments to Securities Exchange Act Rule 15c3-3 (the Customer Protection Rule), Rule 15c3-1 (the Net Capital Rule), Rules 17a-3 and 17a-4 (the Books and Records Rule) and Rule 17a-11 (the Notification Rule). As a registered investment adviser that manages money market funds, FAF Advisors' interest in the Release relates to the proposed amendment to the definition of "qualified security" in Rule 15c3-3 ("Qualified Security" or "Qualified Securities") and to the proposed capital "haircut" requirement for holding money market fund shares, as set forth in Rule 15c3-1.

FAF Advisors applauds the Commission for considering expanding the definition of Qualified Securities to include shares of certain types of money market funds. We believe, however, that the Commission should take this opportunity to consider expanding the type of money market funds whose shares would constitute a Qualified Security to include money market funds that would be more economically attractive to broker-dealers, without compromising customer protection. For reasons noted below, we believe that significant operational efficiencies would be realized by broker-dealers having the ability to deposit shares of money market funds in a customer reserve account. Accordingly, we believe the Commission has an interest in structuring a definition of Qualified Securities to include as broad a category of money market fund as is possible without increasing the risk to customers of those broker-dealers who choose to use such money market funds for their customer reserve deposits.

The Commission's general approach with respect to the proposed revised definition of Qualified Security is to include shares of money market funds that invest only in securities that a broker-dealer could otherwise directly deposit in a customer reserve account under the current definition, subject to certain additional conditions to insure liquidity. This approach fails to recognize that money market funds have characteristics that significantly reduce the risks associated with direct ownership of the securities held by money market funds, including diversification requirements, maturity limits, quality restrictions, professional management and independent board of director oversight. These risk-reducing characteristics justify expanding the definition to include certain money market funds that might hold securities other than securities issued or guaranteed by the U.S. government ("Government Securities")¹. Specifically, FAF Advisors endorses the primary aspects of the proposal (the "Federated Proposal") outlined in the comment letter submitted by Federated Investors, Inc., dated May 1, 2007 (the "Federated Comment Letter"). The Federated Proposal would expand the definition of Qualified Securities to include shares of money market funds that have received the highest rating from a NRSRO ("Top-Rated MMF"). This change would result in shares of money market funds that invest in securities, other than Government Securities, to become Qualified Securities.

¹ Paragraph (a)(6) of Rule 15c3-3 defines "qualified securities" as a "security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States." NYSE Intrap. 03-7 contains a more detailed description as to what types of securities are included and excluded from the definition.

While FAF Advisors strongly believes that the definition of Qualified Securities should extend to any Top-Rated MMF that satisfies the additional liquidity requirements set forth in the Commission's proposal, if the Commission does not determine to so revise the proposed definition, we urge it to at least clarify that shares of money market funds that engage in repurchase transactions involving Government Securities, in accordance with Rule 5b-3 under the Investment Company Act, be considered Qualified Securities.²

FAF Advisors also supports the recommendation contained in the Federated Comment Letter to make shares of Top-Rated MMFs acceptable collateral for fully paid for and excess margin securities borrowed by broker-dealers from their customers ("Rule 15c3-3 Collateral"). In Securities Exchange Act Release 47685 (April 16, 2003), the Commission set forth a range of securities and other instruments that qualify as acceptable Rule 15c3-3 Collateral, including several types of securities that could not reasonably be considered to necessarily be "safer" than shares of a Top-Rated MMF.³ If the Commission concludes that Top-Rated MMFs constitute Qualified Securities, we can see no reason why that decision would not extend to making such shares acceptable Rule 15c3-3 Collateral. Doing so, would further promote the operational efficiencies described below.

Operational Efficiencies

The Release correctly notes that a broker-dealer may chose to deposit qualifying money market fund shares into a customer reserve account based on operational considerations. We believe the operational efficiencies could be significant, especially for smaller broker-dealers that might not have direct access to Government Securities markets. These operational efficiencies (some of which are relevant to shares of Top-Rated MMF serving as Rule 15c3-3 Collateral) would include the following:

² Rule 5b-3 under the Investment Company Act permits an investment company to treat the acquisition of a repurchase agreement as the acquisition of the underlying security if the repurchase agreement is "collateralized fully." A repurchase agreement relating to Government Securities is "collateralized fully" under Rule 5b-3 if (i) the value of the Government Securities (reduced by costs the fund reasonably expects to incur in the event of a default) is, and at all times remains, at least equal to the agreed resale price, (ii) the fund has perfected a security interest in the Government Securities, (iii) the Government Securities are held with a custodian as required under the Investment Company Act and (iv) the repurchase agreement provides for an exclusion from the automatic stay under the bankruptcy laws. The "look through" purpose of Rule 5b-3 is designed to enable a registered investment company to, among other things, satisfy issuer diversification requirements. It is recognition by the Commission that, as a practical matter, the holder of a security under a repurchase agreement that is collateralized fully incurs limited, if any, counter-party credit risk. This approach is consistent with SEC Staff interpretations regarding the eligibility of borrowed securities to be deposited in a customer reserve account. Specifically, in a no action letter to the NYSE, the SEC Staff indicated that Qualified Securities that have been obtained through repurchase agreements initiated by other broker-dealers may be deposited in a customer reserve account (SEC Letter to NYSE, July 16, 1974).

³ For example, the list of acceptable Rule 15c3-3 Collateral includes mortgage backed securities and certain bank certificates of deposit and bankers acceptances, as well as certain corporate debt obligations rated in one of the two highest ratings by an NRSRO.

- **No need to manage or monitor a portfolio of securities.** This is done by the money market fund's investment adviser as the core service for which it is paid its management fee. FAF Advisors believes an investment adviser to a Top-Rated MMF is generally more experienced at, and focused on, managing and monitoring a portfolio than are the personnel at many broker-dealers who might be charged with multiple tasks, only one of which is managing the firm's special reserve account(s).
- **No need to mark to market.** Shares of money market funds are valued daily based on an amortized cost or penny-rounding methods of valuation of their assets.⁴ Most money market funds use the amortized cost method of valuation. To rely upon amortized cost, money market funds are required to compare that valuation against a mark-to-market valuation of their assets conducted on a regular, periodic (usually weekly) basis. Shares of money market funds have historically marked to market at minimal deviation from \$1.00 per share. Thus, regardless of when money market fund shares are purchased, the same net asset value per share is used for their valuation. Accordingly, there is no market fluctuation of investment from day to day or hour to hour and no need for the broker-dealer to value either the money market fund shares which it holds or the pro rata interest in the assets of the money market fund which such shares represent.
- **No need to monitor and ensure delivery of multiple securities.** Monitoring the delivery of the shares from one or two money market funds will be much easier than tracking delivery of various government securities issues from multiple counterparties.
- **No need to monitor principal and interest payments.** Principal remains constant (plus/minus any purchases and redemptions), and dividends are declared daily and paid monthly. Like monitoring delivery, tracking principal and interest payments on multiple government securities is time consuming and labor intensive.
- **Money market fund shares have no maturity date.** Once an account is open, the day-to-day recordkeeping and accounting for the money market fund position simplifies the broker-dealer's accounting. The money market fund's administrative services agent provides all necessary information on daily dividend accrual and share balances.
- **Transactions.** A broker-dealer can purchase or redeem any amount of shares of a money market fund on a daily basis without incurring transaction costs. With

⁴ Under the amortized cost method, portfolio securities are valued by reference to their acquisition cost as adjusted for amortization of premium or accretion of discount. Under the penny rounding method of valuation, share price is determined by valuing securities at market value, fair value, or amortized cost and rounding the per share net asset value to the nearest one percent.

Government Securities, as a practical matter, it is necessary to transact in round lots and incur transaction costs.

- **Timing.** Broker-dealers wishing to purchase Government Securities to satisfy the customer reserve account requirements would be required to place orders before 1:00 p.m. Eastern time to ensure execution prior to closing of the Government Securities market. The ability to purchase or redeem Top-Rated MMFs later in the day (generally 4:30 p.m. Eastern time) would provide broker-dealers with additional timing flexibility.
- **Statements.** A monthly statement summarizes and documents all daily money market fund account transaction activity. Daily confirms would be provided when necessary.

These operational efficiencies would be achieved, in part, because of the professional portfolio management and related administrative services that are inherent in a money market fund structure. To make these operational efficiencies available to broker-dealers, the type of money market fund shares that would be considered Qualified Securities or eligible Rule 15c3-3 Collateral must offer yields that are competitive with direct investing⁵ and must result in capital charges (“haircuts”) that are not less favorable than holding permitted direct investments. We believe that the regulatory structure around money market funds, particularly when enhanced by the conditions required to receive and retain the highest rating of an NRSRO, provides the Commission with an opportunity to address the needs of the marketplace by: (i) expanding the type of securities that a money market fund could own under the revised definition of Qualified Security; and (ii) reduce the required haircut to 0% on the shares of such money market funds, without compromising investor protection.

Proposed Definition of Qualified Security

Rule 15c3-3 requires broker-dealers to deposit cash or Qualified Securities into a bank account to meet the customer reserve requirements under that Rule. Currently, the only securities that are Qualified Securities are Government Securities. The Release notes that the Commission supports expanding the definition of Qualified Security to “include money market funds that, among other things, invest only in securities meeting the definition of “qualified security” in Rule 15c3-3” In addition, under the proposal, such money market funds (i) could not be affiliated with the broker-dealer, (ii) must agree to redeem shares for cash within one business day, and (iii) must have net assets at least 10 times the value of the broker-dealer’s interest in the money market fund.

FAF Advisors will comment below, under “Liquidity Risk”, on matters in clauses (ii) and (iii), but first wishes to express its concerns that the proposal limiting eligible money market funds to those that invest only in securities that the broker-dealer could

⁵ We agree with the observation in the Federated Comment Letter that, restricting the type of money market fund shares that would be considered Qualified Securities to shares of money market funds that hold only Government Securities, would make such shares a very unattractive alternative to direct investments.

deposit directly in a customer reserve account is unnecessarily restrictive and may result in significantly reducing their utility, thereby effectively depriving broker-dealers the operational efficiencies outlined above.

Expand Definition Qualified Security to Include Broader Range of Funds

In evaluating whether the definition of Qualified Security can appropriately be expanded, as set forth in the Federated Proposal and endorsed by FAF Advisors, the Commission should assess whether the expanded definition imposes any additional interest rate risk, credit risk or liquidity risk and, if so, whether the risk is so small as to be entirely justified either in an absolute sense or in light of the benefits that will be enjoyed by the operational efficiencies their use will afford broker-dealers.⁶

The Federated Comment Letter offers a very comprehensive evaluation of how money market funds, and particularly Top-Rated MMFs, operate under substantial regulatory and NRSRO constraints and that operating within those constraints they pose little, if any, risk as an alternative to holding Government Securities and as an alternative to a cash deposit in a bank. We do not intend to repeat the detailed review of the risk-reducing features of Rule 2a-7 and NRSRO demands but concur with the analysis set forth in the Federated Comment Letter regarding those matters. At the risk of some duplication, however, we do make the following observations and comments.

Interest Rate Risk

Expanding the definition of Qualified Security to include Top-Rated MMFs would not, in our view, create any greater risk to customers than permitting broker-dealers to deposit in a customer reserve account Government Securities. Indeed, shares of such money market funds would be subject to less interest rate risk than certain Government Securities.

Under the existing and proposed definition of Qualified Security, a broker-dealer can deposit any Government Security in a customer reserve account, including securities with long maturities and thus subject to significant interest rate risk. This is in contrast to a money market fund that under Rule 2a-7 must have an average weighted maturity not to exceed 90 days and to be rated in the highest rating by an NRSRO must have an average weighted maturity not to exceed 60 days.

⁶ The Commission should consider the overall history of the safety of money market funds generally and Top-Rated MMFs, specifically. Since the early 1970's, when money market funds were first introduced, there has been only one instance when the shares of a money market fund "broke the buck" This occurred in 1994, when Community Bankers U.S. Government Money Market Fund (the "Community Banker's Fund") liquidated at \$.961 per share due to significant derivative-related holdings. We believe it is significant that the Community Banker's Fund was both relatively small (\$86 million in assets at the time of liquidation and \$150 million in assets at its largest) and inexperienced in operating money market funds (it began operations in 1991 and liquidated in 1994). Since that time, Rule 2a-7 has been significantly revised and enhanced to address issues relating to risk and the industry has matured with experience.

Rule 2a-7 and NRSRO maturity requirements clearly would expose shareholders of a Top-Rated MMF to less interest rate risk than owners of Government Securities with remaining maturities which may be as long as thirty years.

Credit Risk

The regulatory structure under which money market funds operate, particularly the credit quality requirements along with the diversification requirements of Rule 2a-7, coupled with the additional protective requirements necessary to be a Top-Rated MMF, provide all necessary protection to offset any perceived credit risk that might exist as a result of holding securities that are not limited to Government Securities.

Rule 2a-7 and NRSRO requirements also serve to reduce significantly, if not virtually eliminate, credit risk associated with holding shares of a Top-Rated MMF. These requirements, as previously referenced, include rigorous diversification, maturity, liquidity and quality standards and constraints. NRSROs assign ratings to money market funds based on credit quality and liquidity, and money market fund's ability to manage both the market risks and the liquidity risks associated with its investments given the money market fund's shareholder base.

- *Diversification*—Immediately after the acquisition of any security, a money market fund must not have invested more than 5% of its total assets in securities issued by the issuer of the security. Additional diversification requirements pertaining to industry concentration, NRSRO security ratings and security Guarantor limitations provide additional Top-Rated MMF shareholder protections.
- *Maturity*— A money market fund must maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share. However, a money market fund may not: i) acquire any instrument with a remaining maturity of greater than 397 days; or ii) maintain a dollar-weighted average portfolio maturity that exceeds 90 days. Additionally, a Top-Rated MMF has been assessed by an NRSRO for the sensitivity of the market value of the money market fund's assets to interest rate changes, with a lower sensitivity having a more favorable influence on the money market fund's rating. A Top-Rated MMF must have a maximum weighted average maturity of no more than 60 days.
- *Liquidity* – Liquidity of a money market fund's investments is critical to maintaining a stable NAV. Rule 2a-7 permits a money market fund to elect to classify and hold 10% of its portfolio in illiquid securities. In determining the rating of a money market fund, NRSROs consider each money market fund's liquidity needs and its ability to quickly sell portfolio holdings if the need arises to meet cash outflows or large redemptions.

- *Quality* — Each security in a money market fund must satisfy three requirements respecting quality: i) generally, a money market fund may consist only of U.S. dollar-denominated securities; ii) a money market fund may only invest in securities that its board of directors has determined to have minimal credit risks, based on various factors pertaining to credit quality as well as ratings assigned to such securities by an NRSRO; iii) a money market fund may only invest in securities that are deemed to be “eligible” securities at the time of acquisition. Additionally, in order to be a Top-Rated MMF the securities held by the money market fund must individually satisfy the NRSROs’ credit quality standards⁷.

Liquidity Risk

When assessing liquidity risk in the context of money market fund ownership, the risk can be examined at the portfolio level and at the shareholder level. However, the two are closely linked because maintaining a highly liquid portfolio ensures money market funds the ability to instantly raise cash to meet any shareholder redemption requests. As noted above, Rule 2a-7 requires that a money market fund may not have more than ten percent of its assets in illiquid investments. In addition to the illiquidity constraints of Rule 2a-7, an NRSRO may place increased evaluation on liquidity risk by creating portfolio percentage limitations on money market fund investments with potentially reduced liquidity. This concept is designed to address occurrences in the marketplace that could create a potentially less liquid market for these types of securities and NAV pricing problems for money market funds.

Reduced Liquidity Risk with Broader Scope of Funds

Potential liquidity risk issues can be addressed by structuring the definition of Qualified Security to include the broadest scope of money market funds as is possible, consistent with the overriding concern of customer protection.

As proposed, the definition of Qualified Securities is confined to Government Securities and money market funds that own only Government Securities. That limited definition removes from the potential source of liquidity a large number of money market funds, including Top-Rated MMFs that could be included without adding any meaningful risk. For example, if the definition were to remain as proposed, we believe there would be approximately 99 money market funds with aggregate net assets of approximately \$70 billion that would potentially satisfy the definition.⁸ If the definition were revised to include any Top-Rated MMF, those numbers would be substantially larger and would include approximately 667 taxable money market funds with aggregate net assets of approximately \$1 trillion.⁹

⁷ As an example, for money market funds with the highest rating by Standard & Poor’s all of the securities held as investment should either carry a short-term rating of ‘A-1+’ or ‘A-1’ or be deemed to be of equivalent quality by Standard & Poor’s.

⁸ iMoneyNet, Money Fund Report for Period Ending April 30, 2007

⁹ iMoneyNet, Rated Money Fund Report for Period Ending April 30, 2007. Included in those 667 money market funds are (i) approximately 261 money market funds with approximately \$678 billion in assets that are prime obligation funds which may invest in any Rule 2a-7 securities, (ii) 347 money market funds that

Ownership Limitations

To further address liquidity concerns, the Commission has proposed that for a money market fund to be a Qualified Security it must have assets at least equal to ten times the value of the broker-dealer's interest in the money market fund. The Commission has requested comment on whether this 10% limit is an adequate safeguard to ensuring that broker-dealers will be able to quickly redeem shares.

While portfolios of Top-Rated MMFs are extremely liquid, we understand the desire to place some limit on the percentage of any money market fund a broker-dealer might own to ensure, in the case of the need to convert the entire customer reserve account to cash, that liquidity does not become an issue. The 10% threshold proposed seems reasonable to us and does not appear to impose any undue burden on broker-dealers wishing to take advantage of money market funds for meeting their customer reserve deposit requirements or Rule 15c3-3 Collateral requirements.¹⁰

With respect to liquidity at the money market fund shareholder level, the proposed rule would require that for shares of a money market fund to be a Qualified Security, the money market fund must agree to redeem shares in cash no later than one business day after a redemption request. Accordingly, we agree that liquidity at the money market fund shareholder level seems appropriately addressed by this requirement.

Though we support the requirement to require cash redemptions in one business day, we urge the Commission to provide reasonable exceptions to the requirement where failure to redeem is beyond the control of the money market fund. Thus, we recommend that the requirement be modified so as not to apply in the event of an unscheduled closing of the Federal Reserve Banks or the New York Stock Exchange.

Net Capital Haircut

Under paragraph (c)(2)(vi)(D)(1) of Rule 15c3-1, broker-dealers are required to take a 2% haircut on the value of any money market fund shares included in their computation of net capital. The Commission is absolutely correct in recognizing that a 2% haircut for shares of a money market fund meeting the requirements of Rule 2a-7 is disproportionately high in relationship to the haircut imposed on other instruments. Unfortunately, the proposal to reduce the haircut to 1% perpetuates the disparate

invest only in Rule 2a-7 eligible U.S. Government and Agency securities (including repurchase agreements collateralized by such securities) with approximately \$296 billion of assets, and (iii) 59 funds that may invest only in Rule 2a-7 eligible U.S. Treasury securities with approximately \$31 billion in assets, in each case subject to the further limitations and restrictions imposed by the NRSROs. All information is at April 30, 2007.

¹⁰ Pursuant to Section 2(a)(3) of the Investment Company Act an "affiliated person" of an investment company includes any person owning 5% of the investment company's voting securities. Section 17 of the Investment Company Act prohibits certain transactions involving investment companies and their "affiliated persons." Thus, any broker-dealer acquiring more than 5% of a money market fund would implicate Section 17 of the Investment Company Act.

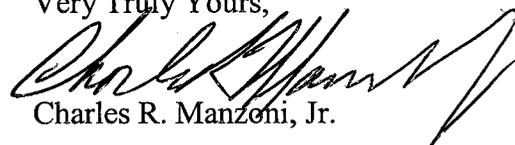
treatment. When compared to the haircuts imposed on other instruments, we believe a haircut of 0% for a Top-Rated MMF is entirely reasonable and appropriate and in the public interest. The Federated Comment Letter identifies examples where a 1/8th of 1% haircut is imposed on securities that could be riskier than the shares of a Top-Rated MMF.

There are at least three categories of securities that, under Rule 15c3-1, currently enjoy a 0% haircut—(i) Government Securities with less than three months to maturity (Rule 15c3-1(c)(iv)(A)), (ii) municipal securities with less than 30 days to maturity (Rule 15c3-1(c)(iv)(B)), and (iii) short term corporate obligations rated in one of the three highest categories by at least two NRSROs and certain short term bank obligations, in each case with less than 30 days maturity (Rule 15c3-1(c)(iv)(E)). While securities identified in clauses (ii) and (iii) must have a shorter maturity than the average weighted maturity of a Top-Rated MMF (60 days), there is no diversification requirement that would serve to reduce the credit risk associated with those types of securities. In the case of Government Securities referred to in clause (i), such securities could have longer maturities than the average weighted maturity of a Top-Rated MMF (three months as opposed to 60 days) making them subject to greater interest rate risk.

We believe that shares of Top-Rated MMFs that hold securities with an average weighted maturity of less than 60 days present less credit risk than is presented by the securities in clauses (ii) and (iii). The securities in clauses (ii) and (iii) lack diversification requirements, and therefore are subject to slightly more credit risk than shares of Top-Rated MMFs. In the case of securities in clause (i)—Government Securities with up to three month maturities-- we believe that shares of Top-Rated MMFs that hold securities with an average weighted maturity of less than 60 days present less interest rate risk and, with the diversification requirements, pose only slightly greater credit risk. On balance, based on these comparisons, shares of Top-Rated MMFs, appear to appropriately be entitled to a 0% haircut.

We appreciate the opportunity to comment on these proposals and hope the Commission and its Staff finds our comments helpful. If you have any further questions, we would be happy to respond.

Very Truly Yours,



Charles R. Manzeni, Jr.