UBS Global Asset Management (Americas) Inc.
51 West 52nd Street
New York, NY 10019-6114
U.S.A.
www.ubs.com

June 18, 2007

Ms. Nancy M. Morris
Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File Number S7–08–07

Dear Ms. Morris:

UBS Global Asset Management (Americas) Inc. ("UBS Global Asset Management") appreciates the opportunity to comment on Securities Exchange Act Release No. 55341.[1] UBS Global Asset Management is an indirect, wholly owned subsidiary of UBS AG. UBS AG and its affiliated companies ("UBS") include a leading global wealth manager, a top tier investment banking and securities firm, and one of the largest global asset managers. UBS operates in over fifty countries and from all major international financial centers. UBS Global Asset Management had approximately $152.4 billion in assets under management as of March 31, 2007. UBS Global Asset Management is a member of the UBS Global Asset Management Division, which had approximately $726.3 billion in assets under management worldwide as of the same date. UBS Global Asset Management provides a variety of investment solutions for its clients and serves as manager, advisor or sub-advisor to well over 90 funds registered with the US Securities and Exchange Commission (the "SEC" or the "Commission").

UBS Global Asset Management commends the SEC for proposing certain changes to modernize the financial responsibility rules under the Securities Exchange Act of 1934 (the "Exchange Act"). We strongly support key aspects of the proposal and recommend broadening the types of money market funds available to broker-dealers to satisfy their regulatory requirements. We also recommend that the "haircut" that broker-dealers would apply to proprietary positions in money market funds be reduced to zero percent from the proposed one percent. Our recommendations are explained below in detail.

Issues for Comment

UBS Global Asset Management is pleased that the Commission has proposed amendments to the financial responsibility rules that would permit broker-dealers to make greater use of money market mutual funds in conjunction with financing their operations.

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[1] March 9, 2007; 72 FR 12899 (March 19, 2007) (the "Release").

We applaud that effort. However, UBS Global Asset Management wishes to suggest several modifications relating to money market mutual funds.[2]

A. Proposed Amendments to the "Customer Protection Rule"

The Commission has proposed amendments to Rule 15c3-3[3] to permit a broker-dealer to use certain money market mutual funds as deposits to fund the broker-dealer's special reserve account. The proposed amendments provide:

> (6) The term *qualified security* shall mean:
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> > (i) A security issued by the United States or guaranteed by the United States with respect to principal or interest; and
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> > (ii) A redeemable security of an unaffiliated investment company registered under the Investment Company Act of 1940 and described in § 270.2a–7 of this chapter that:
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> > > (A) Has assets consisting solely of cash and securities issued by the United States or guaranteed by the United States with respect to principal and interest;
> > >
> > > (B) Agrees to redeem fund shares in cash no later than the business day following a redemption request by a shareholder; and
> > >
> > > (C) Has net assets (assets net of liabilities) equal to at least 10 times the value of the fund shares held by the broker-dealer in the customer reserve account required under paragraph (e) of this section.[4]

UBS Global Asset Management respectfully suggests that these limitations are too restrictive and will undermine the Commission's goal of allowing broker-dealers to use money market mutual funds for the special reserve account. We also suggest that the

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[2] UBS Global Asset Management wishes to limit its comments regarding the Release to proposed changes affecting money market mutual funds.

[3] 17 CFR §240.15c3-3, sometimes referred to as the "customer protection rule."

[4] Release, at 12894. We refer to money market funds whose net assets consist solely of cash and securities issued by the United States or guaranteed by the United States with respect to principal and interest as "Treasury-only money market funds."

unduly restrictive provisions discussed below are inconsistent with the requirements of Sections 3(f) and 23(a)(2) of the Exchange Act.

1. *Limitations on Affiliated Funds* –

The Release notes that under the proposal, "the money market fund could not be a company affiliated with the broker-dealer. The broker-dealer may experience financial difficulty caused by liquidity problems at the holding company level that are adversely impacting an affiliated money market fund as well in terms of the fund's ability to promptly redeem shares."[5]

We respectfully suggest that these comments do not take fully into account the protections afforded investors in SEC registered money market funds. As the Commission is well aware, the Investment Company Act of 1940 (the "1940 Act") pervasively regulates money market mutual funds as investment companies, in general, and as money market mutual funds, under Rule 2a-7 under the 1940 Act[6], in particular. For example, Section 17(f)(1) of the 1940 Act requires among other things, that every registered management company place and maintain its portfolio securities in the custody of a bank or certain other specified financial institutions.[7] The 1940 Act and its rules require that the assets would be fully segregated from the funds of the broker-dealer and would be protected in the event of financial difficulties at the broker-dealer or its affiliated fund adviser. As discussed in more detail below, Rule 2a-7 establishes strict standards for portfolio quality, diversification, and maturity.

If a broker-dealer experienced financial difficulties caused by liquidity problems at the holding company level, we do not believe that there is a reasonable basis to assume that those liquidity problems would somehow contaminate or adversely impact an affiliated money market fund. The fund is a separate legal entity with its own board, and the fund has an independent custodian for its assets. If the Commission's concern relating to "the fund's ability to promptly redeem shares" is an indirect reference to a concern that management of a holding company might improperly attempt to influence an asset management subsidiary's employees to hinder the redemption of fund assets, we find the concern to be unwarranted because an affiliated fund would be subject to the same limitations on redemptions as an unaffiliated fund, which are addressed further below. The affiliated fund would be legally required to redeem its shares to the same extent as any unaffiliated fund; the asset management subsidiary's employees would not have discretion to delay the redemption.

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5 Release at 12865.

6 17 CFR §270.2a-7 (we refer to this provision as "Rule 2a-7").

7 *See also* Rules 17f-1 through 7 (17 CFR § 270.17f-1 through 7) and Frankel, 2 The Regulation of Money Managers (2d. ed.) §17.03.

We also note that the language of the rule as proposed to be adopted appears to be internally inconsistent. The term "affiliated person" is defined in Rule 15c3-3(a)(13) to include any person who directly or indirectly controls a broker or dealer or any person who is directly or indirectly controlled by or under common control with the broker or dealer. Ownership of 10% or more of the common stock of the relevant entity is specifically deemed to be prima facie control of that entity for purposes of the rule. Under the proposed 10% ceiling, it would be possible for a broker-dealer to acquire a maximum of 10% of the outstanding shares of a money market fund. Given the definition of "affiliated person", however, this would automatically make the money market fund not "unaffiliated", thereby making the fund shares not eligible for investment under the proposed definition of a qualified security.

We believe that a broker-dealer would not jeopardize the assets in its special reserve account simply by selecting an investment in a money market mutual fund sponsored by an affiliated investment adviser. We note that the protections of the 1940 Act are in addition to the requirements for the special reserve account under Rule 15c3-3(e). Accordingly, we believe that it would be an unnecessary and unwarranted restriction to prevent a broker-dealer from using an affiliated money market mutual fund for the special reserve account.

2. *Limitations on Portfolio of Money Market Mutual Funds* – The Commission's proposal would permit a broker-dealer to use a Treasury-only money market fund for the special reserve account under Rule 15c3-3, rather than any money market mutual fund that qualifies under Rule 2a-7. UBS Global Asset Management believes that this requirement is too narrow and will limit the utility of the proposal. As noted, the 1940 Act imposes strict limitations on registered investment companies. Moreover, Rule 2a-7 imposes extensive restrictions on the portfolio quality and maturity of a money market mutual fund. For example, Rule 2a-7(c)(2)(iii) provides that a money market mutual fund must not, among other things, "maintain a dollar-weighted average portfolio maturity that exceeds ninety days." Rule 2a-7 includes restrictions on portfolio quality. For example, a taxable money market mutual fund may not have invested more than five percent of its total assets[8] in securities that are Second Tier securities.[9] In general, a taxable money market mutual fund must not have invested more than five percent of its total assets in securities of one issuer.

From a practical perspective, there are relatively few Treasury-only institutional money market funds; such funds are estimated to have assets of less than $30 billion. Similarly, assets in Treasury-only retail funds are estimated at less than $50 billion.

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[8] Rule 2a-7(a)(25).

[9] Rule 2a-7(a)(22).

This is small when compared to the amount of assets invested in "prime" institutional money market funds (over $900 billion) or "prime" retail funds (over $600 billion). ("Prime" money funds invest in a broad array of money market securities, including commercial paper, bank obligations as well as government obligations.) Forcing broker-dealers to choose Treasury-only funds could result in those brokers becoming very significant investors in a relatively small group of funds. When combined with the proposed limitation on purchasing more than 10% of any one fund (discussed further below), the limit to Treasury-only funds unduly constrains and severely limits the effectiveness of the proposed broadening in investment flexibility.

We additionally note that the Commodity Futures Trading Commission ("CFTC") has allowed futures commission merchants ("FCMs") to use money market mutual funds to hold segregated funds for many years without known incident. The CFTC's segregation rule is not restricted to Treasury-only or specially rated money market mutual funds.[10]

UBS Global Asset Management believes that the proposed limitation to Treasury-only money market funds is unduly restrictive; the yields on Treasury-only money market funds are too low to be attractive to most broker-dealers. As noted, the requirements of Rule 2a-7 ensure appropriate investor protection. Accordingly, we suggest that the Commission should expand the proposed definition of "qualified securities" to include all money market mutual funds that qualify under Rule 2a-7.

In the event that the Commission does not agree with the suggestion of allowing any money market mutual fund to be a qualified security, we suggest that the Commission should define a qualified security to include any money market mutual fund that invests only in First Tier securities[11] and that has an average daily maturity of sixty days

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[10] 17 CFR §1.25(c) ("CFTC Rule §1.25") provides in relevant part:

> (c) Money market mutual funds. The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).
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> > (1) The fund must be an investment company that is registered under the Investment Company Act of 1940 with the Securities and Exchange Commission and that holds itself out to investors as a money market fund, in accordance with Sec. 270.2a-7 of this title.
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> > (2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, an investment adviser registered under the Investment Advisers Act of 1940, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation.
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> > ***

[11] Rule 2a7(a)(12).

or less. As an alternative to that formulation, the Commission may wish to consider defining a qualified security as a money market mutual fund that receives a "AAA" rating from a nationally recognized statistical rating organization.

Finally, if the Commission is unwilling to include the broader formulations suggested above, it should at least clarify that a money market mutual fund constituting a qualified security may engage in "repo" transactions that are fully collateralized by U.S. Treasury securities.

3. *Limitation to 10% of Assets* - The Commission proposes that to constitute a qualified security, the money market mutual fund must have an amount of net assets (assets net of liabilities) that is at least 10 times the value of the fund's shares held by the broker-dealer in its customer reserve account. The Release notes at 12865 that:

> [O]ur proposal would require that the money market fund have an amount of net assets (assets net of liabilities) that is at least 10 times the value of the fund's shares held by the broker-dealer in its customer reserve account. This is designed to prevent a broker-dealer from holding too concentrated a position in a single fund. It also limits a potential redemption request by the broker-dealer to 10% or less of the fund's assets. While a redemption request that equaled 10% of a fund's net assets would be very substantial, we believe it is a reasonable threshold between a request that could be handled promptly and one that could have the potential to cause the fund some degree of difficulty in meeting the request within one business day. We seek comment on this threshold, particularly with respect to whether it should be smaller (*e.g.*, 5% or 2%) or higher (*e.g.*, 15% or 25%).

UBS Global Asset Management believes that the 10% ceiling in the Commission's proposal is too restrictive. As noted, a money market mutual fund must segregate its portfolio assets and use a custodian bank to hold those assets. A fund's board has control over the fund. We note that Section 2(a)(9) of the 1940 establishes a presumptive control test for an investment company.[12]

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[12] Section 2(a)(9) provides in part that

> "Control" means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company.
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> Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than

Accordingly, we believe it is highly unlikely that a broker-dealer could gain control of a money market mutual fund with a 10% or higher investment ceiling.

As noted, the requirements of Rule 2a-7 provide that the money market mutual fund must hold securities of very short maturities and of very high quality. In addition, the Staff has long taken the view that money market mutual funds may not hold more than 10% of their assets in illiquid securities.[13] In fact, most money market mutual funds maintain a much lower level of illiquid assets in recognition that they may be called upon to redeem their shares at any time. Accordingly, we believe that money market mutual funds should be able to accommodate even large transactions without difficulty.[14] We also note that CFTC Rule §1.25(a)(4)(A) specifically exempts money market mutual funds from the concentration test to which other securities are subject.

It should be noted that any broker-dealer that purchases 5% or more of the shares of a money market fund would become an "affiliated person" of the fund, as that term is defined in Section 2(a)(3) of the 1940 Act. While this status would not restrict the ability of the broker-dealer to purchase additional shares or redeem the shares it holds, it would subject the broker-dealer to the restrictions on the ability of the firm to engage in principal transactions with, joint transactions involving or agency transactions on behalf of the money market fund. For this reason, many broker-dealers may choose to invest in a money market fund only if the aggregate investment can be limited to less than 5% of the money market fund's outstanding shares.

If the Commission believes that it must set a ceiling on the value of the fund's shares held by the broker-dealer in its customer reserve account, UBS Global Asset Management believes that 25% would be a more appropriate figure.

4. *Limitations on Redemptions* – The Release notes that the Commission proposes to impose very strict redemption requirements on money market mutual funds that constitute qualified securities. "Our proposal would require the broker-dealer to use a fund that agrees to redeem fund shares in cash on the next business day. There should be no ability of the fund to delay redemption beyond one day or to require a multi-day redemption notification period."[15]

> 25 per centum of the voting securities of any company shall be presumed not to control such company. ***

[13] Investment Company Act Rel. No. 18612 (Mar. 12, 1992). *See also* Letter to Matthew P. Fink (pub. avail. Dec. 9, 1992).

[14] *See* discussion below regarding emergency or unusual circumstances.

[15] Release at 12865.

UBS Global Asset Management appreciates that broker-dealers should be able to redeem money market mutual fund shares and receive cash with little or no delay. However, we believe that the proposal does not include some reasonable exceptions to this redemption requirement. Section 22(e) of the 1940 Act lists some exigent circumstances under which a registered investment company may suspend rights of redemption.[16] UBS Global Asset Management believes that money market mutual funds that meet the definition of qualified security should include similar exceptions, such as unscheduled closings of Federal Reserve Banks, the Fedwire system, or national securities exchanges, or during such other periods as the SEC may order or permit.

Again, by analogy, we note that CFTC Rule 1.25(c)(5)(ii) includes exceptions for following circumstances:

A. Non-routine closure of the Fedwire or applicable Federal Reserve Banks;
B. Non-routine closure of the New York Stock Exchange or general market conditions leading to a broad restriction of trading on the New York Stock Exchange;
C. Declaration of a market emergency by the Securities and Exchange Commission; or
D. Emergency conditions set forth in section 22(e) of the Investment Company Act of 1940.

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[16] Section 22(e) of the 1940 Act provides:

> **Suspension of right of redemption or postponement of date of payment.** No registered investment company shall suspend the right of redemption, or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption, except—
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> 1. for any period (A) during which the New York Stock Exchange is closed other than customary week-end and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;
>
> 2. for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or
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> 3. for such other periods as the Commission may by order permit for the protection of security holders of the company.
>
> The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection.

Accordingly, we believe that the Commission should adopt some limited exceptions to its proposed redemption requirements to address market emergencies and similar events.

5. *Collateral* – UBS Global Asset Management respectfully suggests that the SEC should permit broker-dealers to use money market mutual funds as collateral under Rule 15c3-3(b)(3)(iii)(A) for customers' fully-paid or excess margin securities.[17] The Release does not address this issue, and we believe that the Commission or its Staff should act promptly in this regard.

UBS Global Asset Management notes that the Commission has approved assets for collateral that are no safer, and in some instances, are less secure than shares of a money market mutual fund. Accordingly, we urge the Commission to allow broker-dealers the additional flexibility of using money market mutual funds that meet the requirements of Rule 2a-7 as collateral for customers' fully paid or excess margin securities.

B. Proposed Amendments to the Net Capital Rule

One Percent Haircut – The proposal would amend Rule 15c3-1[18] and reduce the haircut on money market mutual funds from 2% to 1%. The Release notes:

> We are proposing an amendment that would reduce the ''haircut'' broker-dealers apply under Rule 15c3–1 for money market funds from 2% to 1% when computing net capital. *** The 2% haircut was adopted before the Commission adopted certain amendments to Rule 2a-7… that strengthened the risk limiting investment restrictions for money market funds.
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[17] Rule 15c3-3(b)(3)(iii)(A) permits a broker-dealer to pledge collateral which fully secures the loan:

> consisting exclusively of cash or United States Treasury bills and Treasury notes or an irrevocable letter of credit issued by a bank as defined in section 3(a)(6)(A)-(C) of the Act or such other collateral as the Commission designates as permissible by order as necessary or appropriate in the public interest and consistent with the protection of investors after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness.

See also Exchange Act Release No. 47480 (March 11, 2003); 68 FR 12780 (March 17, 2003); and Exchange Act Release No. 46783 (April 16, 2003); 68 FR 19864 (April 22, 2003).

[18] 17 CFR §240.15c3-1, sometimes referred to as the "net capital rule."

> This amendment is designed to better align the net capital charge with the risk associated with holding a money market fund.
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> We request comment on all aspects of this amendment, including on whether it is appropriate to reduce the haircut to 1% and, alternatively, whether the haircut for certain types of money market funds should be reduced to 0%…[19]

UBS Global Asset Management commends the Commission for proposing to reduce the haircut on money market mutual funds but believes that the proposed reduction from 2% to 1% is still too restrictive. Money market mutual funds have an exemplary record of safety and investor protection. Large and small investors use money market mutual funds as cash equivalents, purchasing and redeeming shares at their net asset value ("NAV") of $1.00 per share.

Rule 2a-7 permits money market mutual funds to use the amortized cost method of calculating NAV.[20] Briefly, Rule 2a-7 provides that when the price per share determined using market prices differs from the price calculated using the average cost method by more than 1/2 of 1 percent, the fund's board must consider whether to take any action. It also requires that the board must take action in any event if the calculation of price per share is unfair to investors. In addition to these requirements, virtually every money market mutual fund and its adviser have policies and procedures to monitor the value of the fund and to alert the board well before reaching the 1/2 of 1 percent level.[21] Accordingly, advisers and boards monitor the value of the portfolios and can take appropriate action, if necessary.

Because of the Commission's own stringent rules and because of money market mutual funds' extraordinary record of safety, UBS Global Asset Management believes that a 1% haircut is still too great and will unduly discourage broker-dealers from using money market mutual funds for net capital purposes. We believe that the Commission should reduce the haircut to zero percent for money market mutual funds that satisfy Rule 2a-7.

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19 Release at 12874.

20 Rule 2a-7(a)(2).

21 *See generally* Jack W. Murphy & Dougls P. Dick, *Money Market Funds*, in FINANCIAL PRODUCT FUNDAMENTALS: A GUIDE FOR LAWYERS, Ch. 9 (Clifford E. Kirsch ed., 2001).

Conclusion

UBS Global Asset Management appreciates the opportunity to comment on the Release. Again, we commend the Commission for proposing to modernize the financial responsibility rules and for its efforts to permit broker-dealers to make greater use of money market mutual funds. However, we believe that without the changes outlined above, the proposed amendments to Rule 15c3-3 and Rule 15c3-1 will have limited practical value. Accordingly, we urge the Commission to incorporate these changes into its proposal and to adopt them promptly.

Respectfully submitted,

UBS Global Asset Management (Americas) Inc.

By: /s/ Keith A. Weller
Keith A. Weller
Executive Director & Senior Associate General Counsel

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Annette L. Nazareth, Commissioner
The Honorable Kathleen L. Casey, Commissioner
Erik R. Sirri, Ph.D., Director, Division of Market Regulation
Andrew Donohue, Director, Division of Investment Management
Robert L.D. Colby, Deputy Director, Division of Market Regulation
Michael A Macchiaroli, Associate Director, Division of Market Regulation
Robert E. Plaze, Associate Director, Division of Investment Management
Thomas McGowan, Assistant Director, Division of Market Regulation