Preserving the Ability of Money Market Funds to Invest in A2/P2 Securities

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COMPETITIVENESS

Outline

1. **CHALLENGING THE BASIS FOR THE PROPOSED PROHIBITION**

   A. **Examining the SEC's Analysis and Conclusions**
      - *i.* ***Size of the market*** – $46.8 billion is an important source of financing for many major U.S. companies
      - *ii.* ***Credit spreads*** – CPFF caused A2/P2 credit spreads to widen in Fall 2008
      - *iii.* ***Risk reduction*** – The proposed prohibition would not have prevented the events of September 2008

   B. **Additional Factors to Consider**
      - *i.* ***Backstop credit facilities*** – 100% backstop credit facilities are required for the A2/P2 rating, but not for A1/P1
      - *ii.* ***Default risk*** – Default risk of A1/P1 is very similar to A2/P2
      - *iii.* ***Reliance on ratings*** - Transition rates between the top two tiers

2. **NEGATIVE AND UNINTENDED CONSEQUENCES OF THE PROPOSED PROHIBITION**

   A. **Diversification –** Reduced ability to diversify 2a-7 portfolios
   B. **Impact on capital formation –** Decreased flexibility and increased costs
   C. **Domino effect –** Impact of an SEC benchmark prohibiting investment in A2/P2
   D. **Impact on bank lending** – A2/P2 companies drawing down their credit facilities would reduce the ability of banks to lend to other parts of the economy

SEC proposal: the size of the A2/P2 market "has remained consistently small over time."

$46.8 billion is an important source of financing for many major U.S. companies

A2/P2 Issuers

- 204 companies
- 4 million employees
- $2 trillion in revenue
- $1 trillion in market capitalization

Issuer	Outstandings ($mm)
CVS/Caremark Corp.	1,606
Devon Energy Corp.	1,330
Safeway, Inc.	626
Clorox Company	538
Alcoa, Inc.	520
Dominion Resources	379
Comcast Corp.	87

Source: Public filings and Bloomberg. Data reported at end of Q2 FYE 2009

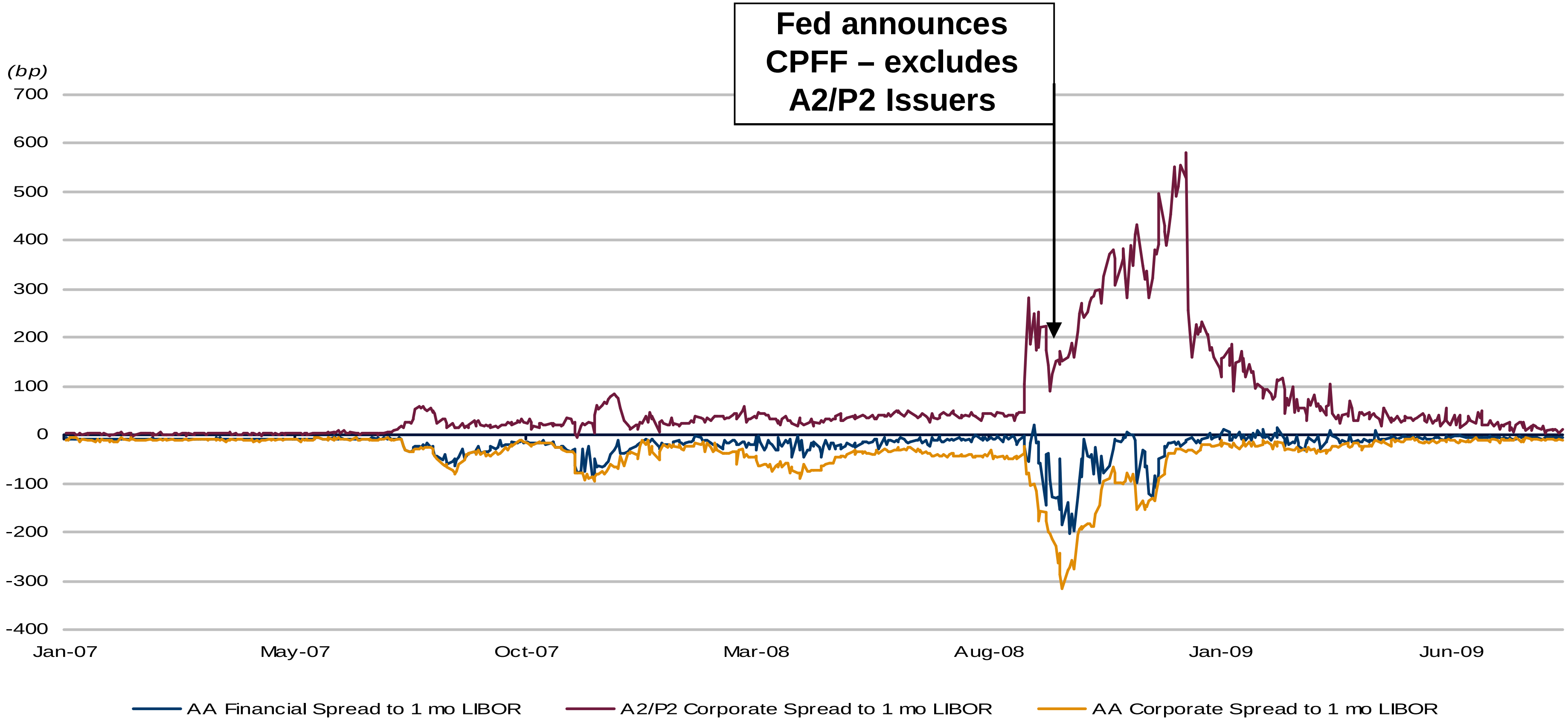
Although A2/P2 securities represent only a realtively small portion of total CP held by all funds, 2a-7 funds represent a significant source of financing for individual corporate CP programs

Corporate Issuer	*Percentage of CP Program Financed by 2a-7 Funds**
Comcast	80%
CVS Caremark	30%
Devon Energy	20%

This amount fluctuates over time, figure indicates the maximum percentage in the last year

SEC proposal: A2/P2 securities present "potentially substantially more risk than first tier securities."

The CPFF caused A2/P2 credit spreads to widen



Source: Federal Reserve. Spread to 1-month LIBOR.

The proposed prohibition would not have prevented the events of September 2008

•Lehman Brothers was an issuer of A-1 commercial paper up until the day it filed for bankruptcy.

•Most commercial paper defaults have resulted from unforeseen liquidity events, which is a risk equally applicable to A1/P1 Issuers.

•The commercial paper market is generally efficient in removing weaker companies from the market in an orderly manner **prior to any material credit deterioration.**

A2/P2 Issuers: **100% Backstop Credit Facilities are Required to Maintain Rating**

•Credit rating agencies require A2/P2 issuers to have 100% backstop facilities for their commercial paper programs in order to maintain the investment grade A2/P2 rating.

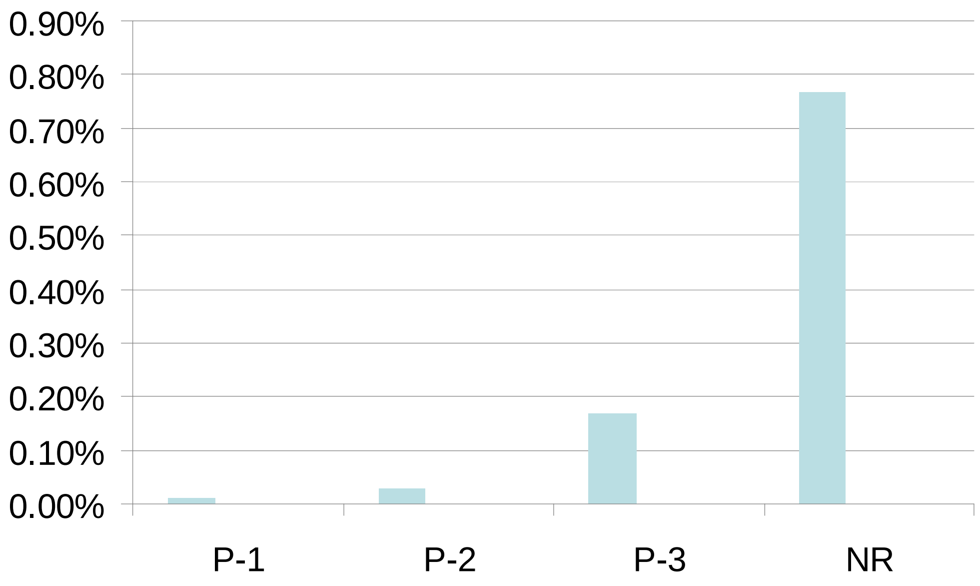
•This means that a disruption in the commercial paper market **<u>will not automatically force a default</u>** on the paper as the issuer already has alternative financing pre-arranged.

•The slightly higher default rate between A1/P1 Issuers and A2/P2 Issuers is more than compensated for by the incremental yield paid by A2/P2 Issuers.

SEC proposing release did not examine historic default rates for commercial paper

A2/P2 Default Risk is Very Similar to A1/P1

180 Day Corporate Commercial Paper Default Rate 1972 – 2006



	30 days	60 days	90 days	120 days	180 days
P-1	0.00%	0.00%	0.00%	0.01%	0.01%
P-2	0.00%	0.01%	0.01%	0.02%	0.03%
P-3	0.03%	0.05%	0.07%	0.10%	0.17%
NR	0.15%	0.28%	0.40%	0.52%	0.77%

Source:
http://www.moodys.com/cust/content/Content.ashx?source=StaticContent/Free%20Pages/Regulatory%20Affairs/Documents/st_corp_and_struc_transition_rates_06_07.pdf

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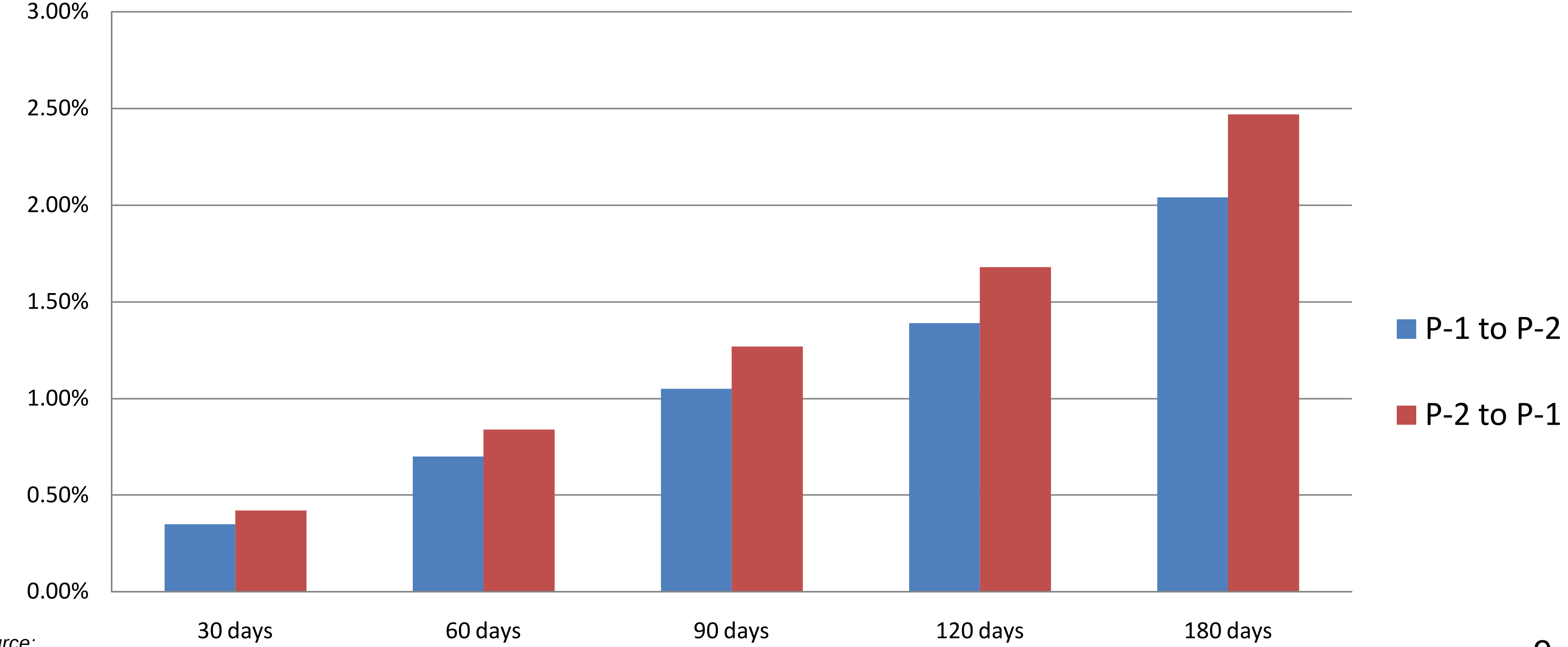
Short-term rating transition rates between the top two tiers –

The SEC should not increase reliance on ratings under 2a-7 as it works to decrease reliance in other areas

180 Day Corporate Commercial Paper Transition Rates 1972 – 2006



Source: http://www.moodys.com/cust/content/Content.ashx?source=StaticContent/Free%20Pages/Regulatory%20Affairs/Documents/st_corp_and_struc_transition_rates_06_07.pdf

Proposal increases reliance on credit ratings

- Overreliance on credit ratings contributed significantly to recent economic events

- This proposal runs counter to other SEC rulemaking initiatives seeking to reduce reliance on credit ratings

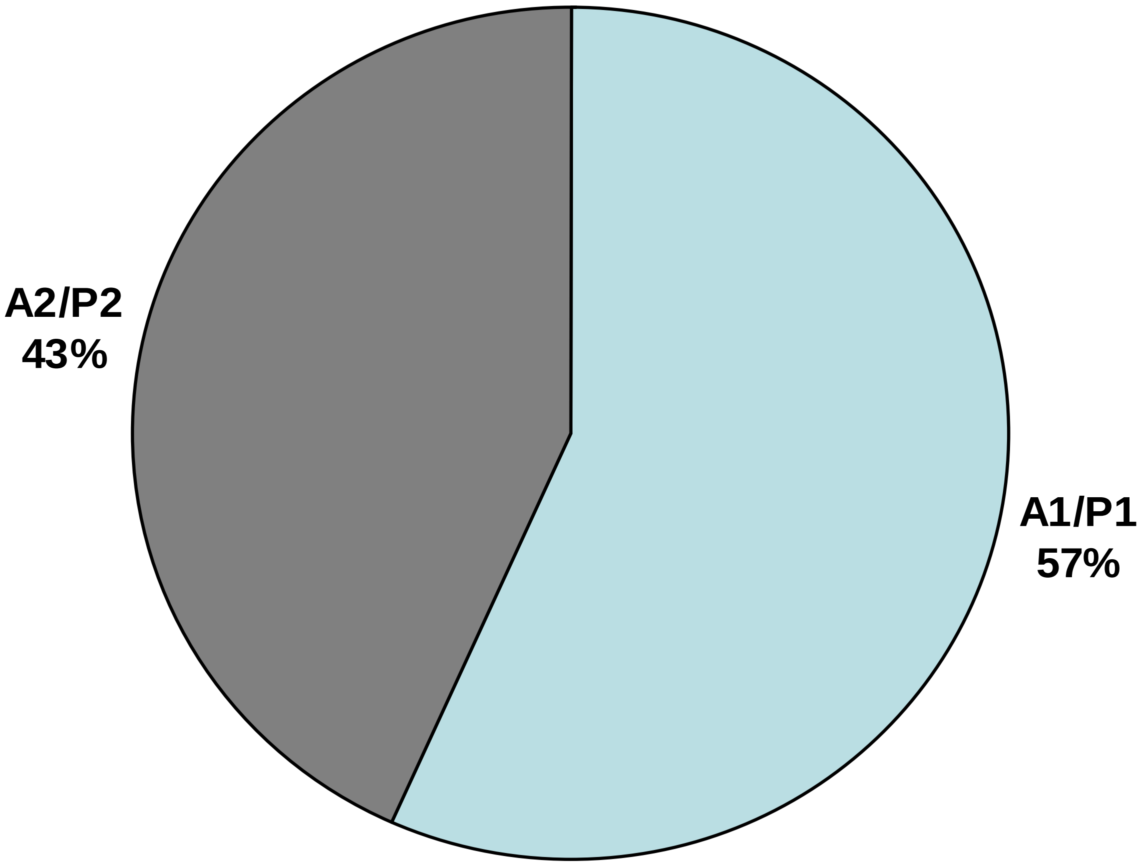
"Domino effect" on non-2a7 money: **The SEC Benchmark**

•Many cash managers for insurance companies, corporations, municipalities, high net worth individuals, and other investors use Rule 2a-7 as a guideline for investment practices.

•Managers of non-2a-7 assets may use the Proposed Prohibition as a benchmark for best practices and further limit or eliminate their holdings of A2/P2 Securities.

•This could result in a domino effect that could quickly constrict the market for A2/P2 Securities.

Reduced Ability to Diversify 2a-7 Portfolios: The proposed prohibition would cut the pool of potential issuers by 43%



Data reported at end of Q2 FYE 2009

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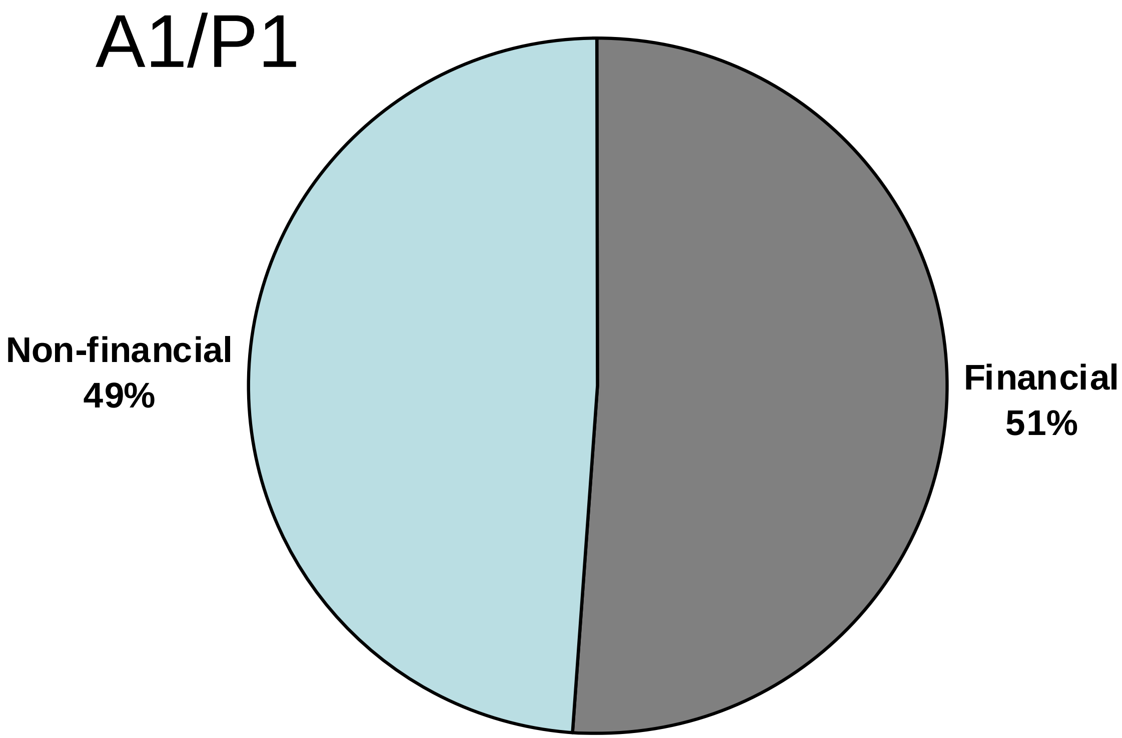
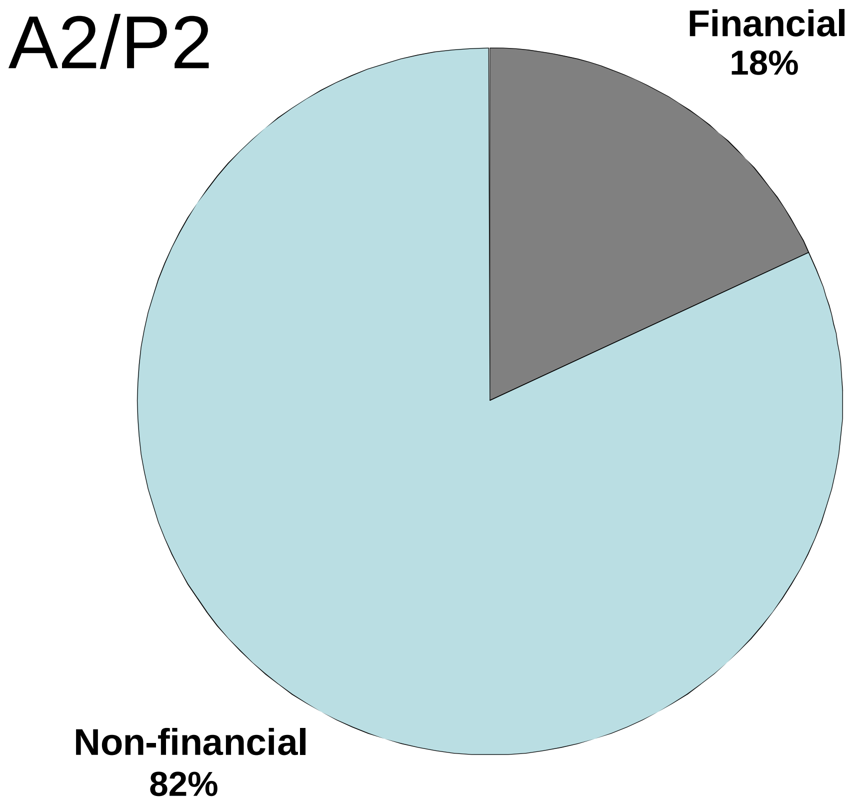
Reduced Ability to Diversify 2a-7 Portfolios:
A1/P1 vs. A2/P2 - Financials v. Non-Financials





Data reported at end of Q2 FYE 2009

"Domino effect" on non-2a7 money: **Analyst Coverage**

- Many firms manage both 2a-7 and non-2a-7 money for cash management vehicles.

- When they can invest in A2/P2 Securities, there are efficiencies that can justify the cost of credit analysts covering A2/P2 Securities as the paper could be held by both the 2a-7 and non-2a-7 accounts.

- Prohibiting the ability of investment companies to invest 2a-7 money in A2/P2 Securities could reduce these efficiencies and force firms to restrict analyst coverage and all of their investments to A1/P1 Securities.

Impact on capital formation:
Decreased Flexibility and Increased Costs

- Greater flexibility in financing through 2a-7 investment vs. bank loans
- The recent economic downturn has severely limited the ability of banks to make these types of loans
- The increased cost of capital could negatively affect investors in these companies and consumers in these industries

Negative Impact on Bank Lending

The Proposed Prohibition could drive A2/P2 Issuers to draw down their credit facilities which would negatively impact the ability of banks to lend to other parts of the economy.

Joint Signatories: *September 3 Letter* Urging SEC to Preserve Ability of Money Market Funds to Invest in A2/P2 Securities*

- Aetna, Inc.
- Alcoa
- Avon
- Clorox Corp.
- Comcast
- Consolidated Edison
- CVS/Caremark
- Devon Energy Corporation
- Dominion Resources
- Duke Energy
- FMC Corporation
- U.S. Chamber of Commerce Center for Capital Markets Competitiveness
- National Association of Corporate Treasurers
- Financial Executives International
- Association for Financial Professionals
- Manufactured Housing Institute
- Hubbell Inc.
- Marriott International
- Nissan Motor Acceptance Corporation
- Pacific Gas and Electric
- Safeway Inc.
- The Service Master Co.
- The Walt Disney Company
- Time Warner
- Time Warner Cable
- XTO Energy

**Joint Letter resubmitted on September 23 with additional signatures*