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February 24, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. 4-619; Release No. IC-29497 President's Working Group Report on Money Market Fund Reform; Supplemental Comment of Federated Investors, Inc. in Response to Comment of The Squam Lake Group

Dear Ms. Murphy:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), to provide a supplemental comment in response to the U.S. Securities and Exchange Commission's (the "Commission's") request for comments on the President's Working Group Report on Money Market Fund Reform. We supplement Federated's earlier comments submitted in this docket in order to respond to a comment letter filed after the close of the comment period by The Squam Lake Group (the "Squam Letter"), which is a consortium of academic economists.[1] Federated has served since 1974 as an investment adviser to money market mutual funds ("Money Funds").[2] We appreciate the opportunity to submit this supplemental comment letter.

We agree with the Squam Letter on one major point: moving Money Funds to a floating NAV is a fundamentally unsound idea that, if acted upon, would not only make Money Funds unattractive to investors, it would also significantly increase systemic risk in the banking industry. This view, that moving Money Funds to a floating NAV would be a very bad idea, is also shared by a broad cross section of other commenters

[1] Letter from Professor René M. Stulz, PhD., on behalf of the Squam Lake Group (Jan. 14, 2011).

[2] Federated has more than thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

representing consumers and investors,[3] academia,[4] businesses,[5] business journalists,[6] state and local governments,[7] and investment management firms.[8]

We disagree with the Squam Letter, however, on two other basic points: (1) the premise of the Squam Letter that the current way in which Money Funds are structured and regulated is flawed and creates systemic risk; and (2) the conclusion of the Squam Letter that there is a need to fundamentally change the capital structure of Money Funds to address the alleged systemic risk.

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[3] Letters from the American Association of State Colleges and Universities; the Port of Houston Authority; Cincinnati/Northern Kentucky International Airport; Treasurer of the State of New Hampshire; Tom Welch. *Accord*, Letter from Consumer Federation of America and Fund Democracy (Sept. 8, 2009) (in Commission comment docket for Rule 2a-7 amendments, S7-11-09).

[4] Paper submitted by Professor Jonathan Macey, *Reducing Systemic Risk: The Role of Money Market Mutual Funds as Substitutes for Federally Insured Bank Deposits*, at 58-62.

[5] Letters from the Business Council of New York State; Dallas Regional Chamber; Associated Industries of Florida; New Jersey Chamber of Commerce. *See also* letter from the following businesses and associations: Agilent Technologies, Inc.; Air Products & Chemicals, Inc.; Association for Financial Professionals; The Boeing Company; Cadence Design Systems; CVS Caremark Corporation; Devon Energy; Dominion Resources, Inc.; Eastman Chemical Company; Eli Lilly & Company; Financial Executives International's Committee on Corporate Treasury; FMC Corporation; Institutional Cash Distributors; Kentucky Chamber of Commerce; Kraft Foods Global, Inc.; National Association of Corporate Treasurers; New Hampshire Business and Industry Association; Nissan North America; Pacific Gas and Electric Company; Safeway Inc.; Weatherford International; U.S. Chamber of Commerce.

[6] Letter from Crane Data, LLC.

[7] Letters from the Port of Houston Authority; Cincinnati/Northern Kentucky International Airport; Treasurer of the State of New Hampshire. *See also* letter filed by following associations of state and local entities: the American Public Power Association; the Council of Development Finance Agencies; the Council of Infrastructure Financing Authorities; the Government Finance Officers Association; the International City/County Managers Association; the International Municipal Lawyers Association; the National League of Cities; the National Association of Counties; the National Association of Local Housing Financing Agencies; the National Association of State Auditors, Comptrollers and Treasurers; the National Association of State Treasurers and the U.S. Conference of Mayors ("State and Local Entities Letter").

[8] Letters from Vanguard; UBS Asset Management; Goldman Sachs Asset Management; Dreyfus Corporation; JP Morgan Asset Management.

On the first point, the Squam Letter notes that during the financial crisis, one Money Fund, the Reserve Primary Fund, broke a buck and was forced to halt redemptions and liquidate. The Squam Letter goes on to note that 36 other Money Funds received financial support from their sponsors, with the levels of support of these 36 funds depicted in a bar chart. From this, the Squam Letter posits that there is a systemic risk posed by Money Funds.

We see these numbers in a very different way. As of the beginning of 2008, there were 807 Money Funds in existence.[9] Of these 807 Money Funds, 771 -- over 95% -- did not receive any financial support from their sponsors. Moreover, of these 807 Money Funds, 806 did *not* break a buck during the worst financial crisis since the Great Depression. In other words, roughly 99.9% of Money Funds did *not* break a buck during a financial crisis the likes of which most of us had never before seen. The Reserve Primary Fund, the *only* Money Fund to break a buck, was liquidated and it shareholders received back 99.2% of their money. And *none* of these Money Funds or their shareholders received a federal bail-out. That is not simply good performance. That is phenomenally good performance, during a period of near economic chaos.

The sudden collapse of Lehman Brothers and the weakness of a number of other large financial firms that were major issuers of commercial paper caused the problem in the money markets in September 2008 and caused the Reserve Primary Fund to break a buck. Money Funds did not cause the problems at the issuers or in the money markets, but instead experienced redemptions and credit quality concerns that reflected the problems at commercial paper issuers. Those concerns over the issuers of commercial paper led to illiquidity in the money markets in 2008, much as was the case in 1974 when Penn Central defaulted on its commercial paper obligations.

Changing the capital structure of Money Funds would do nothing to address credit quality or liquidity issues among the issuers of commercial paper and the impact that problems at one or more major issuers can cause to the money markets as a whole. However, the focus in Title I of the Dodd Frank Act on improving the transparency, capital and liquidity standards of significant bank and nonbank financial firms that are major commercial paper issuers, and the actions that the regulators will take to implement those requirements, will have the beneficial effect of reducing risk and increasing

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[9] Investment Company Institute, 2008 Investment Company Factbook, Table 34.

stability in the money markets. Greater stability among the major issuers of commercial paper into the money markets will translate into lower risks at Money Funds.

We note that an additional destabilizing factor, which has been largely overlooked in the discussion, was an increase in deposit insurance limits and a competing money management deposit product introduced suddenly by Congress and the FDIC in the midst of the crisis. On October 3, 2008, Congress temporarily increased deposit insurance coverage for all bank depositors to $250,000 (up from $100,000), and on October 13, 2008, the FDIC issued an unlimited federal insurance guarantee of bank deposits bearing an interest rate of 0.5% (a rate defined in the FDIC rules as "noninterest bearing," but that was actually a very competitive rate at the time for federally-insured money) or less.[10] Money Funds are attractive to persons with cash balances in excess of the federal deposit insurance limit. Many sophisticated investors believe there is far greater risk in holding a bank deposit in excess of the deposit insurance limit than in holding shares of an entirely uninsured Money Fund, due to the more stringent portfolio requirements, transparency, and absence of interest rate risk at a Money Fund. The FDIC took the extraordinary step of granting unlimited deposit insurance in order to stabilize funding of banks, many of which were facing a liquidity crunch of their own. But an unintended consequence of the FDIC's sudden move was to establish a risk-free, higher yielding cash management product without a dollar cap, which without the temporary Treasury Department guarantee program for Money Funds described below would have created a financial incentive for sophisticated money managers and investors to move cash from Money Funds to banks. The Treasury in response to the crisis in late September 2008 announced a new program for a Treasury guarantee of shareholders of Money Funds that opted in, but it was far more limited than the FDIC's unlimited bank deposit insurance and covered only Money Fund investor balances in existence prior to September 20, 2008. The Treasury's Money Fund guarantee program expired in September 2009, without a single claim being made upon it, and the substantial premiums paid by Money Funds to the Treasury in connection with that program were profitable to Treasury.

The stable performance of Money Funds during the recent financial crisis is consistent with how stable Money Funds have been over the entire 40 years that there have been Money Funds. Since 1971, only two Money Funds have broken the buck --

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[10] See FDIC Press Release: *FDIC Board of Directors Approves TLGP Final Rule* (Nov. 21, 2008) (available at http://www.fdic.gov/news/news/press/2008/pr08122.html).

the Reserve Primary Fund mentioned above, and the Community Bankers U.S. Government Fund, a small institutional fund that broke the buck in 1994 and on which investors received back 96 cents on the dollar. During that 40-year period, roughly $335 trillion in investor balances have flowed through Money Funds, with no federal bail-outs of Money Funds.

Now let us compare that record with the solvency records of banks during the same period. Since 1971 over 2,800 banks have failed, and an additional 592 were kept afloat through federal bailouts, at a total cost to the federal government of over $164 billion.[11] During the financial crisis, from January 2008 through February 18, 2010, 344 banks failed in the United States. Keep in mind that U.S. banks are policed by an army of 26,000 federal bank regulators[12] divided among four (formerly five) agencies, plus 50 state bank regulators, and are subject to 14 weighty volumes of federal banking statutes and regulations totaling many thousands of pages of small print, plus state banking laws and regulations, governing all aspects of their operations, including elaborate capital and liquidity standards. An observer might reasonably conclude that the regulatory approach taken to maintain the solvency and stability of banks is not working very well.

Yet, surprisingly, the Squam Letter proposes a "solution" to the "problem" at Money Funds in the form of an entirely new capital structure that looks like, well, the capital structure of banks. But without FDIC insurance. The proposal is reminiscent of the program for maintaining the solvency of banks before the creation of the FDIC in 1934. In essence, the Squam Letter proposal is to instill confidence in Money Fund investors that their investments are safe from loss by requiring Money Fund sponsors to hold a class of junior capital amounting to a few percent of each Money Fund, that will absorb portfolio losses without impacting the rest of the Money Fund's investors. The Squam Letter suggests that this small capital cushion will reassure Money Fund investors and prevent future "runs;" and make them think of themselves like depositors. This approach has not worked well at banks and there is no reason to believe it would work at Money Funds.

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[11] FDIC Failed Bank List (*available at* http://www.fdic.gov/bank/individual/failed/banklist.html); FDIC Database of Failures and Assistance Transactions (*available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30).

[12] FDIC 2009 Annual Report, Federal Reserve 2009 Annual Report, OCC 2009 Annual Report, OTS 2009 Annual Report.

First, the most immediate problem during the financial crisis, as in the start of the Great Depression, was not asset quality. It was liquidity. A few percentage points of junior capital does little or nothing to address liquidity problems. Instead, maintaining a short-term fixed income portfolio, which holds a large chunk of ready cash and near-cash assets and essentially self-liquidates in its entirety in a relatively short period of time, provides a much better protection against a "run." This is the approach taken by the SEC in Rule 2a-7, and these liquidity requirements have been made even more stringent through the 2010 amendments to that rule.[13]

Second, the Squam Letter proposal would transform shareholders of Money Funds essentially into depositors or creditors, who are protected against loss by a small, more junior class of shareholder, and who would not share in any upside yield. This essentially would introduce a form of leverage to Money Funds for the first time. Currently, Money Funds have 100% equity capitalization. Shareholders are not guaranteed against losses. Instead, they are very clearly told that, although the fund will attempt to maintain a stable net asset value per share (generally $1 or $10 per share) there is no guarantee that it will be able to do so, and are told very clearly that there is no federal guarantee of the value of their shares. This creates an incentive for investors not to chase yield, but instead to consider the quality of the investment portfolio of the Money Fund. The absence of a junior class of securities also reduces the incentive for the sponsor as the holder of that junior class to pursue a higher risk portfolio investment strategy in order to increase the residual return to the junior class of equity after paying the senior investor class its yield, the way, for example, that bankers and hedge fund sponsors do.

Money Funds are not able to maintain stable net asset value simply because a Commission rule says they can, or due to sponsor support. Creating a new junior class of capital would not enhance the mechanism by which Money Funds are able to maintain stable net asset value per share. Money Funds are usually successful in their attempt to maintain a stable net asset value per share due to the very tight restrictions on their investment portfolios which greatly reduces both interest rate risk and default risk in the underlying portfolio. Within these limits, the value of the portfolio assets are very resilient, and can quickly be converted to cash at par value through sale or near term maturity. But Money Funds are also required to calculate the floating NAV per share,

[13] SEC Rel. No. IC-29132, *Money Market Fund Reform*, 75 Fed .Reg. 10060 (Mar. 4, 2010).

and if it diverges to any significant degree from the stable net asset value, to immediately shift to a floating net asset value, and if necessary, to suspend redemptions and promptly liquidate.[14] When that happens (as noted above it has happened only twice in forty years) investors share in the loss, but they get back almost all of their money, and they get it back quickly.

We also note that the capital structure proposed by the Squam Letter also bears a striking resemblance to the capital structures formerly used for asset securitization and structured finance vehicles. These vehicles typically had a junior capital structure in roughly the same small percentages suggested for Money Funds by the Squam Letter, a second senior equity tranche, and several senior equity or debt tranches above it that were rated investment grade by the rating agencies. Those vehicles failed dramatically during the recent financial crisis. It is not clear why the authors of the Squam Letter would resurrect that structure as a model for Money Funds, although we note that the complex securitization vehicle capital structure, like the one proposed here by the Squam Letter for Money Funds, was developed by academics and rating agencies.[15]

Finally, we note that the general thrust of the Squam Letter proposal is a variation on the theme of increased sponsor support of Money Funds as a means to reduce the investment concerns of risk-averse investors, a position that has been championed by one of the rating agencies.[16] A major goal of financial reform is to reduce systemic risk. Tying the solvency of Money Funds to sponsor support for those funds as a means to reduce the concerns of risk-averse investors, is fundamentally the wrong direction to go in order to reduce systemic risk.[17]

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[14] The Squam Letter suggests that Money Fund shareholders will get advance notice of an impending switch to floating NAV and will have an incentive to pull their money out to avoid the loss, thereby triggering a run. The Commission has a rule for that. 17 C.F.R. § 240.10b-5.

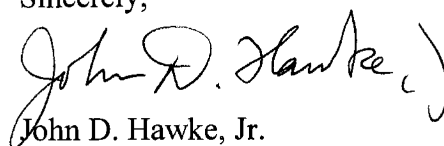
[15] *See* fn * on page 1 of Squam Letter.

[16] *See* Emily Flitter, *Moody's Drops One Money Fund Rating Method Change*, Reuters (Jan. 24, 2011) (available at http://www.reuters.com/article/2011/01/24/markets-money-idUSN2418535620110124).

[17] *See* Letter from Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to Anthony J. Carfang (Dec. 9, 2010); Letter from John Walsh, Acting Comptroller of the Currency, to the Honorable Gregory W. Meeks (Feb. 17, 2011), copies of which are attached hereto.

We appreciate the opportunity to submit this supplemental comment letter on the Report of the President's Working Group on Money Market Fund Reform.

Sincerely,



John D. Hawke, Jr.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

BEN S. BERNANKE
CHAIRMAN

December 9, 2010

Mr. Anthony J. Carfang
Partner
Treasury Strategies, Inc.
309 W. Washington Street – 13th Floor
Chicago, Illinois 60606

Dear Mr. Carfang:

Thank you for your letter expressing your concerns about a new rating system for money market funds proposed by Moody's Investor Services that involves an assessment of "a fund sponsor's ability and willingness to support a financially stressed fund."

In its recent report on "Money Market Fund Reform Options" (released on October 21, 2010), the President's Working Group on Financial Markets (PWG), of which I am a member, recognized that discretionary financial support from sponsoring institutions raises a number of important policy issues.[1] In particular, the PWG report noted that uncertainty among investors about the actual availability of discretionary support during crises may contribute to the vulnerability of money market funds to "runs"--that is, to large, destabilizing redemption requests from investors that may spread quickly through the industry. While emphasizing that money market funds and their investors have several characteristics that increase this vulnerability, the report found that a history of discretionary financial support may have helped foster the perception that money market funds are very safe investment vehicles and, thus, may have attracted highly risk-averse investors who are particularly prone to flight when they perceive the possibility of a loss. In light of the report's findings, an evolution in market conventions that might reinforce this dynamic is of concern, and I believe it is important to address sponsor support of money market funds in the broader context of reforms that can make the funds less vulnerable to runs.

The PWG report framed a number of policy options that might help mitigate the susceptibility of money market funds to runs, including options that could materially change the nature of sponsor support for such funds. The PWG requested that the Financial Stability Oversight Council (FSOC), of which I am a member, consider these policy options and pursue

[1] The report can be found on the U.S. Department of the Treasury's website, http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf
The President's Working Group on Financial Markets comprises Treasury Secretary Geithner, Chairman Shapiro of the Securities and Exchange Commission, Chairman Gensler of the Commodity Futures Trading Commission, and me as Chairman of the Board of Governors of the Federal Reserve System.

the implementation of those deemed most likely to materially reduce funds' susceptibility to runs. I expect the FSOC to carry out this request.

To assist the FSOC in any analysis, the Securities and Exchange Commission (SEC), in its role as the primary regulator of money market funds, is soliciting public comments on the options described in the PWG report as well as on the broader policy issues raised by the vulnerabilities of money market funds. I would encourage you to submit your comments about discretionary sponsor support and Moody's intended rating system to the SEC so that these views may be considered by all members of the FSOC in their deliberations. Instructions for submitting public comments are available on the SEC's website, at http://www.sec.gov/rules/other/2010/ic-29497.pdf.

Sincerely,

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

February 17, 2011

The Honorable Gregory W. Meeks
2342 Rayburn House Office Building
Washington, DC 20515-3461

Dear Representative Meeks:

Thank you for your letter of December 17, 2010, regarding Moody's proposal to change its rating methodology for money market mutual funds (MMFs). You asked that we clarify for you what impact the Moody's proposal could have on banks, their sponsored MMFs, and the financial system more broadly, if bank sponsors were to implicitly or explicitly indicate, and ultimately have to provide, support to these MMFs. You also asked what we have communicated to banks on this subject to date.

As your letter noted, Moody's recently proposed to include as a major factor in its rating assignment the likelihood and ability of a sponsor to support a MMF should the fund run into difficulties. As you may be aware, on January 18, 2011, Moody's issued an update to their proposed money market fund rating methodology in which they announced, in response to comments on their proposal, that they would redesign their methodology for rating MMFs to reflect a fund's own characteristics rather than focus upon the sponsor of the fund.[1] Moody's noted that some had expressed concern over its intention to consider sponsorship as a factor in the proposed MMF ratings. In particular, Moody's noted:

> These respondents argued that despite a long history of sponsor support as a critical factor in preserving MMF stability, future support is less certain, assessment of sponsors involves judgment and [Moody's] considering sponsorship could cause investors to over-rely on sponsors' implicit support for their funds.

Moody's update notes that their revised methodology "is re-designed to reflect a fund's own characteristics and thus strong sponsorship will not enhance a fund's rating." Nonetheless, Moody's observes that "the quality of a fund's sponsor will continue to be a factor in our ratings, including our expectation that funds rated in the top category (Aaa-mf) would be sponsored by firms having an investment-grade or equivalent credit profile."

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[1] Moody's Investors Service, Global Credit Research Announcement (January 18, 2011) Moody's: *Update on Money Market Fund Ratings Methodology.*

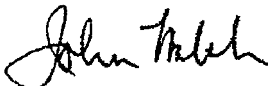
Under its proposal, in order to receive Moody's top rating, Moody's assessment was to focus not only on whether the fund sponsor is highly creditworthy, but would also consider the sponsor's willingness to provide support to the MMF.[2] Moody's does not define which entity they consider to be the "sponsor" of a MMF. As the regulator of national banks, the OCC is in a position to offer our observations to the extent that the Moody's proposal may treat a national bank as a "sponsor" of a MMF.

Because of both safety and soundness and legal concerns raised by the prospect of a bank providing financial support to a MMF or other investment funds, on January 5, 2004, the Federal banking agencies issued the *Interagency Policy on Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates* (Interagency Policy).[3] The banking agencies were concerned that a bank's support to a fund could: (1) inappropriately place the bank's resources and reputation at risk for the benefit of the fund's investors and creditors; (2) violate the limits and requirements contained in sections 23A and 23B of the Federal Reserve Act and Regulation W, as well as other applicable legal requirements and other special supervisory conditions imposed by the agencies; and (3) create an expectation that the bank would prop up the advised fund. Banks were advised that because of the potential risks posed by the provision of financial support to advised funds, that bank management should notify and consult with their appropriate federal banking agency prior to (or immediately after, in the event of an emergency) the bank providing material financial support to its advised funds. We would then scrutinize the circumstances surrounding the transaction and address situations that raise supervisory concerns. Accordingly, even in cases where a national bank may otherwise be willing to provide support to a sponsored fund, the OCC can restrict them from doing so for legal or safety and soundness reasons.

We believe, consistent with the 2004 Interagency Statement, that banking companies should continue to have the ability, in limited circumstances, to provide support to their sponsored MMFs, particularly where this support comes from the bank holding company rather than the bank. However, as indicated above, we are opposed to any policy that creates an expectation that a national bank will be relied upon to provide support to a sponsored fund.

I hope this information is helpful. If you would like to discuss this further, please do not hesitate to contact me or John Hardage, Director of the OCC Congressional Liaison Office, at (202) 874-1881.

Sincerely,



John Walsh
Acting Comptroller of the Currency

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[2] Moody's Investors Service Request for Comment, *Moody's Proposes New Money Market Fund Rating Methodology and Symbols* (September 7, 2010), pp. 13-14.

[3] http://www.occ.gov/news-issuances/bulletins/2004/bulletin-2004-2a.pdf