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555 Twelfth Street, NW
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June 19, 2012

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: President's Working Group Report on Money Market Fund Reform; Rel. No. IC-29497; File No. 4-619

Dear Mary:

Enclosed is a copy of comments we submitted on behalf of our client, Federated Investors, to the Office of the Comptroller of the Currency (the "OOC") on proposed revisions to OCC rules that apply to bank-managed short-term investment funds ("STIFs"). STIFs are collective investment funds that are managed by banks and that seek to maintain a stable share price of $1.00 per share. Yet they are not subject to the liquidity, credit quality, or transparency requirements that SEC Rule 2a-7 establishes for money funds. This can lead to substantial risks, as demonstrated by the Commission's enforcement action against a bank sponsor of a fund that collapsed in 2007 after the fund unduly concentrated its investments in subprime mortgage-backed securities, and failed to disclose this fact to investors.[1]

As you are aware, certain bank regulators and alumni of bank regulatory agencies are calling for the regulation of money funds to become more bank-like and maintain that reserve requirements, redemption hold-backs, and the like would make the financial system more stable. We call your attention to the fact that, notwithstanding these arguments, the OCC has chosen to model its proposed new rules for STIFs after Rule 2a-7 (although with certain elements missing, as noted in our letter). The OCC is an office of the Department of the Treasury, and the Comptroller is a member of the Financial Stability Oversight Council. Thus, the OCC's use of

[1] *Matter of State Street Bank and Trust Company*, SEC Rel. No. 33-9107 (Feb. 4, 2010) (*available at* http://www.sec.gov/news/press/2010/2010-21.htm); State of Massachusetts Securities Division, Consent Order: *Matter of State Street Bank and Trust Company* (*available at* http://www.sec.state.ma.us/sct/sctss/ss_complaint.pdf).

Rule 2a-7 as a model is telling: it acknowledges that bank-like regulation is not appropriate for short-term fund management, and that Rule 2a-7 is well suited to that task.

I hope the enclosed letter will be helpful to the Commission and we appreciate the opportunity to provide you with our thoughts.

Sincerely,

Jerry

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June 7, 2012

The Honorable Thomas J. Curry
Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Proposed Rule: Short Term Investment Funds;
RIN 1557–AD37 / Docket No. OCC-2011-0023

Dear Comptroller Curry:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), and on behalf of money market mutual funds ("Federated Money Funds") for which a Federated subsidiary serves as investment adviser and distributor, to provide comments in response to the above-referenced notice of proposed rulemaking ("NPR") by the Office of the Comptroller of the Currency ("OCC").[1]

The NPR describes a proposal to revise rules applicable to national banks with respect to their management of Short-Term Investment Funds (STIFs).[2] As noted in the NPR,[3] STIFs are collective investment funds that seek to maintain a stable share price of $1.00 per share, managed by banks and regulated by the OCC, that are similar to money market mutual funds ("Money Funds") regulated by the Securities and Exchange Commission ("SEC") but which are not subject to the liquidity, credit quality, transparency and other requirements of SEC Rule 2a-7.[4] Federated has served since 1974 as an investment adviser to and sponsor of Money Funds. We believe that Federated's experience in the management of Money Funds may provide useful perspective on the NPR, and we appreciate this opportunity to provide you with our comments.[5]

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[1] *Short Term Investment Funds*, 77 Fed. Reg. 21057 (Apr. 9, 2012).

[2] 12 CFR § 9.18(b)(4)(ii)(B).

[3] *Short Term Investment Funds*, 77 Fed. Reg. 21058-21059 (Apr. 9, 2012).

[4] 17 C.F.R § 270.2a-7.

[5] During its thirty-eight years in the business of managing Money Funds, Federated has participated actively in the development of the money markets. The registration statement for Federated's Money

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In brief, a STIF is a type of Collective Investment Fund (CIF) that is managed by a bank, generally in connection with trust and fiduciary services. Banks use CIFs to more efficiently perform trust and investment management services by gathering assets from different accounts into one pool that may be operated with a single strategy. A STIF is a particular type of CIF that values assets on an amortized cost basis, maintains a stable net asset value, and is deemed "a liquid, low risk investment."[6] STIF assets are generally invested in short-term, high quality, highly liquid instruments. They enable a bank to invest funds that are required to be invested in safe, liquid assets, or that are awaiting disbursement or investment in longer-term instruments.

As the NPR notes, STIFs are similar in some ways to Money Funds. Like STIFs, Money Funds value their assets on an amortized cost basis, maintain a stable net asset value, and are highly liquid, with low risks. And like STIFs, Money Funds are used to manage short-term cash flows, such as during periods where cash is awaiting investment or disbursement.

Notwithstanding such similarities, STIFs and Money Funds are regulated differently. Under SEC Rule 2a-7, Money Funds are subject to an array of detailed standards that require very specific levels of liquidity, limits on the maturity of portfolio securities, concentration limitations, stress testing, detailed public disclosure of portfolio holdings on fund websites and regulatory reporting.[7] In contrast, STIFs are not presently subject to such specific requirements. OCC rules specify only that STIFs must maintain a maximum dollar-weighted average portfolio maturity of 90 days, accrue income on a straight-line basis, and hold securities until maturity under usual circumstances.[8] Otherwise, the rules rely on banks to adopt written plans for the administration of STIFs and provide a list of matters that such plans must address.[9]

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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.

[6] *Short-Term Investment Funds*, 77 Fed. Reg. 21058.

[7] 17 C.F.R § 270.2a-7.

[8] 12 C.F.R § 9.18(a)(4)(ii)(B).

[9] 12 C.F.R § 9.18(b).

This approach can lead to substantial risks. For example, in 2007, a Federal Reserve member bank supervised by the Federal Reserve Bank of Boston operated a bank collective investment fund known as a "Limited Duration Bond Fund," that it marketed as a safe and diversified alternative to a Money Fund. That collective fund became "almost entirely invested in subprime residential mortgage-backed securities and derivatives that magnified its exposure to subprime securities," and was not invested in the diverse array of safe investments that was represented to customers. Ultimately, the fund's value plummeted, and the sponsor bank paid approximately $663 million to settle fraud charges by the SEC and state securities regulators, and investor claims (notwithstanding the supervisory authority of the Federal Reserve Bank of Boston, the SEC retains authority to pursue fraudulent misrepresentation under the general authority of Section 17 of the Securities Act of 1933, and it did so here).[10]

To address such matters, the NPR would change OCC rules that apply to STIFs to conform somewhat more closely to certain aspects of SEC Rule 2a-7, including some, but not all of the amendments to Rule 2a-7 adopted by the SEC in 2010.[11] The SEC has had a high degree of success with Rule 2a-7. In the 41 years since the inception of Money Funds, only two have "broken the buck" and returned shareholders less than 100 cents on the dollar: the Community Bankers U.S. Government Fund, which in 1994 repaid its investors 96 cents on the dollar,[12] and the Reserve Primary Fund, which was forced to liquidate in September 2008 (as a result of a run triggered by Lehman Brothers' bankruptcy) and which repaid its investors more than 99 cents on the dollar.[13] Significantly, no taxpayer funds have ever been used to "bail out" Money Funds.[14]

[10] SEC Rel. No. 33-9107 (Feb. 4, 2010) (*available at* http://www.sec.gov/news/press/2010/2010-21.htm); State of Massachusetts Securities Division, Consent Order: Matter of State Street Bank and Trust Company (*available at* http://www.sec.state.ma.us/sct/sctss/ss_complaint.pdf).

[11] *Short-Term Investment Funds*, 77 Fed. Reg. 21057, 21059 (Apr. 9, 2012), *citing* SEC, *Money Market Fund Reform,* 75 Fed. Reg. 10060 (Mar. 4, 2010).

[12] The fund had only institutional investors, so individual investors were not directly harmed. *See* Investment Company Institute, *Report of the Money Market Working Group*, at 39)(available athttp://www.ici.org/pdf/ppr_09_mmwg.pdf); *see also* Saul S. Cohen, *The Challenge of Derivatives*, 63 Fordham L. Rev. 1993, 1995 n.15 (1995) (internal citations omitted).

[13] *See* SEC Press Release, *Reserve Primary Fund to Distribute $215 Million* (July 15, 2010); *see also* SEC Press Release, *Reserve Primary Fund Distributes Assets to Investors* (Jan. 29, 2010). The time period between the shuttering of the Reserve Fund and the distributions is due to the litigation of fraud charges by the SEC concerning the fund's abusive handling of redemption requests. *See* Jonathan Stempel, *Reserve*

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This is a remarkable record, especially when considering that over the same time period, 2,913 federally insured depository institutions have failed, and an additional 592 were the subject of "assistance transactions" in which the government injected capital to keep them from failing.[15] From 1971 through 2011, total estimated FDIC losses incurred in connection with failed banks or assistance transactions amount to $188.5 billion.[16] As of October 2011, the FDIC projected that bank failures from 2011 to 2015 will cost another $19 billion.[17]

Accordingly, due to the similarity of the products, and because of the SEC's successful record in its oversight of Money Funds, we believe that it is appropriate for the OCC to more closely conform its regulations that apply to STIFs to SEC rules that apply to Money Funds. In particular, we note that the NPR would require that a STIF have, as a primary objective, a stable, or "constant" NAV of $1.00 per participating interest,

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Primary Fund Founder Fails To End SEC Fraud Case, Reuters (Mar. 29, 2012) (available at http://www.reuters.com/article/2012/03/29/reserve-sec-idUSL2E8ETAM120120329).

[14] In 2008, the Department of the Treasury and the Federal Reserve Board created programs to foster liquidity in the commercial paper markets, but the government did not infuse capital into a Money Fund, as it did for so many banks. Specifically, the Treasury announced a guaranty facility under which Money Funds could, for a fee, procure insurance for outstanding Money Fund shares. The guaranty program was never drawn upon by any Money Fund, and it actually earned $1.2 billion for the Treasury. Press Release, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 19, 2009). The Federal Reserve also implemented the Asset-Backed Commercial Paper Money Market Liquidity Facility ("AMLF"), which provided nonrecourse loans to banks and broker-dealers for the purchase of high quality assets from Money Funds, with those assets serving as collateral. The Federal Reserve earned $543 million from its advances under the AMLF. Office of the Inspector General, Board of Governors of the Federal Reserve System, *The Federal Reserve's Section 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status, and Risk Management* (Nov. 2010). Indeed, the size of the AMLF is dwarfed by the enormous support programs that were provided to banks and other financial institutions. On an aggregate basis, it was less than 1% of the government's overall liquidity effort.

[15] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[16] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30. Actual losses are likely to be much higher because FDIC estimates of losses do not include losses paid by insurance fund assets for FDIC-insured failures prior to 1986, or for FSLIC-insured failures prior to 1988.

[17] FDIC Press Release, *FDIC Board Announces Projected Deposit Insurance Fund Losses, Income, and Reserve Ratios for the Restoration Plan* (Oct. 11, 2011) (http://www.fdic.gov/news/news/press/2011/pr11161.html).

employing the amortized cost method of accounting.[18] The managing bank would have to "shadow price" assets in order to determine the extent of any divergence between the market-based and amortized price per interest, and take action to reduce dilution (such as by ceasing fiduciary account withdrawals) in the event of a divergence of more than $0.005 per interest.[19]

We believe it appropriate for banks that manage STIFs to employ the amortized cost method of accounting, to value interests at a constant $1.00 NAV, and to employ shadow pricing procedures in this manner only if the OCC's STIF rules are much more closely conformed to amended Rule 2a-7. Rule 2a-7, like the proposed OCC regulations, permits a Money Fund to maintain a $1.00 per share constant NAV and to employ the amortized cost method of valuation. The amortized cost method of valuation is appropriate for the types of short term, high quality debt instruments that Money Funds and STIFs hold. It is widely utilized by other types of institutions and is recognized and approved by other regulators.[20] In practice, the price difference between amortized cost and market-to-market pricing in the valuation of holdings is not significant for Money Funds that comply with the portfolio restrictions of Rule 2a-7 (described further below). Finally, the proposed "shadow pricing" procedures, which are similar to those required of Money Funds, should serve to ensure that deviations between amortized cost and mark-to-market valuations are prevented, and promptly detected and addressed if they occur.[21]

Of course, in order to reduce interest rate, long-term credit and liquidity risk, Rule 2a-7 requires Money Funds that employ amortized cost accounting to comply with

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[18] Under the amortized cost method of accounting, portfolio holdings are valued at acquisition cost as adjusted for amortization of premium or accretion of discount rather than market value. *See* 17 C.F.R. § 270.2a-7(a)(2).

[19] 77 Fed. Reg. 21061. The bank's procedures would have to implement a floating NAV if the STIF re-priced its NAV below $0.995 per interest. A bank would also have to implement procedures to suspend redemptions and initiate liquidation of a STIF if heavy redemptions might result in material dilution. 77 Fed. Reg. 21065.

[20] Banks also use historical cost to value most assets on their balance sheets, and use amortized cost to value their loan portfolios, Office of the Chief Accountant, SEC: *Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting* (Dec. 30, 2008) at 27, even though bank loan portfolios have much longer average maturities and lower credit quality than Money Fund or STIF portfolios. As receiver for failed banks, the FDIC uses a similar method, "accreted value," to determine principal amounts of bank obligations.

[21] *See* 17 C.F.R. § 270.2a-7(c)(8)(ii)(B); *Money Market Fund Reform*, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

stringent liquidity, credit quality, maturity, and diversification standards. These SEC standards were strengthened by amendments in 2010 that were "designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market mutual fund that is unable to maintain a stable net asset value per share."[22] In this vein, we note that the NPR would establish several new rules that correspond with changes implemented by the SEC in 2010. In brief, the NPR would:

- Require a bank that manages a STIF to disclose data about the STIF to participants and the OCC within 5 business days of each month's end;[23]

- Require banks managing STIFs to notify the OCC within one business day of certain events, such as the provision of financial support to the STIF in order to support a stable NAV;

- Reduce the maximum dollar weighted average portfolio maturity of a STIF from 90 to 60 days or less. It would also establish a dollar-weighted average portfolio life maturity of 120 days or less. Maturities would be calculated in the manner prescribed by SEC Rule 2a-7. A managing bank would also have to adopt procedures to address contingency funding needs, so that the STIF has sufficient liquidity to meet redemption requests;

- Require banks that manage STIFs to adopt portfolio and issuer qualitative standards and concentration restrictions, which must address market events and deterioration in an issuer's financial condition; and

- Require a bank managing a STIF to adopt procedures providing for stress testing on at least a monthly basis.

As noted above, these proposed new measures are intended to parallel existing provisions of SEC rules that apply to Money Funds.[24] In 2010, the SEC implemented

[22] *See Money Market Fund Reform*, 75 Fed. Reg. 10060 (Mar. 4, 2010).

[23] Such data would include mark-to-market and amortized cost NAVs of the STIF (both with and without capital support agreements), dollar-weighted average portfolio maturity, dollar-weighted average portfolio life maturity, and information about individual portfolio securities (such as name of issuer, principal amount, maturity dates, yield, and amortized cost value).

[24] *See* 17 C.F.R. § 270.2a-7(c)(12) (disclosures); 17 C.F.R. §§ 270.2a-7 (c)(7)(iii), 270.30b1-7 (regulatory reporting); 17 C.F.R. § 270.2a-7(c)(2) (60 day maximum dollar weighted average portfolio maturity, 120

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changes to Rule 2a-7 that, like the NPR, address such matters as disclosure, reporting, stress testing, portfolio quality and issuer concentration. Nonetheless, we note that the NPR does not propose specific liquidity standards. Thus, STIFs would be subject to significantly less stringent liquidity requirements than Money Funds, which must maintain overnight liquidity of 10% or more of total assets and 7-day liquidity of 30% or more of assets, and higher levels of liquidity based upon an assessment of the liquidity needs of the investors in the Money Fund. Because maintaining robust levels of liquidity is essential to preventing a fund from needing to sell portfolio assets into the markets prior to maturity in order to meet investor redemption, (and thereby affirm a key assumption underlying the use of amortized cost accounting that the portfolio assets will be held to maturity) this is a particularly significant departure from Rule 2a-7. In addition, available liquidity is critical to preventing investor redemptions from causing a damaging "run" on a fund.[25] In several places, the NPR explains that the proposed rules are meant to address liquidity risk.[26] It therefore is important for OCC to include specific liquidity standards comparable to those contained in Rule 2a-7.

Specific liquidity requirements, along with the other provisions of Rule 2a-7, have improved the resiliency and stability of Money Funds. In 2011, at a time of extreme volatility in world markets caused by fear of major sovereign defaults and the potential for related contagion, Money Funds experienced dramatic shareholder redemptions in June and again in late July/early August. As of June 22, 2011, "prime" money market money funds held about $1.6 trillion in assets, requiring daily liquid assets under Rule 2a-7 of at least $160 billion and weekly liquid assets of at least $480 billion. From June 22 to June 29, 2011, following reports of exposures to European banks and Greek debt, about $48 billion was redeemed from prime Money Funds.[27] Under Rule 2a-7's minimum standards, prime Money Funds had about ten times the weekly liquidity needed

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day maximum dollar-weighted average portfolio life maturity); 17 C.F.R. § 270.2a-7(c)(5) (liquidity standards); 17 C.F.R. § 270.2a-7(c)(4) (quality and concentration standards); 17 C.F.R. § 270.2a-7(c)(10)(v) (stress testing).

[25] A 2006 Paper in the FDIC Working Paper Series confirms that liquidity issues, rather than credit issues, are the triggers behind banking runs and panics. Kathleen McDill and Kevin Sheehan, *Sources of Historical Banking Panics: A Markov Switching Approach*, Working Paper 2006-01 (Nov. 2006) *available at* www.fdic.gov/bank/analytical/working/wp2006…/wp2006_01.pdf.

[26] *Short Term Investment Funds*, 77 Fed. Reg. 21057 at 21060-21062.

[27] Investment Company Institute, *Historical Weekly Money Market Data (available at* http://www.ici.org/research/stats).

to cover actual withdrawals in this period. Consistent with Rule 2a-7's requirement for Money Funds to assess foreseeable redemptions and hold assets sufficiently liquid to meet them, actual amounts of daily and weekly liquid assets held by money funds exceeded these requirements.

As of late July, 2011, taxable Money Funds (Money Funds other than municipal securities Money Funds) held approximately $2.3 trillion in assets.[28] In the last week of July, 2011, when negotiations over the federal debt-ceiling reached an impasse, almost $120 billion in share value was redeemed from taxable Money Funds.[29] In the week ending August 3, net outflows from taxable Money Funds totaled $69 billion, apparently due to concerns about the U.S. debt ceiling negotiations and Eurozone debt.[30] Thus, under Rule 2a-7's minimum requirements, taxable Money Funds held weekly liquid assets of at least 5.7 times the amounts redeemed in late July and 10 times the amounts redeemed in early August. In fact, the minimum daily liquid asset requirement would have been more than sufficient to cover the heaviest week of withdrawals.

From the end of May until August 3, 2011, investors redeemed over 10% of their prime (taxable non-government) Money Fund investments, totaling over $169 billion in redemptions.[31] Yet no Money Fund "broke the buck," faltered or was unable to meet redemption requests.

An analysis prepared by Fidelity Investments also demonstrates how the amendments to Rule 2a-7 have made Money Funds more resilient than ever.[32] Fidelity examined how various hypothetical scenarios in which interest rates rose suddenly and investors abruptly redeemed shares would affect the NAV of a typical institutional prime

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[28] *Id*.

[29] Mark Jewell, *With Risk of Debt Default Allayed, Money Funds Remain Safe Bet*, Associated Press (Aug. 7, 2011) *available at* http://articles.boston.com/2011-08-07/business/29862085_1_money-funds-crane-data-money-market; *see* Appendix B: Daily Change In Money Market Fund Assets (July 22 - August 4, 2011) (Source: Crane Data).

[30] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[31] Investment Company Institute, *Historical Weekly Money Market Data* (available at http://www.ici.org/research/stats/mmf.

[32] Fidelity Investments, *A Look at Regulatory Reform for Money Market Mutual Funds: Studying the Impact of the 2010 Changes* (Mar. 1, 2012) (*available at* http://www.sec.gov/comments/4-619/4619-125.pdf).

money market fund. The analysis showed that even "an instantaneous rise in interest rates of 200 basis points, as well as a simultaneous shareholder redemption of 50% of outstanding shares," would not cause the Money Fund to "break the buck."[33] By comparison, "in 2008, it took four weeks for the three-month LIBOR rate to rise by 200 basis points. Moreover, shareholder redemptions in the week following the [Lehman] bankruptcy totaled approximately 30% of institutional prime MMF assets."[34]

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We believe that OCC's choice of SEC Rule 2a-7 as a pattern of regulation for STIFs is appropriate. Rule 2a-7 takes a very simple, common sense regulatory approach in that it permits investment only in diverse, short term, high quality instruments. Under the rule, Money Funds have succeeded in providing an efficient means by which cash balances can be invested in short-term, safe and liquid assets. The proposed amendments will improve bank customers' ability to protect themselves through enhanced disclosures, and will promote the liquidity and stability of STIFs. The OCC has not adopted all of the requirements of Rule 2a-7, however, which may create a false impression, yet again, that STIFs are as solvent and soundly managed as SEC-regulated Money Funds. In order to buttress the stability of STIFs, we urge the OCC to adopt stringent liquidity standards for STIFs comparable to those that apply to Money Funds under SEC Rule 2a-7.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

cc: Eugene F. Maloney
Executive Vice President
Federated Investors, Inc.

33 *Id*. at 8.

34 *Id*. at 8.