MEMORANDUM

TO: File

FROM: Jennifer B. McHugh

DATE: May 30, 2013

RE: Money Market Regulation and Money Market Fund Study

On May 28, 2013, Mary Jo White, Chair; Norm Champ, Director, Division of Investment Management; Lona Nallengara, Chief of Staff; and Jennifer McHugh, Senior Advisor to the Chair, met with J. Christopher Donahue, President and CEO of Federated, and John W. McGonigle, Vice Chair and Chief Legal Officer of Federated.

During the meeting, the Federated representatives reiterated the points made in their materials titled "Assessment of the Impact of Proposed Structural Reforms to Money Market Funds Based on a Review of their Operations, History and Regulation," which is available at the following link: http://www.sec.gov/comments/mms-response/mmsresponse-49.pdf. The Federated representatives also discussed a "trigger" approach to money market fund reform, as laid out in the attached materials.

The "Trigger" Approach to Money Market Fund Reform

Background

Near the end of 2011, the Money Market Fund Working Group was moving towards a consensus on the need to "trigger" a response when a MMF showed clear signs of stress. Work on this approach stopped when Chairman Schapiro and the Federal Reserve rejected any reforms that did not continually restrict MMFs or their shareholders.

Objective of Reform

The goal is to prevent a "first mover advantage" from developing in a MMF. There is no advantage from redeeming during normal market conditions (when shadow NAVs fluctuate between \$1.001 and \$0.999) or even difficult market conditions (when shadow NAVs fluctuate between \$1.002 and \$0.998). An advantage only arises when there is a serious risk of a MMF breaking a dollar and the MMF's board fails promptly to address the risk. A trigger would force a prompt response to a serious risk.

Nature of Triggers

Triggers can be "hard"—the response occurs automatically following the event, or "soft"—the MMF's board must consider a response to the event, but is not required to respond. Federated believes that one lesson of the financial crisis is that hard triggers create more risk because the market tries to anticipate the triggered response. We propose a middle path, where some triggers require a response, but the MMF's board has discretion in choosing what the response will be.

Soft triggers have the effect of escalating an event to board oversight. They can be combined with harder triggers to encourage a more robust response if an event becomes more serious.

Nature of Responses

Currently, MMF boards can respond to an event in one of three ways: (1) the fund can continue to maintain a stable price in compliance with rule 2a-7, (2) the fund can break a dollar, or (3) the fund can liquidate and suspend redemptions in compliance with rule 22e-3. These options should be preserved, and additional options should only be added if they offer clear advantages to the existing options. For example, a "liquidity fee" that results in shareholders receiving the same value as they would receive if the fund broke a dollar does not really add to the range of responses.

Federated believes that a temporary restriction on redemptions would, in the appropriate circumstances, be a better response than the current alternatives. It would allow boards to prevent a first mover advantage without having to commit to an ultimate resolution of the event. The advantage is that it allows a reasonable time to develop a better resolution for shareholders, such as sponsor support or a merger with another MMF, than liquidation.

Enhancement of Board Oversight to Protect Shareholders from Potential Threats to a Money Market Fund's Stable NAV

Overview of Proposal

Proposals to require money market funds ("Funds") to continually hold back or otherwise limit the redemption of their shares are unnecessarily broad and harmful to shareholders. There is no reason to continuously restrict redemptions if there is a system to assure equitable treatment of shareholders in the event of a threat to a Fund's stable net asset value per share ("NAV").

Money market fund boards ("Boards") have specific responsibilities under Rule 2a-7 to assure the protection of shareholders. Instead of focusing on old proposals that do not further the regulatory goal of preventing runs, the Commission should consider enhancements to Board oversight of Funds to assure that appropriate actions are taken if needed to mitigate the risk of run by the shareholders and avoid any "first mover" advantage.

1. One such enhancement could be to expand the events ("Trigger Events") under which Rule 2a-7 requires a Board meeting to determine whether a Fund should continue to maintain, or should take some action to assure it continues to maintain, a stable NAV. For example, Boards are not currently required to consider action where a Fund's weekly liquid assets drop below a certain amount, but this type of circumstance could be added to the list of events requiring Board consideration.

2. Another could be to require the Board to take action in response to a subset of Trigger Events ("Mandatory Action Events"). For example, Rule 2a-7 currently requires the Board to meet and consider what action should be taken in response to a deviation of ½¢ between the shadow price and $1.00, but does not require the Board to take any action. The Commission could amend it's the rule to require some action to protect shareholders in this circumstance.

3. In addition, while currently the only course of action for a Board that suspends redemptions is to liquidate a Fund, the Commission could authorize the Board, in response to a Trigger Event, to temporarily suspend redemptions in excess of a certain dollar amount (the "Redemption Limit") while the Board explores responses to the Trigger Event. This would allow a Board to explore options that may be more beneficial and less disruptive to shareholders than liquidation of a Fund or breaking a dollar.

TRIGGER EVENTS

Current Trigger Events Rule 2a-7 requires the Board to meet and consider what action, if any, should be taken in response to (1) a Fund's NAV based on estimates of its portfolio's current market value (its "shadow price") deviating by more than ½¢ from $1.00 or (2) a deviation in the shadow price that may result in material dilution or other unfair results to investors or existing shareholders. In addition, if a security: (a) defaults, (b) is subject to an event of insolvency, (c) no longer qualifies as an eligible security or (d) is determined to no longer present minimum credit risks, then the Fund must "dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security ... absent a finding by the [Board] that disposal of the portfolio security would not be in the best interests of the [Fund]."

Comments *Although the security specific current trigger events require a Board meeting only if the Fund does not dispose of the security, in practice, Funds regularly call Board meetings to review these events and determine an appropriate course of action.*

Additional Trigger Events The Board could be required to meet and consider responding to events short of a Fund needing to break a dollar or a portfolio default. These additional Trigger Events are described below.

Comments *Since the goal should be to enable a Board to act before any first-mover advantage develops, Trigger Events should be based on information that is not publicly available, so that shareholders cannot try to redeem in anticipation of the Board acting. Trigger Events should also not be so severe as to possibly warrant public disclosure prior to the Board meeting*

1. The Fund's Weekly Liquid Assets would be less than 10% of its Total Assets, after taking all pending portfolio transactions into account.

Comments *A large amount of redemptions should not require Board action, so long as the manager anticipates the redemptions and increases the Fund's liquidity. A large reduction in liquidity due to unanticipated redemptions may warrant Board review, however.*

2. The Fund's net realized losses exceed 25 basis points of its net assets.

Comments *Temporary fluctuations in a Fund's shadow price will rectify themselves quickly without the need for Board action. Net realized losses, in contrast, will continue to reduce the shadow price unless the Fund takes appropriate action. This would also encourage managers to realize offsetting gains whenever possible, so as to avoid a build-up of realized losses that might trigger a Board meeting.*

3. The shadow price of a portfolio security is less than 95% of its amortized cost.

Comments *A significant decrease in a portfolio security's market value indicates a market perception of deterioration in its credit quality. Additional Board oversight of the manager's minimum credit risk determination may be appropriate in this circumstance.*

Reporting Trigger Events A Fund would report the occurrence of any Trigger Event to the Division of Investment Management within one business day, and would report the Board's response to the Trigger Event within three business days, of its occurrence.

Comments *This will alert the Division to Trigger Events and allow them to monitor the Board's response.*

MANDATORY BOARD ACTION

Mandatory Action Events The Board would be required to take some action in response to particularly significant Trigger Events. These Mandatory Action Events might include the following:

1. The Fund's Weekly Liquid Assets would be less than 7.5% of its Total Assets, after taking all pending portfolio transactions into account.

Comments *This would represent a significant depletion of the Fund's liquidity.*

2. The Fund's net realized losses exceed 40 basis points of its net assets.

Comments *A large net realized loss may bring a Fund to the verge of breaking a dollar.*

3. A default on a portfolio security that exceeds ½% of the Fund's total assets.

Comments *Defaults are public events, and therefore likely to prompt redemptions if the Board does nothing in response.*

4. The Fund's shadow price falls below $0.995.

Comments *Although Rule 2a-7 currently does not require the Board to act in this event, it is unlikely that the Board would do nothing in response. Setting a trigger higher than $0.995 would be the same as reducing the maximum permitted deviation in the shadow price.*

Potential Responses In response to a Mandatory Action Event, the Board must take one of the following actions that it determines would be in the interest of shareholders:

1. Stop using the amortized cost or penny rounding method to maintain a stable $1 share price, and calculate a fluctuating share price in accordance with Rule 2a-4;

2. Adopt a plan of liquidation and suspend redemptions in compliance with Rule 22e-3;

3. Temporarily suspend redemptions in excess of the Redemption Limit for a period not to exceed 10 business days (the "Suspension Period"); or

4. Take other actions (which may occur during the Suspension Period) reasonably designed to assure that the Fund continues to maintain a stable $1 share price notwithstanding the Mandatory Action Event (such as a Rule 17a-9 transaction or other form of external support, merger with another money market fund, redemption in kind, restricting investment of new cash flows to highly liquid investments such as Daily Liquid Assets, a communication plan to correct reports causing unwarranted shareholder concerns or other appropriate steps).

TEMPORARY SUSPENSION OF REDEMPTIONS

Authority to Impose Temporary Suspension of Redemptions

In response to a Trigger Event, the Board may direct the Fund's transfer agent to suspend redemptions in excess of the Redemption Limit. The transfer agency could accomplish this by placing a hold on each account for amounts in excess of the Redemption Limit.

Intermediaries authorized to maintain subaccounts on behalf of the Fund would be permitted to redeem shares up to the Redemption Limit from each subaccount. Intermediaries would be required to provide a reconciliation showing compliance by their subaccounts with the Redemption Limit in order to redeem shares from their master account with the transfer agent in excess of the Redemption Limit.

Comments

Temporary suspension of redemptions will give the Board time to explore alternative responses to a Trigger Event and implement the response that is in the best interest of shareholders. Permitting redemptions up to a Redemption Limit would mitigate any impact on the payment system, as most checks and debit payments drawn in the ordinary course should come within the limit. The reconciliation process for subaccounts should assure that all shareholders are treated equally.

This approach favors smaller shareholders over larger shareholders, as smaller shareholders may be able to redeem all or most of their account without exceeding the Redemption Limit, and thereby avoid any eventual loss. Nevertheless, the Redemption Limit appears to be a better approach than suspending redemptions entirely (which would maximize the disruption to the payment system) or imposing a percentage limit on redemptions (which would be more complicated to calculate and would require some form of *subordination or redemption fee so redeeming shareholders continue to bear their share of any ultimate loss).*

Termination of the Suspension At or before the end of the Suspension Period, the Board must determine whether:

1. If the Trigger Event is resolved without a material loss, to find that the amortized cost or penny rounding method continues to fairly reflect the market price of the fund's shares, and resume redemptions at a stable price per share; <u>otherwise</u>,

2. To stop using the amortized cost or penny rounding method to maintain a stable $1 share price, and calculate a fluctuating share price in accordance with Rule 2a-4; or

3. To suspend redemptions entirely and adopt an irrevocable plan of liquidation for the Fund.

SEC Imposed Suspension During the Suspension Period, the SEC could exercise its authority under Section 22(e) to declare an emergency or issue orders extending the Suspension Period.

Comment *The Suspension Period would also give the SEC time to determine if a wider scale or longer term response is appropriate..*