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Federated

WORLD-CLASS INVESTMENT MANAGER®

September 16, 2013

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

Re: Money Market Fund Reform; Amendments to Form PF, File Number S7-03-13 —Comments Regarding Proposed Alternative 2

Dear Ms. Murphy:

This is one of a series of letters from Federated Investors, Inc. ("Federated") regarding the various money market reform proposals made by the Securities and Exchange Commission (the "Commission") in Investment Company Act Release No. 30551 (the "Reform Proposal").[1] This letter addresses Federated's comments regarding Alternative 2 of the Reform Proposal,[2] which we regard as a more promising approach than any of the reform options previously included in the President's Working Group on Financial Markets' Report on Money Market Fund Reforms[3] or in the recommendations considered by the Financial Stability Oversight Council.[4] Federated appreciates the time and effort taken by the Commissioners and their staff, including particularly the staffs of the Division of Investment Management and the Division of Economic and Risk Analysis, in patiently evaluating years of intense debate over money market fund reform. These efforts have yielded the first formal proposal, in the form of Alternative 2, that could be of practical benefit to investors and the credit market.

In general, Alternative 2 would require a prime or tax exempt money market fund (a "MMF") to implement a 2% liquidity fee if, at the end of any business day, the MMF's weekly liquid assets were less than 15% of its total assets, unless the fund's board of directors or trustees (its "Board") determines that imposing the fee is not in the best interest of the fund. Alternative 2 would also give the Board the option under these circumstances of (a) imposing a lower liquidity fee or (b) suspending redemptions for a period not to exceed 30 calendar days, if it concludes

[1] 78 Fed. Reg. 36834 (June 19, 2013). An overview of Federated's comments is provided in its initial comment letter on the Reform Proposal, John D. Hawke, Jr., Arnold and Porter, LLP on behalf of Federated Investors, Washington (Sept. 11, 2013), http://www.sec.gov/comments/s7-03-13/s70313-107.pdf.

[2] For purposes of these comments, "Proposed Rule 2a-7" refers to the Alternative 2 version of Rule 2a-7 that begins on page 37005 of the Reform Proposal. For convenience, this letter incorporates the terms defined in Proposed Rule 2a-7, even if such terms are already defined in the current version of Rule 2a-7.

[3] Published by the Commission for comment in ICA Release No. 29497, 75 Fed. Reg. 68636 (Nov. 3, 2010).

[4] Proposed Recommendations Regarding Money Market Mutual Fund Reform, Docket Number FSOC–2012–0003, 77 Fed. Reg. 69455 (proposed Nov. 13, 2012).

that either action is in the best interest of the fund. The Board could not suspend redemptions for more than 30 days in any 90-day period, but could impose a liquidity fee indefinitely.

Although Federated does not believe further structural reforms are necessary, of the alternatives proposed in the Reform Proposal, Federated supports the adoption of Alternative 2, for prime MMFs, subject to certain modifications necessary to enhance the protection of shareholders and assure that Boards only impose liquidity fees or suspend redemptions in appropriate circumstances. This reform, and only this reform, directly addresses the Commission's concerns regarding the risk of large-scale redemptions from a prime MMF by allowing a Board to halt redemptions. This reform, if modified in accordance with our recommendations, will also eliminate the risk of redemptions forcing "fire sales" by prime MMFs that might adversely affect short-term credit markets. It is also the least onerous of the structural reforms under consideration.

1. INTRODUCTION

Federated has long been a proponent of permitting a Board to suspend redemptions temporarily when a MMF's ability to redeem shares at a stable NAV is uncertain. Federated supported the recommendation made in the ICI's Money Market Working Group Report that "under exigent circumstances, [a Board] may temporarily suspend redemptions for up to five business days in order to seek a 'cure' for a fund that has either broken or reasonably believes it may be about to break a dollar."[5] In its comment letter on the Commission's 2009 proposals, Federated recommended that the Commission permit a Board to suspend redemptions for up to five business days in response to a default on a portfolio security or similar event.[6] More recently, representatives from Federated met with commissioners and with the staff of the Commission to review a detailed term sheet of reforms that would enhance a Board's oversight of MMFs, which included the ability to suspend redemptions for up to ten business days.[7] The independent trustees of Federated's MMFs have written in support of these proposed reforms.[8]

Alternative 2 is an amalgam of proposals, including elements of Federated's recent proposal. Others have promoted a liquidity fee as a means of controlling large-scale redemptions, as it would give shareholders the option of either staying in the fund or paying a penalty to access their cash. Federated does not object to a right to impose a liquidity fee—so long as it is not mandatory. Federated expects that Boards will ultimately determine which alternative best serves the interest of shareholders based on the particular circumstances of their MMF.

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[5] Report of the Money Market Working Group at 6 (Mar. 17, 2009), http://www.ici.org/pdf/ppr_09_mmwg.pdf.

[6] Comments of Federated Investors, Inc., Section III.A (Sep. 8, 2009), http://www.sec.gov/comments/s7-11-09/s71109-104.pdf.

[7] Letter from Federated Investors, Inc. to Norm Champ, Director of the Division of Investment Management (Feb. 11, 2013), http://www.sec.gov/comments/mms-response/mmsresponse-32.pdf.

[8] Letter from Peter E. Madden, Chairman of the Independent Trustees of the Federated Funds, to the Financial Stability Oversight Council (Feb. 13, 2013), http://www.sec.gov/comments/mms-response/mmsresponse-33.pdf.

While Federated supports the Commission's adoption of Alternative 2,[9] Federated believes that certain changes are necessary in order for Alternative 2 to operate effectively and to limit potential disruptions. Federated recommends the following changes to Alternative 2:

- Reducing the threshold for weekly liquid assets that would require a Board to consider the imposition of a liquidity fee or temporary suspension of redemptions to 10% (rather than 15%) of total assets.

- Reducing the maximum period that redemptions may be suspended to ten calendar days (rather than thirty), and subjecting liquidity fees to the same limitation.

- Permitting a Board to implement a liquidity fee or suspend redemptions temporarily *before* the end of a business day, so the Board can respond to situations in which unimpeded redemptions are likely to impair a fund's liquidity or the Board otherwise determines that such redemption restrictions are in the best interest of shareholders. Specifically, a Board should be permitted to impose a liquidity fee or temporarily suspend redemptions if: (a) it determines there is a substantial risk that a prime MMF's weekly liquid assets will be reduced to less than 10% of its total assets before the end of a business day or (b) it determines that such an action is appropriate to avoid material dilution or other unfair results to shareholders.

- Stating in any release adopting Alternative 2 that the Commission expects that Boards will impose liquidity fees or suspensions of redemptions rarely and only for so long as necessary to protect the interest of shareholders.

- Including tax exempt funds in the exemption proposed in paragraph (c)(2)(iii).[10]

2. INVESTOR VIEWS ON ALTERNATIVE 2

Federated has engaged in in-depth discussions with scores of intermediaries and shareholders who offer or use its MMFs. Their views are strikingly uniform. With few exceptions, they:

- Do not think a case has been made for any significant reform of MMFs;

- Fully appreciate the risk of losing some cash in rare and extraordinary situations (such as defaults or severe market dislocations), but will not risk routine fluctuations on their cash investments, no matter how small; and

[9] However, Federated opposes the elimination of the amortized cost method of maintaining a stable NAV. As this reform is common to both Alternatives 1 and 2, Federated will address this proposal in a separate comment letter.

[10] A copy of Proposed Rule 2a-7(c)(2), marked to show the modifications needed to implement Federated's recommendations, is attached to aid the Commission's understanding of these comments.

- Are extremely concerned about the risk of losing daily access to the full amount of their cash.

In summary, investors are satisfied with their current MMFs and are likely to move to alternative cash investments if the Commission does more than what is truly necessary to address its concerns regarding widespread redemptions from MMFs.

Federated also found that many intermediaries and shareholders became more comfortable with Alternative 2 after discussing how remote the circumstances are that would lead to a MMF imposing a liquidity fee or suspending redemptions. In contrast, talking in greater depth about Alternative 1 generally heightened their apprehensions. The fact that the Board exercised ultimate control over the imposition of a liquidity fee or suspension of redemptions was an important factor in addressing their concerns about Alternative 2. Some intermediaries and investors observed that they would not have the resources to monitor the weekly liquid assets of their MMFs, so the availability of this information was not significant to their willingness to accept Alternative 2. On the other hand, one intermediary already had discussions with clients who planned to monitor their MMF's weekly liquid assets and redeem immediately if it fell below a percentage that was in excess of the percentage at which the fund could impose a liquidity fee or suspend redemptions.

Our conversations with investors demonstrate that successful implementation of Alternative 2 will require a concerted educational outreach to investors in MMFs. In order to reassure investors that Alternative 2 will not arbitrarily restrict access to their cash, the Commission should carefully tailor Alternative 2 to apply only in extraordinary circumstances and for short-periods of time. It will be particularly important not to set a standard that leads to a large number of "false positives:" a situation where a MMF must report a failure to meet a threshold for weekly liquid assets or other objective standard, but where no action was required to protect the interest of shareholders. Frequent false positives will undermine investor confidence in MMFs without furthering the goal of investor protection. The Commission must proceed cautiously with Alternative 2 if it intends to "preserv[e], as much as possible, the benefits of money market funds."[11]

Federated also urges the Commission carefully to consider the trade-offs inherent in continuously disclosing a MMF's weekly liquid assets. While basing a Board's ability to restrict redemptions on the fund's percentage of weekly liquid assets will make this information more material to shareholders, it also creates the potential for unintended consequences. As discussed in more detail in a separate comment letter, we believe that the Commission can strike a more appropriate balance by requiring disclosure of weekly liquid assets as of the end of each week, and posting the information on a fund's website at the beginning of the following week. This will provide the fund's manager with an opportunity to explain the circumstances leading to any substantial reduction in weekly liquid assets and plans for restoring weekly liquid asset to required levels.

[11] Reform Proposal at 36848.

3. A TEMPORARY SUSPENSION OF REDEMPTIONS IS THE MOST EQUITABLE, MOST EFFECTIVE, LOWEST COST, AND LEAST RESTRICTIVE METHOD OF HALTING LARGE-SCALE REDEMPTIONS

Suspending redemptions would allow a Board to deal with large-scale redemptions directly, by effectively calling a "time out" until the Board can decide how to deal with the circumstances prompting the redemptions. Suspending redemptions is an inherently equitable response to an uncertain situation. While redemptions are suspended, a Board would have an opportunity to assure that all shareholders have access to the same information about the fund, shareholders have an equal opportunity to place redemption orders and that every redemption order would be treated consistently.[12] Even if a Board decides to implement a liquidity fee, a brief suspension of redemptions may be useful to allow for the dissemination of information about the liquidity fee to shareholders and intermediaries.

The actions of the Board of the Putnam Prime Money Market Fund (the "Putnam Prime Fund") demonstrate the efficacy of a temporary suspension of redemptions during a financial crisis. The Putnam Prime Fund held $17.4 billion on September 12, 2008, but experienced a decline in assets over September 15 and 16 (the day of and following the Lehman Brothers bankruptcy) of more than $5 billion. On September 17, the fund's Board voted to suspend redemptions and liquidate the fund.[13]

The Board's prudent and timely action prevented the Putnam Prime Fund from experiencing the uncontrolled redemptions suffered by the Reserve Primary Fund and provided the Putnam Prime Fund with enough time to negotiate a solution with Federated that restored liquidity on terms that were equitable to all shareholders. On September 25, the Putnam Prime Fund exchanged $12.3 billion of assets in-kind for shares of Federated's Prime Obligations Fund. The Putnam Prime Fund immediately liquidated by distributing the Prime Obligations Fund shares to its shareholders. At that point, Prime Obligation Fund honored another $5 billion of outstanding redemptions from former Putnam Prime Fund shares at $1 per share.

The Reform Proposal correctly notes other instances in which European MMFs used temporary suspensions of redemptions to stem widespread redemptions during the financial crisis.[14] The ability of Putnam Prime Fund and these European MMFs to implement the suspension of redemptions on the fly, under the most difficult circumstances, demonstrates the feasibility and effectiveness of this approach to dealing with widespread redemptions.

A temporary suspension of redemptions gives a MMF's Board and its sponsor time to address the cause of large-scale redemptions. The solution may be as simple as arranging for

[12] Federated anticipates that, in most cases, a Board would also suspend sales of a fund's shares at the same time it suspends redemptions. Nothing in the Investment Company Act of 1940 requires a MMF to sell shares, however, so this step would not require the same exemptive relief as would suspending redemptions.

[13] *See, e.g.,* Diana B. Henriques, "Professional Money Fund is Closed by Putnam," NY TIMES (Sep. 18, 2008), available at http://www.nytimes.com/2008/09/19/business/19money.html.

[14] Reform Proposal at 36881 n. 360. (Also noting the use of the combination of a suspension of redemptions and imposition of liquidity fees by a Florida local government investment pool to stem redemptions in 2007.)

delivery of a letter of credit or as complex as an exchange of assets with another fund. Suspending redemptions may even be appropriate to assure an orderly transition to a fluctuating NAV. Regardless of the circumstances, suspending redemptions allows a Board and its MMF to focus on getting things right, rather than scrambling to respond within a single business day.

Finally, suspending redemptions is the least costly reform to implement in the Reform Proposal.[15] The fund's transfer agent may implement a suspension of redemptions simply by ceasing to process redemption orders. This will force intermediaries to implement the suspension, as they will not have received any redemption proceeds from the transfer agent from which to pay their net redemptions. Prompt and clear communication to intermediates and shareholders regarding the suspension will be important, but similar communications would be required if a fund breaks a dollar or suspends redemptions in connection with a plan of liquidation. Thus, funds should already be prepared to make the necessary communications and should not incur significant additional costs.

4. ALTERNATIVE 2 WOULD BE MORE EFFECTIVE IN PROTECTING SHAREHOLDERS AND THE MARKET WITH MODIFICATIONS TO THE CIRCUMSTANCES IN WHICH A BOARD MAY ACT

As proposed, Alternative 2 would go too far and not far enough. Alternative 2 would go too far by raising concerns that shareholders may be subject to a liquidity fee even when their prime MMF is plainly capable of meeting foreseeable redemptions at a stable price. Alternative 2 also would raise concerns that shareholders may lose access to their cash for a full month or be subject to liquidity fees for an indefinite period. As noted in above, Federated has found that these concerns are important to investors.

Alternative 2 fails to go far enough by requiring a Board to wait until the end of the day to respond to large-scale redemptions. In most cases, this will be too late to protect the remaining shareholders. We therefore recommend that the Commission modify the circumstances in which a Board would be permitted to implement a liquidity fee or temporarily suspend redemptions (impose "redemption restrictions").

4.1 Shareholders Should Not Be Subjected to a Liquidity Fee or a Temporary Suspension of Redemptions unless there is a Clear Threat to the Fund's Liquidity

The Reform Proposal notes that Alternative 2 "could result in some shareholders redeeming their money market fund shares and moving their assets to alternative products (or government money market funds) out of concern that the *potential* imposition of a liquidity fee or gate could make investment in a money market fund less attractive due to less certain liquidity."[16] Federated's conversations with its clients confirm that this is a serious risk that the Com-

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[15] Shareholders may bear a significant cost in using other cash resources to bridge outlays while their MMF has suspended redemptions. The amount of these costs cannot be estimated, but can be mitigated substantially by limited the maximum period during which redemptions may be suspended, as discussed *infra* in Section 4.2.

[16] Reform Proposal at 36882 [original emphasis].

mission must address in adopting Alternative 2. The best means of assuaging such shareholders' concerns is to limit the imposition of a liquidity fee or a temporary suspension of redemptions to circumstances in which a fund would already be likely to break a dollar or forced to liquidate.[17] In such circumstances, shareholders should appreciate that redemption restrictions would be less onerous than breaking a dollar or a suspension of redemptions throughout the course of the fund's liquidation.

Alternative 2 would not be limited to these circumstances, however, insofar as it would permit the imposition of redemption restrictions if a prime MMF's weekly liquid assets fall below just 15% of its total assets. "[A Commission] staff's analysis of Form N-MFP data show[ed] that, between March 2011 and October 2012, there were two months in which funds reported weekly liquid assets below 15% (one fund in May 2011, and four funds in June 2011)."[18] As Table 1 of the Reform Proposal does not show any funds receiving sponsor support in these two months,[19] it appears that all five funds were able to bring their weekly liquid assets back to the required 30% level without difficulty. The Reform Proposal does not cite any cases in which a loss of weekly liquid assets threatened a MMF's ability to provide daily liquidity at a stable NAV.

If Alternative 2 had been in effect in May 2011, it would have required these five funds to either implement a liquidity fee or, as would have been far more likely, call a Board meeting to determine that imposition of a liquidity fee was not in the fund's interest. Each fund would have been required to file a Form N-CR reporting the circumstances and the reasons its Board chose not to impose a liquidity fee, and post and maintain the same information on its website for one year. All of this activity and disclosure would have been required for situations posing no actual risk to the funds' shareholders, and could only have reinforced shareholder concerns regarding an unwarranted imposition of a liquidity fee. The goal of reform should be not to have the filing of a Form N-CR cause the widespread redemptions the Reform Proposal seeks to avoid.

Federated therefore recommends reducing the level of weekly liquid assets required for redemption restrictions from 15% to 10% of total assets. According to the Commission staff's study, only one fund has fallen below this level (in May 2011). This shows that false positives will occur even at a 10% level, but they will be much less likely than at a 15% level. This modification would also complement the recommendation discussed below in Section 4.3 to allow a Board to implement redemption restrictions in anticipation of large-scale redemptions, as it would emphasize that the Board must conclude there is a substantial risk to the fund's ability to meet redemptions before taking such actions. This should increase shareholders' confidence that their prime MMF will continue to provide daily liquidity without a fee so long as it is capable of doing so.

[17] Restricting the frequency with which prime MMFs disclose their weekly liquid assets would also mitigate this risk.

[18] Reform Proposal at 36885.

[19] Reform Proposal at 36841. Analyses of Form N-MFPs show that the three funds that sold Eksportfinans notes to their sponsors did not do so until after October 2011.

The risk of such false positives is why the Commission should not impose an automatic, mandatory liquidity fee or suspension of redemptions. Redemption is a fundamental right of shareholders in a mutual fund. The right to redeem should not be restricted (by imposing a liquidity fee or otherwise) unless there is a reasonable prospect that shareholders would benefit from the restriction. Federated cannot conceive of any formulation of a nondiscretionary liquidity fee or suspension of redemptions that would not run the risk of needlessly restricting shareholder redemptions. As a fund's Board is charged with safeguarding the interest of its shareholders, it is appropriate for the Board to make this determination.

The Commission also should not adopt a rule that unduly discourages funds from utilizing their weekly liquid assets for liquidity. The purpose of the weekly liquid asset requirement is to buffer liquidity shocks—not to cause them. When the market for non-government securities becomes illiquid, a prime MMF is *supposed* to use its weekly liquid assets to fund redemptions and avoid placing additional selling pressure on the market. An adviser will be reluctant to use weekly liquid assets in this manner, however, if it would force the fund to call an emergency Board meeting and file a Form N-CR. This is an unavoidable consequence of basing redemption restrictions on the level of a fund's weekly liquid assets, but the Commission could mitigate this consequence by setting the level at 10% rather than at 15%. Thus, requiring a prime MMF to suffer a more significant impairment of its liquidity before imposing a liquidity fee or suspending redemptions should provide greater protections for both MMF shareholders and the short-term credit market.

4.2 Shareholders Should Not Be Subjected to a Liquidity Fee or a Temporary Suspension of Redemptions for more than Ten Calendar Days

Another step that should reduce shareholder concerns would be to further limit the period during which a Board may suspend redemptions. Federated believes that, generally, 30 calendar days is too long a period to suspend redemptions unless the fund is undergoing a complete liquidation.[20] Shareholders will find it increasingly difficult to compensate for their loss of liquidity the longer the suspension of redemptions continues. It is therefore important for Alternative 2 to limit the suspension of redemptions to a period in which the potential benefits to shareholders of delaying redemptions outweigh the potential disruptions caused by the delay.

Federated had previously proposed limiting any suspension of redemptions to five or ten business days. Alternative 2, on the other hand, would set the limit in terms of calendar days. Federated therefore recommends limiting a temporary suspension of redemptions to not more than ten calendar days. This would be a significantly shorter period than proposed by the Commission, while still allowing prime MMFs more than a week to address whatever problem led to the suspension of redemptions. This would also be consistent with the comments of some of the investors who indicated to Federated that they probably could not go more than two weeks without access to the cash held in their MMF. Permitting a longer suspension may thus impose undue hardships on shareholders who rely on prime MMFs for liquidity. In extraordinary circum-

[20] A fund in liquidation makes regular distributions of cash to its shareholders, thus restoring liquidity to shareholders as rapidly as practical under the circumstances, even if the fund suspends the right of redemption.

stances, the Commission would still have the authority under Section 22(e) to issue an order allowing for a longer suspension of redemptions.

We should emphasize that, regardless of the limit, a Board should suspend redemptions only for the minimum period needed to address the threat to a fund's stable NAV or liquidity. If the need to break a dollar or liquidate the fund is clearly unavoidable, there is no sense in the Board continuing any temporary suspension of redemptions for the entire permitted period.

Federated also recommends limiting the period that a prime MMF may impose a liquidity fee. If the liquidity fee works as intended, it will encourage shareholders to delay making redemptions until the fee terminates. Such delays may be as disruptive to shareholders as a suspension of redemptions, so there should be some limit on the period that shareholders are expected to delay their redemptions. To keep it simple, we propose the same limitations for imposing liquidity fees as for suspending redemptions. Thus, a Board could not implement a liquidity fee for a continuous period of more than ten calendar days or for more than ten calendar days in any ninety-calendar day period. The period a liquidity fee could be imposed would be independent of the period for suspending redemptions, so that a Board could suspend redemptions for a day or two in order to implement a liquidity fee without using up any of the permitted ten-calendar day period.

4.3 Boards Should Be Able to Respond to Large-Scale Redemptions or Other Events Whenever it Would Be in the Shareholders' Best Interest

The proposed circumstance in which a Board may impose redemption restrictions is too restrictive to be of use when responding to large-scale redemptions. As proposed, Alternative 2 would permit the Board to act only after the end of a business day on which the fund holds less than 15% of its total assets invested in weekly liquid assets. This would leave the Board powerless to respond to the redemptions that are causing the decrease in weekly liquid assets. This would potentially create a one-day "first mover" advantage, insofar as redemptions would not be affected by a liquidity fee or suspension of redemptions until the business day following the reduction in weekly liquid assets below 15%. The only options available to a Board in this situation would be to either break a dollar or liquidate the fund. Thus, as proposed, in the most likely scenarios, Alternative 2 would leave a Board and its MMF no better off than they are under current regulations.

Alternative 2 seems to assume that a liquidity crisis would "creep up" on a prime MMF: that the fund's weekly liquid assets would decline over several days until one day it fell below 15% of total assets. The findings of the RSFI Study[21] contradict this view. First, Table 1 of the RSFI Study[22] shows that prime MMFs are more likely to experience redemption pressures due to a rare default on a portfolio security or comparable idiosyncratic event than due to general market conditions. Such events are likely to produce an immediate surge in redemptions unless the

[21] Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, a report by staff of the Division of Risk, Strategy, and Financial Innovation (Nov. 30, 2012) (the "RSFI Study"), http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf.

[22] Reproduced in the Reform Proposal at 36840-41.

sponsor or the Board promptly addresses them. Second, in the one period where a global financial panic prompted heavy redemptions from some prime MMFs (the week of the Lehman Brothers bankruptcy), redemptions accelerated rapidly. For example, Figure 5 of the RSFI Study shows net redemptions from "institutional" prime MMFs increasing from less than 5% to more than 10% in just one business day.

The experience of the Reserve Primary Fund demonstrates why it may often not be in the best interest of shareholders to wait before responding to large-scale redemptions or an event that could prompt such redemptions. According to the Commission's complaint against the Reserve Primary Fund's managers, "by approximately 10:10 a.m. on September 15 [the morning of the Lehman Brothers bankruptcy]… the Fund was no longer in a position to pay investors."[23] If Alternative 2 had been in effect during the financial crisis, the Reserve Primary Fund's Board still would have had to wait helplessly until the end of business on September 15 before suspending redemptions or imposing a liquidity fee, long after the fund's liquidity would have been completely exhausted. To protect the fund and its shareholders in this circumstance, the Board would have needed authority to suspend redemptions or implement a liquidity fee as soon as it learned of Lehman Brothers' bankruptcy.

Alternative 2 would also fail to help Boards respond to a rare but severe general market panic that might lead investors to redeem from prime MMFs that do not hold impaired securities. Alternative 2 would require the Board to stand idle when faced with a substantial risk of redemptions that potentially could leave the fund without any liquidity or otherwise harm the remaining shareholders. The Board could act only after the damage was already done.

To make Alternative 2 of practical use to Boards, the Commission must expand the circumstances in which a Board may temporarily suspend redemptions or impose a liquidity fee to situations when there are substantial risks of a significant depletion of liquidity, material dilution or other unfair results to investors. First, the Commission should permit a Board to impose redemption restrictions whenever it determines there is a substantial risk of the fund's weekly liquid assets falling below 10% of its total assets (as we recommend) before the end of a business day.[24] This change would eliminate the "Catch 22" of having to wait for large-scale redemptions to impair a fund's liquidity before the Board can act to protect the fund from these redemptions. Given the significant consequences of suspending redemptions or imposing a liquidity fee, Federated does not anticipate that a Board would make such a determination lightly. The example of the Putnam Prime Fund, however, demonstrates that Boards will act to protect their shareholders, notwithstanding the potential adverse consequences to the MMF's adviser.

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[23] SEC v. Reserve Management Co., et. al., 09CV4346 (S.D.N.Y, 2009), Complaint at ¶9, http://www.sec.gov/litigation/complaints/2009/comp21025.pdf.

[24] A Board is most likely to meet and make this determination during the evening or early morning before their MMF opens for business and, in under such circumstances, we would expect any approved redemption restrictions to take effect when the MMF opens for business. However, to allow for the remote chance that a Board may need to meet during the course of the business day, we propose that the Board be permitted to fix the date and time that any redemption restrictions would take effect.

Second, the Commission should permit the Board to impose redemption restrictions when it determines that a liquidity fee or temporary suspension of shareholders would be in the best interest of shareholders to avoid material dilution or other unfair results to shareholders. This standard—avoiding material dilution or other unfair results—dates back to the original exemptive orders permitting MMFs to use the amortized cost method.[25] The Commission incorporated this phrase into the original version of Rule 2a 7 as the standard for when a MMF must break a dollar (or take other appropriate action), and used it more recently as the standard for when a MMF may suspend redemptions under Rule 22e 3. Directors and shareholders already understand this standard, which has worked effectively for more than three decades.

Rule 2a-7(c)(8)(ii)(A) already requires a Board to meet whenever it "believes the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution[26] or other unfair results to investors or existing shareholders, [and] cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results." A Board meeting is also a standard response to the events specified in Rule 2-7(c)(7)(ii). ("(A) a default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer); (B) a portfolio security ceases to be an eligible security; (C) a portfolio security has been determined to no longer present minimal credit risks; or (D) an event of insolvency occurs with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee.") It would be helpful for the Board to have the option of imposing redemption restrictions in these circumstances, even if they are not yet sure whether the circumstances will result in a substantial reduction in weekly liquid assets. As these are circumstances in which a MMF might otherwise be expected to break a dollar or liquidate, investors should appreciate redemption restrictions as alternatives that may give the Board time to find a less draconian resolution to the situation.

4.4 The Commission Should State in any Release Adopting Alternative 2 that it Expects that Boards Will Impose Redemption Restrictions Rarely and only for so Long as Necessary to Protect the Interest of Shareholders

The Commission could help address investor concerns regarding the potential loss of access to cash held in their MMFs if any adopting release stated that the Commission expects that Boards will restrict redemptions only in rare and extreme circumstances, and that Boards will lift such restrictions as soon as possible, consistent with the best interest of their shareholders. The Commission's statement would help to establish that the only circumstances in which it would be appropriate for a Board to impose redemption restrictions are the same as

[25] See, Intercapital Liquid Asset Fund, Inc., et. al., Order Granting Applications for Exemptions from Section 2(a)(41) of the Act and Rules 2a-4 and 22c-1 thereunder to Permit the Use of Amortized Cost Valuation, and Cancelling Hearing on Such Applications, ICA Release No. 10824, 18 SEC Docket 52 (issued Aug. 8, 1979).

[26] This would include circumstances when a MMF's shadow price deviates from $1 by more than half a cent, so there is no need to include this as an additional circumstance in which Boards may impose redemption fees. *See*, Reform Proposal at 36886 ("Rather than our proposed trigger based on a fund's level of weekly liquid assets, should it be based on the fund's shadow price or its level of daily liquid assets? Should it be based on a certain fall in either the fund's weekly liquid assets or shadow price?") The ability to impose redemption restrictions in anticipation of a sharp fall in weekly liquid assets would be more useful than a trigger based on a reduction in daily liquid assets.

those in which it would be appropriate for a Board to authorize breaking a dollar or liquidating the fund. Such a statement would also help guide Boards when considering whether it would be appropriate to impose redemption restrictions on a MMF.

4.5 The Commission Should Consider Other Steps to Minimize Disruption to the Payment System

Reducing the maximum time during which a prime MMF may suspend redemptions will also limit the impact of the suspension on processing checks and debit card transactions. Banks may be willing to hold checks for payment or make advances against pending redemptions if they know the MMF must make payment within a few business days. This may also prevent shareholders from incurring charges for returned checks or late payments, for which they may seek reimbursement from their MMF. Participants in the payment system may be less accommodating if they run the risk of not receiving payment by the following week.

The Commission should also consider the treatment of checks and debit card transactions following the imposition of redemption restrictions. First, after restricting redemptions, a prime MMF may receive checks and card transactions that were executed before the restrictions were imposed. Technically, for purposes of Rule 22c-1, the "receipt of a tender of [a MMF share] for redemption" may not occur until the fund's transfer agent receives notice of a check or card transaction. A check deposited by a third-party at a bank or a debit card transaction completed the day *before* a prime MMF restricts redemptions should represent a payment in the ordinary course of business, rather than an attempt by a shareholder to gain an advantage over other shareholders. If the Commission made it clear that a MMF could pay (without imposing any liquidity fee) checks cleared through the Federal Reserve System, clearing house transactions and debit card transaction received on the business day immediately following a restriction of redemptions, this would help to minimize the potential disruption to the payment system without creating undue risks for the fund's other shareholders.

Second, it may take more than a day to stop accepting debit card transaction. If fact, some debit card systems allow small transactions (e.g., $50 or less) to go through without checking the shareholder's available balance. It would be easier to permit a fund that has used reasonable efforts to halt debit card transactions after suspending redemptions to pay any transactions that still manage to come through the system. The small amounts of these transactions are not likely to justify the administrative costs of denying payments.

Finally, if a fund imposes a liquidity fee, it will need to treat any check or debit card transaction as a redemption order for "net proceeds." In other words, to make full payment on a check for $100, the fund would have to treat the check as an order to redeem $102.04, so that it may deduct the 2% liquidity fee of $2.04. Federated anticipates that prime MMFs will address this in their prospectus disclosure regarding the potential for a liquidity fee. The Commission should make sure that its disclosure branches are prepared for this, and consider whether any other regulatory accommodations are necessary to permit prime MMF's to "gross up" redemptions in this manner.

5. GOVERNMENT FUNDS AND TAX EXEMPT FUNDS SHOULD NOT BE SUBJECT TO REDEMPTION RESTRICTIONS

Federated supports the exclusion of government MMFs from Alternative 2. As the Reform Proposal noted, shareholders view government MMFs as safe havens during times of market turmoil. Thus, market conditions during which a government MMF would need to implement a liquidity fee or suspend redemptions would be truly extraordinary. Moreover, because Treasury securities and federal agency discount notes with remaining maturities of 60-calendar days or less qualify as weekly liquid assets, government MMFs are extremely unlikely to fall below a 10% (as Federated recommends) or even a 15% (as proposed) threshold. The Commission should not burden Boards and shareholders with the prospect of redemption restrictions that will probably never be put into effect.

Alternative 1 of the Reform Proposal concedes that tax exempt funds did not experience the widespread redemptions of prime MMFs during the financial crisis, and proposes to exclude tax exempt funds from the floating NAV requirement. (Unfortunately, the exclusion would be based on a mistaken premise that all tax exempt funds will qualify as “retail funds” under Alternative 1, which is not the case.) The Reform Proposal does not explain why a similar exclusion from Alternative 2 was not proposed for tax exempt funds. As explained in more detail in a separate letter regarding Federated’s comments on tax exempt funds, we recommend that the Commission extend the exclusion provided for government MMFs in paragraph (c)(2)(iii) of Proposed Rule 2a-7 to tax exempt funds.

6. THE COMMISSION SHOULD NOT ADD FEATURES THAT WOULD UNDULY COMPLICATE ALTERNATIVE 2

One virtue of Alternative 2 is its simplicity. The Reform Proposal includes several questions regarding how funds will assure that intermediaries comply with redemption restrictions. One answer is that it is highly unlikely that anyone would *buy* shares of a MMF that has implemented a liquidity fee or suspended redemptions, even assuming the MMF continued to offer its shares for sale. This means that intermediaries would not have any buy orders to match against redemption orders, and would have to pay redemption orders entirely from redemption proceeds provided by the MMF. As the fund’s transfer agent would net any liquidity fee from an intermediary’s redemptions proceeds, the intermediary would not have any choice but to pass the liquidity fee through to its redeeming customers. Of course, if a prime MMF suspended redemptions, the intermediary could not obtain any redemption proceeds at all and would be forced to suspend redemptions by its customers.

Even in the unlikely event that the intermediary had purchase orders to match against some redemption orders, this would not have any effect on the MMF’s net assets or share price. The intermediary should treat clients as purchasing outstanding shares from other clients, rather than treating them as purchasing shares directly from the MMF, creating, in effect, a secondary market for the shares. Insofar as the transfer of outstanding shares from one client to another would not have any effect on the MMF, there would be no reason to impose a liquidity fee on this transfer..

The simplicity of Alternative 2 stems from its uniformity: all redemptions are treated the same. If a prime MMF implements a liquidity fee, the fund's transfer agent subtracts the same percentage from every redemption; if the fund suspends redemptions, the fund's transfer agent does not process any redemption. This greatly simplifies the operational requirements of Alternative 2. Any attempt to create exceptions, such as allowing redemptions free of any liquidity fee up to a set dollar amount or percentage of the shareholder's account balance, would add significant operational hurdles to the proposed reform. In order to be applied equitably, prime MMF's would have to take steps to assure that intermediaries were implementing the exceptions on a consistent basis. Thus, any exceptions are apt to create the same operational problems as FSOC's ill-considered minimal balance at risk proposal.

Federated previously considered permitting redemptions up to a fixed dollar amount as a means of mitigating the disruption caused by a temporary suspension of redemptions. After reflecting on Alternative 2, we concluded that it would be best to address this disruption by keeping the period of disruption brief, as reflected in our recommendation to reduce the period during which redemptions may be suspended from thirty to ten calendar days. This assures that shareholders are treated equitably, and avoids the operational requirements (and costs) of implementing exceptions to the suspension or down the line enforcement.

The other virtue of uniformity is simplified disclosure. Alternative 2 allows a fund to disclose the potential worst cases (short of breaking a dollar or liquidation of the fund): imposition of a 2% liquidity fee or a suspension of redemptions of up to (we would recommend) ten calendar days. Having been informed of the potential worst case, shareholders should not complain if a Board implements a lower liquidity fee or suspends redemptions for a shorter period. Federated expects that communications would represent the primary costs associated with adjusting a liquidity fee, insofar as shareholders and intermediaries would need to know what fee will be withheld in advance of a redemption. This is one reason Federated does not expect liquidity fees to be a favored option, but it should not prevent a Board from reducing the fee under appropriate circumstances to assure more equitable treatment of their shareholders.

Finally, Federated opposes adding any extraneous provisions to a prime MMF's ability to implement redemption restrictions. For example, the Reform Proposal asks if the Commission should "prohibit advisers to money market funds from charging management fees while the fund is gated?"[27] Management fees have nothing to do with suspending redemptions or imposing liquidity fees—an adviser will still have plenty to do while a suspension or liquidity fee is in place. In fact, the conditions that led to the suspension or liquidity fee will probably add to the amount and difficulty of the adviser's workload. It should remain up to the adviser to determine the extent to which it will waive fees under these circumstances and up to the market to judge whether the adviser has responded in an appropriate manner.

7. CONCLUSION

Alternative 2 would accomplish all of the Commission's stated objectives for reform: "lessen[ing] money market funds' susceptibility to heavy redemptions, improv[ing] their ability

[27] Reform Proposal at 36883.

to manage and mitigate potential contagion from high levels of redemptions, and increas[ing] the transparency of their risks, while preserving, as much as possible, the benefits of money market funds."[28] As Federated will show in a separate comment letter, Alternative 1 would fail to accomplish any of these objectives. There is no justification for the Commission adopting reforms beyond those proposed in Alternative 2.

If modified as recommended in this comment letter, Alternative 2 would allow a Board to respond promptly in the event a fund experienced large-scale redemptions. The Board could deal effectively with such redemptions, either by imposing a liquidity fee to protect the fund against the financial consequences of the redemptions or by suspending redemptions entirely. The Board's actions would reduce or, in the case of suspending redemptions, eliminate the risk of fire sales of a MMF's assets in response to redemptions, thus mitigating the risk of potential contagion. Regarding transparency of risks, shareholders should easily understand and appreciate the risks associated with Alternative 2: a slight possibility of a liquidity fee of up to 2% or a suspension of redemptions for a limited period. Such risks would be analogous to the risks currently faced by MMF shareholders of receiving redemptions in-kind or having redemptions suspended pursuant to Rule 22e-3 in connection with the liquidation of the fund.

Most importantly, Alternative 2 preserves the benefits of MMFs because it affects the shareholders' ability to redeem at a stable price only in rare and extreme circumstances. Insofar as such circumstances might otherwise force a fund to liquidate or break a dollar, Alternative 2 would increase the benefits of MMFs by permitting a less drastic response while the Board searches for a more favorable resolution for shareholders. It is important, however, to limit the duration of liquidity fees or suspended redemptions to ten calendar days in order to minimize the disruption to shareholders.

Federated appreciates the opportunity to comment on the Reform Proposal and the Commission's consideration of our comments. Please feel free to contact John McGonigle if you have any questions regarding these comments.

Very truly yours,

/s/ John W. McGonigle
Vice Chairman
Federated Investors, Inc.

[28] Risk Proposal at 36848.

EXHIBIT A
Recommended Changes to Proposed Rule 2a-7(c)(2)

(2) *Liquidity fees and temporary suspensions of redemptions*. Except as provided in paragraph (c)(2)(iii) of this section, and notwithstanding sections 22(e) and 27(i) of the Act (15 USC 80a-22(e) and 80a-27(i)) and § 270.22c-1:

(i) *Liquidity fees*. If, at the end of a business day, the money market fund has invested less than ~~fifteen~~ ten percent of its total assets in weekly liquid assets, the fund must institute a liquidity fee, effective as of the beginning of the next business day, as described in paragraphs (c)(2)(i)(A) and (B) of this section, unless the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that imposing the fee is not in the best interest of the fund. A money market fund may also institute a liquidity fee if the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines, at any time, based on current redemption activity or current market conditions (including the occurrence of any of the events specified in paragraph (f)(2) of this section), that (*1*) there is a substantial risk of the fund having invested less than ten percent of its total assets in weekly liquid assets at or before the end of a business day or (*2*) imposition of a liquidity fee would be in the best interest of the fund's shareholders to avoid material dilution or other unfair results to such shareholders. As part of any such determination, the fund's board of directors shall also determine the date and time as of which such liquidity fee shall take effect.

(A) *Amount of liquidity fee*. The liquidity fee shall be two percent of the value of shares redeemed unless the money market fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that a lower fee level is in the best interest of the fund. If a liquidity fee remains in effect for more than one business day, the board of directors, including a majority of the directors who are not interested persons of the fund, may vary the level of the liquidity fee (provided that the liquidity fee may not exceed two percent of the value of shares redeemed) if it determines that the new fee level is in the best interest of the fund, with the new fee level taking effect as of the beginning of the next business day.

(B) *Duration and application of liquidity fee*. Once imposed, a liquidity fee, which must be applied to all shares redeemed, shall remain in effect until the money market fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that imposing the liquidity fee is not in the best interest of the fund, provided that the board of directors must terminate the liquidity fee within ten calendar days of the first business day on which a liquidity fee is imposed (or the next business day following such day) or on such earlier business day if, at the end of the preceding ~~if, at the end of a~~ business day, the money market fund has invested thirty percent or more of its total assets in weekly liquid assets~~, the fund must cease charging the liquidity fee, effective as of the beginning of the next business day~~. The money market fund may not impose a liquidity fee pursuant to this paragraph for more than ten days in any ninety-day period.

(ii) *Temporary suspension of redemptions*. ~~If, at the end of a business day, the money market fund has invested less than fifteen percent of its total assets in weekly liquid assets~~Instead of implementing a liquidity fee, the fund's board of directors, including a majority of the directors who are not interested persons of the fund, may determine to suspend the right of redemption temporarily~~, effective at the beginning of the next business day,~~ if the board determines that doing so is in the best interest of the fund. The temporary suspension of redemptions will take effect as of the date and time determined by the fund's board of director, and will~~may~~ remain in effect until the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines to restore the right of redemption, provided that the ~~fund~~ board of directors must restore the right of redemption within ~~thirty~~ ten calendar days of suspending redemptions (or the next business day following such day) or on such earlier business day if, at the end of the preceding business day, the money market fund has invested thirty percent or more of its total assets in weekly liquid assets. The money market fund may not suspend the right of redemption pursuant to this paragraph for more than ~~thirty~~ ten days in any ninety-day period.

(iii) *Exemption for government and tax exempt money market funds*. A money market fund is not required to comply with paragraphs (c)(2)(i) and (ii) of this section if and so long as either (A) eighty percent or more of the money market fund's total assets are invested in cash, government securities, and/or repurchase agreements that are collateralized fully, or (B) the fund is a tax exempt fund, but, in either case, such a fund may choose not to rely on the exemption provided by this paragraph, and may impose liquidity fees and suspend redemptions temporarily, provided that the fund must then comply with paragraphs (c)(2)(i) and (ii) of this section and any other requirements that apply to liquidity fees and temporary suspensions of redemptions (e.g., Item 4(b)(1)(ii) of Form N-1A (§ 274.11A of this chapter)).

(iv) *Variable contracts*. A variable insurance contract sold by a registered separate account funding variable insurance contracts or the sponsoring insurance company of such separate account may apply a liquidity fee or temporary suspension of redemptions pursuant to paragraph (c)(2) of this section to contract owners who allocate all or a portion of their contract value to a subaccount of the separate account that is either a money market fund or that invests all of its assets in shares of a money market fund.