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November 12, 2013

The Honorable Mary Jo White  
Chair  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

**Re: Proposed Rule on Money Market Fund Reform; Amendments to Form PF: File No. S7-03-13 -- Relevance of the Federal Banking Agencies' Proposed Liquidity Coverage Ratio**

Dear Chair White:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), to provide comments in response to the Securities and Exchange Commission's (the "Commission's") proposed rule on money market fund ("MMF") reform (the "Release").<sup>1</sup> Federated has submitted several comment letters addressing various issues raised by the Release. We are submitting this supplemental letter in light of the federal banking agencies' notice of proposed rulemaking titled "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring" (the "LCR Proposal"), which the Board of Governors of the Federal Reserve System issued for comment on October 24, 2013, and the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency issued for comment on October 30, 2013.<sup>2</sup> For the reasons discussed below, this rulemaking is very relevant to the question of whether MMFs should be subject to structural changes, based upon assertions

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<sup>1</sup> *Money Market Fund Reform; Amendments to Form PF*, 78 Fed. Reg. 36834 (proposed June 19, 2013).

<sup>2</sup> Press Release, Board of Governors of the Federal Reserve System (Oct. 24, 2103), <http://www.federalreserve.gov/newsevents/press/bcreg/20131024a.htm>; Joint Press Release, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, "OCC and FDIC Propose Rule to Strengthen Liquidity Risk Management," NR 2013-169 (Oct. 30, 2013), <http://www.occ.treas.gov/news-issuances/news-releases/2013/nr-ia-2013-169.html> and <http://www.fdic.gov/news/news/press/2013/pr13096.html>.

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concerning potential systemic risk resulting from banks' utilization of MMFs as a source of short-term funding.

The LCR Proposal, based on the international liquidity standards published by the Basel Committee on Banking Supervision, would establish the first quantitative liquidity requirement ever for banking firms in the United States.<sup>3</sup> It would require large banks to maintain a minimum liquidity coverage ratio ("LCR") of 100 percent on each business day. The ratio would be calculated as high-quality liquid assets ("HQLAs") divided by the largest total net cash outflow over the next 30 calendar days. HQLAs would include central bank reserves, government and Government Sponsored Enterprise securities, and corporate debt that can be converted easily and quickly into cash.

**The Commission should wait and see how the LCR rule affects MMF risk and systemic risk issues before proceeding with changes to structure and regulation of MMFs**

- The LCR Proposal represents an acknowledgement by the banking agencies that bank-related problems should be solved using banking regulation. The FSOC's systemic risk objectives can and should be dealt with more directly by the banking agencies.
- The LCR Proposal would directly and systematically address, for the first time, the short-term funding risks at banks by requiring banks to hold specified levels of short-term liquid assets on their balance sheets to meet near-term liabilities.

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<sup>3</sup> The LCR requirement would apply to internationally active banking organizations (*i.e.*, those with consolidated total assets of \$250 billion or more or consolidated total on-balance sheet foreign exposure of \$10 billion or more) and nonbank financial companies that the Financial Stability Oversight Council has designated for Federal Reserve supervision under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), as well as the depository institution subsidiaries of these companies that exceed \$10 billion in total consolidated assets. The Federal Reserve has also proposed to apply a modified LCR requirement, which would impose a lower liquidity standard, to depository institution holding companies with total consolidated assets of \$50 billion or more that are not internationally active.

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- If adopted, the LCR Proposal would remove any justification for changing the structure of MMFs as an indirect means to address bank short-term funding risks.<sup>4</sup> MMFs could then continue to operate as highly efficient cash management investment products, regulation of which is dictated by the Commission's statutory mandates concerning investor protection, competition, efficiency, and capital formation.

Before it engages in a rulemaking for MMFs that is designed to help stabilize funding of the banking system, the Commission should wait for implementation of the LCR rule and fully evaluate the effectiveness of the LCR requirement in dealing with the alleged systemic risks.

**Bank liquidity is systemically important, and bank liquidity regulation is long overdue.**

- Financial panics generally start with a liquidity crisis in the financial sector, rather than in other sectors of the economy, as Vice Chair Janet Yellen of the Federal Reserve and others have noted.<sup>5</sup>
- It is clear that fear of another bank liquidity crisis and its systemic implications is a driving force of MMF reform. The banking agencies' claim that runs on MMFs pose systemic risk is largely based on their position that, when investors in MMFs

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<sup>4</sup> See Opening Statement by Federal Reserve Board Governor Daniel K. Tarullo at Board of Governors meeting approving publication of LCR proposal for comment (Oct. 24, 2013), *avail.* <http://www.federalreserve.gov/newsevents/press/bcreg/tarullo20131024a.htm>. (“[T]he liquidity positions of large financial firms came under severe stress in 2008. Creditors formerly willing to lend to financial firms on a short-term, unsecured basis fled.... Liquidity-strained firms found themselves forced to sell positions, which set off adverse feedback loops of falling asset prices, increased margin calls, and more deleveraging. Today's LCR proposal is designed to mitigate these sorts of destabilizing dynamics by helping to ensure that major banking firms have a pool of high-quality liquid assets with which to address potential short-term net cash outflows.”).

<sup>5</sup> See, e.g., Janet L. Yellen, *Interconnectedness and Systemic Risk: Lessons from the Financial Crisis and Policy Implications*, Address at the American Economic Association/American Finance Association Joint Luncheon (Jan. 4, 2013), <http://www.federalreserve.gov/newsevents/speech/yellen20130104a.htm>; Carmen M. Reinhart & Kenneth S. Rogoff, *From Financial Crash to Debt Crisis*, *American Economic Review* 101 (August 2011), available at <http://www.aeaweb.org/articles.php?doi=10.1257/aer.101.5.1676>.

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redeem their shares, MMFs do not roll over commercial paper issued by banking firms, which contributes to a liquidity crunch at banks.<sup>6</sup> The Financial Stability Oversight Council's push for MMF reform was in part intended to prevent such a bank liquidity crunch indirectly, by regulating MMFs so that banking firms could still have their liquidity needs met even if they continue to unduly rely on short-term funding such as commercial paper.<sup>7</sup>

- Bank runs have been a center-piece of financial panics as long as there have been banks. As liquidity is key to preventing bank runs and assuring bank solvency in a financial crisis,<sup>8</sup> it is surprising that bank liquidity risk has not been regulated systematically, with quantitative standards to facilitate monitoring and timely mitigation. Well over 200 years after the first federal bank charter was issued to the Bank of the United States, and 100 years since the formation of the Federal Reserve System, the federal banking agencies have only now, for the first time, proposed to impose specific liquidity requirements on banks.

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<sup>6</sup> See Robert Comment, *Do Money Market Funds Require Further Reform?* (Dec. 31, 2012) (“Translating from governmentspeak: Central bankers cannot rely on prime funds to roll over their holdings of bank-issued short-term debt in a crisis. It may qualify as ironic that reformers seek to limit systemic risk by making money market funds more reliable financing arms of TBTF banks, the balance sheets of which arguably should be shrunk rather than accommodated.”), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2174125](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2174125). See also David W. Blackwell, Kenneth R. Troske & Drew B. Winters, *Money Market Funds Since the 2010 Regulatory Reforms: More Transparency, Increased Liquidity, and Lower Credit Risk*, U.S. Chamber of Commerce Center for Capital Markets Competitiveness (Fall 2012), [http://www.uschamber.com/sites/default/files/reports/FinalpaperwithCover\\_smalltosend.pdf](http://www.uschamber.com/sites/default/files/reports/FinalpaperwithCover_smalltosend.pdf); Fitch Ratings, *Study of MMF Shadow NAV Shows Stability* (June 14, 2012), <http://www.fitchratings.com/web/en/dynamic/articles/Study-of-MMF-Shadow-NAV-Shows-Stability.jsp>.

<sup>7</sup> Financial Stability Oversight Council, 2013 Annual Report (Apr. 25, 2013) (“The first theme concerns vulnerability to runs in wholesale funding markets that can lead to destabilizing fire sales. In the past year, the Council took concrete steps in supporting the implementation of structural reforms to reduce the likelihood of run risks of money market mutual funds (MMFs) by issuing proposed recommendations for reform under Section 120 of the Dodd-Frank Act.”), available at <http://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf>.

<sup>8</sup> Kathleen McDill & Kevin Sheehan, *Sources of Historical Banking Panics: A Markov Switching Approach*, FDIC Working Paper 2006-01 (Nov. 2006), [http://www.fdic.gov/bank/analytical/working/wp2006\\_01/wp2006\\_01.pdf](http://www.fdic.gov/bank/analytical/working/wp2006_01/wp2006_01.pdf); Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, reprinted in Federal Reserve Bank of Minneapolis Quarterly Review (Winter 2000), originally published in the *Journal of Political Economy* Vol. 91, No. 3 (1983).

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- For most of the past century, the regulatory approach to preserving bank liquidity has been to rely on federal government support in the form of FDIC insurance coverage and bank access to the Federal Reserve lending window. In the most recent financial crisis, the Federal Reserve expanded access to the discount window, and the FDIC expanded deposit insurance coverage and guaranteed unsecured bank debt. Congress made clear in the preamble to the Dodd-Frank Act that banks must be self-supporting, and not propped up by taxpayer backing.
- MMFs have been operating under the quantitative liquidity requirements of the Commission's Rule 2a-7 under the Investment Company Act. MMFs are required to hold at least 10% of their assets as overnight liquid assets and 30% as seven-day liquid assets. More must be held based on the MMF's monitoring and analysis of anticipated shareholder redemption needs. In practice, this means that MMFs currently hold well over 40% of their portfolios in short-term liquid assets -- more than a trillion dollars in cash ready to pay redeeming shareholders.<sup>9</sup>
- The banking agencies' LCR Proposal would establish a specific amount of highly liquid assets that a large bank must hold on each business day, similar to what SEC Rule 2a-7 already requires for MMFs (albeit not as stringent a standard as applies to MMFs and not requiring as much be held in liquid assets at banks).

**The LCR proposal confirms that many categories of institutional deposits are very stable and not apt to be redeemed in a crisis.**

- Many of the same categories of corporate uses of MMFs identified in our prior comment letter<sup>10</sup> to the Commission would be characterized as "operational

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<sup>9</sup> Letter from Fidelity Investments to SEC Exhibit 4 (Mar. 1, 2012) (available in File No. 4-619) (citing Federal Reserve, U.S. Treasury, Investment Company Institute as of Feb. 8, 2012 and Crane data as of Jan. 31, 2012 that funds were holding \$1.118 trillion, or approximately 42% 7-day liquidity).

<sup>10</sup> Letter from John D. Hawke, Jr. to SEC App'x 2 (Sept. 13, 2013) (available in File No. S7-03-13) (describing the liquidity and operational needs of specialized users of MMFs including corporations using MMFs for operating cash balances and payroll; broker-dealers offering brokerage and sweep accounts to optimize returns for their institutional and corporate clients; bank trust departments safeguarding funds for individuals, corporations, and other institutions; pension plan administrators; escrow agents; securities and commodity exchanges; and state and local governments).

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services” under the LCR Proposal,<sup>11</sup> which recognizes that funds deposited for such corporate uses (named “operational deposits” in the LCR Proposal) are stable funding not subject to runs.<sup>12</sup> Because these corporate operational balances are commonly well above the FDIC deposit insurance limit, they are better protected against loss when held as MMF shares than as uninsured bank deposits in a crisis.<sup>13</sup> Accordingly, these types of corporate operating balances are even less subject to “runs” or “sustained redemptions” when invested in an MMF than when on deposit at a bank. This further shows that non-retail investors in MMFs are not necessarily more prone to redemption in a crisis than retail investors as has been assumed by the retail exemption contained in the Commission’s Alternative One proposal.

**Imposing VNAV requirements on MMFs in addition to LCR rules would be disruptive to investors, issuers and short-term markets.**

- Corporate and municipal treasurers need an investment to use in holding short-term cash balances. Issuers need a source for obtaining short-term cash funding.
- MMFs and banks are two of the primary vehicles through which these cash balances are intermediated with cash funding needs.
- The LCR Proposal, together with other aspects of the Dodd-Frank Act,<sup>14</sup> would effectively force banks to use less short-term funding to support their balance

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<sup>11</sup> Federal Reserve Notice of Proposed Rulemaking, Liquidity Coverage Ratio: Liquidity Measurement, Standards, and Monitoring, § \_\_.3 at 86, [http://www.federalreserve.gov/FR\\_notice\\_lcr\\_20131024.pdf](http://www.federalreserve.gov/FR_notice_lcr_20131024.pdf) (“Federal Reserve Notice”).

<sup>12</sup> Federal Reserve Notice at 57, § \_\_.32(h)(3), (4) at 106.

<sup>13</sup> Federal Reserve Bank of New York Staff Report, The Minimum Balance at Risk: A Proposal to Mitigate the Systemic Risks Posed by Money Market Funds 52 (July 2012), *available at* <http://www.federalreserve.gov/pubs/feds/2012/201247/201247pap.pdf> (“Even bank deposits have safety disadvantages for large institutional investors whose cash holdings typically exceed by orders of magnitude the caps on deposit insurance coverage; for these investors, deposits are effectively large, unsecured exposures to a bank. MMF shares – which represent claims on diversified, transparent, tightly regulated portfolios – would continue to offer important safety advantages relative to bank deposits.”).

<sup>14</sup> For example, Section 165 of the Dodd-Frank Act authorizes the Federal Reserve to establish a contingent capital requirement for large banks. Under such a requirement, a large bank would have a convertible debt

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sheets, and reduce the availability of several alternatives for institutional investors to place short-term cash balances.

- If banks are effectively forced to curtail acceptance of short-term deposits and issuance of short-term notes, short-term lending through reverse repurchase agreements and securities borrowing transactions becomes less available, and non-retail MMFs are forced to move to a variable NAV (in which event treasurers would no longer be able to invest short-term cash balances in these funds, as clearly indicated in the comment letters filed with the Commission), then corporate, state and municipal government treasurers would be left with the question how and where to invest their cash balances.
- Treasurers will continue to need MMFs that seek to maintain a stable price of \$1 per share as an option for holding short-term liquid assets.

**LCR rules will obviate the need for further MMF changes to address “systemic risk” issues identified by FSOC**

- Preventing bank liquidity crunches through banking regulation would obviate MMF reform intended to support bank liquidity and allow MMFs to meet investor demand for safe, liquid investments. The Commission should not stray from its mandate to promote capital formation, efficiency, and competition in order to accommodate such objectives. Instead, the Commission should wait until after the LCR rule is adopted and implemented, and then assess whether there remain

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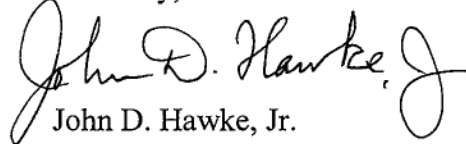
tranche available for a “bail-in” to increase the bank’s equity capital in times of stress. The convertible debt, which would be longer-term funding, would replace some of the short-term funding currently provided by deposits and commercial paper. Also, both Vice Chair Janet Yellen and Governor Daniel Tarullo of the Federal Reserve have indicated that the Federal Reserve plans to impose stricter regulations on short-term securities financing transactions, including repos, reverse repos, securities borrowing and lending transactions, and margin loans. *See* Janet L. Yellen, Regulatory Landscapes: A U.S. Perspective, Address at the International Monetary Conference (June 2, 2013), <http://www.federalreserve.gov/newsevents/speech/yellen20130602a.htm>; Daniel K. Tarullo, Macprudential Regulation, Address at the Yale Law School Conference on Challenges in Global Financial Services (Sept. 20, 2013), <http://www.federalreserve.gov/newsevents/speech/tarullo20130920a.htm>.

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systemic issues that can or should be addressed by further changes to the regulation of MMFs.

We appreciate the opportunity to present to the Commission our views on the implications of the federal banking agencies' LCR Proposal that are relevant to the Commission's proposed MMF reforms.

Sincerely,

  
John D. Hawke, Jr.

cc: Luis A. Aguilar, Commissioner  
Daniel M. Gallagher, Commissioner  
Kara M. Stein, Commissioner  
Michael S. Piwowar, Commissioner

Norm Champ, Director: Division of Investment Management  
Craig Lewis, Director: Division of Economic and Risk Analysis