Federated Investors, Inc.
Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
412-288-1900 Phone
www.federatedinvestors.com

Federated
WORLD-CLASS INVESTMENT MANAGER®

April 23, 2014

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 the Municipal Money Market Funds Exposure to Parents of Guarantors

Dear Ms. Murphy:

This letter responds to the Securities and Exchange Commission's (the "Commission") request for comments[1] on a memorandum, dated March 17, 2014, from the Commission's Division of Economics and Risk Analysis ("DERA") regarding Municipal Money Market Funds Exposure to Parents of Guarantors (the "Memorandum").[2] The Memorandum "examines the extent to which MMFs use the '25% basket' under which up to 25% of the value of securities held in a MMF portfolio may be subject to guarantees or demand features from a single guarantor in municipal MMFs."[3] Elimination of the so-called "25% basket" was among the proposals made by the Commission in Investment Company Act Release No. 30551 (the "Reform Proposal").[4] The Memorandum confirms the comments of Federated Investors, Inc. ("Federated") regarding the 25% basket made in one of our previous comment letters on the Reform Proposal.[5] We do not believe, however, that the Memorandum's analysis supports its conclusion that elimination of the 25% basket would not increase the credit risks of municipal and other money market funds ("MMFs").

As explained in our previous comment letter, the "25% basket" refers to an exception to Rule 2a-7's diversification requirements for providers of guarantees and demand features. Generally, Rule 2a-7 prohibits a MMF from acquiring a security subject to a guarantee or demand feature (an "Enhanced Security") if the acquisition would result in the MMF holding more than

1 Staff Analysis of Data and Academic Literature Related to Money Market Fund Reform, SEC Press Release 2014-56 (Mar. 24, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541253716#.UzB74oVy6F8.

2 http://www.sec.gov/comments/s7-03-13/s70313-323.pdf.

3 Memorandum at 1.

4 78 Fed. Reg. 36834 (June 19, 2013). Terms defined in Rule 2a-7 are used with the same meanings in this letter.

5 Comment letter from Federated to the Commission Regarding the Proposed Regulation of Tax-Exempt Money Market Funds § 4 (Sep. 16, 2013), http://www.sec.gov/comments/s7-03-13/s70313-126.pdf.

10% of its total assets in securities issued by or subject to guarantees and demand features from the provider of the guarantee or demand feature (the “Enhancement Provider”). The 25% basket allows a MMF to acquire first tier Enhanced Securities in excess of this 10% limit, provided: (a) the Enhancement Provider is not an affiliate of the issuer of the Enhanced Security, and (b) the acquisition would not result in more than 25% of the fund’s total assets being invested in Enhanced Securities from Enhancement Providers that exceed the 10% limit.

The Memorandum confirms the following comments made in Federated’s letter:

Federated Comment: “Federated’s tax exempt funds frequently rely on the 25% basket. … Federated believes that other tax exempt fund managers utilize the 25% basket with similar frequencies.”

DERA’s Findings: “78 funds had at least one guarantor above the 10% threshold (green bars) every month we examined, suggesting that this size basket is used regularly. … 59 of the 78 funds (76%) were Single State funds and 18 (23%) were Other Tax-Exempt funds.”

Federated Comment: “[W]e expect that the bulk of the 109 funds utilizing the 25% basket were tax exempt funds. … [I]f at least 91 of the 109 fund identified by the staff [as using the 25% basket] were tax exempt funds, then a majority of tax exempt funds utilized the 25% basket on February 28, 2013. … [W]e would be surprised if a closer examination of the staff’s data failed to show more than a majority of [single state] funds utilizing the 25% basket.”

DERA’s Findings: “80.2% of all Single State funds and 50.0% of all Other Tax-Exempt funds had at least one guarantor above the 10% threshold in November 2012.”

In other words, 53% of single state funds and 23% of other municipal MMFs utilized the 25% basket throughout the entire period analyzed in the Memorandum, and 80% of single state funds and 50% of other municipal MMFs were utilizing the 25% basket at the end of the period. Clearly, the 25% basket is critical to the operation of municipal MMFs.[6]

The Memorandum also confirms, although not as explicitly, Federated’s comments about how municipal MMFs use the 25% basket. A MMF may either (a) use the 25% basket for only one Enhancement Provider so as to maximize its exposure up to 25% of total assets or (b) use or reserve the 25% basket for two Enhancement Providers, in which case the exposure to any one Enhancement provider must be less than 15% and the average exposure to both Enhancement

[6] The Memorandum also reflect some prime MMFs utilizing the 25% basket during and at the end of the period, which confirms comments made in Federated’s letter to the Commission Regarding Amendments to Disclosure Requirements for Money Market Funds and Current Requirements of Rule 2a-7 § 4 (Sep. 17, 2014), http://www.sec.gov/comments/s7-03-13/s70313-186.pdf.

Providers could not exceed 12.5%.[7] Our previous letter observed “most funds either use the 25% basket for two Enhancement Providers or seek to maintain the option of adding a second Enhancement Provider to the basket …,” i.e., the second approach.

The Memorandum’s analysis of “Excess Guarantees” confirms our observation. An “Excess Guarantee” equals a MMF’s exposure to an Enhancement Provider in excess of the general 10% diversification limit. A MMF that used the entire 25% basket to concentrate in one Enhancement Provider could potentially have Excess Guarantees of 60% (15% out of the 25% basket would be Excess Guarantees). In contrast, a MMF that divides the entire basket between two Enhancement Providers would have average Excess Guarantees of 20% (2.5% out of the average 12.5% from each Enhancement Provider in the 25% basket would be Excess Guarantees) and maximum Excess Guarantees from any one Enhancement Provider would be 33% (4.9% out of the 14.9% from the largest potential Enhancement Provider in the 25% basket would be Excess Guarantees).

The table on page 14 of the Memorandum shows that the Excess Guarantees for the 19 largest Enhancement Providers exceeds 20% in only one instance: the State of California[8] for single state funds that, presumably, invest exclusively in California. It also shows that, other than the State of California, the percentages of Excess Guarantees above 15% are quite small.[9] These results are consistent with most MMFs using the 25% basket for two Enhancement Providers. In other words, as used by most municipal MMFs, the 25% basket results in only a small reduction in overall diversification.

DERA did not gather data regarding the market for Enhanced Securities, which is important for understanding the results in the tables on pages 13 and 14 of the Memorandum. Based on information from the Bond Buyer Year Books[10] from 2009 to 2013 and from FMS

[7] Thus, the example given in the Memorandum at 6 of “a fund’s top five guarantors guarant[ying] 23%, 17%, 13%, 11% and 5% of their [*sic*] portfolio” would not comply with the 25% basket, as 64% of the total assets would be invested in securities in excess of the general 10% limit on guarantors.

[8] The Memorandum measures Excess Guarantees at the “guarantor parent” level. It is not clear of which entities the State of California was considered the parent. Federated has not been offered many securities actually guaranteed by the State, so it seems likely that other state related entities were included in these totals. It is possible that municipal Enhanced Securities supported by some independent entities, such as the California pension funds that appear in Tables B and C of this letter, were mistakenly included in the guarantees attributed to the State of California.

[9] An Excess Guarantee above 15% may result from a decline in a MMF’s total assets after the last Enhanced Security was acquired, so the fact that a MMF has an Enhancement Provider somewhat above 15% does not necessarily imply that the MMF was using the 25% basket to concentrate investments exclusively in that Enhancement Provider.

[10] Data on letters of credit and standby purchase agreement providers was compiled from the Variable-Rate Bonds section of the Bond Buyer Years Books from 2010 through 2014. Data from 2009 through 2012 was limited to the top ten providers of letters of credit and of standby purchase agreements, respectively, exclusive of private placements. According to this data, Table A includes approximately 83% of the Enhanced Securities secured by letters of credit and standby purchase agreements publicly issued during the period. If we assume that all privately placed variable rate bonds were also secured by letters of credit or standby purchase agreements, Table A would still represent 71% of the variable rate bonds secured by letters of credit and standby purchase agreements during

Bonds regarding tender option bonds for the same period, Federated has compiled the following table of the top 17[11] first tier providers of letters of credit and standby purchase agreements for municipal VRDOs (including tender option bonds).

TABLE A	
Enhancement Provider	**Enhancements Issued 2009-2013 (in millions)**
JPMorgan Chase & Co.	$ 53,138.2
Citibank N.A.	$ 18,203.3
Bank of America N.A.	$ 16,168.9
Wells Fargo & Co.	$ 15,083.4
Royal Bank of Canada	$ 9,529.3
U.S. Bank N.A.	$ 5,761.6
Barclays Bank PLC	$ 5,748.4
Morgan Stanley	$ 4,540.1
Deutsche Bank A.G.	$ 3,950.0
PNC Bank N.A.	$ 2,133.5
TD Bank N.A.	$ 1,620.8
Branch Banking & Trust	$ 1,415.9
Mizuho Corporate Bank	$ 900.9
Bank of NY Mellon	$ 856.4
Bank of Tokyo-Mitsubishi	$ 765.6
Goldman Sachs & Co.	$ 590.3
State Street B&T Co.	$ 585.2

The top six first tier Enhancement Providers during the five-year period shown in Table A correspond exactly to the top six Enhancement Providers in the table on page 13 of the Memorandum. In addition, thirteen of the Enhancement Providers listed in the table above also appear in the tables in the Memorandum and all but one of those (Bank of NY Mellon) already have Excess Guarantees in some municipal MMFs.

Thus, the concentration of Enhancement Providers in the 25% basket observed in the Memorandum reflects a concentration in the overall market for municipal Enhanced Securities. This does not leave municipal MMFs with much leeway to increase their diversification. DERA can confirm this by examining the available supply of variable rate demand obligations available on Bloomberg. Table B shows the first tier municipal Enhanced Securities that were available at the start of the trading day on April 8, 2014.

---

the period. Thus, Table A may be treated as a highly representative sample of the Enhancement Providers for MMF eligible Enhanced Securities issued during the post-financial crisis period.

[11] This is the same number of Enhancement Providers shown in the tables on pages 13 and 14 of the Memorandum, excluding Dexia (which is now second tier), Assured Guaranty (which is no longer eligible to guarantee conditional demand features) and "<Blank>," which is attributable to incomplete Form N-MFP filings. As in the Memorandum, Enhanced Securities issued by subsidiaries have been included with their parent companies.

TABLE B[12]		
Liquidity Bank	**Enhanced Securities Offered (in 000s)**	**Market Share**
Wells Fargo & Co.[13]	$ 483,745	29.2%
JPMorgan Chase & Co.	$ 333,854	20.2%
U.S. Bank N.A.	$ 159,360	9.6%
TD Bank N.A.	$ 95,205	5.7%
Bank of Tokyo-Mitsubishi	$ 89,960	5.4%
Bank of NY Mellon	$ 85,030	5.1%
Bank of America N.A.	$ 69,705	4.2%
Northern Trust Co.	$ 63,445	3.8%
Royal Bank of Canada	$ 42,540	2.6%
Mizuho Corporate Bank	$ 39,120	2.4%
Barclays Bank PLC	$ 25,115	1.5%
RBS Citizens National	$ 24,580	1.5%
State Street B&T Co.	$ 22,510	1.4%
CA Public Employees	$ 18,610	1.1%
Fannie Mae	$ 15,080	0.9%
Morgan Stanley	$ 13,940	0.8%
Bank of Nova Scotia	$ 13,695	0.8%
Citibank N.A.	$ 12,500	0.8%
Freddie Mac	$ 9,545	0.6%
Texas State Treasurer	$ 6,570	0.4%
BNP Paribas	$ 6,500	0.4%
Bank of Montreal	$ 5,100	0.3%
Commerce Bank N.A.	$ 3,990	0.2%
Federal Home Loan Banks	$ 3,670	0.2%
PNC Bank N.A.	$ 3,660	0.2%
Sumitomo Mitsui Bank	$ 2,800	0.2%
Branch Banking & Trust	$ 2,140	0.1%
CA State Teachers	$ 1,800	0.1%
Deutsche Bank A.G.	$ 1,557	0.1%
KBC Bank N V	$ 850	0.1%
Helaba	$ 400	0.0%
ING Bank NV	$ 50	0.0%
TOTAL	$1,656,626	100.0%

[12] Source: Bloomberg, BOOM screen. The table excludes Enhanced Securities insured by Assured Guaranty, as it is no longer eligible to guarantee conditional demand features.

[13] Wells Fargo does not list its tender option bonds offered for remarketing on Bloomberg, so Table B understates its share of the current market. As Wells Fargo is among the Enhancement Providers with a large percentage of Excess Guarantees, this understatement does not affect the conclusion that current supplies will not permit municipal MMFs to increase their diversification.

Table B reflects the same market concentration as Table A, with the top five Enhancement Providers each identified as Excess Guarantors in the Memorandum. The three largest Enhancement Providers in Table B, representing nearly 60% of the available supply, were among the five largest Enhancement Providers held by municipal MMFs.

In fact, Enhancement Providers with Excess Guarantees account for over 80% of the supply currently available in the market. Table C shows the supply of municipal Enhanced Securities from Enhancement Providers that do not already have Excess Guarantees.

TABLE C		
Liquidity Bank	**Enhanced Securities Offered (in 000s)**	**Market Share**
Bank of NY Mellon	$ 85,030	5.1%
Northern Trust Co.	$ 63,445	3.8%
Mizuho Corporate Bank	$ 39,120	2.4%
RBS Citizens National	$ 24,580	1.5%
CA Public Employees[14]	$ 18,610	1.1%
Fannie Mae	$ 15,080	0.9%
Freddie Mac	$ 9,545	0.6%
Texas State Treasurer	$ 6,570	0.4%
BNP Paribas	$ 6,500	0.4%
Bank of Montreal	$ 5,100	0.3%
Commerce Bank N.A.	$ 3,990	0.2%
Federal Home Loan Banks	$ 3,670	0.2%
PNC Bank N.A.	$ 3,660	0.2%
Sumitomo Mitsui Bank	$ 2,800	0.2%
Branch Banking & Trust	$ 2,140	0.1%
CA State Teachers	$ 1,800	0.1%
KBC Bank NV	$ 850	0.1%
ING Bank NV	$ 50	0.0%
TOTAL	$ 292,540	17.7%

DERA estimated that Excess Guarantees on November 2012 were $6.76 billion.[15] Table C shows the supply currently available to reduce these Excess Guarantees is less than $300 million, only 4.3% of the amount needed to replace Excess Guarantees. Replacement of Excess Guarantees would be particularly challenging for single state funds because not all Enhancement Providers support securities in every state. For example, only $1.16 million of the Enhanced Securities shown in Table C were exempt from Georgia state income taxes.

While Federated appreciates that MMFs would not need to replace all their Excess Guarantees in a single day, we find no basis for presuming that there are sufficient Enhanced Securi-

[14] Federated could not tell if these Enhanced Securities were included in the Excess Guarantees for the State of California. *See*, *supra*, note 8.

[15] Memorandum at 9.

ties in the market to permit municipal MMFs to comply with Rule 2a-7's diversification requirements without a 25% basket.[16] Tables A and B demonstrate that the market for municipal Enhanced Securities is concentrated to such a degree that some Excess Guarantees cannot be avoided.

Current trends suggest that the municipal Enhanced Security market will become more concentrated in the immediate future. Issuance of Enhanced Securities has declined sharply in recent years. Our data shows the principal amount of Enhanced Securities issued in 2013 as only half the amount issued in 2012. Moreover, the Volcker Rule and enhanced capital and liquidity requirements for banks have increased the cost of providing support for Enhanced Securities and created barriers for new entrants. These factors are likely to contribute to increasing concentrations of Enhancement Providers in the municipal money market.

The Memorandum's conclusion "that an increase in guarantor diversification would not necessarily lead to an overall deterioration in guarantor credit quality"[17] is moot if "an increase in guarantor diversification" cannot be achieved by municipal MMFs. Even were we to assume that diversification could be increased, however, the Memorandum's data shows that this would "lead to an overall deterioration in guarantor credit quality." The table on page 13 of the Memorandum shows that the Enhancement Provider with the lowest CDS spread (Wells Fargo & Co.) is already the third largest Enhancement Provider. If MMFs were forced to increase diversification by shifting assets from Wells Fargo to other Enhancement Providers shown in the table, this would necessarily increase the credit risks taken as measured by CDS spreads. The fifth largest Enhancement Provider (U.S. Bank N.A.) has the second lowest CDS spread. Moving assets from US Bancorp to Wells Fargo would reduce overall diversification, as would moving assets from the largest Enhancement Provider (JPMorgan Chase & Co.), which has the third lowest CDS spread. Therefore, reducing the exposure to these large Enhancement Providers could only be accomplished by increasing exposure to Enhancement Providers with higher CDS spreads, that is, by taking more credit risk.

Finally, the Memorandum ignores the potential for increased diversification to reduce liquidity. If, without a 25% basket, municipal MMFs cannot find enough Enhanced Securities to comply with Rule 2a-7's limits on guarantees and demand features, they would be forced to invest in securities without demand features. Demand features are the principal source of liquidity for municipal MMFs, as they allow MMFs to raise cash without incurring transaction costs or realizing gains and losses. A reduction in overall holdings of Enhanced Securities will therefore reduce the liquidity available to meet redemptions and thereby increase risks to shareholders.

In summary, Federated believes that the information available to the Commission, which confirms our original comments in opposition to elimination of the 25% basket, clearly shows that:

---

[16] Federated does not have access to historical supply information from Bloomberg. If the Commission continues to consider elimination of the 25% basket, we recommend that DERA work with Bloomberg to obtain a historical sampling of the supply of municipal Enhanced Securities from different Enhancement Providers over a longer period, rather than the one-day snap shot provided in this letter.

[17] Memorandum at 15.

1. Most municipal MMFs rely on the 25% basket on a regular basis, and the 25% basket is particularly important for single state funds.

2. Because most municipal MMFs use the 25% basket for two Enhancement Providers (or reserve room for a second Enhance Provider), the impact on diversification is small.[18]

3. Elimination of the 25% basket will reduce the credit quality of Enhancement Providers held by municipal MMFs.

4. Municipal MMFs reliance on the 25% basket reflects the concentration of Enhancement Providers in the market. Eliminating the 25% basket would therefore force municipal MMFs either to (a) invest in securities without demand features or guarantees, which are less liquid, or (b) go uninvested, which would reduce returns to investors.

In light of these facts, Federated cannot find any basis for concluding that elimination of the 25% basket would protect investors, or promote efficiency, competition, and capital formation.

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

Very truly yours,

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

[18] Imposing an absolute limit of 15% of total assets on exposures to any single Enhancement Provider would effectively force MMFs to use the 25% basket for two Enhancement Providers. However, it would also further complicate the already complex diversification requirements of Rule 2a-7.