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The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Money Market Fund Reform; Amendments to Form PF; File Number S7-03-13 – Data on Increase in Nonfinancial Commercial Paper

Dear Chair White:

We are writing on behalf of our client, Federated Investors, Inc. ("Federated"), to bring to the Securities and Exchange Commission's ("Commission's") attention recent data on commercial paper issuance relevant to the Commission's consideration of its money market mutual fund ("MMF") reform proposals. Nonfinancial commercial paper now greatly exceeds pre-crisis levels, and the amounts of commercial paper held by MMFs as a percentage of MMF assets has increased substantially in the intervening years. Much of this increase in nonfinancial firms' issuance of commercial paper has occurred after the close of the comment period on the Commission's MMF proposal in September 2013.

Both the Commission staff's 2012 study responding to questions posed by three Commissioners regarding MMF reform ("RSFI Study")[1] and the Financial Stability Oversight Council's ("FSOC's") *Proposed Recommendations Regarding Money Market Mutual Fund Reform* ("Proposed Recommendations")[2] suggested that commercial paper constituted an important source of short-term financing by financial organizations but

[1] Division of Risk, Strategy, and Financial Innovation, U.S. Securities and Exchange Commission, *Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher* (November 30, 2012), http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf ("RSFI Study").

[2] *Proposed Recommendations Regarding Money Market Mutual Fund Reform*, 77 Fed. Reg. 69455 (Nov. 19, 2012).

was less important for nonfinancial issuers.[3] The RSFI Study remarked on the decline in nonfinancial firms' use of commercial paper during the financial crisis, and ultimately limited its analysis of the reduction in the demand for money market instruments to the impact on the ability of financial institutions to borrow. Federated cautioned the Commission not to rely upon such a time-limited analysis, explaining in a comment letter that the RSFI Study was written at a time in the recent economic recovery when credit markets were particularly weak, and businesses were hesitant to expand through borrowing and as a result held high levels of cash.[4] Federated encouraged the Commission to take a broader view and recognize that MMF holdings would continue to contribute to growth when the economy gained strength.

The FSOC in its Proposed Recommendations further stated that "[m]ost of the short-term financing that MMFs provide to non-government entities is extended to financial firms."[5] On that basis, FSOC suggested that MMFs are extensively interconnected with financial firms, the financial system and the U.S. economy – justifying the FSOC's attempts to impose new restrictions on MMFs under the Dodd-Frank Act Section 120 process.[6]

But, as noted in a recent *Wall Street Journal* article, nonfinancial firms have begun borrowing short-term cash at the fastest rate in two years.[7] For the first time in two decades, nonfinancial firms now make up one quarter of the commercial paper market.[8] The return of nonfinancial commercial paper is borne out in Federal Reserve data. Indeed, the amount of seasonally adjusted nonfinancial paper outstanding as of

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[3] RSFI Study at 50 ("Given that the largest commercial paper exposure of money market funds is to financial institutions, a reduction in the demand of money market instruments may have an effect on the ability of financial institutions to issue commercial paper.").

[4] Letter from Federated to Commission (Jan. 7, 2013) (available in the comment file on Special Studies) (citing RSFI Study at Figure 18).

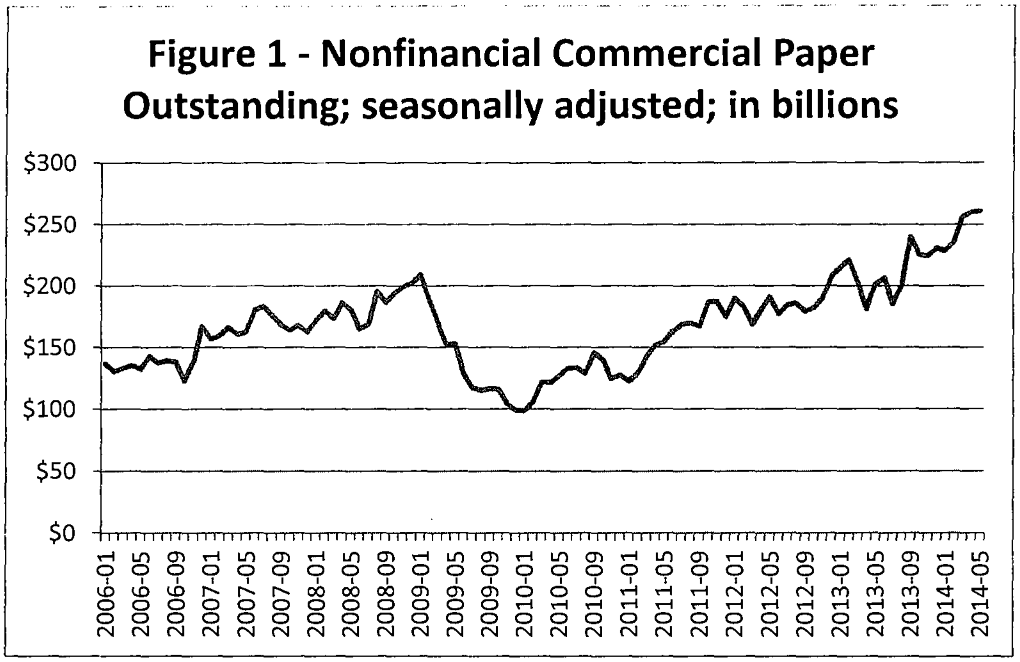
[5] Proposed Recommendations at 22.

[6] *Id.*

[7] The CFO Report, *Companies Feast on Short-Term Cash*, WALL ST. J., June 10, 2014.

[8] *Id.*

May 2014 exceeds pre-crisis levels by 39% as measured against September 2008 levels, which was not the case in 2012.[9] Figure 1 documents this growth.



Correspondingly, prime MMF holdings of nonfinancial commercial paper have also increased as the economic recovery has gained strength, nearly doubling from year-end 2010 (the earliest period for which data is publicly available) to May 2014, from 2.41 percent to 4.32 percent.[10] As of May 31, 2014, 23 percent of nonfinancial commercial paper was held by prime MMFs.[11] In addition to their holdings of commercial paper,

[9] Board of Governors of the Federal Reserve System, *Commercial Paper – Data Download Program* (last visited June 30, 2014), http://www.federalreserve.gov/datadownload/Choose.aspx?rel=CP (comparing the amount of seasonally adjusted nonfinancial commercial paper in May 2014 ($260.97 billion) to September 2008 ($186.77 billion)).

[10] Investment Company Institute, *Taxable Money Market Fund Portfolio Data Archive* (last visited June 30, 2014), http://www.ici.org/research/stats/mmfsummary/archive (comparing prime MMF holdings as of December 31, 2010 to May 31, 2014).

[11] Prime MMFs held $61 billion in nonfinancial commercial paper as of May 31, 2014, according to ICI data on holdings and overall prime MMF assets. Nonfinancial commercial paper totaled $260.97 billion as of May 2014, according to Federal Reserve data.

prime MMFs also provide funding to nonfinancial firms through the purchase of corporate notes. As of year-end 2013, corporate notes (exclusive of bank notes), constituted an additional 4.2% of prime MMF holdings.[12]

We and other commenters previously have objected to bank regulators' efforts to impose limitations on MMFs as a back-door attempt to limit short term borrowing by banking organizations – an effort that has serious collateral consequences for nonfinancial issuers and, in any event, is unnecessary, given the authority of bank regulators to address concerns about banking organizations directly.[13] We also have consistently argued that a dramatic reduction in prime MMF assets – which we are confident will occur if the Commission imposes a floating NAV requirement on prime institutional MMFs – will adversely affect access to and the cost of short-term financing for issuers of all types, including nonfinancial issuers. As we pointed out, banks have built-in cost inefficiencies that add 300 basis points or more to the cost of borrowing from a bank as compared to borrowing in the commercial paper markets.[14] The majority of issuers in the money markets are relatively small in size and are not well known, except to firms – primarily MMFs – that have specialized credit research departments. If prime MMFs are not in a position to invest, many of these issuers would lose direct access to the money markets altogether. Businesses would be forced to borrow from banks, at far higher interest rates and on less favorable terms than through issuances of nonfinancial commercial paper. This ultimately could slow the economic recovery just as private businesses are beginning to expand.

[12] Investment Company Institute, *2014 Investment Company Factbook* at Table 44 (May 14, 2014) http://www.ici.org/pdf/2014_factbook.pdf.

[13] Letter from Arnold & Porter LLP on behalf of Federated to Commission (Nov. 21, 2013). The federal banking agencies are able to regulate short-term borrowing by banks and bank holding companies directly, and have proposed to do so under the "liquidity coverage ratio" rules implementing Basle III. *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring*, 78 Fed. Reg. 71818 (Nov. 29, 2013).

[14] Letter from Arnold & Porter LLP on behalf of.Federated to Commission at 38-41 (Sept. 17, 2013) (available in File No. S7-03-13) (letter titled "Costs of Implementing the Proposals"). The disparity in rates between banks and commercial paper has grown even larger since our September 2013 analysis. As of July 8, 2014, the prime banking rate of 3.25 percent compares with nonfinancial commercial paper rates ranging from .06 to .10 basis points, according to Federal Reserve data. Board of Governors of the Federal Reserve System, *Selected Interest Rates (Daily) - H.15* (July 8, 2014), http://www.federalreserve.gov/releases/h15/update/.

In its deliberations over the economic effects of its rulemaking, including whether a rule will promote efficiency, competition, and capital formation,[15] the Commission must take a broad view of the importance of MMF funding to the nonfinancial commercial paper market. As major purchasers of nonfinancial commercial paper, MMFs play an important role in providing low cost financing to businesses as they expand, create jobs, and fuel economic growth. Adopting regulatory changes that would push assets out of prime MMFs and into banks, such as requiring that prime institutional MMFs use a floating NAV, would inhibit access by nonfinancial borrowers to this low cost source of financing and have a deleterious impact on economic efficiency, capital formation and competition. Such a result would contravene the Commission's obligation to consider whether its rules promote efficiency, competition and capital formation.

We thank you for considering our views. We would be happy to discuss them with you further.

Sincerely,

David F. Freeman, Jr.

[15] 15 U.S.C. § 80a-2.