Promontory
Interfinancial Network

Promontory Interfinancial Network, LLC
1515 North Courthouse Road
Suite 800
Arlington, Virginia 22201

T 703-292-3400
F 703-528-5700

www.promnetwork.com

September 8, 2009

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File Number S7-11-09

Dear Ms. Murphy:

This is in response to the request for comments by the Securities and Exchange Commission ("SEC") on the proposed reforms to money market fund ("MMF") regulations published in Investment Company Act Release No. 28807 (June 30, 2009) (the "Proposing Release").[1]

Promontory Interfinancial Network LLC ("Promontory") developed and operates a program, the Certificate of Deposit Account Registry Service®, or CDARS®, that permits investments in certificates of deposits ("CDs") issued by depository institutions ("banks") insured by the Federal Deposit Insurance Corporation ("FDIC"). Investors with funds whose deposits are in excess of the FDIC Standard Maximum Deposit Insurance Amount of $250,000 ("SMDIA") may have their funds placed in CDs through CDARS so that they can obtain full FDIC insurance on the total amount invested in CDs through CDARS – principal and accrued interest.[2] Since the FDIC was created in 1933 no depositor has lost a single penny in an FDIC-insured account.

We are submitting this comment letter because of our concern that one of the proposed amendments to Rule 2a-7 regarding investments in illiquid securities may have the effect of unnecessarily restricting MMF investments in FDIC-insured CDs. In particular, this proposal, if adopted, would remove a potential source of liquidity for smaller banks that offer FDIC-insured CDs through CDARS and similar arrangements, thus eliminating a fully-insured investment option for MMFs.

1. Background

CDs are time deposits issued by banks with principal payable at the maturity of the CD and interest payable either periodically or upon maturity. CDs may have any term

1 Money Market Fund Reform; Proposed Rule, 74 Fed. Reg. 32687 (July 8, 2009).

2 CDARS currently has approximately 2950 participating banks, which are primarily smaller banks with a median asset size of approximately $228 million. A depositor using CDARS can currently purchase $50 million or more in fully-insured CDs. A description of CDARS is included in FDIC Advisory Opinion--03-03 July 29, 2003, which is attached as Exhibit A.

greater than seven days. Like CDs offered directly to depositors by banks, the fully-insured CDs sold through CDARS are non-negotiable but have early withdrawal rights subject to an early withdrawal penalty, which is typically based on the amount of interest that would have been earned over the term of the CD.[3]

MMFs have historically purchased large denomination CDs (exceeding $1 million) issued by large, highly rated banks. These CDs are typically negotiable, and various broker-dealers make a market in these CDs. FDIC insurance would apply to only a small portion of the principal amount of these CDs.[4] Most of the principal and accrued interest thus remains exposed.

In the absence of CDARS and similar arrangements, MMFs would not be expected to invest in fully-insured CDs because of their relatively small denominations.[5] For example, in order to invest $10 million in insured CDs an MMF would need to contact more than 40 different banks to arrange for the purchase of enough CDs of less than $250,000 each to achieve full insurance of the $10 million investment. By placing the full $10 million through a single institution participating in CDARS, however, an MMF depositor could obtain FDIC insurance coverage on any amount up to $50 million or more in individual FDIC-insured CDs.

2. SEC Proposal Regarding Illiquid Securities

Rule 2a-7 or other SEC rules have not historically included provisions establishing liquidity standards. The SEC and its staff (the "Staff") have provided longstanding guidance that limits an MMF's investments in "illiquid securities" to 10 per cent of its assets (the 10% basket").[6] Under this guidance, an illiquid security is any instrument that cannot be disposed of in seven days without taking a reduced price. The SEC's rationale for this standard has been that illiquid securities could cause valuation and other portfolio management issues and affect the obligations of open-end investment companies ("Funds") under Section 22(e) of the Investment Company Act of 1940, as amended ("1940 Act"), to satisfy redemption requests in seven days. The SEC has stated that a Fund needs to maintain sufficient liquidity and limit its illiquid investments to meet its obligations under Section 22(e). The illiquidity standard for funds other than MMFs has varied but is currently 15%. The SEC has viewed

---

3 The penalty is uniform for CDs with the same maturities. The penalties for early withdrawal of 4 or 13 week CDs are equal to simple interest calculated at the CD rate for the total number of days in the full term. For a CD with a term of 26 weeks or longer, the penalty is equal to simple interest calculated at the CD rate for approximately half the number of days in the full term.

4 In December 2008, large denomination CDs constituted approximately 16% of MMF assets. Report of the Special Committee of the Investment Company Institute (March 2009).

5 There is an active market in retail smaller-denomination CDs maintained by broker-dealers. However, for practical reasons MMFs do not typically access this market.

6 As recently as July 2008, the SEC proposed to incorporate an express provision in Rule 2a-7 limiting MMF investments in illiquid securities to 10% of their total assets. Investment Company Act Release No. 28327 (July 1, 2008). This proposal and other amendments primarily related to nationally recognized statistical rating organizations have not been adopted by the SEC.

MMFs as having an additional obligation to monitor and limit illiquid investments beyond the MMF 10% illiquidity standard because they typically redeem securities on a daily basis.

In the context of proposing minimum daily and weekly liquidity requirements to address the liquidity risks that became apparent in the fall of 2008, the SEC has also proposed requiring MMFs to acquire only "liquid securities."[7] Liquid securities would be defined as those that can be sold or disposed of in the ordinary course of business within seven days at approximately their amortized cost.[8] This explicit requirement in Rule 2a-7 would replace the existing guidance permitting investments in illiquid securities. In the Proposing Release, the SEC stated that many MMF securities became illiquid during market events in the fall of 2008 and, therefore, it may be "imprudent" for MMFs to invest in securities that are already illiquid.

3. Discussion

Under the proposed amendment, investments in FDIC-insured CDs may be considered illiquid because they are likely to have maturities that are longer than seven days and cannot be sold or disposed of at their amortized cost because of early withdrawal penalties and the absence of a secondary market for these CDs. As we set forth below, we urge the SEC to recogn ize and clarify the distinction between fully-insured CDs – b y definition 100% backed by the federal government – and illiquid securities for the purposes of prohibiting investments in illiquid securities.

In the event that the SEC determines not to regard fully-insured CDs as liquid securities, we request that fully-insured CDs nevertheless be permitted investments for MMFs.

a. Fully-insured CDs Should Be Considered Liquid Securities.

Historically, the SEC's concerns about illiquid securities have related to restricted securities, which cannot be sold in the market because they are not registered under the Securities Act of 1933 (the "1933 Act").[9] In the SEC's view, restricted securities create valuation problems because they are securities for which no market quotations are available, requiring a fund's Board of Directors to determine a fair value. In addition, restricted securities are deemed to cause special problems for portfolio management because they cannot be sold or distributed to shareholders in an in-kind redemption. Investments in restricted securities could reduce a fund's flexibility to meet its obligations to satisfy redemption requests within seven days. Portfolio management could be affected because a fund could be required to sell unrestricted securities to meet redemption requests without reference to the investment merits of such investments.

FDIC-insured CDs purchased through CDARS do not present these problems. They are not required to be registered under the 1933 Act. It is not necessary to rely on

---

7 Proposed Rule 2a-7(c)(5). This proposal is in direct contrast with the proposal of just a year earlier, discussed above.

8 Proposed Rule 2a-7(a)(19).

9 *See* Investment Company Act Release No. 5847 (Oct.. 21, 1969); *see also* Investment Company Act Release No. 13380 (July 11, 1983).

market quotations to determine the value of a CD because an issuing bank has a contractual obligation to pay principal and interest at the maturity of a CD. For FDIC-insured CDs acquired using CDARS, this obligation is fully protected by the FDIC. A CD's value would not be determined by, or changed due to, market events. The liquidity of these CDs does not depend on finding a willing buyer, thereby avoiding the problems encountered by MMFs during the adverse market conditions in the fall of 2008. Since these CDs typically have short-term maturities, these investments would not generally affect an MMF's ability to satisfy redemption requests. This is particularly true if the SEC's proposals to require daily and weekly liquidity standards for MMFs are adopted, which would make it extremely unlikely that redemption requests would need to be satisfied from early terminations of investments in fully-insured CDs. Accordingly, we submit that the SEC's determination with respect to illiquid securities should not encompass investments in fully-insured CDs.

We also request that the SEC reconsider the Staff position in Western International Insurance Company (pub. avail. July 24, 1985) (the "Western Letter"), which concluded that FDIC-insured CDs are not "government securities."[10] In the Western Letter (which was not issued in the context of Rule 2a-7), the Staff concluded that FDIC insurance does not constitute a guarantee of principal or interest because it is not contingent on non-performance by the institution issuing the CD but rather on the failure of the institution. Since that letter, the supervisory and enforcement authorities of the FDIC have been strengthened by Congressional action, including the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA")[11] and the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").[12] FDIC insurance is widely acknowledged to be the equivalent of a U.S. government guarantee and is backed not only by the assets of the Deposit Insurance Fund, which is administered by the FDIC, but also by a $100 billion line of credit from the U.S. Treasury.[13] As stated before, no depositor has ever lost any funds that were insured by the FDIC. We urge that FDIC-insured CDs be considered "government securities" for the purposes of Rule 2a-7 and, as such, considered to be liquid securities.[14]

---

10 Under the 1940 Act, a "government security" is a security issued or guaranteed as to principal or interest by the U.S. Government or an instrumentality thereof. Section 2(a)(16) of the 1940 Act.

11 P.L. 101-73 (Aug. 9, 1989)

12 P.L. 102-242 (Dec. 9, 1991)

13 Indeed, Congress amended the Federal Deposit Insurance Act in 1989 to permit insured banks to display a sign stating that insured deposits are backed by the full faith and credit of the United States government. In the case of insured savings association, the statement was mandatory. (Section 221 of FIRREA.) Currently, both insured banks and insured savings associations are required to display an identical sign, which includes that statement. (Section 2(c)(2) of the Federal Deposit Insurance Reform Conforming Amendments Act of 2005, P.L. 109-173 (Feb. 15, 2006).) The borrowing authority of the FDIC was recently increased to $100 billion from $30 billion (and, on a temporary basis, up to $500 billion, with the approval of the Federal Reserve Board and the Secretary of the Treasury in consultation with the President). (Section 204(c) of the Helping Families Save Their Homes Act of 2009 (P.L. 111-22 (May 20, 2009).)

14 Characterizing FDIC-insured CDs as "government securities" would also have the effect of broadening the market for these CDs because government MMFs would have more flexibility to invest in them.

b. Even if FDIC-Insured CDs Are Not Considered Liquid Securities They Should Nevertheless Be Permitted Investments for MMFs.

An investment in an FDIC-insured CD is unarguably an eminently safe investment with no credit risk and cannot reasonably be characterized as imprudent. In fact, FDIC-insured CDs were viewed as safe havens in the fall of 2008. In the ensuing "flight to quality," total investments held in fully FDIC-insured CDs increased by 23.78% during the period from June 30, 2008 to December 31, 2008.[15] Total investments placed in FDIC-insured CDs through CDARS increased at a significantly greater rate, rising by 156.36% during the same period. If the SEC adopts the proposal regarding illiquid securities, this safe investment alternative would not be available to MMFs.

Moreover, many securities became illiquid and lost value due to market pressures during that period amid liquidation of MMF assets to meet redemption requests. These events would have had no effect on fully-insured CDs, which remained payable on maturity at their full principal amount plus interest regardless of market events.

Lastly, we also believe that the SEC has overlooked significant policy issues in potentially limiting investments in FDIC-insured CDs. The banks issuing the fully-insured CDs available through CDARS are smaller banks that do not participate in the large denomination CD market. CDARS and similar arrangements provide a source of liquidity for smaller banks. Limitations on MMF investments in FDIC-insured CDs would affect the availability of liquidity for smaller banks and have an adverse effect on these institutions. Permitting MMFs to invest in FDIC-insured CDs would have a positive effect on the competitive position of smaller banks by increasing their access to capital. Further, we see no justification for limitations on MMF managers that would have the effect of not allowing investments of a portion of MMF assets in safe, fully FDIC-insured CDs.

Section 2(b) of the 1940 Act requires the SEC to consider in any rulemaking whether its actions "will promote efficiency, competition, and capital formation". We therefore believe that the SEC should consider competitive and capital formation issues relating to smaller banks that issue FDIC-insured CDs. We urge the SEC explicitly to permit MMFs to invest in FDIC-insured CDs.

* * * **

We appreciate your consideration of our comments. If you need additional information, please do not hesitate to contact us.

Very truly yours,

Eugene A. Ludwig
Eugene A. Ludwig
Chairman

Alan Blinder
Vice Chairman

Mark P. Jacobsen
President & CEO

15 This information is derived from the 6/30/2008 and 12/31/08 Call Reports reflecting bank-reported totals of time deposits of less than $100,000.

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

EXHIBIT A

FDIC Law, Regulations, Related Acts

4000 - Advisory Opinions

Do "pass-through" deposit insurance rules apply to funds placed in the "Certificate of Deposit Account Registry Service"

FDIC--03-03 July 29, 2003 Joseph A. DiNuzzo, Counsel

This is in response to your request for an opinion on the FDIC deposit insurance coverage available for deposits purchased through a program sponsored by Promontory Interfinancial Network ("Network"). Entitled the "Certificate of Deposit Account Registry Service" ("CDARS"), the program is a deposit-placement service designed to allow FDIC-insured depository institutions to accept deposits of more than $100,000 and obtain full coverage for the depositor by spreading the funds among as many separate FDIC insured institutions as necessary so that no institution holds more than $100,000 (principal plus interest) for each depositor. Your view is that FDIC insurance would apply to all deposits placed through the CDARS program, assuming the program is operated as indicated in the materials enclosed with your letter.

The applicable materials you provided to us are marked "02/03 Version." The "Participating Institution Agreement" defines a *Participating Institution* as an institution participating in the CDARS program and indicates that a *Participating institution* may act from time to time in one or three capacities: a *Relationship Institution*--an institution that submits its depositors' funds for placement through CDARS and acts as custodian with respect to its depositors certificates of deposit ("CDs"); and *Issuing Institution*--an institution that issues CDs to depositors for funds placed with the *Participating Institution* through CDARS; and a *Surplus Institution*--an institution that on an order date is willing to accept time deposits in excess of the funds, if any, it has submitted for placement through CDARS on that order date.

"The CDARS Deposit Placement Agreement" provides the terms and conditions upon which the *Relationship Institution* will place a depositor's funds with other FDIC-insured institutions (*Issuing Institutions*) that have entered into similar contracts with the Network. The agreement states that the *Relationship Institution* will act as the depositor's agent in placing funds in CDs with the *Issuing Institutions.* It indicates that: the *Relationship Institution* will act as the depositor's custodian with respect to the CDs and has entered into an agreement with The Bank of New York ("BNY") to act as the *Relationship Institution's* sub-custodian with respect to the CDs for which the *Relationship Institution* is acting as the depositor's custodian; each CD for which the *Relationship Institution* is acting as the depositor's custodian will be recorded on the *Issuing Institution's* records in the name of the sub-custodian, BNY; the CD will be recorded on BNY's records in the *Relationship Institution's* name; and the CD will be recorded on the *Relationship Institution's* records in the depositor's name.

The Participating Institution Agreement contains these relevant disclosure and recordkeeping provisions:

Section 9.01 Recordkeeping for FDIC Purposes

As custodian for your Depositors, you will maintain, in accordance with applicable published requirements of the FDIC, a record of (i) the name, address, taxpayer identification number, and amount of the account of each Depositor for which CDs have been issued through CDARS and (ii) any representative capacity in which the Depositor may be acting.

Section 9.04 Recordation of CDs

Each CD that you issue will be established on your deposit account records in the name of "[Name of Sub-custodian], acting as agent for itself and others, each acting for itself and others," or in such other manner of recordation as may be approved from time to time by the FDIC to permit "pass-through" of deposit insurance to the beneficial owner of the CD.

The agreement between BNY (the sub-custodian) and the *Participating Institutions* specifies that the sub-custodian will:

2. Record each CD as issued by you [the issuing institution] in the name of "BNY, as agent for itself and others, each acting for itself and others" (or such other manner of recordation as may be approved from time to time by the FDIC to permit "pass-through" of deposit insurance) . . . . (Schedule A)

Discussion

Deposit insurance is provided under the Federal Deposit Insurance Act, as implemented by the FDIC's regulations, based on the rights and capacities in which deposits are held at FDIC-insured depository institutions. 12 U.S.C. § 1821(a) and 12 CFR Part 330. For deposits held by an agent for its principals at FDIC-insured institutions, such as in the CDARS program, deposit insurance is said to "pass-through" the holder of the account (the agent) to the owners of the funds (the principals). 12 CFR § 330.7. The same logic applies where an agent is acting for multiple owners/principals and where there are multiple levels of agency relationships. The FDIC's depository insurance regulations impose specific requirements for funds held in a fiduciary relationship. 12 CFR § 330.5(b) Essentially, as long as the institution's deposit account records indicate that the funds are held in an agency capacity and the institution's records, the agent's records or an authorized third-party's records, maintained in good faith and in the ordinary course of business, designate the ownership interest of the principal(s) in the account, the FDIC will insure the funds on a pass-through basis as if each principal had placed his or her respective funds directly with the applicable depository institution.

For deposits held in multi-tiered fiduciary relationships, such as in the CDARS program, special rules apply. One way to satisfy the disclosure and recordkeeping requirements is for the deposit account records of an insured institution to indicate the existence of each and every level of the fiduciary relationships and disclose at each level the names and interest of the person(s) on whose behalf the party at that level is acting. Another way is to: expressly indicate on the deposit account records of the insured institution that there are multiple levels of fiduciary relationships; disclose the existence of additional levels of fiduciary relationships in records by parties at subsequent levels; and disclose at each of the levels the names and interests of the persons on whose behalf the part at that level is acting. 12 CFR § 330.5(b)(3).

The CDARS program is a self-described deposit-placement service in which participating institutions act as agents for depositors in placing funds at other participating institutions. As specified in the above-quoted provisions of the applicable CDARS documents: (1) the *Issuing Institutions'* records will indicate that the deposits are being held by BNY "acting as agent for itself and others, each acting for itself and others"; (2) BNY's records will record each CD held by BNY as sub-custodian for the *Relationship Institution* as custodian for its depositors; and (3) the *Relationship Institution's* records (and/or an authorized third party's records) will contain the name, address and other identifying information of each depositor for which CDs are purchased through CDARS. This methodology conforms to the disclosure and recordkeeping requirements in section 330.5(b) of the FDIC's regulations. As such, the FDIC's requirements for agency pass-through deposit insurance coverage would be satisfied and, thus, the FDIC would regard each depositor/principal to be the insured party per participating institution for deposit insurance purposes.

As explained in the CDARS materials, please note that if the same depositor/principal also has an ownership interest in other deposits at the same *Issuing Institution*, those deposits would be added to his or her ownership interests in deposits (held in the same ownership capacity) placed through the CDARS system and insured in the aggregate to a limited of $100,000.

In summary, based on the CDARS information in the materials enclosed with your letter, we agree that deposits placed through the CDARS system would be insured on a pass-through basis under the FDIC's rules on the insurance coverage of agency or custodial accounts. For this coverage to be available, the recordkeeping and other applicable procedures specified in the materials would have to be followed. These views are based on the information contained in the version of the CDARS materials enclosed with your letter. Revisions to those documents on deposit ownership and recordkeeping may affect the deposit insurance coverage results. Also, this opinion addresses only the deposit insurance implications of the CDARS program. It is not intended to address any other legal or policy issues.

I hope this is fully responsive to your inquiry. Feel free to call me 202-898-7349 with any additional questions or comments.