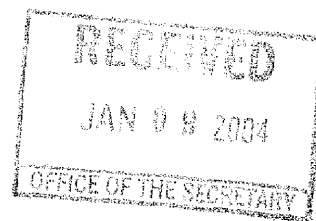




THE DREYFUS CORPORATION

J. Charles Cardona  
Vice Chairman



January 7, 2004

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549-0609

Re: SEC File 4-478, Request for Rulemaking to Amend Rules 15c3-1 and 15c3-3 Concerning Net Capital and Collateral Treatment of Broker-Dealers' Investment in Shares of Certain Registered Investment Companies, Submitted April 3, 2003

Dear Mr. Katz:

The Dreyfus Corporation ("Dreyfus")<sup>1</sup> submits this letter to the Securities and Exchange Commission ("SEC" or "Commission") in support of the above-referenced petition for rulemaking (the "Petition"). Dreyfus welcomes the opportunity to comment in support of proposed rule changes that, if adopted, would treat shares of money market mutual funds that comply with Rule 2a-7 under the Investment Company Act of 1940 ("Investment Company Act") and whose portfolios are limited to short-term U.S. Treasury securities ("Short-Term Treasury Money Funds") as the functional equivalent of (i) direct holdings of securities issued or guaranteed by the United States government or an agency thereof with maturities of less than three months ("government securities") or (ii) Loan Collateral (as defined below) for purposes of certain requirements under the SEC's net capital and customer protection rules ("Financial Responsibility Rules").

<sup>1</sup>

The Dreyfus Corporation, established in 1951 and headquartered in New York City, is one of the nation's leading mutual fund companies, currently managing approximately \$168 billion in more than 200 mutual fund portfolios nationwide as of September 30, 2003. Dreyfus is a wholly owned subsidiary of Mellon Financial Corporation (NYSE: MEL), a global financial services company. Headquartered in Pittsburgh, Mellon offers a comprehensive array of banking services for individuals and corporations and is one of the world's leading providers of asset management, trust, custody and benefits consulting services. Mellon has approximately \$2.6 trillion in assets under management, administration or custody, including approximately \$625 billion under management (as of September 30, 2003). Its asset management companies include The Dreyfus Corporation and Newton Investment Management Limited (U.K.).

200 PARK AVENUE  
NEW YORK, NY 10166

TEL: 212.922.6680

FAX: 212.922.6763

## **Dreyfus's U.S. Treasury Fund**

Dreyfus manages the Dreyfus 100% U.S. Treasury Money Market Fund (the "Fund"). The Fund is designed to provide investors with a vehicle for acquiring an undivided pro rata interest in a large portfolio comprised exclusively of short-term U.S. Treasury securities.<sup>2</sup> Like other money market mutual funds, the Fund seeks to maintain a stable \$1 net asset value per share by valuing its portfolio securities using the amortized cost method in reliance on Rule 2a-7 under the Investment Company Act. This rule requires, among other things, that the portfolio maintain a dollar-weighted average maturity of 90 days or less, and prohibits the portfolio from investing in any security maturing in more than 397 days.<sup>3</sup> By limiting the average maturity of the portfolio, Rule 2a-7 limits a money market fund's possible exposure to interest rate risk.

Credit risk exposure is minimized by limiting portfolio investments to Treasury securities, which present minimal credit risk because they are guaranteed by the United States government. Like the underlying portfolio securities themselves, shares of the Fund provide daily liquidity for investors. Investors may purchase or redeem shares of the Fund on any day the New York Stock Exchange is open, with payment upon redemption typically occurring the same day. The Fund has maintained a stable net asset value of \$1.00 per share since its inception in March, 1987.

The Fund fits precisely the criteria described in the Petition for the type of Short-Term Treasury Money Fund that we believe the Commission should recognize as a safe and efficient alternative to direct investments in government securities.

## **Treatment of Short-Term Treasury Money Funds Under the Financial Responsibility Rules**

SEC Rule 15c3-1 ("Net Capital Rule") and SEC Rule 15c3-3 ("Customer Protection Rule") prescribe financial responsibility requirements of general applicability to broker-dealers. Under these rules, Short-Term Treasury Money Funds are not currently treated as the functional equivalent of direct holdings of U.S. government securities. For the reasons discussed below, we strongly urge the Commission to adopt the rule changes proposed in the Petition to accord Short-Term Treasury Money Funds the same treatment under the Financial Responsibility Rules as is accorded to direct holdings of U.S. government securities.

---

<sup>2</sup> Unlike some other money market mutual funds, the Fund does not invest in commercial paper, bank notes, or other short-term debt instruments. Portfolios that include these instruments may incur credit risks not present in the case of the Fund or similar funds that invest exclusively in short-term Treasury securities or in a combination of short-term treasuries and repurchase agreements collateralized fully by Treasury securities.

<sup>3</sup> The Fund's average portfolio maturity (as of 11/30/03) was 87.0 Days.

### *Net Capital Rule*

In determining net capital requirements, broker-dealers make various adjustments to net worth, including "haircuts." Haircuts are reductions in the market value of securities positions carried by the broker-dealer and therefore deductions from net worth. The percentage required to be deducted varies according to the level of risk involved in carrying particular securities positions, such as market risk, credit risk, and other risks. Discounting the value of proprietary positions reflects the relative liquidity or illiquidity of certain securities positions and provides a capital cushion in case the value of a broker-dealer's positions declines.

Haircuts for Category I short term government securities range from 0% (for maturities less than three months) to 1% (for maturities less than 12 months) of the market value of the broker-dealer's net long or short position in the category,<sup>4</sup> whereas the minimum haircut for a "liquid asset fund" such as a money market fund<sup>5</sup> is two percent of the market value of the greater of the broker-dealer's long or short position in the fund.<sup>6</sup> Thus, a broker-dealer's position in a Short-Term Treasury Money Fund composed entirely of Category I government securities<sup>7</sup> is subject to a two percent haircut for purposes of computing net capital, whereas a broker-dealer's position in individual government securities of the same maturity is subject to a haircut range of 0% - 1% haircut. As a result, for purposes of satisfying net capital requirements, broker-dealers would have a strong disincentive from maintaining positions in Short-Term Treasury Money Funds.

Another adjustment to net worth in determining net capital relates to subordinated liabilities under a satisfactory subordination agreement. A broker-dealer may borrow cash pursuant to a subordination agreement to satisfy net capital requirements. The subordination agreement may be either a "subordinated loan agreement" or a "secured demand note agreement."<sup>8</sup> The collateral value of securities pledged to secure a demand note agreement is the market value of the securities *after* applying the appropriate haircuts in the Net Capital Rule.<sup>9</sup> Again, as a result, a haircut for a Short-Term Treasury Money Fund that invests in Category I government securities is higher than the haircut for the individual securities, and a broker-dealer would need

<sup>4</sup> Exchange Act Rule 15c3-1(c)(2)(vi)(A)(I).

<sup>5</sup> A money market fund is defined in the Investment Company Act generally as a registered investment company whose portfolio (i) contains securities of short term maturity, (ii) contains securities that present minimal credit risk, and (iii) is diversified. See Investment Company Act Rules 2a-7(b)(1) and 2a-7(c)(2), 2a-7(c)(3) and 2a-7(c)(4).

<sup>6</sup> Exchange Act Rule 15c3-1(c)(2)(vi)(D)(I).

<sup>7</sup> Money market funds containing short-term instruments may contain a variety of such instruments and not be composed solely of government securities.

<sup>8</sup> Exchange Act Rule 15c3-1d(a)(2)(i) and (ii).

<sup>9</sup> Exchange Act Rule 15c3-1d(a)(2)(iii).

to pledge Short-Term Treasury Money Fund shares in an amount greater than the value of directly-held government securities in order to secure the same benefit under a secured demand note subordination agreement.

We believe that the SEC should remove the disincentives inherent in the structure of the Net Capital Rule from using Short-Term Treasury Money Funds as the functional equivalent of directly-held government securities. Accordingly, we support the Petition's proposed rule changes in this regard to: (i) add new subparagraph (c)(13) to SEC Rule 15c3-1 to add a definition of "Designated Fund" to apply to Short-Term Treasury Money Funds. (ii) add new subparagraph (c)(2)(vi)(D)(1) to Sec Rule 15c3-1 (and renumber current subparagraphs (c)(2)(vi)(D)(1)-(3) accordingly)<sup>10</sup> to clarify that a "Designated Fund" will have no haircut under the Net Capital Rule.<sup>11</sup>

#### *Customer Protection Rule*

The Customer Protection Rule prevents misuse of customer securities and funds to finance the broker-dealers' own speculative activities by requiring broker-dealers to maintain possession or control of fully-paid and excess margin securities in customer accounts and to segregate customer cash balances.

The Customer Protection Rule currently permits broker-dealers to borrow customers' fully paid or excess margin securities only if the loan is fully collateralized with the types of collateral specified in the Rule, which include only cash, U.S. Treasury bills and notes, or irrevocable letters of credit issued by a bank ("Collateral").<sup>12</sup> Short-Term Treasury Money Funds currently are not permissible Loan Collateral under the Customer Protection Rule.

As the Petition notes, the Commission intends to issue an order designating as new categories of Collateral: (i) "government securities" as defined in Sections 3(a)(42)(A) and (B) of the Exchange 1934 Act; (ii) certain "government securities" meeting the definition in Section 3(a)(42)(C) of the 1934 Act; (iii) securities issued or guaranteed by certain Multilateral Development banks; (iv) "mortgage related securities" as defined in Section 3(a)(41) of the 1934 Act; (v) certain negotiable certificates of deposit and bankers acceptances; (vi) foreign sovereign

---

<sup>10</sup> We note that the Petition incorrectly proposes to add new paragraph (c)(2)(v)(i)(D)(1) to Rule 15c3-1 (emphasis added); the correct rule reference would be to add new paragraph (c)(2)(vi)(D)(1) to Rule 15c3-1 (emphasis added).

<sup>11</sup> We recognize that a "Designated Fund," because of the dollar-weighted averaging requirements of Investment Company Act Rule 2a-7, could contain government securities that, if purchased individually, would be subject to a haircut of greater than zero under the Net Capital Rule. However, the additional market risk for these slightly longer term government securities that justifies the increased haircut is ameliorated when such securities are pooled in the Designated Fund with other government securities, most of which will be short-term (three months or less) in order to meet the Rule 2a-7 average portfolio average maturity requirement of 90 days or less.

<sup>12</sup> Exchange Act Rule 15c3-3(b)(3)(iii)(A).

debt securities; (vii) foreign currency; and (viii) certain corporate debt securities (collectively with "Collateral," "Loan Collateral").<sup>13</sup>

We believe that Short-Term Treasury Money Funds should also be regarded as appropriate Loan Collateral based on the factors the Commission intends to employ in designating by order new categories of Collateral, namely, the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness.<sup>14</sup> In the issuance of such orders, the Commission intends to "weight" these factors on a case-by-case-basis based on the particular category and purpose of the of collateral.<sup>15</sup> This suggests that, for example, exceptional liquidity and market depth could sufficiently compensate for excessive volatility in determining the appropriateness of the new categories as collateral under specific circumstances. We believe that the application of such weighting to Short-Term Treasury Money Funds would show such Funds to be comparable to the safety, stability and liquidity of direct investments in U.S. government securities and, in that regard, superior in certain respects to the new categories of Loan Collateral identified by the Commission. Accordingly, we support the Petition's proposed rule change in this regard to add Short-Term Government Treasury Funds to permissible Collateral in Exchange Act Rule 15c3-3(b)(3)(iii)(A) to clarify that such Funds can be used as Loan Collateral.

The Customer Protection Rule also requires a broker-dealer to establish a "Special Reserve Bank Account for the Exclusive Benefit of Customers" (the "Special Reserve Bank Account") and must maintain in the Special Reserve Bank Account cash and/or qualified securities in an amount not less than the amount of its reserve requirement.<sup>16</sup> The reserve requirement is calculated weekly,<sup>17</sup> as of the last business day of the week, according to the formula included in the Customer Protection Rule.<sup>18</sup> If a broker-dealer's credits (customer monies or monies obtained from the use of customer securities) exceed its debits (monies owed to the broker-dealer by customers or by other brokers or dealers relating to customer transactions), then the broker-dealer must deposit the excess to the Special Reserve Bank Account no later than one hour after

---

<sup>13</sup> Petition at notes 12-15, citing to *Proposed Rule: Customer Protection--Reserves and Custody of Securities*, Securities Exchange Act Rel. No. 26019 (June 3, 2002) ("Proposing Release"), 67 FR 39642 (June 10, 2002); and *Final Rule: Customer Protection--Reserves and Custody of Securities*, Securities Exchange Act Rel. No. 47480 (March 11, 2003), 68 FR 12779, 12780 (March 17, 2003) ("Adopting Release").

<sup>14</sup> Exchange Act Rule 15c3-3(b)(3)(iii)(B). In the Proposing Release, the Commission stated that the weight given to these factors will vary on a case-by-case basis, depending on the specific use of the collateral and that some of the permissible categories may not be appropriate collateral in all circumstances.

<sup>15</sup> See Proposing Release.

<sup>16</sup> Exchange Act Rule 15c3-3(e)(1).

<sup>17</sup> The Customer Protection Rule provides that certain broker-dealers may make the reserve requirement calculation on a monthly basis. See Rule 15c3-3(e)(3).

<sup>18</sup> Exchange Act Rule 15c3-3(e)(3). See also Exhibit A to Rule 15c3-3, *Formula for Determination of Reserve Requirement for Brokers and Dealers under Rule 15c3-3*.

the opening of banking business on the second business day following the computation.<sup>19</sup> If the debits exceed the credits, no deposit is necessary.

As noted above, a broker-dealer may deposit individual U.S. government securities, but not shares of Short-Term Treasury Money Funds, in its Special Reserve Bank Account in order to satisfy its reserve requirement. We believe, as discussed more fully below, that investment in shares of such Money Funds provide a degree of safety, stability and liquidity comparable to direct investments in U.S. Treasury securities. Accordingly, we support the Petition's proposed rule change in this regard to add Short-Term Treasury Money Funds to the definition of "qualified security" in SEC Rule 15c3-3(a)(6) to clarify that such Money Funds can be used to fund the Special Reserve Bank Account.

### **Prior Recognition of Short-Term Treasury Money Funds and Similar Products**

Exhibit B to the Petition describes in detail how Short-Term Treasury Money Funds and similar products are now used in a wide variety of circumstances as an effective alternative to direct investment in U.S. government securities. Federal courts, state legislatures, and Federal and state regulators have recognized investments in shares of Short-Term Treasury Money Funds and similar products as the functional equivalent of investing directly in U.S. government securities. Examples of such circumstances include investment of the assets of national banks (OCC), state-chartered banks (Federal Reserve and FDIC), and federal credit unions (NCUA); customer funds held in custody by futures commission merchants and futures clearing organizations (CFTC); margin collateral (Board of Trade Clearing Corp., New York Mercantile Exchange, Chicago Mercantile Exchange, and Options Clearing Corp.); assets of state and municipal entities, assets subject to trust indentures, and trust and other fiduciary assets.

The treatment accorded holdings of shares of Short-Term Treasury Money Funds and similar products in these circumstances recognizes that such funds offer a highly efficient and convenient mechanism for investing in government securities, with safety of principal and daily liquidity comparable to that which they would achieve were they to invest in such securities directly. Permitting such indirect investment in U.S. government securities, as a functional equivalent of direct investment, has proven to be entirely consistent with the "safety and soundness" and other important policy objectives contemplated in laws and regulations that expressly permit or require investment in government securities.

### **Safety and Soundness of Money Market Funds**

Both retail and institutional investors have long accepted money market funds as an acceptable and safe alternative to individual securities and the functional equivalent of ready cash. The Petition convincingly articulates the key reasons for supporting the proposed rule changes sought, including the protections imposed on money market funds by the restrictive provisions of

---

<sup>19</sup> Exchange Act Rule 15c3-3(e)(3).

Rule 2a-7 and the historical record for the safety and dependability of money market funds, particularly short-term Treasury-only money market funds.

Rule 2a-7 minimizes possible deviation between a money market fund's share price and the market value of its portfolio by imposing conditions for portfolio diversification, quality and maturity, all of which are designed to limit exposure to interest rate (market) risk, liquidity risk, and credit risk. With respect to diversification, the requirements limiting exposure to the credit risk of any single issuer do not even apply to a money market fund's holdings of government securities, since they present virtually no significant credit risk, regardless of the length of maturity of the government security.<sup>20</sup> With respect to quality, money market funds may purchase only securities that pose minimal credit risk and are "Eligible Securities," which are generally defined as, among other things, securities rated in one of the highest two short-term rating categories by an appropriate national statistical rating organization. With respect to maturity, a money market fund may not acquire any instrument with a remaining maturity greater than 397 calendar days,<sup>21</sup> and may not maintain a dollar-weighted average portfolio maturity of more than 90 days.<sup>22</sup>

The historical circumstances under which money market funds have experienced tension between share price and the underlying portfolio market value are rare. The overwhelming majority of general-purpose money market funds have never invested in any money market instrument that did not pay off at maturity. With respect to Treasury-only money market funds, these circumstances are nonexistent: no adviser to such a fund has ever been required to purchase a portfolio security from the fund to preserve the fund's \$1.00 share price, primarily because such funds invest only in instruments backed by the full faith and credit of the United States government.<sup>23</sup>

Thus, as Petitioner notes, while Rule 2a-7 operates to minimize interest rate, credit or liquidity risk in all money market funds, these risks are minimized still further in the context of Short-Term Treasury Money Fund since they could not invest in any obligation not backed by the full faith and credit of the United States government. The conditions that a money market fund must satisfy to meet the definition of a Short-Term Treasury Money Fund should allay any fears that investments in such Funds do not entail the same minimal (or virtually non-existent) market, credit, liquidity, or operational risk as direct investments in government securities..<sup>24</sup>

---

<sup>20</sup> Investment Company Act Rule 2a-7(c)(4)(i).

<sup>21</sup> Investment Company Act Rule 2a-7(a)(10).

<sup>22</sup> Investment Company Act Rule 2a-7(c)(2)(iii).

<sup>23</sup> Petition at notes 59-60.

<sup>24</sup> *Id.*

Finally, we believe the Petition correctly notes that the proposed rule changes would facilitate access to the Treasury securities market by smaller broker-dealers and other institutions that do not have the same direct access to the over-the-counter government securities markets as do primary dealers. Smaller institutions must utilize intermediaries to purchase and sell Treasury securities, which results in increased transaction costs. The use of Short-Term Treasury Money Funds would relieve the smaller firms as well as the intermediaries of the administrative burdens and costs associated with the acquisition, retention and disposition of individual Treasury securities.

### **Conclusion**

We recognize the importance of the Financial Responsibility Rules and the key role they play in maintaining the financial soundness and accountability of broker-dealers. However, as has been demonstrated in other contexts, investments in shares of Short-Term Treasury Money Funds provide a degree of safety, stability and liquidity comparable to direct investments in U.S. government securities. Authorizing investment in shares of such funds on the same terms as direct investments in U.S. government securities or Loan Collateral entails no material additional risk, and will provide greater efficiencies to broker-dealers in managing their positions in satisfaction of the requirements of the Financial Responsibility Rules. The fact that a Short-Term Treasury Money Fund has no maturity, minimal risks, and offers the ability to effect seamless purchases and sales of exact dollar amounts, makes it in fact a superior alternative to the direct purchase of a Treasury bill.

Short-Term Treasury Money Funds have been widely approved by financial regulators, self-regulatory organizations and state legislatures as a safe and efficient alternative to direct investments in Treasury securities. We believe the Commission also should approve them as functional equivalents for purposes of the Financial Responsibility Rules. If you should have any questions regarding this letter of support, please do not hesitate to contact me.

Sincerely,



J. Charles Cardona  
Vice Chairman  
The Dreyfus Corporation

cc:

Paul F. Roye, Director, Division of Investment Management

Robert E. Plaze, Associate Director, Division of Investment Management

Michael A. Macchiaroli, Associate Director, Division of Market Regulation



