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Via www.regulations.gov

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Robert Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Notice of Proposed Rulemaking Regarding Resolution Plans and Credit Exposure Reports Required; 12 C.F.R. Part 225, Regulation Y; Docket No. R–1414; RIN 7100–AD73; 12 C.F.R. Part 381, RIN 3063-AD77

Dear Ladies and Gentlemen:

Introduction

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries ("Federated"), to provide comments in response to the joint Board of Governors of the Federal Reserve System's ("Board's") and Federal Deposit Insurance Corporation's ("FDIC's") Notice of Proposed Rulemaking Regarding Resolution Plans and Credit Reports Required ("Joint NPR").[1] Federated has served since 1974 as an investment adviser to money market mutual

[1] Board of Governors of the Federal Reserve System and FDIC, *Notice of Proposed Rulemaking and Request for Comment Regarding Resolution Plans and Credit Exposure Reports Required*, 76 Fed. Reg. 22648 (Apr. 22, 2011).

funds ("Money Funds").[2] We appreciate the opportunity to assist the Board and FDIC as they consider the regulatory framework for resolution plans and credit exposure reports proposed in the Joint NPR.

Federated, as a participant in the money markets and a sponsor of Money Funds, is interested in many of the details of the Joint NPR and related rulemakings specifying processes for designation and liquidation of financial firms. As an investor and creditor of financial issuers, we are concerned that certain aspects of Titles I and II, the implementing rules, and the way in which they will be interpreted and applied, will increase uncertainty, risk and volatility in the money markets and other fixed income markets, particularly in times of crisis. This letter also addresses fundamental issues regarding the designation of nonbank financial firms under Titles I and II which is a predicate to the application of the regulation contemplated by the Joint NPR.

The Joint NPR is part of an intertwined series of rulemakings by the Board, the Financial Stability Oversight Council ("Council") and the FDIC to implement Titles I and II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").[3] The Board and the FDIC are both represented on the Council, along with other federal and state financial regulators and industry experts.

The Joint NPR requests comments on a joint Board and FDIC rulemaking proposal to implement Section 165(d) of the DFA[4] by requiring each financial firm designated under Title I of the DFA to submit and obtain regulatory approval for a detailed resolution plan, to be used in connection with liquidations conducted by the FDIC under Title II. The plan must include both a

[2] Federated has more than thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement for Federated's Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

[3] Pub. L. No. 111-203, 124 Stat. 1376 (2010). These intertwined rulemakings also include: Financial Stability Oversight Council, *Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 4555 (Jan. 26, 2011); FDIC, *Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 C.F.R. pt. 380, 76 Fed. Reg. 16324-02 (Mar. 23, 2011), FDIC, *Notice of Interim Final Rulemaking Regarding Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 CFR pt. 380, 76 Fed. Reg. 4207 (Jan. 25, 2011) ("NIFR"), and Board, *Proposed Rule: Definitions of ''Predominantly Engaged in Financial Activities'' and ''Significant'' Nonbank Financial Company and Bank Holding Company*, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

[4] Codified at 12 U.S.C. § 5365(d) (2010).

plan for the rapid and orderly resolution of the covered company in the event of financial distress or failure of the company, and a report on the nature and extent of material credit exposure to other major financial companies and the nature and extent to which other major financial companies have material financial exposure to the company submitting the plan.

The resolution plan (referred to in the Joint NPR as a "living will") and report are required by statute to cover the following areas in detail:

- the manner and extent to which any insured bank affiliated with the company is protected from risks arising from the activities of any nonbank subsidiaries of the company;
- the ownership structure, assets, liabilities, and contractual obligations of the company;
- identification of the cross-guarantees tied to different securities;
- identification of major counterparties;
- the process for determining to whom the collateral of the company is pledged; and
- any other information that the Board and the Corporation jointly require by rule or order.

The proposed rule would require in addition:

- an analysis of how the company can be resolved under the Bankruptcy Code in a way that would not pose systemic risk to the financial system;
- a map of the company's business lines to material legal entities;
- an analysis of its corporate structure, credit and other exposures, funding, capital and cash flows; the domestic and foreign jurisdictions in which it operates, and its supporting information systems for core business lines and critical operations.

The FDIC and Federal Reserve estimate that a covered institution will need to devote approximately 12,400 hours to creating and obtaining approval of the initial resolution plan, and approximately 2,881 hours annually in the maintenance of the resolution plan.[5] This hours estimate gives a good idea of the level of detail, information gathering and analysis that will be required to prepare an acceptable resolution plan and credit exposure report.

But the resolution plan is not simply a document prepared by the company and filed with the regulators. It is an interactive process through which the regulators will review the resolution plan and may reject and require changes to the plan, and thus to the structure, assets, balance sheet, activities and operations of the company. In the event that a company does not adequately

[5] 76 Fed. Reg. at 22654.

address the deficiencies found by the Board and FDIC in the resolution plan, the proposed rule specifies that the Board and FDIC may jointly subject the company to more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations.[6]

The Joint NPR requests comments on a number of questions. Our comments focus on two of those questions. Under the heading of "Definitions," the Joint NPR asks: "[w]hat terms defined by the proposal require further clarification and how should they be defined?" For the reasons discussed more fully below, we respectfully suggest that the term "Covered Company" be defined so as specifically to acknowledge that Money Funds are not within the term and are not subject to designation under Titles I, II or otherwise required to submit a resolution plan or credit exposure report and have those documents approved by the Board or the FDIC.

Similarly, under the heading of "Governance," the Joint NPR asks: "[w]hat alternative governance requirements might exist that would ensure that a Covered Company places adequate importance and attention on resolution planning?" As discussed more fully below, the governance, regulatory oversight, and reporting requirements applicable to Money Funds under the Investment Company Act and rules of the U.S. Securities and Exchange Commission ("SEC") ensure that a Money Fund will devote ongoing and detailed attention and efforts to these issues and place more than adequate importance and attention to resolution planning.

Discussion

The requirement that a covered financial company submit and have approved by the Board and FDIC a resolution plan serves two basic regulatory purposes. First, the Board and FDIC can use the approval process effectively to require a firm to reduce the complexity, leverage, and risk in its operations, and increase capital ratios and liquidity, in order to get the plan approved. Second, the resolution plan serves as a roadmap to assist the FDIC as receiver in understanding and quickly implementing a plan to resolve the company should it be at risk of insolvency.

Neither purpose justifies the imposition on a Money Fund of a resolution plan process under Board and FDIC auspices. As discussed below, Money Funds do not have a complex structure. A Money Fund is simply an investment pool that holds short-term high quality, marketable fixed income instruments, with a readily available asset value. Money Funds are entirely transparent. There are no holding companies, foreign affiliates, off-balance sheet structures or complex structures of any kind allowed within a Money Fund. Money Funds do not

[6] 76 Fed. Reg. 22648 at 22652 (Apr. 22, 2011).

use leverage or other forms of borrowing to any material degree. Money Funds do not have concentrated exposures to other companies. They do not have complex capital structures. Money Fund balance sheets are all simple common equity essentially of one class. Money Fund capital ratios are 100% equity, and they hold only high quality, liquid assets. If the fund manager does not continue to reinvest the portfolio, a Money Fund converts to cash in very short order through the customary maturity of its portfolio of assets. All of this is dictated by the Investment Company Act and rules of the SEC that apply to Money Funds.

Money Funds and the SEC over the past 40 years have worked through in detail the issues of maintaining liquidity and asset values in the absence of a federal safety net. These are exactly the type of issues with which the banking regulators are now struggling under the DFA. Money Funds and the SEC have come at this problem from a very different direction and used a much simpler approach than have the banks and their regulators over this period: do not use leverage, only equity, and invest only in short-term, high-quality, liquid debt instruments. That is why, over four decades and through many business cycles, only two Money Funds have ever “broken the buck” (one returning 96 cents on the dollar to investors and the other over 99 cents on the dollar to investors, and no loss to the federal government), while over the same period over 2800 banks have failed at a cost to the federal government in excess of $164 billion.

(1) Money Funds Are Financed By Equity, Not Debt, and Cannot Default in the Way Contemplated by Title II of DFA

The resolution plans required by the Joint NPR will be required of financial companies designated as systemically important under Title I of DFA, in preparation for a potential FDIC receivership and liquidation under Title II. However, the basis for conducting an FDIC resolution under a resolution plan, as specified in the statute and described in the Proposing Release, will not exist for Money Funds. Money Funds do not borrow money or rely on leverage. Money Funds are financed 100% by equity. Shareholders do not have a right to the payment of $1.00 per share. Instead, Money Fund shareholders have a right to the return of their pro-rata portion of the net asset value of the Money Fund upon redemption. If a Money Fund "breaks a buck" and falls below $1.00 per share, the Money Fund has not defaulted on an obligation or breached a contractual right of shareholders. "Breaking the buck" is an occasion for unhappiness, but it is not an insolvency. Money fund shareholders are not creditors. The statutory "hook" for resolution by the FDIC under Title II is simply not triggered.

The central criteria in triggering a receivership under Section 203(a) of the DFA through a recommendation by the Board and the FDIC for a designation under Title II, as well as the determinations that must be made by the Secretary of Treasury under Section 203(b), are premised on a default or potential default by a financial company on its debt obligations. The terms “default or in danger of default” are defined in Section 203(c)(4) in a way that could not reasonably be triggered in the context of a company, such as a Money Fund, that has only equity capital and no material debt, and thus has no debt or other obligations that it could default on. As defined in Section 203(c)(4) of the DFA, a financial company may be considered to be in default or in danger of default if:

> (A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;
>
> (B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
>
> (C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or
>
> (D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

The Joint NPR similarly defines “material financial distress” (the event which triggers the resolution plan being actually used) with regard to a Covered Company to mean that:

> (i) The Covered Company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion; (ii) the assets of the Covered Company are, or are likely to be, less than its obligations to creditors and others; or (iii) the Covered Company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.[7]

None of these statutory or proposed regulatory conditions to a resolution plan actually being used can exist at a Money Fund, because a Money Fund (i) is financed entirely by equity capital, (ii) does not use debt or other forms of leverage or derivatives to a significant degree and thus does not have significant obligations to creditors and others, and (iii) since it has no material debts or similar obligations and is financed entirely by equity capital, it cannot be in a situation where it is unable to pay its obligations in the normal course of business.

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[7] 78 Fed. Reg. at 22649.

If the statutory and regulatory conditions requiring the use of a resolution plan cannot realistically exist at a Money Fund, it makes no sense to require Money Funds to prepare a resolution plan, and have it reviewed and approved by the Board and FDIC.

(2) Money Funds By Nature Are Self-Liquidating Because They Hold Only Short-Term, High Quality Debt Instruments with an Average Maturity of 60 Days or Less

It does not take an elaborate roadmap to understand and figure out how to liquidate a Money Fund. Money Fund balance sheets are filed with the SEC and available to the public online. If there is a need to liquidate a Money Fund, the fund manager can simply wait for the portfolio assets to repay at maturity. Due to the very short weighted average maturity of a Money Fund's Portfolio mandated by SEC rules, most of the assets will be fully repaid in cash in very short order. In the alternative, some or all of the portfolio assets can be sold into the open market for cash. Or, some assets can be held to maturity and others sold. This is not very complicated, and does not justify a separate plan for every Money Fund requiring 12,400 hours to develop and 2,881 hours per year to update, as is contemplated by the Joint NPR.

The liquidity of Money Funds is dictated by SEC rules, including Rule 2a-7 under the Investment Company Act.[8] Money Funds are allowed to invest only in short-term, high-quality debt. Rule 2a-7 and related SEC rules impose requirements on Money Funds in the following areas:

Liquidity Matching of Portfolio Maturities to Cash Needs for Redemptions. Under the 2010 amendments to Rule 2a-7--promulgated in large part in response to the financial crisis-- a Money Fund is required to have a minimum percentage of its assets in highly liquid securities so that it can meet reasonably foreseeable shareholder redemptions.[9] Under new minimum daily liquidity requirements applicable to all taxable Money Funds, at least 10 percent of the assets in the fund must be in cash, U.S. Treasury securities, or securities that convert into cash (*e.g.*, mature) within one business day. In addition, under a new weekly requirement applicable to all Money Funds, at least 30 percent of assets must be in cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, or securities that

[8] *See* 17 C.F.R. § 270.2a-7.

[9] Depending upon the volatility of the fund's cash flows (in particular shareholder redemptions), a fund may be required to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements set forth in Rule 2a-7. *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

convert into cash within five business days. No more than 5 percent of a fund's portfolio may be "illiquid" (i.e., cannot be sold or disposed of within seven days at carrying value).

High Credit Quality. Rule 2a-7 limits a Money Fund to investing in securities that are, at the time of their acquisition, "Eligible Securities." "Eligible Securities" include a security with a remaining maturity of 397 calendar days or less, that meet stringent credit quality standards dictated by the rule.[10] Under the 2010 amendments, 97% of a Money Fund's assets must be invested in "First Tier Securities."[11] Only 3 percent of its assets may be held in lower quality, "Second Tier Securities."[12] In addition, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer (rather than the previous limit of the greater of 1 percent or $1 million). Under the 2010 amendments, a Money Fund also is prohibited from purchasing "Second Tier Securities" that mature in more than 45 days (rather than the previous limit of 397 days). As required by the DFA, the SEC has proposed to remove the references to NRSRO ratings and replace them with equivalent high credit quality determinations by the fund board or its designee.[13]

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[10] Under Rule 2a-7(a)(12), if only one designated NRSRO has rated a security, it will be considered a rated security if it is rated within one of the rating agency's two highest short-term rating categories. Under certain conditions, a security that is subject to a guarantee or that has a demand feature that enhances its credit quality may also be deemed an "Eligible Security." In addition, an unrated security that is of comparable quality to a rated security also may qualify as an "Eligible Security."

[11] A "First Tier Security" means any Eligible Security that:

(i) is a Rated Security (as defined in Rule 2a-7) that has received a short-term rating from the requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);

(ii) is an unrated security that is of comparable quality to a security meeting the requirements for a rated security in (i) above, as determined by the fund's board of directors;

(iii) is a security issued by a registered investment company that is a Money Fund; or

(iv) is a Government Security.

The term "requisite NRSROs" is defined in Rule 2a-7(a)(23) to mean "(i) Any two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) If only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO."

[12] Second Tier Securities are any Eligible Securities that are not First Tier Securities.

[13] *References to Credit Ratings in Certain Investment Company Act Rules and Forms*, 76 Fed. Reg. 12896 (Mar. 9, 2011).

Short Maturity Limits. Rule 2a-7 limits the exposure of Money Funds to risks like sudden interest rate movements by restricting the average maturity of portfolio investments. (This also helps a Money Fund maintain a stable NAV). Under the 2010 amendments to Rule 2a-7, the "weighted average maturity" of a Money Fund's portfolio is restricted to 60 days. In addition, the 2010 amendments limit the maximum "weighted average life" maturity of a fund's portfolio to 120 days.[14] This restriction limits the fund's ability to invest in long-term floating rate securities. In practice, 93% of "prime" Money Funds at year-end 2010 had a weighted average life of 90 days or less, and 80% had a weighted average maturity of 50 days or less.[15]

(3) Money Funds Are Already Required by SEC Rules to Structure their Portfolios and Conduct Operations to Address Liquidity Needs

Money Funds are subject to detailed SEC requirements on the tracking and reporting of portfolio asset values and per-share NAV, maintenance of a portfolio with sufficient liquidity to pay reasonably foreseeable investor redemptions, the ability to pay fund redemption requests at NAV even during a market crisis or if NAV drops below $1 per share, and a program to temporarily suspend redemptions and liquidate, if needed. Key elements of these requirements are highlighted below.

Shadow Pricing. To reduce the chance of a material deviation between the amortized cost value of a portfolio and its market-based value, Rule 2a-7 requires Money Funds to "shadow price" the amortized cost net asset value of the fund's portfolio against its mark-to-market net asset value. If there is a deviation of more than ½ of 1 percent, the fund's board of directors must promptly consider what action, if any, it should take,[16] including whether the fund should discontinue using the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share.[17] Regardless of the extent of the deviation, Rule 2a–7 obligates the board of a Money Fund to take action whenever it believes any deviation may result in material dilution or other unfair results to investors.[18]

[14] The "weighted average maturity" of a Money Fund's portfolio is usually shorter than its "weighted average life" because the former is measured at the earlier of repayment or reset of interest rates, while the latter is tied to the contractual repayment date on the fixed income instrument.

[15] Money Fund Regulatory Changes Post Financial Crisis, 2011 Investment Company Institute ("ICI") Money Market Funds Summit (May 16, 2011) (slides available on ICI website).

[16] 17 C.F.R. § 270.2a-7(c)(8)(ii)(B) (2010).

[17] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

[18] 17 C.F.R. § 270.2a-7(c)(8)(ii)(C).

Monthly Disclosure of Portfolio Information. Under the 2010 amendments, Money Funds also must now file monthly reports of portfolio holdings with the SEC, and post their portfolio holdings each month on their websites,[19] which must include the market-based values of each portfolio security and the fund's "shadow" NAV.[20] The information becomes publicly available after 60 days.[21]

Maintaining Cash to Pay Reasonably Foreseeable Redemptions/Know Your Customer. Under a new requirement added to Rule 2a-7 in 2010, Money Funds must hold securities portfolios that are sufficiently liquid to meet reasonably foreseeable redemptions. To satisfy this new requirement, a Money Fund must adopt policies and procedures to identify the risk characteristics of large shareholders and anticipate the likelihood of large redemptions.[22] Depending upon the volatility of its cash flows, and in particular shareholder redemptions, this may require a fund to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements discussed above.[23]

Processing of Transactions. Under a new requirement adopted in 2010, Rule 2a–7 requires a Money Fund to have the capacity to redeem and sell its securities at a price based on its current NAV. This requirement applies even if the fund's current net asset value does not correspond to the fund's stable net asset value or price per share. The new requirement minimizes operational difficulties in satisfying shareholder redemption requests and increases speed and efficiency if a fund breaks the buck. This change requires Money Funds to be able to process redemptions and thus provide liquidity if market prices of their portfolio assets decline, rather than defer share redemptions and corresponding sales of portfolio assets in order to avoid recognizing that decline in portfolio value. In essence, if market conditions dictate a movement to a floating NAV in order to process transactions and provide liquidity to redeeming shareholders, Rule 2a-7 requires Money Funds to do so. By forcing shareholder transactions to be processed at a price other than $1.00 when portfolio asset market conditions dictate, this rule change both enhances liquidity and addresses policy concerns over potential "runs" by shareholders seeking to redeem Money Fund shares ahead of unrecognized portfolio price declines or related deferrals by Money Funds of processing of redemptions.

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[19] 17 C.F.R. § 270.2a-7(c)(12); 17 C.F.R. § 270.30b1-7(a).

[20] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10083 (Mar. 4, 2010).

[21] 17 C.F.R. § 270.30b1-7(b).

[22] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10075, n.198 and accompanying text (Mar. 4, 2010).

[23] *See* Release No. IC-29132, 75 Fed. Reg. 10060, 10074 (Mar. 4, 2010).

Handling Default in a Portfolio Instrument. Rule 2a-7 establishes procedures that a Money Fund must follow if a portfolio instrument is downgraded or a default or other event occurs with respect thereto. In some cases, a fund may be required to dispose of, or reduce its investments in, the issuers of such instruments.

Risk Management. Money Funds have robust risk management requirements, beginning with Rule 2a-7's requirements that they limit holdings to the safest, most liquid and short-term investments and strict diversification requirements. Moreover, boards of Money Funds have substantial, detailed, and ongoing risk management responsibilities. For example, Money Fund boards must adopt written procedures regarding:

- Stabilization of NAV (which must take current market conditions, shadow pricing and consideration of material dilution and unfair results into account);
- Ongoing review of credit risks and demand features of portfolio holdings;
- Periodic review of decisions not to rely on demand features or guarantees in the determination of a portfolio security's quality, maturity or liquidity; and
- Periodic review of interest rate formulas for variable and floating rate securities in order to determine whether adjustments will reasonably value a security.

In order to ensure that boards are diligent and act in good faith, funds must also keep records of board consideration and actions taken in the discharge of their responsibilities. Management's decision-making processes must also be reflected in records such as whenever a security is determined to present a minimal credit risk, or when it makes a determination regarding deviations in amortized value and market value of securities.

Delegations of responsibilities by the board must be pursuant to written guidelines and procedures, and the Board must oversee the exercise of responsibilities. Even then, boards may not delegate certain functions, such as any decisions as to whether to continue to hold securities that are subject to default, or that are no longer eligible securities, or that no longer present minimal credit risk, or whose issuers have experienced an event of insolvency, or that have been downgraded under certain circumstances Nor may boards delegate their responsibility to consider action when shadow pricing results in a deviation of 1/2 of 1%, or to determine whether such deviations could result in dilution or unfairness to investors.

Rule 2a-7 provides that if a "First Tier Security" is downgraded to a "Second Tier Security" or the fund's adviser becomes aware that any unrated security or Second Tier Security has been downgraded, the board must reassess promptly whether the security continues to present minimal credit risks and must cause the fund to take actions that the board determines is in the best interests of the fund and its shareholders.[24] A reassessment is not required if the fund disposes of the security (or it matures) within five business days of the event.[25]

If securities accounting for 1/2 of 1% or more of a Money Fund's total assets default (other than an immaterial default unrelated to the issuer's financial condition) or become subject to certain events of insolvency, the fund must promptly notify the SEC and state the actions the Money Fund intends to take in response to such event.[26] If an affiliate of the fund purchases a security from the fund in reliance on Rule 17a-9, the SEC must be notified of the identity of the security, its amortized cost, the sale price, and the reasons for such purchase.[27]

In the event that after giving effect to a rating downgrade, more than 2.5 percent of the Money Fund's total assets are invested in securities issued by or subject to demand features from a single institution that are "Second Tier Securities," the fund must reduce its investments in such securities to 2.5% or less of its total assets by exercising the demand features at the next exercise date(s), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[28]

When a portfolio security defaults (other than an immaterial default unrelated to the financial condition of the issuer), ceases to be an Eligible Security, has been determined to no longer present minimal credit risks, or certain events of insolvency occur with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee of a portfolio security, the Money Fund is required to dispose of the security as soon as practicable consistent with achieving an orderly disposition of the security (by sale, exercise of a demand feature, or otherwise), unless the fund's board finds that disposal of the portfolio security would not be in the best interests of the fund.[29]

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[24] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(A).

[25] Where a Money Fund's investment adviser becomes aware that any unrated security or "Second Tier Security" held by the fund has, since the security was acquired by the fund, been given a rating by a Designated NRSRO below the Designated NRSRO's second highest short-term rating category, the board must be subsequently notified of the adviser's actions. *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(B).

[26] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(A).

[27] *See* 17 C.F.R. § 270.2a-7(c)(7)(iii)(B).

[28] *See* 17 C.F.R. § 270.2a-7(c)(7)(i)(C).

[29] *See* 17 C.F.R. § 270.2a-7(c)(7)(ii).

Periodic Stress Tests. Under the 2010 amendments to Rule 2a-7, the board of directors of each Money Fund must adopt procedures providing for periodic stress testing of the funds' portfolio. Fund managers are required to examine a fund's ability to maintain a stable NAV per share based upon certain hypothetical events. These include a change in short-term interest rates, higher redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.

Diversification. In order to limit the exposure of a Money Fund to any one issuer or guarantor, Rule 2a-7 requires the fund's portfolio to be diversified with regard to both issuers of securities it acquires and guarantors of those securities.[30] Money Funds generally must limit their investments in the securities of any one issuer (other than Government securities) to no more than five percent of fund assets.[31] Money Funds also must generally limit their investments in securities subject to a demand feature or a guarantee to no more than ten percent of fund assets from any one provider.[32] Under the 2010 amendments to Rule 2a-7, a Money Fund may not invest more than ½ of 1 percent of its assets in "Second Tier Securities" issued by any one issuer.

Fund Liquidation. New SEC Rule 22e-3,[33] adopted in 2010, permits a Money Fund's board of directors to suspend redemptions and postpone payment of redemption proceeds if the fund is about to break the buck and the board decides to liquidate the fund. This amendment is designed to facilitate an orderly liquidation of fund assets in the event of a threatened run on the fund.[34]

[30] 17 C.F.R. § 270.2a-7(c)(4)(i).

[31] Rule 2a-7(c)(4)(i)(A). Rule 2a-7 includes a safe harbor that permits a taxable and national tax exempt fund to invest up to 25 percent of its assets in the first tier securities of a single issuer for a period of up to three business days after acquisition (but a fund may use this exception for only one issuer at a time). Rule 2a-7(c)(4)(i)(A).

[32] Rule 2a-7(c)(4)(iii). With respect to 25 percent of total assets, holdings of a demand feature or guarantee provider may exceed the 10 percent limit subject to certain conditions. *See* Rule 2a-7(c)(4)(iii)(A), (B), and (C). *See also* Rule 2a-7(a)(9) (definition of "demand feature") and (a)(15) (definition of "guarantee").

[33] *See* 17 C.F.R. § 270.22e-3.

[34] The rule permits a fund to suspend redemptions and payment of proceeds if (i) the fund's board, including a majority of disinterested directors, determines that the deviation between the fund's amortized cost price per share and the market-based net asset value per share may result in material dilution or other unfair results to investors, (ii) the board, including a majority of disinterested directors, irrevocably has approved the liquidation of the fund, and (iii) the fund, prior to suspending redemptions, notifies the SEC of its decision to liquidate and suspend redemptions.

As described further below, the SEC has broad powers under the Investment Company Act and other federal securities laws to oversee the liquidation of a Money Fund.

(4) Money Funds Are Already Subject to Highly Successful SEC and Judicial Resolution Authority; Unlikely FDIC Could Do This Task As Well

The SEC has ample authority to enforce regulatory requirements and take comprehensive emergency actions involving Money Funds. In addition to its comprehensive program of regulation and supervision of Money Funds, the SEC has broad powers to take prompt action to address emergency situations at a Money Fund and promptly resolve the problem. In the Reserve Primary Fund situation, the SEC successfully invoked certain of these powers. Should such a situation arise again in the future, the SEC is able to draw upon the experience it gained in the Fall of 2008, and promptly intervene to oversee an orderly and prompt wind-down of the Money Fund. An FDIC receivership is not necessary to accomplish a wind-down of a Money Fund. The SEC powers to address emergency situations at a Money Fund (some of which must by rule occur automatically without action by the SEC) include:

- SEC rules impose a requirement that the Money Fund make an immediate shift to floating NAV if it departs from the stable NAV;
- Money Fund trustees' are authorized to defer share redemptions, and liquidate the Money Fund, thus treating all investors the same;
- The SEC has the ability to immediately intervene and force a court-supervised liquidation of a troubled Money Fund where the trustees are unwilling or unable to take the above steps;
- The SEC has emergency power under Section 12(k) of the 1934 Act to act by order in an emergency with respect to any matter subject to its regulation, including investment companies;
- The SEC is authorized under Section 25 of the Investment Company Act to intervene in respect of reorganizations and liquidations of investment companies;
- The SEC has cease-and-desist powers under Section 9(f) of the Investment Company Act;
- The SEC has power to obtain injunctive relief under Sections 36 and 40(d) of the Investment Company Act;
- The SEC has power to impose civil money penalties on Money Funds and their related persons under Sections 9(d) and 40(e) of the Investment Company Act;
- The SEC can bring a judicial action and invoke the Federal courts' 1934 Act § 21(d)(5) equitable remedies powers; and

- The SEC can bring a judicial action and petition the Federal court to invoke the All Writs Act[35] powers to enjoin other proceedings that interfere with the court's jurisdiction over the matter.

Other than a federal guarantee of investors, an injection of liquidity into a Money Fund, or a bail-out of Money Fund shareholders (the "too big to fail" federal safety net that Title I of the Dodd Frank Act was designed to limit, Title II prohibits, and which public opinion strongly opposes) there are no additional steps involving Money Funds that the Board could take under Title I of the DFA or the FDIC could take under Title II of the DFA that have not already been addressed by the SEC or for which the SEC does not have ample statutory authority to address going forward.

The proposed resolution plan requirement in the Joint NPR implements the requirements of Section 165(d) of the DFA and helps prepare the FDIC for a resolution of the financial company, if needed, under the receivership powers of Title II of the DFA. The FDIC stated in its January 25, 2011 NIFR that the receivership provisions under Title II were enacted due to the inadequacy of disparate insolvency regimes to effectively address the actual or potential failure of a financial company that could adversely affect economic conditions or financial stability in the United States.[36] Under Title II, the FDIC may be appointed receiver for a nonbank financial company only if the Treasury Secretary finds that the company is in default or in danger of default and "its resolution under otherwise applicable Federal or State law would have serious adverse consequences on financial stability in the U.S." and there is no other viable private sector alternative. This finding cannot be made in respect of a Money Fund, because Money Funds do not use leverage or debt that can be defaulted on, by the nature of their short-term, high-quality, marketable assets they are effectively self-liquidating and Money Funds are required by rule to be in a position to do so if needed, and because the SEC has broad regulatory and supervisory authority to oversee the orderly liquidation of a Money Fund.

If Money Funds cannot legitimately be designated under Title II, it makes no sense in light of the text, structure and purposes of the Act to designate Money Funds under Title I and require a that a Money Fund submit and have approved a resolution plan under Section 165(d) and the rule proposed by the Joint NPR.

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[35] 28 U.S.C. § 1651.

[36] 76 Fed. Reg. at 4207, 4208.

(5) Stable NAV a Result of Stable Portfolio Assets, Not An Accounting Gimmick; And Use Fully Transparent Valuation Methodologies

Money Funds seek to maintain a stable NAV of $1 per share, but do not promise to investors that they will be able to do so, and fully disclose to investors that they might not be able to do so. Money Funds, like all mutual funds, price their shares in dollars and cents, and round asset values up or down to the nearest penny (the "penny rounding" method of calculating share prices). This practice is consistent with most other areas of American commerce, in which most goods and services are priced in dollars and cents, not in mils.

Rule 2a-7 permits a Money Fund to use the "amortized cost" method of accounting for the value of assets held in portfolio.[37] This method for valuing portfolio securities has also been in use for many decades under federal banking regulations for "short term investment funds" operated by bank trust departments for investment of fiduciary and pension accounts.[38]

This method of valuing short-term debt instruments, and rounding share prices to the nearest penny is a convenience that allows investors, broker-dealers, banks, investment advisers and Money Funds to keep track of asset values (and indirectly, customer account values which are calculated by dividing the total net value of the portfolio by the number of outstanding shares of the Money Fund) without excessive and elaborate account-level daily price tracking of fractions of a cent. This use of stable NAV pricing is permitted by SEC rules only for funds that comply with the strict requirements of Rule 2a-7 to ensure that these funds are as stable and low risk as possible, and only for so long as the NAV calculated using the amortized cost value of the portfolio does not materially depart from the shadow price of shares calculated using mark-to-market assets values. Thus, a Money Fund must meet stringent portfolio liquidity, credit quality, maturity, and diversification requirements. These were strengthened by amendments in 2010 that were "designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market mutual fund that is unable to maintain a stable net asset value per share."[39]

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[37] Under the "amortized cost" method of accounting, Money Funds value the securities in their portfolios at acquisition cost as adjusted for amortization of premium or accretion of discount rather than market value. *See* 17 C.F.R. § 270.2a-7(a)(2). The Rule also allows Money Funds to use the "penny-rounding" method of pricing, which permits rounding to one cent rather than one-tenth of a cent. 17 C.F.R. § 270.2a-7(a)(20). However, this method is seldom used because it does not eliminate daily "mark to market" accounting requirements.

[38] 12 C.F.R. § 9.18(b)(4)(ii)(B).

[39] *See* Release No. IC-29132, 75 Fed. Reg. 10060 (Mar. 4, 2010).

But this is not an accounting gimmick. The permitted use by Money Funds of amortized cost accounting recognizes that the underlying market value of the assets held by a Money Fund are, and are required to be, assets that do not fluctuate to any material degree in market value. Money Fund assets are short term to avoid interest rate and liquidity risk. Money Fund assets are diversified and high credit quality to minimize credit risk. To track compliance with this mandate, Money Funds are required to track and report a "shadow price" of their shares based on a mark-to-market asset value of the portfolio of assets of the Money Fund.

An analysis of shadow price data demonstrates that Money Funds' $1 per share stable net asset value is not an accounting trick, but reflects the stable market values of the assets owned by Money Funds. A recent study of Money Fund shadow prices published by the Investment Company Institute ("ICI"), show that, due to the portfolio restrictions in Rule 2a-7, Money Fund NAVs maintain their values in the face of credit events, interest rate changes and extraordinary market changes.[40] Even in September 2008, in the worst days of the financial crisis, average Money Fund shadow share prices did not break a buck – but stayed above 99.8 cents per share, and returned to an average NAV of 100.0000 cents within a very short period.[41]

The stability of Money Fund NAVs is driven by the stable market value of the underlying assets of Money Funds. This is why, in 2008, during the worst financial crisis since the 1930s, only one Money Fund "broke a buck," over 800 Money Funds did not "break a buck," and the overwhelming majority of those did not require any sponsor support to maintain stable net asset value of $1 per share.

The 2010 amendments to Rule 2a-7 have further removed price movements from the portfolios of assets owned by Money Funds, as shown by mark-to-market to shadow NAVs. As of year-end 2010, for example, 50% of "prime" Money Funds' reported shadow prices are between 99.96 cents and 100.01 cents per share, 38% were between 100.01 and 100.10 cents per share, 6% were between 99.91 and 99.95 cents per share, and the remaining 6% had a shadow price between 99.80 and 99.90 cents per share. Money Fund "shadow prices" must move below 99.5 cents per share or above 100.5 cents per share to cause the Money Fund to "break a buck."[42] Nonetheless, Money Funds continue to warn investors that a Money Fund may not always be able to maintain a stable NAV.

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[40] ICI Research Report, Pricing of Money Market Funds (Jan. 2011).

[41] Money Fund Regulatory Changes Post Financial Crisis, 2011 ICI Money Market Funds Summit (May 16, 2011) (slides available on ICI website).

[42] *Id.*

Thus, the ability of Money Funds to maintain a stable net asset value of $1.00 is not the result of an accounting gimmick. It is the result of very stringent portfolio restrictions that apply to all Money Funds under SEC regulations.

Nor is there a lack of transparency of the valuation methods used by Money Funds. Money Funds are also required to calculate the "shadow price" value of their shares, based on a mark-to-market valuation of portfolio assets, file that information with the SEC and publish that information on the Money Fund's website. The use of the amortized cost method of accounting, and of rounding share prices to the nearest penny, is clearly disclosed to investors in the offering documents and reports provided to Money Fund investors. Moreover, if the NAV of Money Fund shares calculated using the amortized cost method departs materially (0.50 cents per share or more) from the "shadow price" calculated using mark-to-market values, the Money Fund is required to notify the SEC and move to the shadow price in offering and redeeming shares with investors. These disclosures to every Money Fund investor, as well as the periodic public disclosure of the shadow NAV and portfolio holdings, make Money funds perhaps the most thoroughly transparent investment available to the public.

(6) Money Funds Are Not "Shadow Banks"

In recent months, some have called for bank-type regulation of money funds on the theory that they are "shadow banks." Until recently, the term "shadow bank" meant an offshore parallel bank operating in an unregulated jurisdiction and engaged in shady dealings. During the financial crisis, the term was repurposed by bank regulators as a pejorative label for segments of the financial services industry that they did not regulate.[43] As redefined, the term "shadow bank" has been used to mean an unregulated financing vehicle with a lot of leverage and little capital.[44] The exemplar is a securitization vehicle, with an asset base of loans and receivables and a capital

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[43] Zoltan, Pozsar, Tobias, Federal Reserve Bank of New York, Staff Report no. 458, Shadow Banking at 4 (July 2010) ("We use the term 'shadow banking system' for this paper, but we believe that it is an incorrect and perhaps pejorative name for such a large and important part of the financial system."). The first use of the term "shadow bank" in August 2007 to refer to ABCP and similar off-balance sheet issuers was apparently by an economist and management officials at a mutual fund management firm, PIMCO, who were seeking to draw bank regulatory policy makers' attention to the risks inherent in the bank regulators allowing these financing structures to grow. *See* Gross, *Beware our shadow banking system,* Fortune Magazine (Nov. 28, 2007); McCulley, PIMCO Global Central Bank Focus, *The Shadow Banking System and Hyman Minsky's Economic Journey* (May 2009). In a classic display of the maxim that "no good deed goes unpunished," the federal bank regulators. who ignored these warnings about the risks associated with ABCP and other off-balance sheet financing in 2007 and early 2008, have now sought to blame the problem on the mutual fund industry that called the issue to their attention in the first place.

[44] The Financial Crisis Inquiry Report: Final Report of the National Commission of the Causes of the Financial and Economic Crisis in the United States at xxi, 27-37 (June 2011).

structure consisting of a couple of percentage points of equity, a tranche of subordinated debt, and a large slug of secured short-term notes, commonly referred to as "asset backed commercial paper" ("ABCP").

Money Funds differ from these entities in that Money Funds are heavily regulated by the SEC, subject to extensive audit, public reporting and transparency requirements, and do not use leverage. Unlike true "shadow banks," Money Funds are financed 100 percent by common equity. In essence, Money Funds do not meet any of the criteria used to define a "shadow bank."

Some in the policy debate have sought to label Money Funds' shares as "debt" (it is equity), argue that shareholders have a "put" to the fund or its manager at $1 per share (they do not)[45] or that the manager or the fund "guarantees" the $1 per share net asset value (they do not). To the contrary, Money Fund investors receive explicit disclosure that investments in Money Funds may lose value and are not insured or guaranteed. Item 4(b) of the Form N-1A registration form that is used by open-end management investment companies to register under the Investment Company Act and to offer their shares under the Securities Act states that if a fund is a Money Fund, it must state:

> An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.

In addition, if a Money Fund is advised by or sold through an insured depository institution, the above disclosure must be combined in a single statement with disclosure that an investment in the fund is not a deposit of, or guaranteed by a bank and is not insured or guaranteed by the FDIC or any other government agency. The Investment Advisers Act of 1940 ("Advisers Act"), prohibits a registered investment adviser from guaranteeing the value of an advised account's assets, including a mutual fund.[46]

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[45] SEC Roundtable Discussion on Money Funds and Systemic Risk (May 10, 2011) (archived webcast *available on* SEC website at http://www.sec.gov/news/otherwebcasts/2011/mmf-risk051011.shtml).

[46] Representations of guarantees violate Advisers Act Sections 206(1), (2) and (4), which prohibit fraudulent and misleading statements by investment advisers (15 U.S.C. §80b-6(1), (2) and (4)), as well as Rule 206(4)-8 under the Advisers Act, which prohibits fraudulent and misleading statements by investment advisers of pooled investment vehicles, including mutual funds. 17 C.F.R. §275.206(4)-8. *See SEC v. Wehrs*, Lit. Rel. No. 21399, 2010 SEC Lexis 259 (Feb. 1, 2010).

Others have sought to label Money Funds as "shadow banks" by claiming that Money Funds are unregulated. For example, a former Board Chairman recently testified before the Financial Crisis Inquiry Commission ("FCIC") that Money Funds were not regulated, and the FCIC summarized in its report that:

> money market funds had no capital or leverage standards…. The funds had to follow only regulations restricting the type of securities in which they could invest, the duration of those securities, and the diversification of their portfolios. These requirements were supposed to ensure that investors' shares would not diminish in value and would be available anytime-- important reassurances, but not the same as FDIC insurance.[47]

The truth is that Money Funds are ***comprehensively regulated*** by the SEC under a statute and regulations that essentially require them to be capitalized entirely with equity and that preclude the use of leverage. The SEC regulations restricting the type of securities in which Money Funds can invest and their maturity and duration are a central reason why only two Money Funds have broken the buck in forty years of the industry's existence; and in those two cases investors got back the overwhelming majority of their investments relatively quickly. The regulatory regime governing Money Funds is not the same as FDIC insurance, it is far more effective than the FDIC and the regime of federal banking regulation, both in protecting Money Funds and their customer/investors against insolvency and in protecting the federal government from having to bail them out. Money Funds do not represent a case of no regulation, but of profoundly successful, yet simple and extraordinarily elegant, regulation.

The stability of Money Funds – especially when compared with banks – is due in large part to a regulatory system that provides for investor protection, active oversight, inspections and a competitive environment. The investment restrictions applicable to Money Funds are far more stringent than those that apply to banks in terms of duration, credit quality, and liquidity. In brief, Money Funds may invest in short-term debt instruments in which a national bank may invest, including prime commercial paper, bank deposits, short-term U.S. government securities, and short-term municipal government securities.[48] However, they may not invest in many of the higher risk, less liquid and longer-term investments that national banks may own, such as medium and long-term government or corporate debt and most types of loans (*e.g.*, mortgages and consumer loans). In short, Money Fund investment portfolios are far less risky and far more

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[47] Final Report of the National Commission on the Causes of the Financial and Economic Crisis In the United States at 33 (Jan. 2011).

[48] 12 U.S.C. §24 (Seventh), 12 C.F.R. Part 1 (2008).

liquid than those of banks. They need to be. Money Funds do not rely on a Federal government guarantee to operate.

Money Funds are a type of mutual fund. As such, they must register with the SEC as "investment companies" under the Investment Company Act, which subjects them to stringent regulatory, disclosure, and reporting provisions. Thus, they must register offerings of their securities with the SEC and provide perpetually updated prospectuses to potential investors. They must also file periodic reports with the SEC and provide shareholders with annual and semi-annual reports, which must include financial data and a list of portfolio securities. In addition, the Investment Company Act governs virtually every aspect of a mutual fund's structure and operations, including its capital structure, investment activities, valuation of shares, the composition of the board, and the duties and independence of its directors. Mutual funds also are subject to extensive recordkeeping requirements and regular inspections. In addition, the advisers to mutual funds, including Money Funds, are subject to SEC registration under the Advisers Act, which imposes its own reporting and recordkeeping requirements, prescribes the terms of advisory contracts, and provides for SEC inspections and examinations. As described elsewhere in this letter, the SEC has adopted and enforces detailed and elaborate rules governing the portfolios and operations of Money Funds, including Rules 2a-7, 17a-9, 22e-3, 30b1-7, and Form N-MFP (17 C.F.R. §§ 270.2a-7, 270.17a-9, 270.22e-3 and 270.30b1-7, and 17 C.F.R. §274.201. No realistic assessment of Money Funds can conclude that they are not regulated.

Money funds have been lumped in with "shadow banks" by some voices in the policy debate in part because prior to 2008, Money Funds were significant investors in ABCP and thus were characterized by some as helping to finance the shadow banking system.[49] Notably, commercial banks have been and continue to be significant investors in ABCP.[50] Indeed, a very large portion of the ABCP market, and the special purpose investment vehicle ("SIV") financing market was created, controlled and driven by commercial banks and was designed and developed to address accounting and commercial bank regulatory issues in getting financing structures off the balance sheets of banks that effectively controlled the conduits that were the issuers of the paper. However, with changes to accounting and commercial bank regulatory capital treatment of commercial-bank-sponsored commercial paper conduits, and to a lesser extent the 2010 amendments to Rule 2a-7, and changes to the SIV, ABCP and commercial paper market, issuances of ABCP have fallen by roughly two-thirds since 2007. As a consequence, Money

[49] Federal Reserve Bank of New York Staff Report No. 458, *supra*, at 11; Konczal, Shadow Banking: What It Is, How It Broke, and How to Fix It, *The Atlantic* (July 13, 2009).

[50] See 12 C.F.R. Part 1 (commercial paper a permitted investment for national banks in an amount of up to 10% of the bank's capital per issuer).

Funds' investments in ABCP have been substantially reduced.[51] Thus, the characterization of Money Funds as "shadow banks" by virtue of these investments no longer has a factual basis, to the extent it ever did, and the true focal point of financing for ABCP and SIVs was commercial banks, not Money Funds.

In summary, Money Funds are not "shadow banks" and are not part of the "shadow banking system."

(7) Money Funds Should be Specifically Excluded Pursuant to Section 170 of DFA

Money Funds are a regulatory success. They are subject to robust regulation by the SEC, which has an excellent record in its oversight of Money Funds and a superior track record in this area in comparison to bank-type prudential regulation or FDIC receivership.

Money Funds should not be designated for prudential regulation by the Board under Title I or FDIC receivership under Title II or required to submit resolution plans to the Board and FDIC. The receivership process created by Title II is inappropriate for Money Funds which rely on equity, rather than debt financing, are essentially self liquidating by the nature of their assets, and are already covered by existing regulatory and judicial protocols when necessary for a prompt and efficient wind-down of a Money Fund.

Section 170 of the DFA dictates that in connection with Council rules implementing Title I, the Board "***shall*** promulgate regulations in consultation with and on behalf of the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies… from supervision by the" Board. Section 170 is not merely a grant of authority, it is a specific rulemaking requirement that the exemptive rules ***shall*** be promulgated.

In oversight hearings before the Senate Banking Committee on February 17, 2011, FDIC Chairman Sheila Bair testified, when asked what criteria will be used to designate companies under Titles I and II, that it is easier to define what companies will *not* be subject to designation.[52] The Chairman is correct. That should be done through the Section 170 exemption

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[51] *See* Crane Data, *ICI's Latest Shows MMF Assets Rising, Cont. Shift from Repo to CDs* (May 27, 2011) (*available at* http://www.cranedata.com/archives/all-articles/3457/).

[52] *Oversight of Dodd Frank Implementation*, Hearings Before Senate Banking Committee (Feb. 17, 2011) *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=c43953db-0fd7-43c3-b6b8-97e2d0da3ef7.

criteria rulemaking that the Board is required to conduct, to provide more certainty around the process.

The U.S. economic system demands stability and a clear regulatory framework. Indeed, the President's recent Executive Order directs that regulations "must promote predictability and reduce uncertainty."[53]

As one of the Federal Reserve Banks recently noted in comments to the FDIC, the uncertainty over the terms, standards and processes to be used under Titles I and II presents a danger and may increase, rather than decrease, risks in the financial system.[54] In comments filed with the FDIC on its rulemaking proposal earlier this year, the Federal Reserve Bank of Richmond stated that:

> the orderly liquidation authority should be as transparent, unambiguous, and predictable as possible, and Title II would benefit from any rulemaking that makes the FDIC's authority clearer and more consistent. For this reason, we're pleased to read that the proposed rule's purpose "is to provide clarity and certainty to the financial industry and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of failing systemic financial companies." We worry, however, that despite the FDIC's efforts to enhance the orderly liquidation authority's transparency and predictability, the constructive ambiguity that accompanies the FDIC's discretion is likely to breed market uncertainty, which can add to financial volatility when market participants are forced to speculate on the FDIC's treatment of various similarly situated creditors. The potential for panics and runs in the face of such ambiguity could in turn impinge on the FDIC's decision making in the midst of a crisis. Greater transparency and predictability would help limit this adverse feedback loop.[55]

We think the best way to reduce the uncertainty created by the ambiguity in Title I is to make clear to investors and the public that Money Funds will ***not*** be required to submit resolution plans under Section 165(d) because they will not be designated for FDIC receivership under Title II or Board supervision under Title I of DFA. This can be done through a combination of revising the definition of "covered company" in the rules proposed by the Joint

[53] *Improving Regulation and Regulatory Review*, Exec. Order No., at 3821 13563 (Jan. 18, 2011).

[54] Letter from Jeffrey M. Lacker, President, Federal Reserve Bank of Richmond to FDIC (Jan. 18, 2011) (*available at* http://www.fdic.gov/regulations/laws/federal/2010/10c35Orderliq.PDF).

[55] Letter from Jeffrey M. Lacker, President, Federal Reserve Bank of Richmond to FDIC, at 2 (Jan. 18, 2011) (*available at* http://www.fdic.gov/regulations/laws/federal/2010/10c35Orderliq.PDF).

NPR, formal statements on this point by the Board, FDIC, and Council, action by the Board on behalf of the Council pursuant to Section 170 of the DFA to exclude Money Funds from coverage, and actions consistent with that position over time by the Board, Council and FDIC.

We note in this regard that it is doubtful that *any* open-end investment company (*e.g.* a mutual fund), including a Money Fund, is within the definition of a "nonbank financial company" that is subject to designation under Title I or Title II of the DFA.[56] The Board has steadfastly refused for nearly six decades to interpret the provisions of Section 4 of the BHC Act that are incorporated into the DFA definition of a "nonbank financial company" to permit bank holding companies to control, be affiliated with, or be open-end investment companies (i.e. mutual funds), and has taken actions to prevent that from occurring.[57] Because the Board has not determined that being or controlling an open-end investment company or mutual funds is an eligible activity under those provisions, the activity of being an open end investment company is not a "financial" activity and thus mutual funds are not "nonbank financial companies" for purposes of Title I of Dodd Frank. The Board cannot have it both ways.[58] If Sections 4(c)(8) and 4(k) do not authorize a bank holding company to engage in the activity of being or controlling a mutual fund, then a mutual fund cannot be a nonbank financial company within the meaning of Title I.

Moreover, a primary purpose of designation of a nonbank financial company under Title I is to prepare it, and place it in line, for a potential FDIC receivership under Title II. Because the text, purpose and structure of Title II (and of Sections 165(d) & (g)) clearly establish that Title II receiverships are to address defaults by a nonbank financial company on its obligations, and Money Funds are financed entirely by shareholder equity and do not borrow or otherwise

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[56] Section 102 of the DFA defines the universe of "nonbank financial companies," that potentially are subject to designation under Title I, by reference to the financial powers of Section 4(k) of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. 1843(k). Section 4(k) in turn has its own list of activities, including those permitted under Section 4(c)(8) of the BHC Act and Regulation K, 12 C.F.R. § 211. Other parts of the BHC Act (Sections 4(c)(5), 4(c)(6) and 4(c)(7) of that Act) authorize investing in securities and in investment companies, and 4(c)(8) and Regulation K have been interpreted by the Board to include sponsoring, advising, administering and providing other services to open-end and closed end investment companies, as well as dealing and underwriting in securities (as contrasted to investing, reinvesting and trading in securities). But the Board has gone out of its way *not* to determine that being, or controlling, an open-end investment company is a permitted Section 4(c)(8) or 4(k) activity. Petition of the United States in *Board of Governors of the Federal Reserve System v Investment Company Institute* (in U.S. Supreme Court Docket No. 79-927, October Term, 1979), 450 U.S. 46 (1981).

[57] *See* 12 C.F.R. §§ 211.10(a)(11), 225.28(b)(6), 225.86(b)(3), 225.125.

[58] *Cf. Citicorp v Bd. of Governors*, 936 F.2d 66 (2d Cir. 1991), *cert. denied* 502 U.S. 1031 (1992) (Federal Reserve Board cannot simultaneously interpret the BHC Act in two different, conflicting ways).

use leverage, they do not have the ability to default on their obligations in a way contemplated by Section 165(d) and Title II. If Money Funds do not have the kinds of debts and counterparty obligations that Titles I and II were intended to address, it makes no sense within the structure and purposes of Titles I and II to treat Money Funds as nonbank financial companies that are subject to designation under those Titles.

To the extent that there is any doubt on this question, it would be appropriate and in the public interest for the Board acting in consultation with the FDIC and the Council to exercise the mandatory exemptive authority in Section 170 of the DFA to exclude Money Funds from coverage under Titles I and II.

(8) The Resolution Plan Requirement Is Part of an Integrated Statutory Program That Is Fundamentally Flawed

The statute and the various proposed rules that would implement the statute contain a number of other flaws and shortcomings, which are discussed in more detail in our previous comment letters, two of which are attached hereto and should be included in the comment file on the Joint NPR. If applied to Money Funds, the Joint NPR is subject to these same flaws. Due to the procedural and practical linkages and statutory intertwining of Titles I and II of the DFA with Title I of the DFA and the rules under both Titles, the Joint NPR implementing Section 165(d) of Title I is made defective by the shortcomings in other parts of Titles I and II and the related implementing rules. Certain of these are highlighted below, and described more fully in our prior comment letters.

The interrelated provisions of Titles I and II concerning the designation of nonbank financial companies contain significant Constitutional defects that have not been addressed, or even mentioned, in the Joint NPR or in the related rulemakings of the Board, the FDIC and the Council implementing Title I and Title II. In the context of this Joint NPR to implement the resolution plan provisions of Section 165(d) of the DFA, the judicial review provisions of Titles I and II of the DFA, which dramatically curtail judicial oversight of agency actions particularly those related to designation of firms under Titles I and II and resolution of firms, and the implementing rules, infringe inappropriately on the role of the Federal courts under Article III of the Constitution and the right of private parties to have access to Article III courts, rather than a federal agency, in the ultimate determination and disposition of their private property rights and interests.

The curtailment of the role and authority of Article III federal courts in the process of reviewing agency action associated with the designation of nonbank financial companies under Titles I and II of DFA, and in adjudicating private rights, violates the Constitution.[59]

Although the property interests and contractual rights of investors, counterparties and other private parties will be profoundly affected by a receivership under Title II of the DFA, and the decisions and determinations of the receiver, the stated purposes of Title II do not include protecting those private parties' interests and rights, as against one another, as against the failed institution or its management, as against the government, or as against the general good of the public. Instead, the prime directive in designating and liquidating companies under Title II is protecting the financial stability of the United States, and the priority of payments places the claims of the United States ahead of everyone (other than the administrative expenses of the receiver).[60]

Unlike banks, which choose to subject themselves to potential FDIC receivership when they apply for FDIC insurance, nonbank financial companies that are designated under Title I of the DFA and potentially subject to Title II FDIC receivership do not elect that treatment. Becoming subject to Title II is not a voluntary, consensual step undertaken by the subject company. It is instead thrust upon a nonbank financial company (and thus upon the company's creditors, counterparties, shareholders and employees and others whose private property and rights would be affected by a receivership) by virtue of engaging in any of a broad and ill-defined swath of activities deemed to be financial in nature. Banks voluntarily apply for and obtain FDIC insurance and thus opt into the federal receivership provisions that come along with FDIC insurance and have direct access to Federal Reserve Bank lending on a regular basis, enjoy a federal government-granted monopoly to subsidized deposit-taking as a means to finance their operations, and in the case of national banks and federal savings associations, are organized and exist under Federal law, and thus are both willing participants in, and direct beneficiaries of, a federal safety net that effectively subsidizes their costs of doing business. In contrast, nonbank financial entities are not voluntary participants in the DFA Title I and Title II designation process and receivership provisions, nor are they participants in the federal safety net on a regular and continuous basis. Whatever may or may not be the Constitutionality of limited

[59] *See N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982); (Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?* (Nov. 16, 2010) (*available at* www.fed-soc.org); Federalist Society Panel Discussion on the Constitutionality of the Dodd-Frank Financial Services Reform Act (Nov. 19, 2010), webcast *available at* www.youtube.com/watch?v=qX2iDe1eox0; Cato Institute Policy Forum, *Is Dodd Frank Constitutional?* (Feb. 15, 2011), webcast *available at* http://www.cato.org/event.php?eventid=7732.

[60] DFA § 210(b).

judicial involvement in and oversight of the designation and receivership powers as applied to banks that voluntarily elect into a federal receivership system outside of the normal bankruptcy process, the analysis is very different in the case of nonbank financial services companies.

As part of the statutory program, judicial review of placement of a nonbank financial company into receivership is extraordinarily limited by Section 202 to a period of 24 hours, on an arbitrary and capricious standard, with no stay. Other provisions of Title II of the DFA, including Section 205(c), 208, 210(a)(4), 210(a)(8), 210(e), and 210(h)(6), further limit judicial participation in the process. Individual claims brought against the receivership, after initial determination by the FDIC as receiver, are subject to determination in the district court on a *de novo* standard, but the resolution or plan for resolution of the estate, payment of those claims, and the ultimate disposition of the assets of the estate, are determined by the FDIC as receiver subject only to very limited judicial review.[61]

Due to the extraordinary limitation on judicial review of the designation and actions taken under Title II of the DFA, the determination and resolution of the property rights and interests of private parties under Title II and the Joint NPR as currently structured would violate due process requirements under the Fifth Amendment to the Constitution, and would otherwise conflict with the due process rights of private parties under the Constitution. Designation under Title I of the DFA places a nonbank financial company by definition and through the interrelated provisions of Title I and Title II at risk of a Title II receivership and thus shares the inherent Constitutional flaw that exists in Title II.

The Board and FDIC have an obligation in conducting a rulemaking to consider the Constitutional issues associated with these provisions.[62] This has not been done, and no effort has been made in the rulemaking to address or ameliorate these issues. If the Constitutional flaws in the statute can be fixed as part of the rulemaking, they must be fixed. If they are not fixable, then the rule cannot be validly adopted and must be withdrawn.

The breadth and vagueness of the authority granted under Titles I and II on such issues as who will be subject to designation and on what grounds, and the lack of clarity as to what agency is responsible, impermissibly delegates legislative authority, a flaw that is compounded by the failure of the regulators in their respective rulemakings to clarify and narrow these provisions. Under these circumstances, the Joint NPR and other actions taken by the Board, the Council, the

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[61] DFA §§ 210(a)(2)-(4), (e)(4).

[62] *See Whitney Nat'l Bank v. Bank of New Orleans*, 379 U.S. 411, 418-425 (1965); *Iowa Indep. Bankers Ass'n v. Bd. of Governors*, 511 F.2d 1288, 1293 n. 4 (D.C. Cir. 1975).

FDIC, and other federal agencies pursuant to Titles I and II are not subject to judicial deference under the standards of *Chevron* and its progeny[63] but instead under the less deferential judicial review standards of *Industrial Union Department, AFL-CIO*, and similar cases.[64]

(9) Paperwork Reduction Act Estimates Internally Inconsistent, In Conflict With Representations Made to Congress

The Paperwork Reduction Act estimates in the Joint NPR do not add up, and are inconsistent with the other estimates of how many companies will be designated under Titles I and II of DFA and how much work will be required by companies to comply with regulatory requirements. The Joint NPR estimates 124 firms will be required to submit resolution plans and reports of exposure, with an average time involved per covered financial institution of 12,400 hours for the first year and 2,881 for subsequent years, for a total of 1,337,600 hours for the first year across all respondents, and 267,544 annually thereafter across all respondents in total. We note that 124 respondents multiplied by 12,400 hours does not equal or even approximate 1,337,600 hours, and 124 respondents multiplied by 2881 hours does not equal or approximate 267,544 hours.

Title I specifies that banking entities with $50 billion or more of consolidated assets shall be deemed to be systemically important and designated under Title I.[65] According to data posted on the FFIEC website, there are approximately 35 U.S. banking organizations with $50 billion or more in consolidated assets.[66] If there are a total of 124 firms designated under Title I, that suggests that approximately 89 foreign banks with U.S. branches and non-bank financial firms will be designated under Title I and required to submit resolution plans.

When Congress was considering Titles I and II of the DFA, Board Chairman Ben Bernanke testified that a total of roughly 25 firms, "virtually all of" which were bank holding

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[63] *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984); *United States v. Mead Corp.*, 533 U.S. 218 (2001).

[64] *Indus. Union Dep't, AFL, CIO v. Am. Petroleum Inst.*, 448 U.S. 607 (1980); *City of New York v. Clinton*, 985 F. Supp. 168 (D.D.C. 1998), *aff'd on other grounds, Clinton v. City of New York*, 534 U.S. 417 (1998); *Whitman v. Am. Trucking Co.*, 531 U.S. 457, 487 (2001) (concurring opinion of Justice Thomas). The normal cure for an overly broad delegation of legislative power is a narrow reading by the courts of the grant of authority in order to avoid the Constitutional issue, *see e.g.*, *Almendarez-Torres v. United States*, 523 U.S. 224, 237-38 (1998); *Whitman*, 531 U.S. at 476 (concurring opinion of Justices Stevens and Souter).

[65] Federal Reserve, *Proposed Rule: Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company*, 76 Fed. Reg. 7731, 7737 (Feb. 11, 2011).

[66] http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx.

companies already regulated by the Board, would meet the test of systemic significance for designation under the Act.[67] In its paperwork estimate as of February 11, 2011, the Board suggested that only three nonbank financial firms will be designated under Title I[68] (and as a result would need to submit resolution plans under Section 165(d)).

"Mission creep" has now entered the DFA rulemaking process. The estimate of 124 firms being subject to the rule proposed in the Joint NPR signals that the regulators will be overly inclusive in their designation of financial companies for supervision under Title I, submission of resolution plans under Section 165(d) and receivership under Title II, in conflict with the intent of Congress, the terms of the statute, and the economic best interests of the American people.

(10) Money Funds Represent a Regulatory Success, Particularly As Compared to Regulation of Depository Institutions

History and Importance of Money Funds

Approximately thirty million investors own shares of Money Funds. The utility of Money Funds and their popularity with citizens, as well as Money Funds' successful forty-year track record of operations, cannot be overlooked in the policy discussion involving whether Money Funds should be regulated like banks by the Board and FDIC.

Money Funds are leading investors in the short-term debt instruments that are issued and traded in the "money market," including Treasury bills, bankers' acceptances, certificates of deposit, federal funds and commercial paper.[69] The money market is the single most important source of liquidity funding for the global financial system. It permits large institutions to meet

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[67] Regulatory Perspectives on the Obama Administration's Regulatory Reform Proposals, Part II, Hearings before the Financial Services Committee, U.S. House of Representatives, 111th Cong., 1st Sess. July 24, 2009, H.R. 111-68 at 47-48 (testimony of Federal Reserve Board Chairman Ben Bernanke). Similar statements that only a very few firms were appropriate for designation under Title I were made on several occasions during consideration of the DFA. *See, e.g.* Written Statement of former Federal Reserve Board Chairman Paul A. Volcker to Senate Banking Committee (Feb. 2, 2010); Written Statement of former Federal Reserve Board Chairman Paul A Volcker to House Financial Services Committee (Sept. 24, 2009) (estimating number between 5 and 25 firms globally).

[68] 76 Fed. Reg. 7731, 7735-37.

[69] Commercial paper consists of short-term, promissory notes issued primarily by corporations with maturities of up to 270 days but averaging about 30 days. Companies use commercial paper to raise cash for current operations as it is often cheaper than securing a bank loan. Federal Reserve Board, *Commercial Paper, available at* http://www.federalreserve.gov/releases/cp/about.htm.

short-term borrowing needs and invest cash holdings for brief periods. Federal, state and local governments also use the money market to meet liquidity needs by issuing short-term paper, including municipal paper and Treasury bills. The Federal Reserve utilizes Money Funds in its reverse repurchase program.

Money Funds were first offered in the U.S. in 1971 as a way to preserve investor principal while earning a reasonable return – and for the first time made a market interest rate available to retail investors. They have become widely held by many types of investors and are subject to pervasive regulation and oversight by the SEC. Due in large part to SEC rules that require them to invest exclusively in specific high-quality, short-term instruments issued by financially stable entities, they also have enjoyed a high degree of success, greatly increasing in number and in assets under management. Thus, Money Funds are now among the most widely held, low-risk and liquid investments in the world.[70]

For investors of all types, Money Funds offer numerous benefits. They come in several forms, including both taxable funds (which invest in securities such as Treasury bills and commercial paper) and tax-free funds (which generally invest in municipal securities), government funds (which invest only in U.S. government and agency securities and repurchase agreements on those securities), and “prime” funds (which invest in short-term corporate and bank debt, but not government securities).[71] Investors can choose between and among funds that offer slightly higher yields, funds that offer less credit risk, and funds that offer tax advantages. For institutional investors, Money Funds offer low cost, convenient ways to invest cash in the short-term. Many institutional investors, including companies and governmental entities, have cash balances swept from their operating accounts into Money Funds on a nightly basis. For retail investors, Money Funds continue to offer a low-risk, low-expense way to diversify liquid holdings.

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[70] Notwithstanding relatively low prevailing yields, according to the Investment Company Institute, as of June 8, 2011, Money Funds had over $2.7 trillion in assets under management. *See* Investment Company Institute, *Money Market Mutual Fund Assets*, Jun. 9, 2011, *available at* http://www.ici.org/research/stats/mmf/mm_06_09_11. Investment Company Institute historical weekly money market data show that assets under management have declined significantly since January 2009. As of January 7, 2009, Money Funds had over $3.8 trillion in assets. *See* Investment Company Institute, *Weekly Total Net Assets (TNA) and Number of Money Market Mutual Funds, available at* http://www.ici.org/pdf/mm_data_2010.pdf.

[71] *See* Sue Asci, *Prime Money Funds See Recent Inflows*, Investment News, Feb. 22, 2009.

Based on Investment Company Institute data, as of December 2010, there were approximately 652 Money Funds.[72] As of June 8, 2011, Money Funds held over $2.7 trillion in assets under management.[73] Money Funds account for investments in almost 40% of outstanding commercial paper, approximately two-thirds of short-term state and local government debt, and a substantial amount of outstanding short-term Treasury and federal agency securities.[74] During the more than 25 years since Rule 2a-7 was adopted in 1983, over $335 trillion has flowed in and out of Money Funds.[75]

Performance Comparison of Money Funds to Bank Failures

Banks and their trade associations viewed Money Funds in their early years as competitors for retail business, and supported efforts to subject Money Funds to “bank-like” or “prudential” supervision.[76] Policy makers, however, recognized that bank-like regulation would

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[72] Investment Company Institute, *Money Market Mutual Fund Assets*, Jun. 9, 2011, *available at* http://www.ici.org/research/stats/mmf/mm_06_09_11.

[73] Of this amount, retail Money Funds held an estimated $933 billion of this sum, while institutional funds held over $1.8 trillion – though this distinction is somewhat arbitrary. Investment Company Institute, *Money Market Mutual Fund Assets*, Mar. 17, 2011, *available at* http://www.ici.org/research/stats/mmf/mm_03_17_11.

[74] *See* REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS 7, *available at* http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf.

[75] *See* Investment Company Institute, *Report of the Money Market Working Group*, Mar. 17, 2009 (hereinafter “ICI Money Market Working Group Report”), at 38, *available at* www.ici.org/pdf/ppr_09_mmwg.pdf.

[76] *See, e.g., Shooting at Money Market Funds*, Time, Mar. 23, 1981, *available at* http://www.time.com/time/magazine/article/0,9171,952946,00.html. The article states that that banking and savings institutions had “undoubtedly been hurt by the Money Funds” and that “banks and savings and loans have launched drives to bring them down…Last week the U.S. League of Savings Associations urged the Government to impose sharp restrictions on the money market funds and asked the Federal Savings and Loan Insurance Corporation to pledge up to $7 billion in low-cost loans.” The article further notes that “Senate Banking Committee Chairman Jake Garn of Utah wants to prevent money market funds from offering check-writing privileges; Congressman James Leach of Iowa has introduced a bill that would diminish the funds' appeal by setting reserve requirements on them…The funds are also under heavy assault in several state legislatures.” *See also* Karen W. Arenson, *Volcker Proposes Money Funds Be Subject to Rules on Reserves*, N.Y. TIMES, June 26, 1981 (noting that former Federal Reserve Chairman Paul A. Volcker testified before a Congressional subcommittee that money market funds should be subject to regulations that would make them more competitive with banking institutions and less attractive to investors. Mr. Volcker also testified that reserve requirements were a key part of monetary policy and because they could not be removed from banking institutions, also should apply to other investment vehicles); Beatson Wallace, *Money Funds Aren’t Banks*, BOSTON GLOBE, May 21, 1981 (noting that “[m]oney market funds continue to be the whipping boy of the banking industry and the delight of the small sum investor.”) The article explains that Treasury Secretary Donald T. Regan testified that “imposing new controls on our financial markets would be the wrong approach to assisting the thrift industry,” but that nevertheless Senator Jake Garn “persists in his effort to curry

Footnote continued on next page

effectively kill off what has become not only an important investment choice for millions of individuals and institutions,[77] but also a highly efficient and essential mechanism to fund the needs of business and government borrowers in the short-term market.[78]

Moreover, Money Funds have enjoyed a stunningly superior safety record compared to insured depository institutions. Only two Money Funds have "broken the buck" and returned shareholders less than 100 cents on the dollar: the Community Bankers U.S. Government Fund, which in 1994 repaid its investors 96 cents on the dollar,[79] and the Reserve Primary Fund, which was forced to liquidate in September 2008 as a result of a run triggered by Lehman's bankruptcy and the fund's holdings of Lehman commercial paper. The Reserve Primary Fund has returned to shareholders more than 99 cents on the dollar.[80] Significantly, no taxpayer funds were used to bail out shareholders.

Footnote continued from previous page
support for legislation to curb the funds' check-writing feature and make the funds maintain a percent of their assets in a reserve account."

[77] *See, e.g.*, *Competition and Conditions in the Financial System*, Hearings Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, 97th Cong., 939 (1981) (statement of former SEC Commissioner John R. Evans, who testified that "we are very concerned with suggestions that legislation should be enacted which would impose bank-type regulation on money market funds to the detriment of [public] investors." Noting that "many depository institutions are having difficulty attracting savings during a period when money market funds are experiencing dramatic growth….We can understand why certain depository institutions might like their competitors to be restricted. We believe, however, that any consideration of legislation to impose bank-type regulatory burdens and limitations on money market funds should include an evaluation of the existing regulation of such funds, the present protection provided to investors, and the negative impact that such proposals would have on the millions of people who invest in money market funds." Further, "[i]t is the Commission's view that the harm to small investors, and the inconvenience to large investors, which could result from the imposition of bank-type regulations on money market funds may not be significantly offset by any benefit to banks and thrift institutions."

[78] *See* Phillip R. Mack, *Recent Trends in the Mutual Fund Industry*, 79 Fed. Res. Bull. 1001, 1005 (1993), *available at* http://findarticles.com/p/articles/mi_m4126/is_n11_v79/ai_14714669/pg_5/?tag=content;col1, stating that "[m]oney market mutual funds grew rapidly in the late 1970s and early 1980s, when interest rates on money market instruments exceeded regulatory ceilings that applied to depository institutions. Flows from depositories to money funds supported expansion of the commercial paper market, an important alternative to bank loans for businesses."

[79] Note that the fund had only institutional investors, so individual investors were not directly harmed. *See* ICI Money Market Working Group Report, at 39, *available at* www.ici.org/pdf/ppr_09_mmwg.pdf. *See* Saul S. Cohen, *The Challenge of Derivatives*, 63 Fordham L. Rev. 1993, 1995 n.15 (1995) (internal citations omitted).

[80] *See* Press Release, *Reserve Primary Fund to Distribute $215 Million* (July 15, 2010), *available at* http://www.reservefunds.com/pdfs/Primary%20Distribution_71510.pdf; *see also* SEC Press Release: *Reserve Primary Fund Distributes Assets to Investors* (Jan. 29, 2010), *available at* http://www.sec.gov/news/press/2010/2010-16.htm.

Money Funds achieved this success under the regulation and oversight of the SEC and its Division of Investment Management.[81] At the core of this regulatory program is SEC Rule 2a-7, which in eleven pages imposes sound principals that are the secret of the stability and solvency of Money Funds: invest only in very short-term, high quality, marketable debt instruments in a diversified manner, and do not use any leverage. Rule 2a-7 is the Occam's Razor of financial regulation.

In comparison, the prudential regulation of banks involves four (formerly five) federal regulators and over fifty regulators in states and other districts. The federal agencies alone require over 26,000 full-time employees.[82] The federal banking code – Title 12 of the United States Code and Title 12 of the Code of Federal Regulations – totals fourteen volumes and many thousands of pages of requirements and prohibitions. Yet, during the 40 years since the launch of the first Money Fund – a period during which the Money Fund industry experienced exactly two "failures" – some 2,840 depository institutions have failed, and an additional 592 were the subject of "assistance transactions" in which the government injected capital to keep them afloat.[83] From 1971 through 2010, total estimated FDIC losses incurred in connection with failed banks or assistance transactions amount to $188,538,945,000.[84]

Performance of Money Funds During the Financial Crisis

Even in times of greatest financial stress, Money Funds have proved to be more stable than depository institutions. Since January 2008, as a result of the financial crisis that followed the burst of the housing bubble and the collapse of mortgage-backed securities investments, at least 358 banks have failed,[85] and even more would have failed but for dozens of federal programs that infused banks with cash. The Board, Department of the Treasury, and FDIC spent approximately $2 trillion on an array of programs to infuse cash into the banking system.[86] In

[81] We note that the SEC's program of regulating and supervising investment companies has been extraordinarily efficient and effective to date and that the SEC is appropriately seeking additional funding to carry out its new responsibilities under the DFA.

[82] FDIC 2009 Annual Report; FRB 2009 Annual Report; OCC 2009 Annual Report; OTS 2009 Annual Report.

[83] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[84] FDIC Database of Failures and Assistance Transactions, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[85] FDIC Failed Bank List, *available at* http://www.fdic.gov/bank/individual/failed/banklist.html.

[86] Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of Its Expiration*, at 145-46 (Sept. 16, 2010).

addition, the Board has kept interest rates close to zero, allowing banks to borrow at almost no cost and to lend at higher rates so as to practically guarantee risk-free profits. This is estimated to cost savers $350 billion each year as banks do not have to compete for depositors' funds, and therefore may offer only low interest rates on deposits.[87]

During the same period, only one Money Fund, the Reserve Primary Fund, failed to return investors' shares at less than 100 cents on the dollar.[88] Nonetheless, the massive requests for redemptions by the Reserve Primary Fund shareholders beginning on September 15, 2008 when Lehman declared bankruptcy, and Reserve's announcement the following day that it would re-price its shares, triggered a run by investors in other prime Money Funds who feared that those funds' holdings of commercial paper of other financial institutions would decline in value. Numerous Money Funds liquidated assets or imposed redemption limits[89] and a number of funds obtained support from their advisers or other affiliated persons.[90] As the PWG Report describes,

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[87] Yalman Onaran and Alexis Leondis, *Bank Bailout Returns 8.2% Beating Treasury Yields*, Bloomberg (Oct. 20, 2010), *available at* http://www.bloomberg.com/news/2010-10-20/bailout-of-wall-street-returns-8-2-profit-to-taxpayers-beating-treasuries.html.

[88] On September 16, 2008, the Reserve Primary Fund's shares were priced at 97 cents after it wrote off debt issued by Lehman Brothers, which had declared bankruptcy the day before. Even so, this event was in large part due to misconduct by the Fund's management, as the SEC has alleged in a pending enforcement proceeding. *See* SEC Press Release: *SEC Charges Operators of Reserve Primary Fund With Fraud* , May 5, 2009, *available at* http://www.sec.gov/news/press/2009/2009-104.htm and related SEC Complaint, *available at* http://www.sec.gov/litigation/complaints/2009/comp21025.pdf, at 35. Moreover, Reserve Fund shareholders recovered more than 99 cents on the dollar after it closed. Press Release, *Reserve Primary Fund to Distribute $215 Million* (July 15, 2010), *available at* http://www.reservefunds.com/pdfs/Primary%20Distribution_71510.pdf; SEC Press Release: *Reserve Primary Fund Distributes Assets to Investors* (Jan. 29, 2010), *available at* http://www.sec.gov/news/press/2010/2010-16.htm.

[89] In response to a request, the SEC, by order, permitted suspension of redemptions in certain Reserve funds in order to allow for orderly liquidation. *See Matter of The Reserve Fund*, Investment Company Act Release No. 28386 (Sept. 22, 2008), 73 Fed. Reg. 55572 (Sept. 25, 2008); Reserve Municipal Money-Market Trust, et al., Investment Company Act Release No. 28466 (Oct. 24, 2008), 73 Fed. Reg. 64993 (Oct. 31, 2008).

[90] The SEC notes that with the exception of the Reserve Primary Fund, all of the funds that were exposed to losses during 2007-2008 from debt securities issued by structured investment vehicles or as a result of the default of debt securities issued by Lehman Brothers Holdings Inc. obtained support of some kind from their advisers or other affiliated persons, who absorbed the losses or provided a guarantee covering a sufficient amount of losses to prevent these funds from breaking the buck. *See* Money Market Fund Reform, Release No. IC-29132, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010).

the liquidation of Money Fund assets to meet redemptions led to a reduction of Money Fund holdings of commercial paper by about 25 percent.[91]

No Money Funds were "bailed out" by the government, but the extraordinary conditions in the market, including illiquidity in the secondary market for commercial paper, led to the adoption of special measures to restore confidence in the money markets and Money Funds and address the freeze-up in the commercial paper market. The Treasury Department implemented a limited "Temporary Guarantee Program for Money Market Funds" whereby Money Funds could, in exchange for a payment, receive insurance on investors' holdings such that if shares broke the buck, they would be restored to a $1 net asset value ("NAV").[92] The program expired about one year later, experienced no losses (because the insurance guarantee was never called upon), and earned the Treasury about $1.2 billion in participation fees.[93]

The Federal Reserve also created an "Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility" ("AMLF") to provide credit for banks and bank holding companies to finance their purchases of commercial paper from Money Funds.[94] This program lent $150 billion in just its first 10 days of operation and was terminated with no credit losses.[95] All loans made under the AMLF were repaid in full, with interest, in accordance with the terms of the facility.[96] Indeed, the Federal Reserve Bank of Boston Statements of Income and Comprehensive Income for the years ended December 31, 2009 and December 31, 2008 show the total amount of interest income made on "other loans" (which refers to the AMLF program)

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[91] *See* REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS 12, (2010) *available at* http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf.

[92] Press Release, *Treasury Announces Guaranty Program for Money Market Funds* (Sept. 19, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1147.aspx.

[93] Press Release, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009), *available at* http://www.ustreas.gov/press/releases/tg293.htm.

[94] Federal Reserve Board, *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility*, *available at* http://www.federalreserve.gov/monetarypolicy/abcpmmmf.htm.

[95] Burcu Duygan-Bump, Patrick M. Parkinson, Eric S. Rosengren, Gustavo A. Suarez, and Paul S. Willen, QAU Working Paper No. QAU10-3, *How Effective Were the Federal Reserve Emergency Liquidity Facilities? Evidence from the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility* (available at http://www.bos.frb.org/bankinfo/qau/wp/2010/qau1003.htm). The program ceased operation in February, 2010. Federal Reserve Board Press Release, FOMC Statement (Jan. 27, 2010), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20100127a.htm.

[96] Federal Reserve Board, *Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, Appendix B at 31 (October 2010), *available at* http://www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201010.pdf.

during 2008 and 2009 was $543 million ($470 million and $73 million in 2008 and 2009, respectively).[97] Advances made under the AMLF were made at a rate equal to the primary credit rate offered by the Boston Federal Reserve Bank to depository institutions at the time the advance was made.[98] In sum, the program was extremely profitable to the government. Both programs were limited in scope and involved relatively low risk to taxpayers when compared to other steps taken by the government during the financial crisis.

Going forward, the type of intervention in which the Government may engage will be limited. Congress has forbidden the use of the Exchange Stabilization Fund to guarantee the obligations of Money Funds.[99] The Board's lending authority has been restricted by Section 1101 of the DFA, so that it is not permitted to lend to individual firms that are insolvent.[100] In addition, under Section 214 of the DFA, financial companies placed in receivership under Title II of the DFA cannot receive bailouts or taxpayer-funded expenditures to prevent their liquidation.[101] It is anticipated that these limitations will go a long way in promoting market discipline by eliminating expectations of a Government "bail out" – either of Money Funds or other institutions.

In addition, changes to accounting standards and commercial bank regulatory capital requirements on off-balance sheet treatment of commercial paper financing conduits, as well as changes to commercial paper market conditions (and to a lesser extent the 2010 amendments to Rule 2a-7) have resulted in a substantial decline (by roughly two-thirds) in Money Fund investments in ABCP. As a result, the category of assets financed under the AMLF program no longer are held by Money Funds at anywhere near the dollar levels that existed at the time of the AMLF program.

Moreover, although the Board and the Council have just begun to consider the use of the Government's new tools under the DFA to identify and apply new prudential regulation to systemically significant nonbank institutions that, like Lehman, may rely heavily upon short term funding, the SEC, as discussed below, already has acted to substantially enhance the liquidity of

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97 *See* The Federal Reserve Bank of Boston, Financial Statements as of and for the Years Ended December 31, 2009 and 2008 and Independent Auditors' Report, *available at* http://www.federalreserve.gov/monetarypolicy/files/BSTBostonfinstmt2009.pdf.

98 *Id.*, at 19.

99 Economic Emergency Stabilization Act of 2008, Div. A of Pub. L. 110-343 (Oct. 3, 2008), §131(b).

100 Pub. L. No. 111-203, 124 § 1101 (2010).

101 Pub. L. No. 111-203, 124 § 214 (2010).

Money Funds and further enhance their ability to withstand the potential failure of institutions in whose securities they invest. In addition, the SEC in September 2010 proposed new rules that will shed new light on a company's short-term borrowing practices, including balance sheet "window dressing."[102] The SEC's proposed rules require public companies to disclose additional information to investors about short-term borrowing arrangements, including commercial paper, repurchase agreements, letters of credit, promissory notes, and factoring, used to fund their operations.[103] These actions by the SEC, in combination with future actions by the Board and the Council to apply prudential regulation to certain financial institutions that are issuers of the commercial paper purchased by Money Funds, should, in combination, amplify and reinforce each other to prevent or mitigate the impact of future failures of systemically significant financial institutions and, in particular, mitigate the impact of their failures on investors, such as Money Funds, in the short-term markets.

Conclusion

Money Funds have been a success story in U.S. financial regulation. Using a very simple, common sense approach, which permits investment only in short term, high quality money market instruments, the SEC has succeeded in supervising an efficient and effective program by which investors' cash balances provide financing for American businesses and governmental units. They are very popular with consumers, government and business investors, and very useful to the economy.

Even if Money Funds were within the statutory criteria for designation under Title II of DFA (which they are not), under an appropriate consideration of the potential damage and lack of benefit to the economic system from such a designation, Money Funds should never be designated for FDIC receivership under Title II of the DFA. We request that the final rules or

[102] *See* Release No. 33-9143, *Short-Term Borrowings Disclosure*, 75 Fed. Reg. 59866 (Sept. 28, 2010). Currently, SEC rules require public companies to disclose short-term borrowings at the end of the reporting period, but generally there is no requirement to disclose information about the amount of short-term borrowings outstanding throughout the reporting period. The only exception is for bank holding companies, which must disclose annually the average and maximum amounts of short-term borrowings outstanding during the year.

[103] *Id.* The proposed rules distinguish between "financial companies" and other companies. Financial companies would be required to report data for the maximum daily amounts outstanding (meaning the largest amount outstanding at the end of any day in the reporting period) and the average amounts outstanding during the reporting period computed on a daily average basis (meaning the amount outstanding at the end of each day, averaged over the reporting period). All other companies would be permitted to calculate averages using an averaging period not to exceed a month and to disclose the maximum month-end amount during the period. *See id. See also*, Release No. 33-9144, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*, 75 Fed. Reg. 59894 (Sept. 28, 2010).

the release that will accompany the final rules provide more clarity on this point and state that due to the comprehensive SEC regulation and supervision of Money Funds, in light of the definitions and criteria in the statute, Money Funds will not be designated under Title I or Title II and thus will not be required to file and have approved resolution plans or exposure reports.

Although we recognize that there continue to be some critics of Money Funds who continue to espouse the Carter Administration-era view that Money Funds should be regulated like banks, the reality is that the SEC's regulation of Money Funds has been far more effective than the federal banking agencies' regulation of banks. In the past 40 years only two Money Funds have broken the buck, and both were liquidated with relatively minimal losses to investors on a percentage basis and zero cost to the federal government. During that same period, more than 2,800 depository institutions failed, and almost 600 were kept afloat with government infusions of capital, at a total cost to the government of more than $164 billion. There is nothing in the historical record to suggest that imposing "bank like" regulatory, resolution or receivership requirements on Money Funds will make Money Funds, or the American economy, safer. The prudent course, in our view, is to continue to build upon what has worked and to refine the current program of regulation of Money Funds under the supervision of the SEC.

Sincerely,

John D. Hawke, Jr.

John D. Hawke, Jr.

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

Attachments