ARNOLD & PORTER LLP

David F. Freeman, Jr.
David.Freeman@aporter.com

202.942.5745
202.942.5999 Fax

555 Twelfth Street, NW
Washington, DC 20004-1206

April 4, 2014

Via email to fsb@bis.org

Financial Stability Board
International Organization of Securities Commissions
c/o Secretariat of the Financial Stability Board
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Proposed Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Ref no: 1/2014)

Dear Members of the FSB and IOSCO:

We are writing on behalf of Federated Investors, Inc. and its subsidiaries ("Federated")[1] to comment on the Consultative Document *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (NBNI G-SIFIs), published by the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO).[2] The Consultative Document ("Consultation") poses a number of questions regarding the assessment methodologies that should be used to identify NBNI G-SIFIs – those institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.

---

[1] Federated has more than forty years of experience in the business of managing MMFs 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 MMF to use the Amortised Cost Method.

[2] Consultative Document *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* ("Consultation"), *available at* http://www.financialstabilityboard.org/publications/r_140108.pdf.

The Consultation requests comments on detailed NBNI financial sector-specific methodologies for finance companies, broker-dealers, and investment funds. The investment funds sector is designed to cover authorised/registered open-end schemes that redeem their units or shares (whether on a continuous or periodic basis), as well as closed-end ones. The Consultation states that, by way of example, the methodology applicable to investment funds "would therefore cover disparate fund categories, from common mutual funds (including sub-categories thereof such as money market funds (MMFs) and exchange-traded funds (ETFs) to private funds (including hedge funds, private equity funds and venture capital)."[3]

Our comments will address the various questions posed, based on the application of the methodologies to investment funds and, in particular, money market mutual funds – particularly European "short-term" money market mutual funds that conform to CESR/ESMA guidelines, and U.S. money market mutual funds that meet the requirements of Securities and Exchange Commission ("SEC") Rule 2a-7 (MMFs). In brief –

- Federated agrees with the approach of the Consultation of developing specific, measurable, published criteria for use in designating NBNI G-SIFIs;

- Federated agrees with the Consultation that, to the extent the proposed methodologies are applied to the investment fund sector, it is appropriate to focus on individual funds and not investment managers or fund families;

- Federated further agrees with the Consultation's analysis regarding certain key aspects of investment funds (and MMFs in particular) that weigh strongly against listing them as NBNI G-SIFIs, including their lack of leverage and their substitutability, simplicity and transparency, as well as applicable legal requirements and practices designed to mitigate risk; and

- Using the methodologies presented in the Consultation, properly applied, we do not believe that any MMF should be listed as an NBNI G-SIFI.

Use Specific, Concrete Numeric Standards in Evaluating Potential NBNI G-SIFIs

The overall approach of the Consultation is to apply a specific, concrete set of criteria, including measurable numeric standards, in evaluating NBNI firms for possible designation as NBNI G-SIFIs. We agree with that general approach. In a recent article, 2013 Nobel Economic Laureate Lars Peter Hansen observed that the term "systemic risk" has become a "grab bag, and

[3] Consultation at 28.

its lack of specificity could undermine" the process.[4] Hansen suggests that "systemic risk be an explicit target of measurement . . . [rather than] be relegated to being a buzz word, a slogan or a code word to rationalize regulatory discretion."[5] In the context of the designation of NBNI G-SIFIs, this counsels in favor of using transparent criteria and numeric standards in evaluating whether a firm may pose systemic risk. Dr. Hansen also cautions, however, that the numerical or model criteria not be overly simplistic as that may lead to poor policy decisions.[6] Others have observed that the numeric measures and other specific criteria must not be viewed in isolation, but instead should be considered together in evaluating systemic risk.[7]

In the context of mutual funds and other regulated investment companies, the absence of material amounts of leverage or derivatives,[8] the detailed regulatory program applicable to regulated funds, the many competing funds and other institutional investors in the relevant markets, and the small percentage any one fund owns of the relevant portfolio asset market, in combination, suggest that a regulated investment company, even a large one, is unlikely to be systemically important. In the specific case of MMFs, an unlevered fund which invests only in short-term, highly liquid, high credit quality fixed income instruments, as part of a very large market for an investment category (the general U.S. money market is well over $12 trillion in assets)[9] with many competing investors (not only other MMFs, but also other types of

[4] Lars Peter Hansen, *Challenges in Identifying and Measuring Systemic Risk* at 1 (Feb. 11, 2013), *available at* http://www.nber.org/chapters/c12507.pdf.

[5] *Id.*

[6] *Id.* at 15-17.

[7] Gonzalo de Cadenas-Santiago, Lara de Mesa and Alicia Sanchis, *Systemic Risk, an Empirical Approach,* 32 Capco Institute Journal of Financial Transformation (Aug. 2011), *available at* http://www.capco.com/capco-institute/capco-journal/journal-32-applied-finance/systemic-risk-an-empirical-approach.

[8] *See* 18 U.S.C. § 80a-18(f)(1).

[9] *Money Markets Today: Moving Past the Financial Crisis* at 2 (May 16, 2011), *available at* http://www.ici.org/pdf/mmsummit11_panel1.pdf. The broader global market for very high quality "safe assets" across all maturities has been estimated at $74 trillion. SEC Division of Economic and Risk Analysis, *Demand and Supply of Safe Assets in the Economy* (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-324.pdf (citing International Monetary Fund, *Global Financial Stability Report: The Quest for Lasting Stability* at 88 (April 2012)). Although MMFs are not permitted to invest in the medium and long-term debt instruments included in the $74 trillion total, the broader market for "safe assets" is relevant because high credit quality borrowers may chose to issue medium and longer term debt instruments as an alternative to accessing credit in the short term money markets. Thus, to the extent that the method of transmission alleged to exist for MMFs is the refunding risk of borrowers whose debt is owned by a MMF, the real market from the borrowers' perspective is much larger than $12 trillion and any one MMF makes up only a small fraction of the investment in this broader market for "safe assets" and thus is even less systemically important.

investment funds as well as banks, insurance companies, governments, corporate treasurers and pension plans all investing directly in money market instruments) is far less likely to be systemically important at $100 billion in net assets under management ("AUM") than is a more highly levered fund or other entity with $100 billion in net AUM that is investing in more idiosyncratic assets in less liquid, smaller, and less active markets. In other words, if $100 billion in net AUM is a threshold number for an investment fund generally, a much larger number would be appropriate for judging whether a MMF is an NBNI G-SIFI, due to the large size of the portfolio asset class in which MMFs invest, the low risk of that asset class, the absence of meaningful debt or other leverage, derivatives or counterparty exposures, and the well-developed regulatory framework that governs MMFs.

In addition, the indirect consequences of designating a firm as an NBNI G-SIFI must be considered in establishing the criteria as well as in determining whether to designate a particular firm as an NBNI G-SIFI. For example, if a consequence of such designation would be the imposition of bank-like capital or other regulatory requirements on a mutual fund such that the fund would no longer be attractive to investors or economic to operate, the consequence would be an exit of large funds from the markets. The assets would move somewhere else – either to the balance sheets of already too-big-to-fail banks,[10] or smaller funds,[11] to less-regulated private funds,[12] or to direct investment by individual corporate treasurers in money market or other safe assets – but this change would not in any way reduce the risks inherent in the financial system. Instead, it potentially would increase them.

Focus on individual funds in the investment fund sector

The Consultation states the following reasons for its approach of focusing on individual investment funds, and not asset managers or families of funds: (1) Economic exposures are created at the fund level; (2) A fund is typically organized as a corporate or business trust under national law and, as such is a separate legal entity from its manager; the assets of a fund are

[10] *See* Douglas J. Elliott, Brookings Institute, *Regulating Systemically Important Financial Institutions That Are Not Banks* at 10-11 (May 9, 2013) *available at* http://www.brookings.edu/research/papers/2013/05/09-regulating-financial-institutions-elliott; Daniel M. Gallagher and Troy A. Parades, *Statement on the Regulation of Money Market Funds*, (Aug. 28, 2012) *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171491064.

[11] *See* Daniel K. Tarullo, *Regulating Systemic Risk* at 6 (delivered at the 2011 Credit Markets Symposium Charlotte, N.C., Mar. 31, 2011), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.pdf.

[12] *See* Luis A. Aguilar, Statement Regarding Money Market Funds (Aug, 23, 2012), *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171491044; Statement on Money Market Funds as to Recent Developments (Dec. 5, 2012), *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171491946.

separated and distinct from those of the asset manager and, as a result, the assets of a fund are not available to claims by general creditors of the asset manager; and (3) Certain data required to be collected under national law is or will be available in a per entity format.[13] Federated agrees that the above, as well as the additional reasons discussed below, support the Consultation's approach of focusing on funds and not asset managers or families of funds.

We hope you will indulge us as we agree at length with the Consultation on this point. It is an important one that must be kept in mind when evaluating investment funds' lack of systemic risk. Regulated investment funds (U.S. registered investment companies and European UCITS funds, for example) and other clients of regulated investment managers, are not subject to risk of loss if the investment manager fails. Therefore, each investment fund should be evaluated separately from its investment adviser, and from other investment funds advised by the same investment adviser, in designating NBNI G-SIFIs.

Investment management is an agency activity. The value of a client's investments managed by an investment manager are not tied to the financial health of the investment manager. Investment managers do not act as principals in managing the investments of their clients. If the clients' investments decrease in value, the client, and not the investment manager, is exposed to the risks of loss. An investment manager does not guarantee results or act as a counterparty to its clients. Thus, it would be inappropriate to focus on investment managers as potential NBNI G-SIFIs.

Investment managers generally are not permitted to borrow money from or owe money to regulated funds, do not have custody of fund assets, and do not guarantee fund portfolios or investment results.

The SEC prohibits registered investment advisers from having custody of investment funds' and other client assets and from transacting as a principal with them. Consequently, investment funds and other clients of an investment adviser retain ownership of all assets acquired by their asset manager on their behalf. Clients do not need to liquidate investments when they terminate an investment adviser; they only need to terminate the adviser's trading authority.

Because an investment adviser generally does not have custody over assets of the investment funds that it advises, and does not guarantee investors in those funds from investment losses, an investment adviser's capitalization is generally not material to investors in the fund or other clients of the adviser.

---

[13] Consultation at 30.

Because investment managers (other than investment managers that are banks) generally have relatively small balance sheets and do not engage extensively in borrowing, lending, derivatives or other activities as principal, the direct risks from the insolvency of an investment manager to the third parties with which it deals as a principal are limited in size, and are not dissimilar to the credit risks posed by other firms of similar balance sheet size. They are not systemically important by any reasonable measure of counterparty risk.

In the United States, Congress and the SEC have put in place a regulatory system under the Investment Advisers Act and Investment Company Act for investment advisers and investment funds that is designed to protect clients from counterparty risk exposure to the investment adviser. Key features of this system include:

- Fund and other client assets must be held in custody at a custodian bank or broker-dealer;[14]

- Transactions between the investment fund or other client on the one hand, and the investment adviser (or the adviser's affiliates) on the other, are generally prohibited, subject only to very narrow and limited exceptions;[15]

- Material risks and conflicts of interest in the investment fund or advisory service must be disclosed in writing to the client;[16]

- Advisers are not allowed to guarantee investment funds' or other clients' investment performance;[17]

[14] Investment Company Act § 17(f); 17 C.F.R. §§ 270.17f-1 *et seq.*, 275.206(4)-2. To similar effect under European law, *see* Parliament and Council Directives 2001/107/EC and 2001/108/EC (21 Jan. 2001) and 2009/65/EC (13 July 2009), On the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities at Art. 22(1) (The UCITS Directive was adopted in 1985, revised in 2001, and recast in 2009.) (together, the "UCITS Directive"), and Parliament and Council Directive 2011/61/EU (8 June 2011), On Alternative Investment Fund Managers at Article 21(1) (Directive 2011/61/EU amends Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010) ("AIFM Directive").

[15] Investment Company Act § 17; Investment Advisers Act § 206(3); 17 C.F.R. §§ 270.17a-1 *et seq.*, 275.206(3)-1 *et seq.*

[16] 17 C.F.R. § 275.204-3; Form N-1A, N-7. To similar effect, *see* UCITS Directive Art. 14(2)(c); AIFM Directive Art. 12(1)(d).

[17] *See* SEC Staff Letter to Robert Reinhart (Sep. 21, 1971); Contingent Advisory Compensation Arrangements, SEC Rel. IA-721 (May 16, 1980).

- Investors in a regulated investment fund must receive audited financial statements,[18] and advisory clients must receive periodic statements of account;[19]

- Standards of current, independent valuation are applied to the financial statements of regulated investment funds, as well as statements to separate account clients on the value of assets;[20]

- Accounts are subject to annual independent audit;[21]

- Advisory fees are limited by fiduciary and anti-fraud standards and must be clearly disclosed in writing;[22] and

- Investment funds and other clients of an investment adviser must, under the terms of advisory contracts, be permitted to terminate the advisory relationship with or without cause, on short notice, and without financial penalty.[23]

The net result of this regulatory framework is that regulated investment funds and other clients of investment advisers are exposed to the risks of a decline in value or illiquidity of their investments – which is precisely the risk that investors knowingly undertake when they choose to invest in securities as the price for potential profit from an increase in value of the investments –

[18] 17 C.F.R. § 275.206(4)-2(b)(4) & (5). To similar effect, *see* UCITS Directive Art. 73; AIFM Directive Art. 22(3).

[19] 17 C.F.R. § 275.206(4)-2(a)(3).

[20] Investment Company Act § 2(a)(41); 17 C.F.R. §§ 270.2a-4, 275.206(4)-8(a)(1); SEC Accounting Series Rel. No. 118 (Dec. 23, 1970); SEC Accounting Series Rel. No. 113 (Oct. 21, 1969); Investment Company Act Rel. No. 26299 (Dec. 17, 2003) (compliance program requirement includes valuation program compliance). To similar effect *see* UCITS Directive Arts. 69, 73; AIFM Directive Art. 22.

[21] 17 C.F.R. § 275.206(4)-2(a)(4). To similar effect *see* UCITS Directive Art. 42.

[22] Investment Company Act §§ 15, 36. For non-investment company advisory fees, similar principle applied under anti-fraud provisions of Advisers Act. *See Equitable Communications Co.*, SEC Staff No-Action Letter (Feb. 26, 1975); *Consultant Publications, Inc.*, SEC Staff No-Action Letter (Jan. 29, 1975); *Financial Counseling Corporation*, SEC Staff No-Action Letter (Dec. 7, 1974); *John G. Kinnard & Co.,* Inc., SEC Staff No-Action Letter (Nov. 30, 1973). *See* UCITS Directive Art. 54(3); AIFM Directive Art. 23(1)(i).

[23] Investment Company Act § 15(a)(3). The same principle for non-investment company advisory clients is stated in *National Deferred Compensation*, SEC Staff No-Action Letter (Aug. 31, 1987) ("An adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service or if it imposes an additional fee on a client for choosing to change his investment."); *National Regulatory Services*, SEC Staff No-Action Letter (Dec. 2, 1992).

but they are not exposed to the risk of loss of value due to the insolvency of the investment manager.

Notably, the European Parliament's Committee on Economic and Monetary Affairs recently issued a report on systemic risk issues associated with various types of non-bank financial firms, including asset management firms.[24] The Report called upon the European Commission to take into account whether the firms "trade on their own account and are subject to requirements regarding the segregation of the assets of their clients," noted that asset management firms' "client assets are segregated and held with custodians, and that therefore, the ability for these assets to be transferred to another asset manager is a substantial safeguard" and stated the committee's belief that "an effective securities law regime may mitigate many of the issues involved in the case of a large crossborder asset manager."[25] The European Parliament committee report further stated that "[t]he size and business model of the asset management sector does not typically present systemic risk."[26]

In the MMF subcategory of investment funds, the same investment manager may advise many different MMFs with different investment focuses.[27] Regardless of what specific investments are in a particular MMF, each MMF portfolio stands alone. The liabilities (if any) and shareholder interests of one MMF do not have a claim on the portfolio assets of another MMF, even if they are invested in the same issuers. The portfolio of each MMF is diversified by issuer and maturity, resulting in limited exposure to any one issuer or group of issuers.

---

[24] *Report on Recovery and Resolution Framework for Non-bank Institutions* (2013/2047(INI)) (Oct. 22, 2013).

[25] *Id.* at 10.

[26] *Id.* at 15.

[27] In the U.S., for example, MMFs fall into three general categories: U.S. government securities MMFs, tax-exempt MMFs, which invest in tax-exempt municipal securities; and prime MMFs, which invest in a combination of different types of securities. Within each broad category, there are different MMFs, each with a different investment specialization. The category of U.S. government securities MMFs includes funds that invest only in U.S. Treasury securities, and other funds that invest in a broader range of U.S. Treasury and agency securities. Within the broad category of tax-exempt MMFs are funds that invest in municipal securities of a particular state and municipalities within that state and are offered primarily to taxpayers of that state (who get the most favorable tax treatment for the home state municipal securities), and MMFs that invest in municipal securities from many states. Similarly, within the broad category of prime MMFs are different funds, each with its own investment portfolio and maturity profile. In the EU, MMFs come in two general varieties: constant net asset value (CNAV) funds and variable net asset value (VNAV) funds. CNAV MMFs operate only as "short-term" MMFs, which invest in very short-term, high-quality, liquid money market instruments. VNAV funds are also permitted to operate as "short-term" MMFs, but most operate as "standard" MMFs, which allows them to hold longer-term money market assets.

Because MMFs hold only very short-term money market instruments, the portfolio composition of every fund is continuously changing, with the great majority of the assets turning over every two or three months. MMFs managed by the same investment manager may invest in many of the same issuers, but at different times with different maturity dates, such that the performance and payment on the two investments will differ and will not necessarily bear the same risks or market values. MMF investment managers select portfolio investments for the funds through extensive and on-going credit review of issuers, which results in a list of permitted issuers and instruments, and the maximum portfolio investment in each fund. To this is applied a matrix of the maturity profile required to meet the liquidity and return objectives of the fund and other investment and diversification requirements. The portfolio manager and traders then select particular investments from the approved list that meet the requirements of the matrix as they become available, depending on price, market outlook on the issuers and instruments, and other considerations, seeking to pick the best of the available investments to optimize the MMFs performance within the criteria set forth in the matrix.

For these reasons, Federated believes it would not be appropriate to aggregate MMFs in a fund family for purposes of applying the methodologies, to focus on asset managers on a stand-alone entity basis, or to focus on asset managers and their funds collectively.

Systemic risk and transmission mechanisms

The Consultation states that, in identifying NBNI G-SIFIs, the methodologies emphasize indicators that point to the systemic impact of the failure of the institution, rather than the institution's likelihood of failure.[28] Thus, an NBNI financial institution should be considered for listing as an NBNI G-SIFI only if its distress or failure could flow through one or more transmission channels to other financial firms and markets.

The Consultation lists three channels whereby financial distress of an NBNI financial entity is most likely to be transmitted to other financial firms and markets, and thereby pose a threat to global financial stability:

(i) the exposures of creditors, counterparties, investors, and other market participants to the NBNI financial entity (*the exposures/counterparty channel)*;

(ii) the liquidation of assets by the NBNI financial entity, which could trigger a decrease in asset prices and thereby could significantly disrupt trading or funding in key financial markets or cause significant losses or funding

[28] Consultation at n.5.

problems for other firms with similar holdings (*asset liquidation/market channel*); and

(iii) the inability or unwillingness of the NBNI financial entity to provide a critical function or service relied upon by market participants or clients (such as borrowers) and for which there are no ready substitutes (*critical function or service/substitutability channel*).[29]

In applying the sector-specific methodologies to identify investment funds that may be NBNI G-SIFIs, however, the Consultation identifies only two systemic risk transmission channels as applicable: the exposures/counterparty channel and the asset liquidation/market channel.[30] Thus, the Consultation essentially acknowledges that investment funds cannot transmit risk through the third channel, the critical function or service/substitutability transmission channel.

Critical function or service/substitutability transmission channel – demonstrates that investment funds, including mutual funds and MMFs, are not systemically important. The Consultation acknowledges that investment funds are highly substitutable:

> [F]unds close (and are launched) on a regular basis with negligible or no market impact. In other words, the investment fund industry is highly competitive with numerous substitutes existing for most investment fund strategies (funds are highly substitutable). A fund may close for a variety of reasons, for example not attracting sufficient investor interest or performing poorly over a given period, leading investors to gradually withdraw their money. As a result, a manager (or a fund's Board, depending on the jurisdiction) may choose among several options. For instance, it may choose to alter the underlying investment strategy, merge the fund's assets with those of another similarly managed fund, arrange (with investors' consent) for the assets to be managed by another manager on the basis of a new investment mandate, or orderly liquidate the assets and return investors' their monies."[31]

In the mutual fund category, funds are highly substitutable and routinely are launched, closed or merged with negligible market impact. In the MMF subcategory in particular, as a matter of prudent investment management and in the interests of its investors, a MMF may determine not to roll over funding with a particular market participant as a credit decision or to

[29] *Id.* at 3.

[30] *Id.* at 29.

[31] *Id.* at 30 (citations omitted).

meet redemptions; nonetheless there are numerous other MMFs and other financial institutions that may be willing to provide credit to a sound borrower. Because they are financed exclusively by equity capital in the form of shares, MMFs can quickly shrink or grow to meet investor demands and market conditions. The hole left by the closing of one MMF will be filled immediately by the movement of shareholder investments to other MMFs, or to direct investment or other intermediaries. As one economist has noted in Congressional testimony:

> On economic grounds, there is no reason to believe that either specific mutual funds or mutual fund complexes should be designated as systemically important. The asset management industry plays a critical role in our economy by managing the funds of investors. The failure of a player in that industry in performing its role does not create a systemic risk. If one player runs in[to] trouble, another player can take its place. In general, difficulties with one player would not mean that the investors in the funds managed by that player would be at risk for regulated funds because the monies of the investors are segregated. Should a firm that manages mutual funds fail, the funds have boards that can replace the manager. There is no reason for that transition to be problematic.[32]

Such substitution can occur in normal economic conditions as well as in a crisis, as demonstrated by the experience of the Putnam Prime Money Market Fund (Putnam Prime Fund) in September 2008. Just days after the Reserve Primary Fund suffered uncontrolled redemptions, the Putnam Prime Fund board acted to suspend redemptions and liquidate the fund, which provided sufficient time to effect a share exchange with Federated's Prime Obligations Fund, followed by an immediate liquidation of Putnam Prime Fund with redemptions of former Putnam Prime Fund shares at $1 per share. As a result of the actions of Putnam Prime Fund's board, shareholders received a quick resolution with minimal disruption. As events turned out, the process was so smooth that investors were actually able to redeem at all times throughout, with no loss of liquidity, and without investment loss.[33]

Further, MMFs do not operate in a vacuum. In addition to the many MMFs in operation globally, other categories of institutional investors, including other types of investment funds, banks, insurance companies, pension plans, governments and corporate treasurers are direct

[32] *Oversight of the Mutual Fund Industry: Ensuring Market Stability and Investor Confidence: Hearing Before the Subcomm. on Capital Markets and Government Sponsored Enterprises of the H. Comm. On Financial Services,* 111th Cong., at 3 (June 24, 2011) (statement of Rene M. Stultz, Everett D. Reese Chair of Banking and Monetary Economics, The Ohio State University), *available at* http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=247410.

[33] *See* Letter from Peter E. Madden to SEC (Feb. 13, 2013), https://www.sec.gov/comments/mms-response/mmsresponse-33.pdf.

investors in the same types of money market instruments in which MMFs invest. As an asset class, the money markets total well over $12 trillion in the U.S. alone. All MMFs in the aggregate hold less than a third of that total.

The issuers of the portfolio instruments issued in the money markets are large companies and governments with access to many institutional investors and lenders, as well as other forms of credit (bank loans and longer-term notes and bonds, for example). Unlike, for example, small businesses and individual borrowers who have limited access to the financial markets and must depend on the credit committee of a single bank that knows their credit and with which they have a relationship,[34] the large issuers with audited, published financial statements that access the money markets have more options for obtaining financing. Although the participation of MMFs as an investor category in the money markets makes those markets more efficient and liquid and lowers costs and creates efficiencies for both issuers and investors, the space left by the departure of any one MMF or group of MMFs is quickly replaced by other MMFs or intermediaries, and the issuers can tap these other sources to quickly obtain financing.

We therefore agree that the critical function or service/sustainability channel is not a transmission channel for the distress or failure of MMFs.

Rather than viewing this as not relevant, however, Federated believes that the substitutability criteria weighs strongly against designating *any* MMFs as NBNI G-SIFIs. Particularly when considered together with the size criteria in the Consultation, the complete and rapid substitutability of a $100 billion net AUM unlevered MMF in the $12 trillion plus money markets makes clear that such a MMF is *not* systemically significant.

Moreover, in the 40 year history of MMFs, there never has been a run on a MMF that invests primarily in U.S. government securities requiring liquidation of the fund and substitution of another fund. As such an event is extremely unlikely, it is appropriate to exclude U.S. government MMFs from the substitutability analysis.[35] When the remaining U.S. prime MMF industry segment of $ 1.51 trillion (excluding the $214.17 billion prime MMFs had invested in

---

[34] Ben S. Bernanke, *Non-monetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REVIEW 257, 263-266 (1983); Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance and Liquidity*, 91 J. OF POLITICAL ECON. 401 (1983).

[35] According to SEC data, 90% of U.S. Government MMFs had little to no exposure to non-U.S. government securities as of November 2013. Division of Economic and Risk Analysis, *Government Money Market Fund Exposure to Non-Government Securities* at 4 (Mar. 17, 2014), *available at* http://www.sec.gov/comments/s7-03-13/s70313-322.pdf.

U.S. government and agency securities as of year-end 2012)[36] is viewed in relation to the $8.35 trillion non-U.S. government or Agency security U.S. money market,[37] it is clear that no single prime MMF with $100 billion in AUM or even several multiples of that amount should be considered systemically significant.

In addition, we believe the other two transmission channels, while potentially relevant to certain types of investment funds, further demonstrate that mutual funds and, in particular, MMFs, do not pose systemic risks and should not be designated as G-SIFIs.

Exposures/counterparty channel. Using leverage to enhance return generally is not an investment strategy for mutual funds; it is categorically not an investment strategy for MMFs. MMFs have no debt or leverage and are 100% equity.[38] MMFs do not use or invest in derivatives to any material degree. Due to the absence of borrowed funds and derivatives, MMFs cannot transmit portfolio losses to lenders or derivatives counterparties, as they have none to speak of. These characteristics of MMFs are addressed in more detail in the discussion of the "Interconnectedness" indicator further below.

In addition, investors in MMFs are equity investors who bear the risk of losses which, in view of the high credit quality and liquidity of MMF portfolios, generally would be very minimal. The potential loss to shareholders of a MMF are far too low to transmit systemic risk from the MMF to investors. For example, in the United States, only two MMFs have ever "broken the buck," or failed to maintain a constant net asset value ("CNAV") of $1 dollar per share, in the more than 40 years that MMFs have been in operation. In one case, investors

[36] Investment Company Institute, *Money Market Mutual Fund Assets* (Mar. 27, 2014), http://www.ici.org/research/stats/mmf/mm_03_27_14; Investment Company Institute, 2013 Investment Company Fact Book at Table 44, *available at* http://www.icifactbook.org/.

[37] This calculation begins with the $12 trillion money market referenced above and removes the $535 billion of U.S. agency debt outstanding with less than one year to maturity as of 2013 and the $3.36 trillion in marketable U.S. government securities with less than one year to maturity. U.S. Agency debt figures are available at SIFMA, *US Agency Debt Outstanding* (updated Mar. 14, 2014) https://www.sifma.org/research/statistics.aspx. According to the U.S. Treasury Department's Quarterly Data Release, 26% of the total $12 trillion in outstanding marketable U.S. Treasury securities have less than one year remaining until maturity as of the first quarter of FY2014, or approximately $3.12 trillion. U.S. Treasury Department, *Monthly Statement of the Public Debt of the United States* (Feb. 28, 2014), https://www.treasurydirect.gov/govt/reports/pd/mspd/2014/opds022014.pdf; U.S. Treasury Department, *Quarterly Data Release* (listing the percentage of marketable debt maturing in the next 12 months) (Q1 FY 2014), http://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Documents/Quarterly%20data%20release.xls.

[38] Investment Company Institute, *Money Market Funds in 2012: Money Market Funds Are Not Banks* (Feb. 14, 2012), http://www.ici.org/pdf/12_mmf_mmfs_are_not_banks.pdf.

received more than 96 cents back on the dollar, in the other, more than 99 cents on the dollar, and in each case at no cost to the government.[39] In the second case – the failure of the Reserve Primary Fund to maintain a CNAV of $1 per share during the height of the Financial Crisis in September 2008 – more than 800 U.S. MMFs in operation at the time were able to maintain CNAV of $1 per share. In contrast, over this same period nearly 3,000 U.S. government-insured banks failed, causing losses of nearly $200 billion to the deposit insurance funds.[40]

The magnitude of shareholder losses on MMFs are simply too small as a percentage matter, and too infrequent, to be a means of transmission of systemic risk from MMFs to shareholders and beyond. MMF investors are able to absorb such small and infrequent losses; a MMF's portfolio losses could not be transmitted to other financial institutions or pose a threat to financial stability.

The Consultation acknowledges that:

> Unlike banks, for instance, where capital is set aside to protect depositors and other creditors against the risk of losses, investment management is characterized by the fact that fund investors are knowingly exposed to the potential gains and losses of a fund's invested portfolio. As such and at least in theory, fund investors decide, based on full disclosure, to take on investment risks. In addition, from a purely systemic perspective, funds contain a specific "shock absorber" feature that differentiates them from banks. In particular, fund investors absorb the negative effects that might be caused by the distress or even the default of a fund, thereby mitigating the eventual contagion effects in the broader financial system. As explained above, fund investors bear both upside rewards and downside risks from movements in the value of the underlying assets. Bank depositors, on the other hand, are not in the same position and generally neither benefit from a

[39] The Community Bankers U.S. Government Fund in 1994 repaid its investors 96 cents on the dollar. That MMF had only institutional investors, so individual investors were not directly harmed. *See* ICI Money Market Working Group Report at n. 47 (Mar. 2009), *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). The Reserve Primary Fund 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. *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.

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

> bank's profits (that goes to bank shareholders) nor do they bear the primary risk of a bank default. Whether funds are managed by an operator (usually investment advisers/managers) or are self-managed (i.e. managed by a board), the manager acts as an "agent", responsible for managing the fund's assets on behalf of investors according to its investment objectives, strategy and time horizon."

Asset liquidation/market channel. With respect to the asset liquidation/market channel, because of daily and weekly liquidity requirements and practices of MMFs and the high credit quality and highly liquid nature of MMF portfolio investments, a MMF portfolio can be liquidated without distressing other financial institutions and markets or posing a threat to global financial stability. As discussed above, in view of the very large size of the money markets, and the even larger size of the longer-term markets for "safe assets" of prime issuers to which prime issuers can turn to obtain financing, this channel does not appear to provide a means of transmission of systemic risk from a MMF to the financial system.

As the Consultation also observes, there are also important factors worth considering that may dampen the global systemic impact of a fund failure (beyond the obvious observation that unlevered funds cannot "fail" in the default sense, they can simply lose money for their investors). For instance, depending on national regulation, asset managers may temporarily implement specific liquidity management tools such as swing pricing, anti-dilution levies, redemption gates, side-pockets, redemptions in kind or temporary suspensions.[41] We note here that while, under U.S. and other laws, a distressed MMF may suspend redemptions to assure fair treatment of investors and proceed with an orderly liquidation, Federated currently supports enhancement of those authorities in proposed amendments to MMF regulations in the U.S.[42] and proposed amendments to the European Commission's proposed regulation on MMFs.

The contention that a MMF may transmit risk to financial institutions and markets through the liquidation channel is based on the overreliance of some banks on short-term funding and the fact that MMFs (and all other non-sovereign lenders) may not renew maturing funding to troubled banks in a crisis, resulting in a liquidity issue at these banks. In some cases, the pressure not to roll over short-term investments is applied by regulators, as in the 2011 European debt crises, when U.S. regulators pressured U.S. MMFs not to renew funding to European banks.[43] SIFI designation will not change this behavior by regulators or the underlying

[41] Consultation at 30.

[42] *See* Letter from Federated to Securities and Exchange Commission (September 16, 2012) (titled "Comments Regarding Proposed Alternative 2").

[43] U.S. regulators began making public statements questioning MMF investments in European banks in May 2011. At an SEC roundtable discussion on MMFs, then-Commodity Futures Trading Commission Chairman Gary Gensler

Footnote continued on next page

economic incentives involved. However, Basle III requirements (in the U.S., the proposed liquidity coverage ratio rule applicable to banks) will regulate this issue directly by regulating bank liquidity and reliance on short-term funding. If bank regulators implement those rules properly, MMFs cannot transmit liquidity risk to banks because banks will not be allowed to depend upon short-term funding. Regulating MMFs as a way to prevent banks' circumvention of the new bank liquidity rules is unnecessary.

More generally, the Consultation mentions the possibility of forced asset liquidations causing an investment fund to dump assets at any price, triggering a downward spiral in overall prices.[44] Others have cited the risk of heavy redemption requests on a MMF in a stressed

Footnote continued from previous page
stated, "The [MMF] industry does support U.S. commercial paper, but the majority of the money, I think this was correct, is funding European and Asian banks' dollar deposits. . . . Be a heck of a perverse outcome if our taxpayers have to stand behind European and Asian financial institutions through the transmission of U.S. money market funds . . . ." Then-Bank of England Deputy Governor Paul Tucker responded, "Capital flows seamlessly across borders, as Gary said. The U.S. money fund industry is heavily invested in the European banking system. Were there to be, God help us, renewed problems in the European banking system, I don't doubt that that could cause an entrenchment of the provision of liquidity by U.S. money funds to Europe, which would no doubt exacerbate difficulties in Europe, and that would eventually flow back to the larger banks in the U.S. This is a highly interconnected world." Roundtable on Money Market Funds and Systemic Risk (May 10, 2011), *available at* https://www.sec.gov/spotlight/mmf-risk/mmf-risk-transcript-051011.htm. Within weeks, Federal Reserve officials were making public statements warning of the risks to MMFs of holding the short-term debt of European banks. Federal Reserve Bank of Boston President Eric Rosengren stated in a June 2011 speech, "Consider that many (but not all) MMMF's have sizeable exposures to European banks, by virtue of holding the banks' short-term debt. This means some MMMFs are potentially sensitive to a disruption in the European banking system, should one arise from the fiscal and sovereign-debt problems we are seeing in some European countries." Eric Rosengren, President, Federal Reserve Bank of Boston, Defining Financial Stability, and Some Policy Implications of Applying the Definition (June 3, 2011), *available at* http://www.bostonfed.org/news/speeches/rosengren/2011/060311/index.htm. Press coverage warning of potential risks to European banks, from a Greek default or otherwise, appeared shortly thereafter. *See, e.g.*, Graham Bowley, *Worries Grow About Breadth of Debt Crisis*, N.Y. TIMES, June 16, 2011 ("The worry is that the worst case, a Greek debt default, would lead to damaging losses for European banks and spur a global panic, replaying the events of September 2008."); Mary Pilon, *Investors New Worry: Is There Greek Debt in My Money Fund?*, WALL ST. J., June 28, 2011 ("Last week, lawmakers and regulators registered concerns about money-market funds' exposure to the European debt crisis. About half of the assets in the 10 largest U.S. prime money-market funds are invested in European bank debt, according to a report from Fitch Ratings."). At a press conference soon afterward, then-Federal Reserve Board Chairman Ben Bernanke stated, "With very few exceptions, the money market mutual funds don't have much direct exposure to the three peripheral countries which are currently dealing with debt problems . . . . They do have substantial exposure to European banks in the so-called core countries: Germany, France, etc. So to the extent that there is indirect impact on the core European banks, that does pose some concern to money market mutual funds." Graham Bowley, *The Ripples of a Debt Crisis*, N.Y. TIMES, June 29, 2011. Given the intense scrutiny of this issue by U.S. regulators, MMFs were left with little choice but to divest from European banks.

[44] Consultation at 3, 29.

market, like a run on a bank, as a reason large investment funds and asset managers could pose "systemic risk."[45] The normal financial context in which the downward spiral phenomenon is cited involves margin calls and sales of collateral by creditors and counterparties, who are seeking to recover a portion of a bad or defaulted credit by selling a collateral security quickly.[46] MMFs do not borrow or employ leverage or derivatives to a material degree. MMFs do not have significant creditors or counterparties that have a need or an incentive to foreclose on collateral and sell it at any cost. MMFs have shareholders. As the Consultation notes, these shareholders are equity owners of the fund and experience any portfolio losses; a risk shareholders knowingly undertake when they invest in the fund. As the Consultation indicates, the risk of a bank run is different from redemptions from a mutual fund. A bank is legally obligated to pay demand deposits on demand. If a bank fails to do so, it defaults. When the depositors of a bank rush to withdraw funds from the bank, the bank is under the stress of the demands of numerous creditors and the default risk is concentrated in the bank.

In contrast, investments in mutual funds are the investor's equity, not the fund manager's liability. When investors in a fund make redemption requests, they cannot put the fund manager in default. Mutual fund shares are issued and sold under a "forward pricing" convention.[47] An investor placing a purchase or redemption order does not get the share price from the previous market close, nor a share price based on portfolio values as of the time that the order was placed. Instead, the shareholder gets the share price determined *after* the order is placed. This means the price impact of selling pressure on the individual securities in a mutual fund's portfolio is factored into the redemption price that the investor receives. The forward pricing convention does a good job of addressing any first mover advantage related to pricing that is caused by the open-end fund structure.

Moreover, MMFs are an efficient method used by investors to invest in a portfolio of money market instruments. For large institutional investors, MMFs are an alternative to direct

---

[45] Office of Financial Research, *Asset Management and Financial Stability* at 12-16 (Sept. 2013), *available at* http://www.treasury.gov/initiatives/ofr/research/Documents/OFR_AMFS_FINAL.pdf.

[46] *Id.* at 17, 22. Redemptions from mutual funds have a weak effect on market prices on the underlying markets in which they invest, in part because they do not have a sufficient share of those markets, and are not strong enough to sustain a market decline. Eli M. Remolona, Paul Kleiman, and Debbie Gruenstein, *Market Returns and Mutual Fund Flows*, Federal Reserve Bank of New York Economic Policy Review (July 1997) at 33, 36, 45 (1997), http://www.newyorkfed.org/research/epr/97v03n2/9707remo.pdf. The effect tends to be greater in smaller and less liquid markets. The effect in the underlying markets of any such decline is temporary and reverses after a period of time. Amil Dasgupta, Andrea Prat, & Michela Verardo. *Institutional Trade Persistence and Long-Term Equity Returns*, 66 Journal of Finance 635 (2011).

[47] 17 C.F.R. §§ 275.2a-4, 275.22c-1.

investment in money market instruments, at lower transactions costs and with greater diversification. If MMFs are disintermediated and institutional investors return to direct investment in money market assets on a broader scale, the same impact on underlying money market liquidity and access to short-term funding in a crisis that has been ascribed to MMFs will continue to occur in the direct investor market (as it always has in every financial crisis). Market liquidity and prices for assets go up and down based on buyer and seller interest. Viewing investment managers that invest fund assets in markets, and buy and sell these positions to meet client objectives, as a form of "systemic risk" or method of transmission of "systemic risk" is a significant analytical mistake.

Application of sector-specific methodologies to investment funds for identifying NBNI G-SIFI

The Consultation identifies a "basic set" of impact factors designed to capture different risks posed by all NBNI financial entities: (i) size; (ii) interconnectedness; (iii) substitutability; (iv); complexity; and (v) global activities (cross-jurisdictional activities). Our comments will focus on the Consultation's methodologies and the specific impact factors as they apply to investment funds and, in particular, MMFs.

Size

Focusing on the value of the assets under management for investment funds, the Consultation states, "in theory, the larger the size of a fund, the greater its potential impact on counterparties (counterparty channel) and markets (market channel)."[48] Therefore, the Consultation states that size is used to determine the assessment pool of investment funds subject to the methodology.

The Consultation proposes a materiality threshold as an initial filter of the NBNI financial universe and to limit the pool of firms for which more detailed data will be collected and to which the methodology will be applied.[49] For investment funds, the threshold is set at USD $100 billion in net AUM.[50] While larger funds may not be screened out from the initial screening, we believe, applying the other factors and indicators discussed below, no MMF should be listed as an NBNI G-SIFI.

---

[48] Consultation at 33. For hedge funds, the Consultation proposes Gross Notional Exposure as an alternative indicator.

[49] Consultation at 8-9.

[50] Consultation at 9. For hedge funds, an alternative threshold will be set at a value between USD $400-600 billion in Gross Notional Exposure.

In this regard we note that the $100 billion threshold proposed by the Consultation is based on *net* assets for investment funds. In this context, a highly regulated and transparent $100 billion net AUM MMF which has zero leverage or derivatives triggers the threshold, while a highly leveraged $390 billion *gross* AUM hedge fund with $90 billion in equity capital, and little transparency, does not (assuming its gross notional exposure to counterparties is under $400 billion). Levered portfolios have more risk – to investors, counterparties, and markets as a whole, which is why there are margin rules – than do unlevered portfolios. Moreover, regulated investment funds tend to have strict limits on leverage, while unregulated investment funds commonly do not. Use of a *net* AUM threshold creates the wrong incentives and establishes the wrong measure of systemic risk. A net AUM test falsely equates the asset size of an unlevered fund with a much larger levered fund. Moreover, when consideration is given to the size, depth and liquidity of the money markets in which MMFs invest and the consequent substitutability of a MMF in that market, a $100 billion asset threshold is too low for a MMF, and too high for a levered hedge fund that operates in smaller and murkier markets, in evaluating an investment fund's status as an NBNI G-SIFI.

While size matters at some level, the size threshold should be based on gross assets and take into account the size of the entity relative to the market in which it participates. In sum, a much higher threshold for NBNI G-SIFI status than $100 billion would be appropriate for a MMF as an unlevered investment fund that invests in an over $12 trillion portfolio market with many, many competitors.

Interconnectedness

The Consultation describes three indicators designed to capture an investment fund's interconnectedness with market counterparties, including brokerage and trading counterparties.

Indicator 2-1: The Consultation states that the *leverage ratio*–

> "serves as a proxy for the overall level of leverage. The more interconnected a fund, or the greater the counterparties' credit exposures are to that fund, the greater that fund's potential impact in case of default on counterparties and to the broader financial system. Equally, the greater a fund's leverage, the greater its potential impact on counterparties that have provided finance (counterparty channel) and on markets in the event of a disorderly and rapid de-leveraging (market channel)."[51]

[51] Consultation at 33-34.

This is measured as the "Gross AUM of the fund/NAV of the fund."[52]

A MMF is a pool of short-term debt investments owned by shareholders. There is no material debt or other borrowing by the MMF. It is 100% equity. Its leverage ratio is therefore zero under normal tests and 1:1 assets to equity or 100% equity under the ratio in the consultation. This indicator demonstrates that a MMF should not be viewed as presenting systemic risk.

Indicator 2-2: The *counterparty exposure ratio* is measured as "total net counterparty credit exposure at the fund/Net AUM (NAV) at the fund."[53] The total net counterparty credit exposure at the fund is further defined as "the total sum of all residual uncovered exposures that the fund positions represent for its counterparties, after considering valid netting agreements and collateral/margin posted by the fund to its counterparties."[54] The Consultation explains that dividing this figure by the NAV gives an indication of the potential losses a fund's failure could immediately cause its counterparties.

This indicator further demonstrates that a MMF should not be viewed as presenting systemic risks, because a MMF does not engage in derivatives transactions or borrowings to any material degree. Rather, MMFs are creditors. In addition, a MMF's investments are required to be highly diversified among many unrelated issuers, and be limited to very liquid, short maturity, high credit quality debt instruments. Thus, the counterparty exposure ratio when applied to MMFs shows they do not have a set of creditors or derivatives counterparties that can be put at risk by a "failure" of the MMF to pay or perform.

Indicator 2-3: The *intra-financial system liabilities* are measured by the total net counterparty credit exposure at the fund in value, primarily with G-SIBs and G-SIIs. The Consultation states, "The larger the exposure of the fund to counterparties, especially with more systemically important financial entities, the greater the impact of its failure."[55]

As stated above, a MMF does not engage in derivatives transactions or borrowings to any degree. Thus, total counterparty credit exposure is essentially zero MMFs.

---

[52] Consultation at 34.

[53] Consultation at 34.

[54] *Id.*

[55] *Id.*

Substitutability

The Consultation notes that while most investment funds are generally substitutable in that investors have multiple options for making their investment, some funds are highly specialised and invest in thinly traded markets. It measures substitutability using the following three indicators.

Indicator 3-1: The *turnover of the fund related to a specific asset/daily trading volume of the asset* attempts to measure a fund's substitutability by its turnover related to the asset.[56]

MMFs are not trading vehicles but generally buy and hold short-term debt instruments to maturity. The types of money market instruments purchased for MMF portfolios generally do not actively trade, and trading volume is not generally reported. While the assets of a fund "turn over," it is through the normal maturation of portfolio debt instruments and not through trading activity.

However, as discussed above, the total asset size of the money markets exceeds $12 trillion in the U.S. alone. If one compares the asset size of a MMF to the size of the markets in which MMFs invest, the percentage of the market reflected in any one MMF is small. At $100 billion in assets as contemplated by the Consultation, a "large" MMF holds less than one percent of the overall market. If one factors in the even larger global market for longer-term "safe assets" to which prime borrowers may turn for financing, the percentage of the "safe assets" market held by any one MMF is minimal.

Indicator 3-2: A higher ratio of *total fund turnover to total turnover of funds in the same category/classification* is an indicator of higher potential systemic risk of the fund.[57]

We believe the "turnover" rate of MMFs are generally similar: MMFs are not trading vehicles, as discussed above, but are "buy and hold" investors. Indeed, this is why MMFs are allowed to use the amortised cost method to value their portfolio assets. A MMF purchases its portfolio assets in the money markets with an intent and ability to hold the assets to maturity.

Indicator 3-3: The measurement of *investment strategies (or asset classes) with less than 10 market players* is designed to capture the extent to which a particular fund occupies a

[56] *Id.*

[57] *Id.*

specific position in its market that may not be easily and rapidly replaced by other financial entities.[58]

As of year-end 2012, there were in the U.S. 580 MMFs, with 158 in the category of government MMFs, 242 in the category of "prime" MMFs, and 180 in the category of tax-exempt MMFs.[59] According to a survey conducted by the European Systemic Risk Board, as of June 30, 2012, there were 123 CNAV MMFs and 842 VNAV MMFs in six E.U. countries (namely, France, Germany, Ireland, Italy, Luxembourg, and Spain).[60] MMFs are highly substitutable. We are aware of no MMF that uses an investment strategy or invests in an asset class with less than 10 market players. Moreover, the aggregate size of all these U.S. and E.U. MMFs combined is around $4 trillion or less. The aggregate size of the U.S. money markets alone in which MMFs invest is over $12 trillion. The asset size of all U.S. and E.U. MMFs combined is less than a third of the size of the total U.S. money market alone. Other institutional investors, such as bond funds, banks, insurance companies, governments and corporate treasurers are also direct investors in money market assets. The share of these markets held by any one MMF is very small.

We agree with the Consultation that investment funds (and particularly MMFs) are highly substitutable. Rather than being inapplicable, however, we believe this fact is highly relevant to the rest of the criteria for NBNI G-SIFI analysis, and supports a conclusion that *no* regulated MMFs should be listed as G-SIFIs.

Complexity

A MMF does not have a complex structure. A MMF is simply an investment pool that holds short-term, high quality, marketable fixed income instruments, with a readily available asset value. MMFs are entirely transparent. There are no holding companies, foreign affiliates, off-balance sheet structures or complex structures of any kind allowed within a MMF. MMFs do not use leverage or other forms of borrowing to any material degree. MMFs do not have concentrated exposures to other companies. They do not have complex capital structures. MMF balance sheets are all simple common equity. MMF capital ratios are 100% equity, and they hold only high quality, liquid assets. If the fund manager does not continue to reinvest the

[58] *Id.* at 35.

[59] Investment Company Institute, 2013 Investment Company Fact Book at Table 38, *available at* http://www.icifactbook.org/.

[60] European Systemic Risk Board, Annex to the ESRB Recommendation on money market funds, at 12, *available at* https://www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_1_annex.en.pdf?6b22701d0e8ab1e4b4b4678531cb540c.

portfolio, a MMF converts to cash in very short order through the customary maturity of its portfolio of assets.

Indicator 4-1: The Consultation states that funds that engage in a significant v*olume of OTC derivatives in comparison to their total trading activity* potentially could be exposed to higher counterparty risk.[61]

MMFs do not use derivatives to any material degree. A MMF is simply an investment pool that holds short-term, high quality, marketable fixed income instruments, with a readily available asset value. This indicator further demonstrates that MMFs should not be viewed as NBNI G-SIFIs.

Indicator 4-2: The Consultation states that a fund possessing a high percentage of collateral that it has re-hypothecated increases exposure risks for counterparties.[62]

Because MMFs generally do not borrow, they do not need to pledge collateral, or re-hypothecate collateral posted by their counterparties. Therefore, this indicator further demonstrates that MMFs should not be viewed as NBNI G-SIFIs.

Indicator 4-3: The Consultation states that *high frequency trading strategies* can introduce market risk.[63]

MMFs do not engage in high frequency trading. A MMF is allowed to use the amoritised cost method of accounting for its portfolio assets precisely because it buys the portfolio assets with the intent and ability to hold the assets to maturity.

This indicator further demonstrates that MMFs should not be viewed as NBNI G-SIFIs

Indicator 4-4: The Consultation states that the lower the ratio of *weighted average portfolio liquidity to weighted average investor liquidity (both measured in days)* the lower the potential that the fund is exposed to liquidity risk and mismatch with investors' liquidity demands.[64]

---

[61] Consultation at 35.

[62] *Id.*.

[63] *Id.*

[64] *Id.*

MMFs maintain highly liquid, short-duration portfolios that closely match the liquidity needs of their investors. In the U.S., a prime MMF must maintain at least 10 percent of its assets in cash, U.S. Treasury securities, or securities that convert into cash (*e.g.*, mature) within one business day. 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 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). The overall weighted average maturity of a U.S. MMF must be 60 days or less.[65]

In addition, a U.S. MMF must adopt policies and procedures to identify the risk characteristics of large shareholders and anticipate the likelihood of large redemptions.[66] Larger MMF complexes have dedicated departments whose function is to gather information from shareholders and financial intermediaries on the anticipated timing and volume of future purchases and redemptions. They also monitor actual transaction experiences from those shareholders and follow up on discrepancies. Moreover, they generate forward-looking estimates of cash availability and needs within each portfolio that are used by portfolio managers in managing the liquidity and portfolio maturities of the fund. Depending upon the volatility of cash flows, and in particular shareholder redemptions, MMFs therefore generally maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements discussed above.[67]

In the E.U., the UCITS Directive has provided a regulatory framework for UCITS-authorised MMFs since the early days of the industry, even though it is not specific to MMFs. For example, it prescribes the types of assets in which a UCITS may invest, imposes risk management requirements, and limits the concentration of credit risk exposure.[68] Furthermore, rules specific to MMFs have been developed in most E.U. countries, typically limiting eligible investments to money market instruments and requiring compliance with maturity restrictions.[69]

[65] 17 C.F.R. § 270.2a-7(c)(5).

[66] *See* Money Market Fund Reform, 75 Fed. Reg. 10060, 10075, n.198 and accompanying text (Mar. 4, 2010).

[67] *Id.* at 10074.

[68] UCITS Directive, ch. VII.

[69] Technical Committee of the International Organization of Securities Commissions, Money Market Fund Systemic Risk Analysis and Reform Options: Consultation Report, 46 (27 April 2012), *available at* http://www.iosco.org/library/pubdocs/pdf/ioscopd379.pdf.

MMFs that are not authorised under the UCITS Directive are now covered by the AIFM Directive, adopted in 2011.[70] This would include the ability to suspend redemptions.

The CESR also adopted guidelines on a common definition of European MMFs in 2010.[71] Under the guidelines, a "short-term money market fund" (which may offer a constant net asset value) is subject to the most demanding liquidity and maturity standards. It must maintain a weighted average maturity of portfolio assets of 60 days or less. Only funds that qualify as "short-term money market funds" may operate as CNAV MMFs and use amortised cost accounting to value portfolio assets and price shares. A "money market fund" (later referred to as a "standard" MMF in the European Commission's proposed regulation on MMF) is subject to many of the same requirements as a "short-term money market fund," but is permitted to operate with a longer weighted average life (up to 12 months) and a longer weighted average maturity (up to 6 months). These funds must operate with a VNAV.

Many European CNAV MMFs have voluntarily adopted similarly high portfolio liquidity standards. For example, many CNAV MMFs in the E.U., adhere to the standards in the Code of Practice of the Institutional Money Market Funds Association ("IMMFA"), the trade association representing the European triple-A rated CNAV money market fund industry.[72] The Code of Practice codifies industry best practices for liquidity management, portfolio diversification, and "know-your-customer" requirements, among other things. It is similar to SEC Rule 2a-7, which is the primary regulation applicable to CNAV MMFs in the U.S. Like SEC Rule 2a-7, the Code of Practice was most recently updated to reflect new industry best practices in light of experience gained during the financial crisis. Thus, MMFs manages liquidity risk through a combination of highly liquid, high-quality portfolios and understanding customer needs.

As a result of higher liquidity standards imposed pursuant to SEC Rule 2a-7 in 2010, on average, as of February 2014, U.S. MMFs held more than 40% of their portfolios in overnight or seven-day liquid assets.[73] During the worst week of the recent Financial Crisis, U.S. MMF

---

[70] The UCITS Directive allows a fund to temporarily suspend redemptions in exceptional cases to protect the interests of shareholders. The AIFM Directive also allows the manager of a fund to use special arrangements to cope with illiquidity of a fund's assets.

[71] Committee of European Securities Regulators, CESR's Guidelines on a Common Definition of European Money Market Funds at 6 (19 May 2010), *available at* http://www.esma.europa.eu/system/files/10_049.pdf ("CESR Guidelines").

[72] The IMMFA Code of Practice is available at http://www.immfa.org/about-immfa/immfa-code.html.

[73] *Money Market Fund Holdings, February 2014* (Mar. 18, 2014), *available at* http://www.ici.org/research/stats/mmfsummary/nmfp_02_14 (based on Form N-MFP data, as of February 2014, reporting that U.S. prime MMFs held 37.27 percent of their portfolios in weekly liquid assets and U.S. government funds held 84.54 percent of their portfolios in weekly liquid assets).

shareholders redeemed approximately 14% of their shares in one week.[74] At current portfolio liquidity levels, U.S. MMFs on average hold enough liquidity to meet one week outflows nearly three times larger than those experienced in the worst week of the Financial Crisis. The effectiveness of the new liquidity standards in addressing large investor redemptions was demonstrated in Summer 2011 during the European debt crisis and U.S. Treasury debt ceiling crisis. Many MMFs experienced large outflows, and none were forced to "break a buck" or suspend redemptions.[75]

Notably, investors in MMFs are equity shareholders, not creditors. They are not guaranteed daily liquidity or a stable NAV per share. Instead, a MMF discloses to its shareholders that it will seek to provide daily redeemability at a stable NAV, but may not always be able to do so. There is no default or breach of contract if a MMF fails to maintain a stable NAV or allow daily liquidity. Shareholders will be unhappy, but this is part of the risk set that MMF shareholders accept when they chose to invest in a MMF.[76]

Indicator 4-5: The Consultation also states that the lower the ratio of unencumbered cash to gross notional exposure, the higher the potential systemic risk of the fund.[77]

MMFs do not engage in derivatives transactions. This factor further demonstrates that MMFs should not be viewed as NBNI G-SIFIs.

Cross-Jurisdictional Activities

Indicator 5-1: The Consultation states that the number of jurisdictions in which a fund invests is an indicator of a larger global impact.[78]

We agree that a fund that invests in more jurisdictions might have a larger global impact, but the nature and extent of leverage and derivatives (as an indicator of interconnectedness) and investments relative to the size of the relevant market are more telling indicators. Moreover, at a given AUM, the fact that a MMF is invested in many jurisdictions would limit the impact of any particular MMF's divestment of portfolio assets or decision not to purchase new investments on

[74] Money Market Fund Reform; Amendments to Form PF, 78 Fed. Reg. 36834, 36843-44 (June 19, 2013).

[75] *Id.* at 36845-46 (noting that assets held in prime MMFs declined approximately $100 billion, or six percent, during a three-week period in June 2011, with some funds losing closer to 20 percent of assets, while "no money market fund had to re-price below its stable $1.00 share price).

[76] *See* Consultation at 29.

[77] *Id.* at 35.

[78] *Id.* at 36.

issuers' access to funding in any one jurisdiction. This suggests that a MMF of a given size may be *less* systemically important if it has a diverse portfolio with issuers drawn from several jurisdictions.

Indicator 5-2: The Consultation states that the number of jurisdictions in which a fund is sold may indicate its global impact.[79]

We believe that, for an investment fund, having a wide investor base is an indicator of stability. The greater the number and diversity of investors, and the lower percentage of a MMF's shares that are owned by any one investor or group of investors, the less likely is a mass redemption by shareholders to put stress on the ability of the MMF to generate cash from its portfolio liquid assets to meet those redemptions.

Moreover, at a given AUM, if a MMF has investors based in many countries, it necessarily has a smaller market share in any one country than if its investors were all concentrated in one country. An entity with a very small share of investor assets in many jurisdictions may in some cases be less systemic than an equally-sized MMF concentrated in one jurisdiction. This suggests that a MMF of a given size may be *less* systemically important if it has a diverse customer base drawn from many jurisdictions.

Indicator 5-3: The Consultation states that the higher the number of different jurisdictions faced by a fund through its trading counterparties, the more complex the situation may be if the fund had to be liquidated.[80]

Although the multi-jurisdictional element adds some complexity for some types of entities (such as a failed bank or swaps dealer), in the context of MMFs which do not engage in material amounts of derivatives or trading, nor use borrowing or other forms of leverage, that complexity is largely illusory. The portfolio assets of MMFs are held in custody at large custodian banks with global operations directly or through sub-custodians in the relevant markets. When a MMF goes into wind-down mode, its portfolio assets are still good assets, with short maturities. At maturity, the custodian bank receives the cash from the issuer of each portfolio instrument. Given that U.S. MMFs currently have average liquid portfolio assets of 40% or more, a weighted average maturity under 60 days, and a maximum maturity of 397 days, a large portion of these portfolio assets reverts to cash in a week, and most of the portfolio of a MMF liquidates and is paid to the custodian bank within 60 days, and the residue converts to

[79] *Id.*

[80] *Id.*

cash in under 13 months. If the portfolio manager sells assets prior to maturity, this process occurs even faster.

Assessment process and outcome

The Consultation describes an assessment process in which, after the initial screening based on the materiality threshold, the primary national authority (home authority) would conduct an in-depth assessment of the global systemic importance of the financial entities that meet the materiality threshold. The assessment would be based on the various indicators described above. The FSB and IOSCO will form an international oversight group (IOG) to coordinate the assessment process conducted by their members. The IOG will compile "reference" lists of the NBNI financial entities that are subject to the relevant NBNI G-SIFI methodologies in the member jurisdictions that exceed the materiality thresholds. Each home jurisdiction will communicate to the IOG the relevant authority or authorities that will be engaged in the assessment process, and the national authorities will construct "Stage 1" lists for each type of financial entities that meet the materiality thresholds in their jurisdictions, as well as other NBNI financial entities that may be below the thresholds but which they believe should be added for a more detailed assessment.

The Consultation explains that national authorities will then collect data/information on the indicators for each entity in the Stage 1 list, including a range of public information, supervisory information and information collected directly from the entities. National authorities will then develop a "Narrative Assessment" discussing the impact of the failure or distress of each entity and the relevant transmission mechanisms and will make a recommendation on which NBNI financial entities should be designated as NBNI G-SIFIs to the IOG. After considering feedback from the IOG and conducting any further analysis, national authorities will reach a preliminary determination on designation of the NBNI entities in the Stage 1 list and communicate that determination to the IOG, which will provide the Narrative Assessments and other information from all national authorities for discussion and review by the SRC, and the IOSCO Board for NBNI financial entities within IOSCO's competence. The FSB and national authorities together will determine the final list of G-SIFIs. This process will be completed annually.

We understand that, in the U.S., the national authority participating in this international assessment process with respect to the investment fund sector, and MMFs in particular, will be the SEC. Given the significant impact of an NBNI G-SIFI designation, the SEC and its international counterparts should allow entities being considered for this designation to present their analyses, and to challenge the national authority's preliminary determination before it is presented to the IOG.

Selected Questions

Q1-1. In your view, are the three transmission channels identified above most likely to be the ones transmitting financial distress of an NBNI financial entity to other financial firms and markets? Are there additional channels that need to be considered?

Federated agrees that the three transmission channels identified are potential channels through which the financial distress of *some* NBNI financial entities may be transmitted to other financial firms and markets but they would not serve to transmit the financial distress or failure of a MMF to other firms and markets or pose a threat to global financial stability. In the case of MMFs, as described above, each of these transmission channels either demonstrates that MMFs are not likely to pose systemic risks or is being more appropriately addressed by direct regulation of the liquidity of banks.

Q2-1. Does the high-level framework for identifying NBNI G-SIFIs (including the five basic impact factors) adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity? Are there any other impact factors that should be considered in addition to those currently proposed or should any of them be removed? If so, why?

Federated agrees that the identified impact factors are appropriate for consideration as potential risks posed by NBNI financial entities and believes application of the impact factors to MMFs makes clear that a MMF should never be listed as an NBNI G-SIFI.

Federated believes that the AUM threshold for investment funds should be measured based upon *gross* assets (rather than net), that not all investment funds should have the same size threshold, and that the threshold number set for a particular category of investment fund should take into account both the size of the asset market in which its participates and whether the investment fund is subject to a comprehensive regulatory framework such as UCITS or the Investment Company Act. MMFs regulated under UCITS or the Investment Company Act should have a much higher asset threshold for G-SIFI consideration than $100 billion, taking into consideration that MMFs are unlevered and do not make material use of derivatives, the large size of the money markets as a whole, and the amount and quality of regulation applied to MMFs.

Federated believes that the direct and indirect consequences on the financial system of imposing G-SIFI regulation upon a MMF should also be considered. To the extent that such a designation results in imposition of bank-like capital and regulatory requirements on MMFs, such designation would increase, rather than decrease, systemic risk by making MMFs far less useful to investors and not economically viable, resulting in a shift of investor assets into either "too big to fail" G-SIFI banks or into other less regulated and less transparent fund and investment structures.

Q2-2. Is the initial focus on (i) finance companies, (ii) market intermediaries, and (iii) investment funds in developing sector-specific methodologies appropriate? Are there other NBNI financial entity types that the FSB should focus on? If so, why?

Federated is only addressing the application of the indicators to regulated investment funds, and in particular MMFs, a type of investment fund which does not present the type of risks that are the focus of the Consultation, and is not arguing for inclusion of other types of financial entities.

Federated agrees with the Consultation's focus on individual funds. Each MMF portfolio stands alone. The liabilities (if any) and shareholder interests of one MMF do not have a claim on the portfolio assets of another MMF, even if they are invested in the same issuers. The portfolio of each MMF is diversified by issuer and maturity, resulting in limited exposure to any one issuer or group of issuers.

Q3-1. Is the proposed scope of assessment outlined above appropriate for operationalising the high-level framework for identifying NBNI G-SIFIs? Are there any practical difficulties associated with the proposed scope of assessment?

The AUM criteria for identifying whether an investment fund is an NBNI G-SIFI has the benefit of being simple to apply. As discussed above, we believe that the asset test should, however, be based on gross AUM, rather than net, and take into account the system of regulation of the category of investment fund and the size of the underlying asset market in which the fund invests, as well as the use of leverage and derivatives by the fund. We do not believe these enhancements to the size criteria would make the assessment methodology more complex, but it would avoid falsely equating in size and risk an unlevered fund with a levered fund, and take into account the context in which the fund operates to more accurately select which funds are more likely to pose systemic risk issues.

Q3-2. In your view, are the proposed materiality thresholds … appropriate for providing an initial filter…?

As discussed above, Federated believes that the AUM threshold for investment funds should be measured based upon *gross* assets (rather than net), that not all investment funds should have the same size threshold, and that the threshold number set for a particular category of investment fund should take into account the size of the asset market in which its participates, the fund's use of leverage and derivatives, and whether the investment fund is subject to a comprehensive regulatory framework such as UCITS or the Investment Company Act.

As a direct consequence, the threshold set of investment funds generally is too low as applied to MMFs. MMFs regulated under UCITS or the Investment Company Act should have a much higher asset threshold for G-SIFI consideration than $100 billion, taking into consideration that MMFs are unlevered and do not make material use of derivatives, the large size of the money markets as a whole, and the amount and quality of regulation applied to MMFs.

Q6-2. Does the above description of systemic importance of asset management entities adequately capture potential systemic risks associated with their financial distress or disorderly failure at the global level?

The Consultation overstates the potential for systemic risk among regulated investment funds that do not use borrowed funds or engage in derivatives to a material degree. As discussed above, unlevered, regulated investment funds that do not have significant derivatives exposures, invest in large, deep, liquid markets, and have external custodians, do not present systemic risks. Although unlevered investment funds can lose money for investors, they cannot "fail" or default on debt obligations, as they do not use borrowed money but instead use equity to finance investments. Investors in investment funds are not exposed to the credit risk of the investment management firm that advises the funds.

Q6-3. Which of the following four levels of focus is appropriate for assessing the systemic importance of asset management entities: (i) individual investment funds; (ii) family of funds; (iii) asset managers on a stand-alone entity basis; and (iv) asset managers and their funds collectively? Please also explain the reasons why you think the chosen level of focus is more appropriate than others.

As discussed above at pages 4-8, Federated agrees with the Consultation's focus on individual investment funds. Each MMF portfolio stands alone. The liabilities (if any) and shareholder interests of one MMF do not have a claim on the portfolio assets of another MMF, even if they are invested in the same issuers. The portfolio of each MMF is diversified by issuer and maturity, resulting in limited exposure to any one issuer or group of issuers.

Q6-5. Are the proposed indicators appropriate for assessing the relevant impact factors? If not, please provide alternative indicators and the reasons why such measures are more appropriate.

Federated agrees that, subject to the discussion above, certain of the proposed indicators are appropriate for assessing the relevant impact factors but believes application of the indicators to MMFs makes clear that a MMF should never be listed as an NBNI G-SIFI. Comments on specific indicators are set forth above. As noted above in response to Question Q2-1, however, Federated believes that the direct and indirect consequences on the financial system of imposing G-SIFI regulation upon a MMF should also be considered. To the extent that such a designation results in imposition of bank-like capital and regulatory requirements on MMFs, or a mandatory variable net asset value on MMFs, such designation would increase, rather than decrease, systemic risk.

Q6-6. For "cross-jurisdictional activities", should "the fund's use of service providers in other jurisdictions (e.g. custody assets with service providers in jurisdictions other than where its primary regulator is based)" be used?

No. As discussed more fully above at pages 23-24, in the context of an unlevered, regulated investment fund that does not make material use of derivatives, the investment by the fund in multiple markets and use of local, highly regulated sub-custodians in those markets, should not be viewed as an indicator of systemic risk.

Q6-7. Is the definition of "net AUM" and "GNE" appropriate for assessing the "size" (indicators 1-1 and 1-2)?

No as to "net AUM." As discussed more fully above at pages 3 and 16, gross AUM is a more relevant factor, and fund size should be considered in relation to the asset market in which the investment fund invests.

Q6-10. Are there additional indicators that should be considered for assessing the relevant impact factors? For example, should "the fund's dominance in a particular strategy (as measured by its percentage of net AUM as compared to the total AUM" also be considered for "substitutability"? Similarly, should "leverage" or "structure" of a fund also be considered for assessing "complexity"? Please explain the possible indicators and the reasons why they should be considered.

As discussed above at pages 3, 16 and 18, the indicators should be considered in conjunction with one another rather than in isolation. The gross size of a fund relative to the markets in which it invests is relevant to substitutability, and a fund's use of leverage and derivatives are relevant to complexity, as well as to an assessment of what size should be viewed as an indicator. As noted above in response to Question Q2-1, Federated also believes that the direct and indirect consequences on the financial system of imposing G-SIFI regulation upon a MMF should also be considered, including the potential that regulating an investment fund as a SIFI may cause assets to move to riskier, less transparent, or more systemically important "too big to fail" entities.

Q6-11. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of investment funds? If so, please explain which indicator(s) and the reasons for prioritisation.

Yes. As discussed above, factors to prioritize include use of leverage and derivatives exposures, the liquidity of the markets in which the fund invests, the size of the investment fund relative to the underlying asset market in which it invests, and the existence of a detailed regulatory program governing the investment fund.

CONCLUSION

We agree with the approach of establishing specific metrics and criteria for determining what entities to designate as NBNI G-SIFIs. Moreover, subject to the discussion above, we generally agree with the criteria discussed by the FSB, and its recommendation to evaluate investment funds individually, rather than together with the investment manager or family of funds. As discussed above, however, we note flaws certain of the criteria, including the a size criteria for investment funds that is based on net AUM at a fixed amount that is not tied to the overall size of the investment market in which the fund participates. This has the effect of causing unleveraged funds operating as relatively small participants in large markets (such as MMFs operating in the overall money markets) to appear of equal systemic risk to highly leveraged funds invested in smaller markets that have the same equity capitalization but much larger gross asset sizes. For example, a MMF with $100 billion in assets, $100 billion in equity capital, and no leverage or derivatives, is less likely to be of systemic importance in the $12+ trillion money markets than a hedge fund with $100 billion in equity capital, with significant borrowings from banks and other leverage and derivatives exposure to banks and others, in a far smaller and more volatile asset category. Similarly, using participation of a fund in multiple markets as an indicator of greater systemic ignores the fact that a fund participating in the markets of multiple jurisdictions has broader risk diversification, and in addition, necessarily has a smaller share of the market in each country than does a fund of equal size, both of which suggest a fund with investments and investors in multiple jurisdictions may present *less* systemic risk than a fund of equal whose investments and investors are all drawn from a single jurisdiction.

We also note the interrelationships among the criteria and factors must be considered. MMFs do not borrow or engage in derivative transactions to any material degree. The only identified avenues for potential transmission of risk from a MMF to other entities are the investment loss risks of shareholders and the alleged "roll over" or refinancing risk for issuers whose notes are held by the MMF if the MMF does not buy new notes later when the old notes mature. As to investment risk, an investment in shares of a MMF is an efficient substitute to investing directly in the underlying money market instruments, but with greater diversification and more professional management and hence lower non-diversified risk than a direct investment in money market instruments. The loss exposure of investors in MMFs is lower than their loss exposure if they were to invest directly in money market instruments or hold a deposit in a bank in excess of the limits of government deposit insurance schemes. Worst case, with a MMF, the investor looses a couple of cents on the dollar, which is much safer than most other alternatives in a crisis. As to rollover risk, once it is acknowledged that MMFs have a high degree of substitutability (among themselves and with other institutional investors in the vast money markets), not only to their shareholders but also to the portfolio issuers that obtain financing in the money markets, it is difficult to give credence to the concept that a run on a MMF creates "roll over" risk for issuers in the money markets. More realistically, in a financial crisis, credit markets tighten appreciably, regardless of whether any one MMF continues to invest in new notes or seeks to sell its positions and even regardless of whether MMFs as a group exist at all. This is not entity-based systemic risk caused by a MMF. This risk is caused by borrower institutions being too reliant on the availability of short-term funding.

We appreciate the opportunity to provide our comments in response to the Consultation.

Respectfully submitted,

David. F. Freeman, Jr.