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Peter Dittus
General Secretariat
Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
Via email: baselcommittee@bis.org

Re: International Framework for Liquidity Risk Measurement, Standards and Monitoring

Dear Mr. Dittus:

This letter is filed on behalf of my client, Federated Investors, Inc., one of the largest mutual fund managers in the world with $389 billion in assets under management as of December 31, 2009. We are commenting on the new framework for measuring the liquidity of banking organizations as proposed by the Basel Committee on Banking Supervision in a consultative paper on December 17, 2009.[1]

The new framework would require each banking organization to establish a liquidity coverage ratio based on the amount of "high-quality liquid assets" it holds that can be used to offset the net cash outflows it would encounter under acute short-term stress scenarios. Under the liquidity coverage ratio, a banking organization's high quality liquid assets would need to equal 100 percent or more of its estimated net cash outflows over a 30-day time period. Banks would be expected to meet this ratio continuously and to hold unencumbered high-quality assets against the potential onset of severe liquidity stress.

We recommend that money market funds be designated as high-quality liquid assets for purposes of the new liquidity framework.

[1] Basel Committee on Banking Supervision, Consultative Document: International Framework for Liquidity Risk Measurement, Standards, and Monitoring (issued for comment by 16 April 2010) (Dec. 2009).

Under the proposal, assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value. The fundamental characteristics of high quality liquid assets under the proposal are low credit and market risk, ease and certainty of valuation, low correlation with risky assets, and listing on a developed and recognized exchange market. The market-related characteristics are market breadth and depth, the presence of committed market makers, low market concentration, and a tendency of the market to move into the assets in a systemic crisis. The consultative paper stated that the Basel committee is assessing the impact of both a narrow definition of "liquid assets" comprised of cash, central bank reserves, and high quality sovereign paper, as well as a broader definition that could also include a proportion of high quality corporate bonds and covered bonds.

Money market funds satisfy the characteristics of "high quality liquid assets" in the consultative paper and we recommend that they be specifically designated as such in the new liquidity framework.

Money market funds are among the most stable high quality liquid assets in U.S. financial markets.

Money market funds are open-end management investment companies registered with the U.S. Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940 that invest in high-quality, short-term debt instruments such as commercial paper, Treasury bills and repurchase agreements. As of March 2010, money market funds had approximately $3.0 trillion in assets under management.

Among their assets, money market funds hold approximately 45 percent of all U.S. commercial paper outstanding, 65 percent of short-term state and local government debt, and 26 percent of short-term Treasury and agency securities.

Money market funds pay dividends that reflect prevailing short-term interest rates and maintain a stable net asset value ("NAV") per share of $1.00 per share. Money market funds are valued daily and investors may purchase and redeem shares each business day. Money market funds are commonly used as cash equivalents by corporate treasurers, municipal comptrollers, pension funds, and other investors.[2]

[2] The Securities and Exchange Commission has stated that "investors generally treat money market funds as cash investments." 61 Fed. Reg. 13955, 13957 (Mar. 28, 1996).

Money market funds are highly regulated under U.S. law.

Money market funds operate under strict credit, liquidity and other requirements imposed by the Securities and Exchange Commission under Rule 2a-7 pursuant to the Investment Company Act of 1940. The SEC recently adopted amendments to strengthen the Rule in the aftermath of the financial crisis.[3] Among other things, the amended Rule requires funds to undergo stress tests under which fund managers must evaluate each fund's ability to maintain a stable net asset value per share in the event of shocks such as interest rate changes, higher rates of redemptions, and changes in the credit quality of the fund's portfolio.

Money market funds have low credit and market risk.

Rule 2a-7 imposes stringent credit quality standards on money market funds. Among other things, a money market fund is limited to purchasing only securities that are specifically eligible and pose minimal credit risk to the fund. A money market fund's portfolio securities must be rated in the top two rating categories (or be unrated securities of comparable quality). In addition, a fund's managers are required to perform an independent credit analysis of every security purchased for the fund's portfolio. Each fund must maintain a diversified portfolio to limit the fund's exposure to the credit risk of any single issuer. For example, a taxable fund may invest not more than five percent of its total assets in the securities of any single issuer.

Money market funds also are subject to limitations on the maturity of their portfolios. Rule 2a-7 limits the maximum weighted average maturity of a fund's portfolio to 60 days.[4] The maximum weighted average life maturity of a fund's portfolio is 120 days, thereby limiting the ability of a fund to invest in long-term floating rate securities.

These regulatory restrictions assure that money market funds have a low correlation with risky assets and limited exposure to market risks affecting the value of their portfolio holdings. Money market funds do not have market risk in the sense that they are not traded (on an exchange or otherwise) but rather can be redeemed on any business day directly from the fund or its transfer agent at a $1.00 net asset value. In only rare circumstances can a fund's board of trustees suspend redemptions if the fund is about to break a dollar and the board decides to liquidate the fund, thereby allowing an orderly liquidation of the portfolio.

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[3] *See* 17 C.F.R. Parts 270.2a-7 & 272; 75 Fed. Reg. 10060 (March 4, 2010).

[4] The dollar weighted average portfolio maturity is the average of the maturities of all securities held in the portfolio, weighted by each security's percentage of net assets.

Money market funds offer ease and certainty of value.

Money market funds offer ease and certainty of value. Because they are valued daily at $1.00 per share, shares of a money market fund can be converted into cash at no loss of value.

SEC Rule 2a-7 facilitates the ability of money market funds to maintain a stable net asset value of $1.00 per share by permitting them to use the amortized cost method of valuation and the penny-rounding method of pricing. Under the amortized cost method, portfolio securities generally are valued at cost plus any amortization of premium or accumulation of discount. The premise of the amortized cost method is that high-quality, short-term debt securities held until maturity will eventually return to their amortized cost value, regardless of any current disparity between the amortized cost value and market value, and would not ordinarily be expected to fluctuate significantly in value. Therefore, Rule 2a-7 permits money market funds to value portfolio securities at their amortized cost provided the deviation between the portfolio's amortized cost and current market value remains minimal and results in the computation of a share price that represents fairly the current net asset value per share of the fund.

Rule 2a-7 requires a fund's board of directors to periodically "shadow price" the amortized cost net asset value of the fund's portfolio against the mark-to-market net asset value of the portfolio. If there is a difference of more than one-half of one percent (or $0.005 per share), the fund's board of directors must consider promptly what action if any should be taken, including whether the fund should discontinue the use of the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share, an event known as "breaking the buck."[5]

Money market funds gained assets during the financial crisis.

Money market funds gained assets during the financial crisis. They were viewed as a safe haven by many investors who moved out of equities seeking stable value short-term investments.

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[5] Only one money market fund failed to maintain a $1.00 NAV during the recent financial crisis—the Reserve Primary Fund, whose NAV fell below $1.00 as a consequence of its holdings of Lehman Brothers' paper in 2008. Even so, investors in the Reserve Fund received more than 98 cents on the dollar upon the fund's liquidation. In only one other instance in history has a money market fund failed to maintain a $1.00 NAV, and that instance involved a small money market fund which ultimately paid investors 97 cents on the dollar. The recent amendments to SEC Rule 2a-7 are designed to make it less likely that any money market fund will break a dollar in the future and to strengthen the protection for fund investors in the event of such a rare occurrence.

Because of the important role of money market funds in the short-term credit markets, the Federal Reserve and Treasury acted to reassure investors in money market funds during the crisis by implementing a temporary guarantee program and liquidity facilities. These actions (which since have been terminated) enabled money market funds to continue to serve as a source of liquidity for the short-term financial markets during the crisis. Money market fund assets increased significantly from $3.1 trillion at the end of 2007 to $3.84 trillion as of December 30, 2008. As the financial crisis eased and the equity markets regained momentum, money market fund assets gradually have declined to their current level of just under $3 trillion.

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Based on the foregoing, we believe that money market funds subject to SEC Rule 2a-7 satisfy the standards required for "high quality liquid assets" under the proposed liquidity framework for banks. We urge the Committee on Banking Supervision to specifically designate such money market funds as high-quality liquid assets for purposes of the proposed framework.

Please do not hesitate to contact me if we can answer any questions or provide you with additional information.

Sincerely,

Melanie L. Fein

Melanie L. Fein

cc: Eugene F. Maloney
Executive Vice President and Corporate Counsel
Federated Investors, Inc.