INVESTMENT COMPANY INSTITUTE

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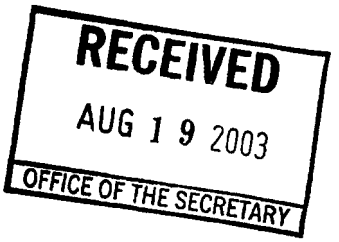
August 19, 2003



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

Re: Support for Petition for Rulemaking (File No. 4-478)

Dear Mr. Katz:

The Investment Company Institute[1] is submitting this letter in support of the Petition for Rulemaking[2] submitted on behalf of Federated Investors, Inc., seeking amendments to Rules 15c3-1 and 15c3-3 (the "Rules") under the Securities Exchange Act of 1934, as amended. The proposed amendments would accord to a broker-dealer's investments in shares of money market funds that invest exclusively in U.S. Treasury bills and notes and meet certain other criteria ("Designated Funds") the same treatment with respect to net capital, customer collateral and special reserve accounts that the Rules accord to direct investments in U.S. Government or agency securities having maturities of less than three months ("Qualifying Government Securities").[3]

The Institute believes that extending equivalent treatment to investments in Designated Funds as that available to investments in Qualifying Government Securities is appropriate. Such treatment would promote numerous cash management efficiencies for broker-dealers, particularly in the form of enhanced liquidity and reduced borrowing costs, without compromising asset safety or the other customer protections that Rules 15c3-1 and 15c3-3 were designed to effect. The use of money market funds for this purpose is particularly appropriate given that they provide daily liquidity and are subject to the strict regulatory requirements of Rule 2a-7, which are designed to enable money market funds to seek to maintain a stable net

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,673 open-end investment companies ("mutual funds"), 588 closed-end investment companies, 106 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.801 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

[2] *See* Letter from Dechert LLP, on behalf of Federated Investors, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated April 3, 2003 (the "Petition").

[3] We note that the Division of Market Regulation also may grant certain aspects of the requested relief by order pursuant to delegated authority. In the recent release adopting amendments to Rule 15c3-3, the Commission delegated to the Director of the Division of Market Regulation exemptive authority that effectively allows the Director to designate the securities that are permissible collateral for purposes of paragraph (b)(3) of Rule 15c3-3. *See* SEC Release No. 34-47480 (March 11, 2003), 68 FR 12779, 12780 (March 17, 2003).

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asset value of $1.00 per share. This has resulted in the near-total absence of investor losses in money market funds since their inception more than 30 years ago.[4]

As an extension of the above requested relief, the Institute believes that the permitted characteristics of Designated Funds should be broadened slightly from those set forth in the Petition to include money market funds that invest in repurchase agreements that themselves are collateralized fully by U.S. Treasury bills and notes. In our view, these changes collectively would preserve the desired level of customer protection while providing brokers, particularly those smaller firms whose access to the direct Treasury markets is more limited than that of the primary dealers, with a larger number of appropriate investment vehicles to help meet their capital, special reserve account and customer collateral needs.

A. Proposed Amendments to Exchange Act Rules 15c3-1 and 15c3-3

As discussed more fully in the Petition, the proposed amendments to Rule 15c3-1 would provide the same net capital treatment to broker-dealers' investments in shares of the Designated Funds as is currently available to Qualifying Government Securities. The proposed amendments to Rule 15c3-3 would: (a) provide the same collateral treatment to Designated Fund shares as is provided under that Rule and a recent Commission order to U.S. Treasury, agency and many non-government securities; and (b) treat such shares as "qualified securities" that may be deposited into a broker-dealer's Special Reserve Bank Account for the Exclusive Benefit of Customers ("Special Reserve Account").

Currently, Rules 15c3-1 and 15c3-3 work to provide incentives for broker-dealers to hold Qualifying Government Securities, while making it relatively disadvantageous for them to hold money market funds that invest exclusively in substantially the same securities. For example, when calculating the value of their assets for purposes of satisfying their net capital requirements under Rule 15c3-1, no haircut is applied to a broker-dealer's holdings of Qualifying Government Securities.[5] In contrast, holdings of a government (or any other) money market fund are subject to a 2% haircut.[6] This is higher than the haircuts applied to broker-dealer holdings of both government and non-government money market instruments having remaining maturities that are longer than is permitted for money market fund investments.[7]

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[4] As noted in the Petition, the few instances in which money market funds have incurred losses sufficient to cause them to have a per share value of less than $1.00 per share have resulted from investments in lower quality securities that would not be possible for Designated Funds or from now-prohibited investments in adjustable rate securities that would not re-set to par. *See* "Safety Record of Money Market Funds," Petition at 13.

[5] Exchange Act Rule 15c3-1(c)(1)(vi)(A)(1)(i). A 0% haircut is also applied to municipal securities, Canadian government securities, commercial paper, bankers acceptances and certificates of deposits having remaining maturities of less than 30 days. *See* Rule 15c3-1(c)(1)(vi)(B)(1), (C), and (E)(1).

[6] Exchange Act Rule 15c3-1(c)(1)(vi)(D)(1).

[7] Money market funds generally cannot hold portfolio securities deemed to have remaining maturities of over 397 days; the net capital haircut imposed on municipal securities and bank certificates of deposit maturing in 365 days is only ½ of 1%, and the haircut on municipal securities maturing in 731 days is only 1%. Rule 15c3-1(c)(1)(vi)(B)(1)(v) and (vii) and (c)(1)(vi)(E)(5). Similarly, while money market funds are required to maintain dollar weighted average maturities of no more than 90 days, the Rule 15c3-1 haircut on municipal securities, commercial paper, bankers' acceptances or certificates of deposit having maturities of up to 90 days is no more than 1/8%. Rule 15c3-1(c)(1)(vi)(B)(1)(ii) and (c)(1)(vi)(E)(2).

Greater disparities exist under Rule 15c3-3, which permits broker-dealers to borrow customers' fully paid or excess margin securities provided that, among other things, the loan is fully collateralized with Rule 15c3-3 collateral. Under the Rule, broker-dealers must deposit either cash and/or "qualified securities" into the Special Reserve Account to cover the net amounts that they owe their customers by reason of their use of securities carried in customer accounts.[8] However, because the Rule defines "qualified securities" to include only U.S. government issued or guaranteed securities,[9] a broker-dealer holding shares of a U.S. government money market fund could not use those shares to satisfy its obligations to make Special Reserve Account deposits. The Rule also requires that broker-dealers who borrow customer securities must fully collateralize those borrowings with cash, U.S. Treasury bills or notes, qualifying letters of credit or, under amendments adopted this past March, such securities as may be designated by Commission order.[10] Pursuant to that rulemaking, the Commission issued an order designating a variety of additional securities as permissible collateral, including highly rated corporate debt securities regardless of maturity.[11] We strongly urge the Commission to consider including Designated Funds within the list of permitted collateral.

B. Repurchase Agreements as Permitted Investments for Designated Funds

The Petition contemplates that Designated Funds have policies requiring them to invest exclusively in U.S. Treasury bills and notes,[12] to redeem in cash and (subject to very limited exceptions) within one business day, and to notify shareholders at least 60 days prior to any change in those policies. The Institute agrees that it is appropriate to limit the money market funds that would qualify for equivalent treatment under the Rules to U.S. government money market funds that have redemption policies as contemplated by the Petition.

However, we believe that the permitted investments for Designated Funds should include not only U.S. Treasury bills and notes, but also repurchase agreements that themselves are collateralized fully by U.S. Treasury bills and notes. This modification would expand the number of U.S. government money market funds that could be utilized by broker-dealers without compromising asset quality.

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[8] Rule 15c3-3(e)(1).

[9] Rule 15c3-3(a)(6).

[10] *See* note 3 *supra*.

[11] SEC Release No. 34-47683 (April 16, 2003), 68 FR 19864 (April 22, 2003).

[12] Notably, this requirement is more stringent than Rule 15c3-3, which applies the same haircut for net capital purposes to any security issued or guaranteed by the United States or any agency thereof, and more stringent than Rule 15c3-3(a), which makes any security issued or guaranteed by the United States a "qualified security" that can be deposited in a Special Reserve Account. *See* Rule 15c3-1(c)(1)(vi)(A)(1) and Rule 15c3-3(a)(6). Similarly, while the permitted collateral for borrowed customer securities that is specified in Rule 15c3-3(b)(3)(iii) includes only cash, qualifying letters of credit and Treasury securities, the collateral permitted under the Commission's order includes all "government securities" within the meaning of Exchange Act § 3(a)(42)(A) and (B), securities guaranteed by FNMA, FHLMC, SLMA and the Financing Corporation, as well as many non-government securities.

Repurchase agreements are recognized by the Commission as having substantially the same safety and investment quality characteristics as the underlying securities to which they relate. Under Rules 2a-7 and 5b-3 under the Investment Company Act, money market and other mutual funds that invest in repurchase agreements that are collateralized fully[13] are permitted to "look through" the repurchase agreements to the underlying securities. These rules codified long-standing SEC staff interpretations and no-action letters and enable funds to avoid having to treat the repurchase agreements as obligations of the counterparty for purposes of portfolio diversification requirements and applicable limits on investments in securities issued by broker-dealers. As the Commission recognized in adopting Rule 5b-3, "[a] fund investing in a properly structured repurchase agreement looks primarily to the value and liquidity of the collateral rather than the credit of the counterparty for satisfaction of the repurchase agreement."[14]

Other regulators that have accorded investments in money market funds equivalent treatment to that of direct investments in U.S. government securities have not distinguished between funds that make only direct investments in government securities and those that also invest in repurchase agreements that are fully collateralized by those government securities.[15] In fact, some specifically recognize repurchase agreements as themselves being the equivalent of direct investments.[16]

Accordingly, the Institute recommends that the Commission propose amendments to the Rules as suggested by the Petition, but revise the definition of the term "Designated Fund" as follows (changes highlighted):

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[13] Rule 5b-3(c)(1) defines the term "collateralized fully" to mean a repurchase agreement for which, among other things, the value of the securities collateralizing it, reduced by expected transaction costs in the event of a default, is at least equal to the contractual resale price and remains at that level throughout the term of the agreement. The other aspects of the definition require that the fund's security interest in the collateral be perfected, that the collateral be maintained in a fund custodial account, that the collateral be limited to certain highly rated securities (for the proposed Designated Funds, however, only Treasury securities could be used), and that the repurchase agreement qualify for favored treatment under applicable insolvency laws.

[14] SEC Release No. IC-25058 (July 5, 2001), 66 FR 36156 (July 11, 2001).

[15] Exhibit B to the Petition contains a list of federal and state financial regulators, state legislatures and federal courts that have recognized investments in shares of money market funds that invest in government securities as the functional equivalent of direct investments in those securities. Those authorities do not withhold that equivalent treatment from money market funds that invest in the underlying securities indirectly through repurchase agreements.

[16] For example, the Office of the Comptroller of the Currency allows national banks to invest on an unlimited basis in shares of investment companies that invest exclusively in assets in which the bank may invest directly on an unlimited basis. *See* Currency Banking Circular BC-220 (November 21, 1986). The Currency Banking Circular makes clear that this includes investments in funds that invest in repurchase agreements, provided that those repurchase agreements satisfy prudential and similar standards that are applicable to the bank's own use of them. Similarly, Commodities Futures Trading Commission Rule 1.25(a) allows futures commission merchants and clearing organizations to invest customer funds in repurchase agreements with respect to U.S. government securities and other permitted direct investments, as well as in money market mutual funds. Of the 11 funds that the Board of Trade Clearing Corporation has approved for original margin deposits pursuant to that Rule, at least 10 invest in repurchase agreements. *See* Board of Trade Clearing Corporation Newsletters, *"Money Market Funds as Collateral,"* available at http://www.botcc.com/newsletters/q32001/10103q-5mmmf.html (viewed 06/13/2003).

"The term "Designated Fund" shall mean an open-end management investment company registered under the Investment Company Act of 1940 which assets consist of cash or money market instruments and which is generally known as a "money market fund," and which:

(i) invests exclusively in United States Treasury bills, ~~and~~ United States treasury notes and repurchase agreements that are collateralized fully, as defined in Rule 5b-3(c)(1) under the Investment Company Act of 1940 (17 CFR 270.5b-3(c)(1)), by such bills or notes;

(ii) has agreed to redeem fund shares in cash, with payment being made no later than the business day following a redemption request by a shareholder, except in the event of an unscheduled closing of Federal Reserve Banks or the New York Stock Exchange; and

(iii) has adopted a policy that it will notify its shareholders 60 days prior to any change in its policy to: (a) invest exclusively in Treasury securities and repurchase agreements, as stated in (i) above; or (b) redeem fund shares in cash no later than the business day following a redemption request by a shareholder, with limited exceptions for unscheduled closings of Federal Reserve Banks or the New York Stock Exchange."

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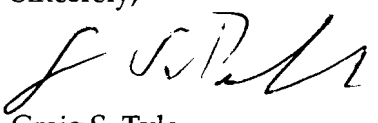
If you have any questions or comments regarding our views in support of the Petition, please contact the undersigned at (202) 326-5815 or Barry E. Simmons at (202) 326-5923.

Sincerely,



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