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*Via Electronic Submission*

September 5, 2008

Ms. Florence E. Harmon, Acting Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: File No. S7-19-08: References to Ratings of Nationally Recognized  
Statistical Rating Organizations**

Dear Ms. Harmon:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries ("Federated")<sup>1</sup> on the recent issuance by the Securities and Exchange Commission ("SEC," or "Commission") of a Release proposing amendments to Rule 2a-7 (the "Proposed Amendments") under the Investment Company Act of 1940 (the "1940 Act").<sup>2</sup> Federated strongly opposes the Proposed Amendments, which would eliminate references to credit ratings issued by nationally recognized statistical rating organizations ("NRSROs") from Rule 2a-7 under the 1940 Act.<sup>3</sup> Federated believes that the Proposed Amendments would compromise investment standards for money market funds, and remove an important investor protection under Rule 2a-7.

Federated would like to express its support for, and join in, the comments made by the Investment Company Institute in its letter of September 5, 2008. Federated also wishes to add

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<sup>1</sup> Federated Investors, Inc. is one of the largest investment management firms in the United States, managing \$333.5 billion in assets as of June 30, 2008. With 147 mutual funds and a variety of separately managed accounts options, Federated provides comprehensive investment management to more than 5,400 institutions and intermediaries including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers.

<sup>2</sup> The Proposed Amendments were published for comment in Release No. IC-28327, IA-2751 (the "Release").

<sup>3</sup> The Release also would eliminate references to NRSRO credit ratings from Rules 3a-7, 5b-3, and 10f-3 under the 1940 Act; and Rule 206(3)-3T under the Investment Advisers Act of 1940. While Federated believes that the removal of references to NRSRO credit ratings is problematic in all of these rules, it is most concerned with their removal from Rule 2a-7.

comments from its perspective as one of the largest and oldest managers of money market funds.<sup>4</sup> First and foremost, Federated wants to make it clear that the events of the past twelve months illustrate in dramatic fashion that Rule 2a-7 works, and that extreme caution is in order when considering any changes thereto. We have come through an unprecedented period of market upheaval with money market fund investors emerging unscathed. This happy result is not an accident. It is the confluence of several important factors, including a good regulatory framework, good credit work, and good cooperation between the industry and the regulators. Federated believes that the work of the industry and the regulators in averting an outcome that would have further undermined investor confidence should be studied and emulated in future circumstances.

With those remarks as a prelude, Federated believes that the SEC may want to review Rule 2a-7 as part of a separate exercise, given that Rule 2a-7 hasn't undergone substantive amendment in more than ten years. Although Federated believes that Rule 2a-7 is a strong and effective rule that appropriately regulates money market funds, we believe that certain changes may be warranted and appropriate at this time. We have outlined our ideas with respect to two potential changes, and we anticipate that others within the industry would have additional input.

Finally, Federated wants to provide specific comments on the Proposed Amendments in the event that the Commission proceeds with the Proposed Amendment substantially in their current form.

### **NRSRO Credit Ratings Establish Independent Boundary that Safeguards Investors by Providing Consistent Minimum Credit Quality**

As dramatically illustrated above, since its adoption in 1983, Rule 2a-7 has provided a strong regulatory framework for money market funds. Through different economic cycles, issuer defaults and bankruptcies, and the recent credit market turmoil, money market fund investors have been well served by the protections afforded by Rule 2a-7. Federated appreciates the SEC's concerns that some money market funds may have placed undue reliance on NRSRO credit ratings that were flawed or otherwise inaccurate. However, Federated believes that their total elimination from Rule 2a-7, as provided in the Proposed Amendments, would substantially weaken Rule 2a-7 to the potential detriment of money market fund investors.

Federated believes that the SEC already has taken important steps toward addressing its concerns regarding unreliable NRSRO credit ratings by proposing amendments to Form NRSRO, and Rules 17g-2, 17g-3 and 17g-5 under the Securities Exchange Act of 1934 (the "NRSRO Amendments"). Federated believes that, consistent with the SEC's goal, the NRSRO Amendments may result in increased accountability, transparency and competition. Federated is supportive of the Proposed Amendments, and applauds any SEC action that would result in increased transparency and more timely reporting by the NRSROs.

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<sup>4</sup> As of June 30, 2008, Federated managed registered money market funds with \$242 billion in assets.

Federated generally has regarded Rule 2a-7 as imposing two requirements directly related to the creditworthiness of a money market fund's portfolio securities. First, Rule 2a-7(c)(3)(i) provides that every security acquired by a money market fund must be an "Eligible Security," which generally is an objective standard determined by reference to NRSRO credit ratings.<sup>5</sup> Second, Rule 2a-7(c)(3)(i) provides that every security acquired by a money market fund must present minimal credit risks, which is a subjective standard determined by the board or its delegate.<sup>6</sup> Federated believes that NRSRO credit ratings continue to be a key protective element to Rule 2a-7, because they establish a uniform and independent boundary for a money market fund's portfolio securities. Such an industry-wide boundary is critical because it limits a money market fund's ability to pursue higher yields through riskier securities, based solely on the subjective analysis of the board or its delegate.

In the Release, the Commission expressed concern that "the inclusion of requirements related to ratings in its rules and forms has, in effect, placed an 'official seal of approval' on ratings that could adversely affect the quality of due diligence and investment analysis." The Commission further indicated that the Proposed Amendments "could reduce undue reliance on credit ratings and result in improvements in the analysis that underlies investment decisions." To the extent that money market funds have placed undue reliance on NRSRO credit ratings, Federated believes that such money market funds may have failed to meet their Rule 2a-7(c)(3)(i) obligation to make an independent minimal credit risk determination, and overlooked the Commission's long and consistent guidance that NRSRO credit ratings should not serve as the sole basis for determining whether a potential security is eligible for purchase by a money market fund.

Since the first exemptive order permitting the use of the amortized cost method of valuing shares, the Commission has required that a money market fund "limit its portfolio investments...to those instruments which the Board of Directors (Trustees) determines present minimal credit risk."<sup>7</sup> When it adopted Rule 2a-7, the Commission further explained the need for both a high NRSRO credit rating *and* a minimal credit risk assessment, observing that a potential security must be "evaluated for the credit risk that it presents to the particular fund at that time in light of the risks attendant to the use of amortized cost valuation or penny rounding" and that the board "may look at some aspects when evaluating the risk of an investment that would not be

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<sup>5</sup> Under Rule 2a-7(a)(10), an "Eligible Security" is a "First Tier Security" or a "Second Tier Security" with a remaining maturity of 397 days or less. Federated recognizes that an "Unrated Security" may be a "First Tier Security" or a "Second Tier Security" based on the subjective analysis of the board of directors ("board") or its delegate. [However, Federated generally has made limited use of "Unrated Securities" in its money market funds, and believes that "Unrated Securities" that are "Eligible Securities" are not broadly available for purchase by money market funds.]

<sup>6</sup> Rule 2a-7(e) permits the board to delegate this responsibility to the adviser or officers of the money market fund. Most boards delegate responsibility for determining minimal credit risk to the money market fund's adviser or to a credit committee composed of advisory personnel.

<sup>7</sup> In the Matter of Intercapital Liquid Asset Fund, Inc., *et. al.*, Investment Company Act Release No. 10824, 18 SEC Docket 52 (August 8, 1979).

considered by the [NRSROs].”<sup>8</sup> Subsequently, the SEC has observed that a board must determine minimal credit risk “based upon an analysis of the issuer’s capacity to repay its short-term debt,” and provided “[e]xamples of elements of such an analysis.”<sup>9</sup>

Federated believes that Rule 2a-7’s dual requirements that a portfolio security be an “Eligible Security” *and* present minimal credit risk provide “belt and suspenders” protections to money market fund investors. The Proposed Amendments would remove the “belt” protection of an independent boundary generally established by reference to NRSRO credit ratings. However, they would in no way strengthen or otherwise buttress the “suspenders” protection of a minimal credit risk determination by the board or its delegate. Consequently, the Proposed Amendments do not appear to achieve the Commission’s stated goal of providing “substitute alternative provisions that are designed to appropriately achieve the same purpose as the ratings.”

### **Rule 2a-7 Potential Changes**

We would like to reiterate our belief that Rule 2a-7 provides strong regulation for money market funds and affords investors therein with appropriate protections. However, we recognize that the SEC has not substantively amended Rule 2a-7 in more than a decade. Accordingly, Federated encourages the Commission to separately and methodically examine Rule 2a-7 and its provisions, with appropriate input from the money market fund industry.

If the SEC undertakes such a review, Federated requests that the Commission consider incorporating the changes described herein. Federated’s suggested changes are unrelated to the Proposed Amendments or the recent credit market turmoil, and stem from our long-standing experience with, and observations regarding, Rule 2a-7. However, Federated believes that its changes may offer the additional benefit of addressing the Commission’s concern regarding undue reliance on NRSRO credit ratings by requiring a money market fund to (1) place greater emphasis on the minimal credit risk determination of the board or its delegate; and (2) select and document the NRSRO ratings on which it will rely for purposes of compliance with Rule 2a-7.

First, Rule 2a-7(c)(6)(ii)(B) provides that if a portfolio security ceases to be an “Eligible Security,” the money market fund is required to dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, absent a finding by the board that disposal of the portfolio security would not be in the best interests of the money market fund. Under Rule 2a-7(e), such finding is non-delegable. Federated suggests that the Commission (1) delete Rule 2a-7(c)(6)(ii)(B); and (2) include as a new requirement under Rule 2a-7(c)(6)(i)(A) that if a portfolio security ceases to be an “Eligible Security,” the board will reassess promptly whether such security continues to present minimal credit risks and will cause the money market fund to take such action, if any, as the board determines is in the best interests

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<sup>8</sup> Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380, 28 SEC Docket 375 (July 11, 1983).

<sup>9</sup> Letter to Registrants, WSB File No. 051490039 (publicly available May 8, 1990).

of the money market fund and its shareholders. Consistent with most other board responsibilities under Rule 2a-7(c)(6)(i), such reassessment and determination would be delegable.<sup>10</sup>

Second, there currently are ten NRSROs, and Federated has found that monitoring all of the NRSROs requires substantial time and resources.<sup>11</sup> Federated is concerned that if the proliferation of NRSROs continues, it may elect not to subscribe to future NRSROs. Federated believes that it is difficult to perform a meaningful analysis of an NRSRO credit rating if it is not familiar with the NRSRO providing the rating.<sup>12</sup> While the SEC has made it clear that “the rule does not require, and the Commission does not expect, investment advisers to subscribe to every rating service publication in order to comply with this requirement,” it also has indicated that it “would expect an investment adviser to become aware of a subsequent rating if it is in the national financial press or in publications to which the adviser subscribes.”<sup>13</sup>

Accordingly, Federated suggests that Rule 2a-7 be amended to require the board or its delegate to select by security type at least three NRSROs on which it will rely under Rule 2a-7 (“Specified NRSROs”).<sup>14</sup> Federated further suggests that the Commission amend Rule 2a-7 to provide that for purposes of determining whether a security is an “Eligible Security,” a “First Tier Security, or a “Second Tier Security,” the only credit ratings that are relevant are those of the Specified NRSROs. Finally, Federated suggests that Rule 2a-7 be amended to clarify that the Rule 2a-7(c)(6)(i)(A) minimal credit risk reassessment is triggered only where one of the Specified NRSROs has downgraded a portfolio security as contemplated under Rule 2a-7(c)(6)(i)(A)(1) and (2).

Of course, there may be other appropriate amendments of, or clarifications to, Rule 2a-7. For example, the Commission may want to underscore the requirement of an independent minimal credit risk determination, or explicitly provide for compliance oversight thereof. As a result, if the SEC considers separately amending Rule 2a-7, Federated strongly suggests that the Commission re-propose amendments, and give all market participants the opportunity to comment generally on Rule 2a-7.

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<sup>10</sup> Federated understands that Rule 2a-7(c)(6)(i)(C) is non-delegable under Rule 2a-7(e), and does not recommend any changes with regard thereto.

<sup>11</sup> The ten credit ratings agencies that are registered with the SEC as NRSROs include: Realpoint LLC, A.M. Best Company, Inc.; DBRS, Ltd; Egan-Jones Rating Company; Fitch, Inc.; Japan Credit Rating Agency, Ltd.; LACE Financial Corp.; Moody’s Investors Services, Inc.; Rating & Investment Information, Inc.; and Standard & Poor’s Rating Services.

<sup>12</sup> See Federated Comment Letter dated March 12, 2007 regarding File No. S7-04-07: Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations.

<sup>13</sup> Release No. IC-18005, [1990-91 Transfer Binder] Fed. Sec. L. Rep. (CCH) 84,710 at n. 71 (February 20, 1991).

<sup>14</sup> This assumes multiple NRSRO credit ratings.

## Specific Comments Regarding Proposed Amendments

As noted previously, Federated strongly opposes the Proposed Amendments. However, in the event that the Commission proceeds with the Proposed Amendments, substantially in their current form, Federated suggests the following specific changes.

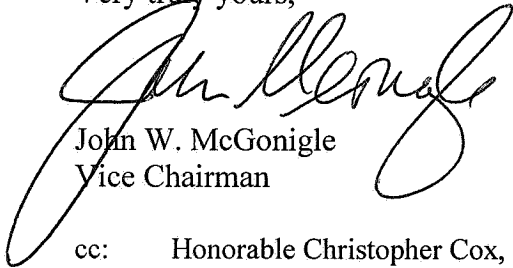
1. Federated suggests that the SEC make the following change to Proposed Amendment Rule 2a-7(a)(17):

*Liquid Security* means a security that can be sold or disposed of in the ordinary course of business within seven days at approximately the ~~value~~ shadow price ascribed to it by the money market fund.

2. With respect to Rule 2a-7(c)(5), Federated suggests that the Commission confirm that the determination of whether a shareholder redemption is “reasonably foreseeable” could be based upon historical redemption patterns. Additionally, Federated suggests that the SEC clarify that if changes in the money market fund’s portfolio or other external events cause the money market fund’s investments in illiquid instruments to exceed 10% of the money market fund’s assets, the money market fund would not be forced to sell or otherwise dispose of investments to bring the aggregate amount of illiquid securities back within the proposed limitations, provided that the board or its delegate has determined that such sale or other disposition would not be in the best interests of the money market fund.
3. Federated suggests that the SEC consider deleting Proposed Amendment Rule 2a-7(c)(7)(i), which provides that “[i]n the event the money market fund’s investment adviser (or any person to whom the fund’s board of directors has delegated portfolio management responsibilities) becomes aware of *any* information about a portfolio security or an issuer of a security that *suggests* that the portfolio security may not continue to present minimal credit risks,” the board or its delegate must reassess whether the security continues to present minimal credit risk. Federated believes that Proposed Amendment Rule 2a-7(c)(7)(i) is so vague that it would be impossible to administer from a compliance perspective. Federated is concerned that Proposed Amendment Rule 2a-7(c)(7)(i) could be interpreted to require the board or its delegate to monitor sources that it does not deem to be reliable and to otherwise respond to unsubstantiated market rumor.
4. Federated suggests that the SEC amend Rule 17a-9 to incorporate no-action positions permitting affiliated buy-outs of securities that remain “Eligible Securities,” but that have dropped in price due to market illiquidity.

Again, Federated commends the SEC for its proactive leadership over the past year, and for helping the industry to address the widespread credit issues that have arisen. We appreciate the opportunity to comment on the Proposed Amendments. Please do not hesitate to contact me at 412-288-1936 with any questions about this submission. Thank you.

Very truly yours,



John W. McGonigle  
Vice Chairman

cc: Honorable Christopher Cox, Chairman  
Honorable Kathleen L. Casey, Commissioner  
Honorable Elisse B. Walter, Commissioner  
Honorable Luis A. Aguilar, Commissioner  
Honorable Troy A. Paredes, Commissioner

Andrew J. Donahue, Director, Division of Investment Management  
Robert E. Place, Associate Director, Division of Investment Management  
Erik R. Sirri, Division of Market Regulation