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BY ELECTRONIC MAIL

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File No. S7-04-07: Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations

Dear Ms. Morris:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries ("Federated")[1] on the recent issuance by the Securities and Exchange Commission ("SEC," or "Commission") of a Release proposing rules implementing the Credit Rating Agency Reform Act of 2006 (the "Act").[2] Federated strongly supports the promotion of competition among nationally recognized statistical rating organizations ("NRSROs") and the increased transparency that should result from the Act. In particular, Federated would like to express its support for, and join in, the comments made by the Investment Company Institute in its letter of March 12, 2007.

Federated also wishes to add some comments from its perspective as one of the largest and oldest managers of money market and bond funds. These comments spring from an expectation that the Act will succeed in increasing the number of NRSROs and the variety of rating products offered to investors. Unless the SEC uses its new oversight authority to guide these changes, Federated believes that existing regulations may impose unintended burdens on investment managers. The SEC may also find that these changes reduce the effectiveness of regulations that rely on NRSRO ratings.

For example, Rule 2a-7(c)(6)(i)(A)(2) under the Investment Company Act requires the manager of a money market fund to reassess the minimal credit risk of a portfolio security whenever it "becomes aware that any Unrated Security or Second Tier Security held by the money market fund has, …, been given a rating by ***any*** NRSRO below the NRSRO's second highest short-term rating category." [Emphasis added.] In the release adopting this requirement, the SEC 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.

[1] Federated Investors, Inc. is one of the largest investment management firms in the United States, managing approximately $237 billion in assets as of December 31, 2006. With 148 mutual funds and various separately managed accounts, Federated provides comprehensive investment management worldwide to more than 5,400 institutions and intermediaries.

[2] The proposed rules were published for comment in Release No. 34-55231, 72 FR 6378 (Feb. 9, 2007) ("Release").

> The Commission would expect an investment adviser to become aware of a subsequent rating if it is reported in the national financial press or in publications to which the adviser subscribes."

Release No. IC-18005, [1990-91 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84,710 at n. 71 (Feb. 20, 1991).

Federated has found that monitoring five NRSROs requires substantial time and resources. This burden will grow even larger as NRSROs proliferate. More importantly, there is no reason to suppose that Federate and other investment managers will become familiar with every new NRSRO, particularly if the NRSRO specializes in one class of credit ratings. As a result, a manager who sees a report of a new rating may not know what the rating agency's second highest short-term rating category is, or even recognize that the rating agency is an NRSRO. Moreover, unless the manager is already familiar with the NRSRO, it will not be able to interpret the significance of the new rating for purposes of reassessing credit risk.

Federated therefore requests that the SEC reconsider its expectations under this provision of Rule 2a-7. In a competitive world of ever changing NRSROs, Federated believes that investment managers should be free to choose which NRSROs they will rely upon and monitor only their ratings. If the SEC shares this belief, then it would be helpful if the release adopting the final rules includes language:

- Reiterating that investment managers are not expected to subscribe to every NRSRO, and
- Stating that a money market fund manager need only respond to ratings below the second highest short-term rating category issued by NRSROs that the manager employs for purposes of determining whether securities are Eligible Securities under Rule 2a-7.

It would also be helpful if the SEC would clarify the significance of registering as an NRSRO for limited classes of credit ratings. For example, suppose a rating agency registers as an NRSRO for corporate issuers, but not for issuers of asset-backed securities. If the rating agency begins to rate asset-backed securities without changing its NRSRO registration, may a manager rely on the ratings for purposes of Rule 2a-7? Federated presumes that it could not treat a rating of an asset-backed security by such an agency as a rating "by an NRSRO," and may therefore ignore the rating for all purposes under Rule 2a-7.

Federated's second concern relates to the potential lack of consistency among NRSROs. As with the Rule 2a-7 provision just discussed, several regulations under the Investment Company Act rely on "rating categories" as indicia of credit risk. For example, the four highest long-term ratings of an NRSRO are generally understood to signify an "investment grade security." Rules 3a-7 and 10f-3 rely on this correspondence to exempt transactions subject to a certain level of credit risk. Similarly, Rule 5b-3 treats securities receiving the highest rating as equivalent to Government Securities, which implies that the credit risks should be commensurate.

However, nothing in the Release requires that an NRSRO have any particular number of rating categories, or that these categories correspond to those of other NRSROs. A new NRSRO might use five categories for investment grade securities, or only three. In the first case, Rules 3a-7 and 10f-3 will exclude securities that should not be excluded; in the second case, they will permit transactions that the SEC did not intend to permit. The Release identifies a similar problem regarding the "haircuts" specified in Rule 15c3-1. Release at 6387.

The short-term rating categories of Dominion Bond Rating Service illustrate that this is a real concern. Dominion defines securities with an R-2 rating as having "adequate" credit quality, while securities with an R-1(low) rating are defined as having "satisfactory" credit quality. In comparison, both S&P and Fitch use "satisfactory" to define their second highest short-term rating categories and "adequate" to define their third highest short-term rating categories. Thus, a money market fund could treat a security receiving only a R-1(low) rating by Dominion as a First Tier Security for purposes of Rule 2a-7, even though the security would only be a Second Tier Security if it were also rated by any other NRSRO. This is significant, because Rule 2a-7 permits a money fund to invest up to 5% of its portfolio in an issuer's First Tier Securities, but only up to 1% of its portfolio in an issuer's Second Tier Securities.

Federated would not suggest that the SEC dictate to NRSROs how many rating categories they should have or what the categories should signify. Instead, Federated suggests that Form NRSRO include a table in which an NRSRO would disclose the correspondence between its ratings and the rating categories specified in SEC regulations. Ideally, this would be coupled with amendments to existing regulations specifying the degree of credit risk intended (*e.g.*, superior, high quality, investment grade, *etc*.), rather than the number of rating categories. However, if this cannot be accomplished by the deadline for the new rules, the SEC could use one or more of the existing NRSROs as benchmarks for such a comparison.

This disclosure would also increase the transparency of ratings. This would help investors evaluate new NRSROs and make comparisons among NRSROs. The SEC could also gauge the quality of NRSRO ratings by monitoring the default rates of corresponding categories.

Federated appreciates the opportunity to register its comments and hopes that the SEC finds them useful. If you have any questions regarding this letter, please contact the undersigned at (412) 288-1567.

Cordially,

/s/ Stephen A. Keen

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cc: Peter Germain
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