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Federated
WORLD-CLASS INVESTMENT MANAGER
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August 29, 2002

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7f
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Letter of Comment No: 71
File Reference: 1082-200
Date Received: 09/03/02

Re: File Reference No. 1082-200
Exposure Draft on Consolidation of Certain Special Purpose Entities, a
Proposed Interpretation of ARB No. 51

Dear Ms. Bielstein,

Federated Investment Management Company is a registered investment adviser which, with its affiliates ("Federated"), manages and advises mutual funds and other investment vehicles. At June 30, 2002, Federated had total assets under management of \$185 billion, \$60 billion of which was attributable to investments in prime money market funds ("Prime Funds"). Federated's Prime Funds routinely invest from 25% to 30% of their assets in asset-backed commercial paper ("ABCP"). As a significant participant in the ABCP market, Federated is pleased to provide comment on the exposure draft ("Draft") referenced above.

Scope of Comment Letter

We support FASB's goal of increased transparency in the ABCP market. As a major investor, we welcome the opportunity to review complete information about the resources, obligations, risks and opportunities of both the special purpose entities ("SPEs") that issue ABCP and the sponsors of ABCP programs ("Sponsors").

Nevertheless, we are deeply concerned that if the Draft is implemented in its current form, there could be a significant contraction in the ABCP market. This letter is to explain (1) the importance of ABCP to Federated's Prime Funds; (2) why implementation of the Draft would lead to a reduced supply of ABCP; and (3) the adverse consequences that Federated's Prime Funds (and the shareholders therein) would experience if there were a reduction of the supply of ABCP. This is not intended to address the technical merits of the Draft.

Potential Adverse Consequences for Prime Funds

A. Rules Governing Prime Funds.

Prime Funds are governed by Rule 2a-7 under the Investment Company Act of 1940, which allows money market funds to use amortized cost, rather than mark-to-market methods to value portfolio securities, so that the funds can maintain a \$1.00 net asset value per share. Rule 2a-7 is a lengthy and complicated regulation that protects investors by significantly limiting the risk characteristics of portfolio investments (including ABCP) that money market funds can buy. The three basic criteria for the composition of a money market fund's portfolio can be summarized as follows:

1. *Credit Quality.* All portfolio securities must have received a rating from the requisite nationally recognized statistical rating organizations ("NRSROs") in one of the two highest short-term rating categories (or be comparable in quality to such rated instruments). Rule 2a-7 further differentiates between "first tier" securities, which are rated in the highest short-term category by the requisite NRSROs, and "second tier" securities, which include all other money market fund eligible securities. It imposes more stringent diversification requirements on "second tier" securities, as described below. In addition, the adviser to such fund must determine that each security acquired by the fund presents minimal credit risk at all times the security is held by the fund.
2. *Diversification.* Rule 2a-7 subjects a money market fund to diversification requirements designed to limit the fund's exposure to the credit risk of any single issuer. A Prime Fund may not invest more than 5% of its total assets in securities issued by the same entity. In addition, a Prime Fund may not have invested more than (1) 5% of its total assets in all second tier securities; or (2) 1% of its total assets in second tier securities of any one issuer.
3. *Maturity.* Rule 2a-7 provides that a money market fund may not acquire any instrument having a remaining maturity of greater than 397 days, and may not maintain a dollar-weighted average portfolio maturity of more than 90 days.

B. Use of ABCP by Prime Funds.

Prime Funds purchase enormous amounts of ABCP. It is estimated that Prime Funds held more than \$343 billion, or over 48%, of all outstanding ABCP as of May 31, 2002.¹ Federated routinely invests between 25% and 30% of its Prime Fund assets in ABCP.

Federated considers ABCP to be one of the strongest asset classes available to its Prime Funds. ABCP offers Prime Funds strong credit profiles and competitive yields.

¹ Moody's Investors Services Global Credit Research, "U.S. Money Market Funds Carry a Big "Buy-Side" Stick with ABCP," July 2002.

Moreover, it is available in ample supply, thereby facilitating compliance with Rule 2a-7's diversification requirements.

Federated believes that ABCP offers significant credit advantages to other corporate obligations. For example, in the late 1990s and early 2000s, a significant amount of unsecured commercial paper ("CP") fell from first tier to second tier status. Prime Funds holding such CP frequently had to dispose of it to comply with Rule 2a-7's credit quality and diversification requirements. More alarming, there were many instances where CP credit ratings dropped to such an extent that the CP became ineligible for use by the Prime Funds that were holding it. Often, this occurred in an unprecedented short period of time.

In contrast, ABCP has been downgraded from first tier to second tier status only when the support provider has been downgraded (such as the Japanese bank downgrades in 1998.) Moreover, we are not aware of any circumstances in which ABCP has been downgraded such that it was an ineligible investment for Prime Funds.

We believe that if the Draft is adopted in its current form, it could result in an immediate and marked decrease in the supply of ABCP. We believe that the proposed changes under the Draft would have the greatest direct impact on the Sponsors of ABCP programs, which could be required to consolidate the SPE's assets and liabilities on their balance sheets. We anticipate that a large number of ABCP programs could be withdrawn, because such programs would not be economically viable if their Sponsors were required to consolidate with their SPEs. We are already experiencing a contraction in the supply of available ABCP, which we attribute to the threat of consolidation posed by the Draft.

A reduction in the supply of ABCP would force Federated, and other advisers of Prime Funds, to have to search for alternative investments that meet the requirements of Rule 2a-7. We believe that it would be difficult to find a sufficient supply of replacement investments, so that Prime Funds could conceivably be forced to leave some portion of their assets uninvested; at best, the Prime Funds would be forced to accept lower-yielding overnight investments. Moreover, we believe that any replacements with comparable yields, even though they would meet the requirements of Rule 2a-7, would be inferior to ABCP from a credit perspective. Finally, we believe that a reduction in ABCP would make it significantly more difficult for money market funds to comply with Rule 2a-7's diversification requirements.

In addition, we note that the Draft would not have an equal effect on all Sponsors. For example, foreign financial institutions, which are significant participants in the ABCP market, would not be required to consolidate their SPEs on their balance sheets. In addition, we have been advised that certain other financial entities, whom we consider to be marginal from a credit and experience perspective, would not be concerned with the effects of consolidation. Consequently, we believe that the Sponsors who would be most impacted by the Draft would be U.S. banks with extremely strong credit profiles and extensive experience in the ABCP market.

Alternative Approaches to Transparency

The basic goal should be to enhance disclosure by Sponsors who use SPEs. Consolidation is one option, but in our view, there are other, better approaches. For example, we would support measures that would require Sponsors to provide the detailed information that General Electric did in its 2001 annual report. The report included detailed footnote information on General Electric's securitization practices, including the structure of (1) sponsored SPEs and (2) transactions that result in gains on sales and removal of assets from General Electric's financial statements. In addition, the footnote information detailed the support, both from a financial and operational perspective, that General Electric provided for SPEs. We view this information as far more beneficial than merely consolidating General Electric's SPEs on its balance sheet, as would be mandated by the Draft.

In addition, please note that we currently receive monthly reports on the assets underlying ABCP. The reports contain performance information, such as delinquencies and charge-offs, as well as coverage ratios. This information enables us to monitor the underlying assets, so that we are not solely reliant on credit enhancement or liquidity for the repayment of our ABCP. The information contained in the reports is significantly more comprehensive than the loan information that is available from a bank's balance sheet; the balance sheets provide no detail on the loan customer, such as credit rating, or the assets securing the loan.

Finally, we would note that Federated's bank analysts have indicated that the consolidation mandated by the Draft would not facilitate their analysis of a bank Sponsor's financial position. Our analysts have indicated that they would need to bifurcate the financial statements of the bank Sponsor to assess the financial position of the bank, because the bank Sponsor is not entitled to the cash flow from the SPE's assets, nor is it responsible for the SPE's liabilities.

Other Points

We would encourage FASB to consider the technical revisions that have been suggested by industry groups, including the American Securitization Forum and the Multi-Seller SPE Consolidation Working Group of the American Securitization Forum. We believe that if FASB is to adopt rules regarding SPE consolidation, it is critical that such rules be precise and comprehensive to eliminate inconsistent interpretations. We would also encourage FASB to provide SPEs with sufficient time to implement any rules that it may adopt. Sponsors of ABCP programs will need time to evaluate their current programs, amend legal documents and program computer systems.

Federated appreciates the opportunity to provide the foregoing comments in response to the Draft. Should you have any questions or desire clarification concerning the matters addressed in this letter, please do not hesitate to contact the undersigned at 412-288-8481 or Natalie Metz at 412-288-1259.

Sincerely,

A handwritten signature in black ink, appearing to read "Deborah A. Cunningham". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Deborah A. Cunningham