



WORLD-CLASS INVESTMENT MANAGER

November 3, 2010

Mr. Trevor Farber
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: International Accounting Standards Board Staff Draft on Consolidated Financial Statements

Dear Mr. Farber:

We appreciate the opportunity to comment on the questions posed by the FASB staff regarding the International Accounting Standards Board Staff Draft on Consolidated Financial Statements (the Staff Draft). Federated is one of the largest investment managers in the United States with \$341 billion in managed assets as of September 30, 2010. The majority of Federated's revenue is derived from advising and administering Federated mutual funds and separate accounts in both domestic and international markets.

Federated has been closely following the joint FASB and IASB project on consolidation and supports the development of a converged consolidation model with the IASB. We continue to be very interested in opportunities to participate in the education and comment process on the topic of consolidation and the asset management industry. As we have expressed in previous letters to the FASB and in previous discussions with the FASB staff and IASB staff, we deeply disagree with a consolidation model that could require an asset manager to consolidate investment products, including collateralized debt obligations (CDOs), in which its economic involvement is limited to earning fees for service and a minor equity interest, if any.

We note paragraph BC5 of the Staff Draft which states: "The financial crisis in 2007/2008 also highlighted a lack of transparency about the risks to which investors were exposed from their involvement with structured vehicles, including those that they had set up or sponsored." We believe that this lack of transparency that was highlighted as a result of the financial crisis was also a primary driver behind the FASB's decision to revise the variable interest consolidation model in 2008 which resulted in the issuance of FASB statement No. 167, "Amendments to FASB Interpretation No. 46(R)". We agree that entities that expose enterprises to significant risk of loss should be consolidated. Unlike service providers for structured products however, asset managers do not have off-balance sheet risk associated with our sponsored products,

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including mutual funds and CDOs. We believe consolidation of such products would ultimately lead to illogical financial statement results that would not accurately reflect Federated's operations and financial condition. We believe this illogical result is evidenced by the recent increase in the use of non-GAAP measures by publicly-held asset managers in order to present "core" business results, exclusive of the impact of consolidated products.

Federated actively participated in the SIFMA Asset Management Group's review of the Staff Draft and supports the comments reflected in its letter to the FASB dated October 18, 2010. In light of the limited amount of time we have had to consider the Staff Draft and respond to the FASB's related questions, we have limited our comments to those questions below where we have focused the majority of our review to date. Please do not assume that our lack of comment on the remaining unanswered questions implies agreement. Rather, we have not had sufficient time to consider our position and thus have simply refrained from comment at this time.

In addition, we have been following the FASB and IASB deliberations on the definition of an investment company and whether the parent of an investment company can retain investment-company accounting upon consolidation of a fund. In light of the ongoing debate and lack of conclusion thereon, we caveat our responses below by stating that our comments on the merits of this consolidation model might be substantially different if the Boards determine that an investment company should be defined in such a way that does align with the definition included in ASC 946-10-15.

Question 1

The Staff Draft provides a single concept of control that is used to evaluate control on a consistent basis for all types of entities (both voting interest entities and variable interest entities). Do you agree that a single-model approach to assess control will provide more consistent financial reporting for all types of entities rather than providing separate models for voting interest entities and variable interest entities? If not, why not?

We support the IASB's aim to improve understandability of the consolidated financial statements by developing a single basis for consolidation irrespective of the nature of the investee. The determination of whether an entity is a variable interest entity under ASC 810 involves significant complexity in accounting application that results in diversity in practice. We have spent a significant amount of time discussing with external auditors and others in the industry whether certain fund structures meet the definition of a variable interest entity, including open-end mutual funds registered under the Investment Company Act of 1940 (the 1940 Act) organized as series funds¹. We understand that there is diversity in interpretation and practice today regarding the variable interest determination for series funds. We believe that the elimination of the need to determine

¹ As permitted by the 1940 Act, investment management companies use the Series Company structure to organize their registered investment companies. Under the Series Company structure, the assets being held by the Series Company are legally segregated into individual series portfolios which are commonly referred to as mutual funds or registered investment companies (RICs). These underlying portfolios, the RICs, are not in and of themselves legal entities and it is not clear therefore whether they are included in the scope of FIN 46R.

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whether or not the entity is a variable interest entity could significantly reduce the potential that substantially the same entities will receive different accounting treatment.

Notwithstanding the above, we would like to note that under current US GAAP, as a result of Accounting Standards Update to defer Statement 167 for Certain Investment Funds issued by the FASB in February 2010 (the Deferral), we have two different variable interest models dependent upon whether or not the entity is deemed to be an investment fund eligible for the Deferral. The risk and rewards model prescribed by FIN 46R², though complex in its application, produces a reasonable result for asset managers. That is, Federated consolidates those investment funds in which we hold a majority of the variability in expected gains or losses. To repeat ourselves, we deeply disagree with a consolidation model that could require an asset manager to consolidate investment products in which its economic involvement is limited to earning fees for service and a minor equity interest, if any. Being able to construct a one-size-fits-all consolidation model that produces relevant and reliable financial statements for a variety of enterprises in a variety of industries involved with a variety of different investee entities is proving to be very difficult. We believe having a separate consolidation model for certain entities that meet the definition of an investment company is an acceptable result and may be the most appropriate outcome.

Question 7

When determining whether a reporting entity acts as an agent, the reporting entity must consider the overall relationship between it and other parties involved with the entity, considering the following factors:

- a. The scope of its decision-making authority over the entity*
- b. The rights held by other parties*
- c. The remuneration the reporting entity is entitled to in the arrangement*
- d. The reporting entity's exposure to variability in returns as a result of other interests that it holds in the entity.*

Do you believe the guidance related to assessing decision-making arrangements in the Staff Draft is appropriate and operational? Do you believe the Staff Draft would lead to appropriate consolidation conclusions?

In a consolidation model based on control, the principal versus agent determination is a critical component for any entity in a service-based industry such as ours. We are supportive of a qualitative approach for determining whether a decision maker is acting as a principal or an agent. However, we believe the criteria for consideration of principal versus agent should be modified as follows:

1. In addition to the criteria outlined in the Staff Draft, we believe it is imperative to consider the extent to which the decision maker is obligated to fund losses of the entity. While we agree that for purposes of determining control, the criteria should consider the existence of either exposure to losses or rights to benefits, we believe only the obligation to fund losses separates an enterprise acting as a service provider from an enterprise acting as an

² FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities an Interpretation of ARB No. 51"

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owner. A decision maker acting in the role of an agent would not accept obligations to fund losses out of pocket as part of its servicing responsibilities. Thus a requirement for a decision maker to fund losses would be indicative of a principal relationship as the decision maker has the risk of ownership. We note that the Deferral included this criterion as a consideration for whether or not an entity should be considered for consolidation under SFAS 167. An analysis of principal versus agent that ignores this consideration for obligations to fund losses is incomplete and could result in the consolidation of entities in which we have no risk of loss.

2. Further, while we certainly agree that the level of equity interest should be considered for purposes of determining control, we disagree that the level of equity interest should be a factor in determining whether the decision maker is acting as a principal or agent. The Staff Draft requires that the level of equity interest be considered in this determination of principal versus agent and further suggests that the greater the equity interest, the more weight that factor should carry. In addition, significant discussions and debate are already underway within the industry and with external auditors to determine what level of equity investment triggers a change in an asset manager's role from that of an agent to that of a principal. In the case of asset managers, the investment service provided does not change with a change in the level of equity held by the asset manager. Asset managers are required by fiduciary duty to make decisions in the best interest of the investors of the fund. This fiduciary duty is not affected by the existence of an investment in the fund by the asset manager, regardless of the size of the investment. Allowing our equity investment in the fund to alter our investment decisions would violate fiduciary law. Regulations under the 1940 Act and other applicable laws are devised to mitigate any apparent conflicts of interest including conflicts which may arise as a result of holding investments in the fund. Thus we wholly disagree with a model that suggests that these decisions differ depending on the extent of our holdings in the fund. Rather, we believe the determination of agent should be made independent of the level of equity interest that an entity holds in an investee.
3. Another factor that we believe should be considered in the determination of principal versus agent is the existence of a board of trustees/directors. As required by the 1940 Act, the board, acting as a single unit, has the full power and authority to carry out all actions necessary and appropriate in connection with the management of a registered mutual fund, including decisions regarding all service providers, fee structures, the introduction of new fund classes, the declaration of dividends, and distributions of income and capital gains, to name a few. Also as required by the 1940 Act, the board has the ability to fire the asset manager without cause. The notion that a 1940 Act board is in some way less meaningful or less substantive in terms of power than a board for an operating entity is unfounded and untrue. To conclude this way would be to conclude that the 1940 Act rules and regulations are not meaningful. We believe the existence of a 1940 Act board should be sufficient to conclude that the investment advisor is an agent of the fund.

Question 8

When evaluating a decision-maker's role, rights held by other parties are considered when determining whether a decision-maker is an agent. Specifically, situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an

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agent. However, if numerous parties hold such rights, those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent. In such a situation, those rights would be considered together with the other factors included in question 7 above, to determine whether the decision-maker is an agent. Do you believe that removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is an agent? If so, do you agree that it should be one factor but not in and of itself determinative, when evaluating whether a decision-maker is an agent?

We believe that removal rights held by numerous parties should be a determinative factor. The 1940 Act specifically requires such simple majority kick-out rights and we believe that a conclusion that they are not substantive implies that the 1940 Act requirement is unnecessary and meaningless. In addition, for nonregistered products, kick-out rights are provided because they are demanded by the marketplace. An asset manager would rather not provide kick-out rights to investors. The fact that they are demanded by the marketplace and that the absence of kick-out rights could render an investment fund unmarketable is further evidence that the rights are substantive. The lack of significant precedence in the industry for exercising kick-out rights should not be viewed as evidence that the rights are not substantive but rather that the rights are operating effectively.

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We appreciate your consideration of this letter and we remain interested in participating in the upcoming FASB roundtable on this topic scheduled for November 22, 2010. Please contact Stacey Friday at (412) 288-1244 to discuss any questions you may have regarding our comments.

Sincerely,

/s/ Denis McAuley III
Denis McAuley III
Principal Accounting Officer

/s/ Stacey H. Friday
Stacey H. Friday
Director, Accounting Policy