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February 28, 2005

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
3 Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

COMMENT

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Re: Comments Proposed Amendments to Rule 1.25, 17 CFR Part 1, RIN 3038-AC15

Dear Ms. Webb:

I am writing on behalf of Federated Investors, Inc., Pittsburgh, Pennsylvania ("Federated"), concerning the amendments proposed by the Commodity Futures Trading Commission (the "Commission") to its regulations regarding the investment of customer funds and related recordkeeping requirements as published in the Federal Register on February 3, 2005. Specifically, we comment on the proposed amendment to Rule 1.25(b)(2)(i)(E) (the "Proposed Amendment") under the Commodity Exchange Act, as amended, contained in Part II, E of the proposal, regarding the investment of customer funds by futures commission merchants ("FCMs") in money market mutual funds ("MMMFs").

Background

Federated is the sponsor, distributor, and investment adviser for the Federated Family of open-end investment companies registered under the Investment Company Act of 1940, as amended (the "1940 Act"), which held \$179.3 billion in total assets as of December 31, 2004 (the "Federated Funds"). Approximately 66 percent of the assets in the Federated Funds are held in 55 MMMFs that operate in accordance with Rule 2a-7 promulgated by the Securities and Exchange Commission under the 1940 Act ("Rule 2a-7").

For the reasons that follow, Federated believes that the Proposed Amendment should be adopted in the form proposed in order to eliminate the current requirement under Rule 1.25(b)(2)(i)(E) that a MMMF that is rated by a nationally recognized statistical rating organization ("NRSRO") be rated at the highest rating of the NRSRO in order to qualify as a permitted investment for customer funds.

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The Current Rule Creates an Artificial Competitive Inequity

According to Federated, the MMMFs that most commonly are used by FCMs as investments for customer funds are unrated, and these unrated funds account for the majority of the investments of customer funds by FCMs. These funds generally do not qualify for the highest rating by an NRSRO because they hold split-rated and other securities in their portfolios which are not approved by the NRSROs for triple-A rated funds and because the average maturity of their portfolios may exceed 60 days.

Federated believes that the rating requirement currently contained in Rule 1.25(b)(2)(i)(E) creates a competitive inequity for rated MMMFs that have similar yield and portfolio characteristics to those of the unrated funds that are commonly used as investments for customer funds by FCMs.

For example, Federated offers a single-A rated MMMF that carries a yield comparable to that of the unrated funds and has similar portfolio characteristics.¹ This fund, called the Federated Prime Value Obligations Fund, had total assets of \$6.6 billion as of December 31, 2004, and is used by certain of Federated's institutional customers who seek a higher yield MMMF but whose investment parameters require the fund to be rated. Federated has been told by a number of FCMs that they would like to have the option of using the Federated Prime Value Obligations Fund as an investment for their FCM accounts.

Federated believes that Rule 1.25(b)(2)(i)(E) creates an artificial competitive disadvantage for the Prime Value Obligations Fund and other MMMFs which are rated below the highest NRSRO rating. These funds have essentially the same yield and portfolio characteristics as their unrated competitors yet, solely because of the fact that they are rated, they currently fail to qualify as permitted investments for customer funds under Rule 1.25(b)(2)(i)(E). If anything, the fact that a fund is rated should make it a more acceptable investment than an unrated fund, but that currently is not the case.

The Current Rule Unnecessarily Limits Investment Options

All of the commodities exchanges permit FCM customer funds to be invested in unrated MMMFs and, as a result, the rating requirement currently contained in Rule 1.25(b)(i)(2)(E) fails to serve a useful purpose. The rating requirement does not currently prevent FCM customer

¹ Federated believes that only four single-A rated MMMFs exist in the market at present. Federated offers five triple-A rated MMMFs in its institutional investor series. These funds generally are not used by FCMs and their customers, however, because they carry a lower yield than unrated MMMFs. Federated presently does not offer any unrated MMMFs.

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funds from being invested in MMMFs that fail to qualify for the highest NRSRO rating and, indeed, Federated believes that most FCM customer funds are invested in MMMFs that do not qualify and are unrated.

If adopted, the Proposed Amendment would expand the investment options available for FCM customer funds without sacrificing investor protections and would eliminate the present competitive inequity for MMMFs that are rated below the highest NRSRO rating but which have the same yield and portfolio characteristics as unrated funds. This result would benefit both FCMs and investors by providing greater and more varied choices for higher yielding investments for customer funds. Accordingly, Federated supports the adoption of the Proposed Amendment in the form proposed.

Rule 2a-7 Affords Ample Investor Protection

Federated also believes that the Proposed Amendment is justified because the extensive investor protections in Rule 2a-7 make the current provisions of Rule 1.25(b)(2)(i)(E) unnecessary and superfluous. MMMFs are open-end management investment companies registered under the 1940 Act which have as their investment objectives generation of income and preservation of principal and liquidity through investments in short-term, high quality securities.² These funds generally seek to maintain a stable price of \$1.00 per share pursuant to the requirements of Rule 2a-7, which are designed to minimize the deviation between a fund's share price (using either the amortized cost method or the penny-rounding method of valuation, each as specified under Rule 2a-7) and the market value of its portfolio. Largely as a result of the restrictions of Rule 2a-7, MMMFs have been almost universally successful in continually meeting the standard of a \$1.00 stable share price³ and have been widely accepted by both retail and institutional investors as a cash management tool.

Under Rule 2a-7, MMMFs must meet strict portfolio quality, diversification and maturity standards which greatly limit the possibility of significant deviation between the share price of a fund and its per share net asset value. In addition, these funds are subject to oversight regarding their investment processes by their boards of directors or trustees. Federated believes that these restrictions sufficiently protect customers of FCMs such that the restrictions of Rule 1.25(b)(2)(i)(E) are not needed to ensure the credit quality of permitted investments for customer funds.

² *Revisions to Rules Regulating Money Market Funds*, Investment Company Act Rel. No. 21837 (March 28, 1996), 61 Fed. Reg. 13956, 13957 (1996).

³ The liquidation and distribution of less than \$1.00 per share of the US Government Money Market Fund, a series of Community Bankers Mutual Fund, Inc., in September, 1994 is an exception to this otherwise consistent pattern.

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The portfolio quality of MMMFs is regulated by both broad and specific requirements under Rule 2a-7. Generally, a MMMF may invest only in U.S. dollar-denominated securities which the fund's board of directors or trustees (or, more commonly, the fund's investment adviser as delegate) has determined present minimal credit risks, based on various measures of the issuer's credit quality as well as any rating assigned by an NRSRO.⁴ The rating assigned by an NRSRO is a factor in this review but is not determinative and must be supplemented by additional issuer credit information. While a fund's board may, and frequently does, delegate the responsibility for this and other determinations required by Rule 2a-7 to the fund's investment adviser, the board is required to establish and periodically review written guidelines and procedures regarding these determinations, as well as fund investments and investment procedures, and to review investment decisions in the event of a portfolio security default.⁵ In all cases, the fund's board retains sole responsibility for reassessing the credit quality of any portfolio security which is downgraded by an NRSRO or, if unrated, which experiences a decline in credit quality.⁶

The portfolio quality of a MMMF is further assured by the fact that the fund is limited to investing only in "eligible securities" which are defined as those which are rated by at least two NRSROs in one of the two highest short-term rating categories or, if unrated, are of comparable quality in the view of the fund's investment adviser.⁷ As an additional portfolio quality requirement, we note that Rule 2a-7 requires funds to invest at least 95 percent of their assets in "first tier securities" which must be rated at the highest NRSRO short-term rating level or, if unrated, must be of comparable quality (or must consist of securities issued by another money market mutual fund or U.S. government securities).⁸

Rule 2a-7 also requires MMMFs to hold diversified portfolios of securities. Generally, a taxable MMMF may not invest greater than five percent of its total assets in the securities of a single issuer (with an exception for temporary larger investments in first tier securities under certain circumstances).⁹ In addition, a fund may not invest more than the greater of one percent of its total assets or \$1,000,000 in "second tier securities" issued by a single issuer.¹⁰ Single state

⁴ Rule 2a-7(c)(3)(i).

⁵ Rule 2a-7(e).

⁶ Rule 2a-7(c)(6).

⁷ Rule 2a-7(a)(10).

⁸ Rule 2a-7(a)(12).

⁹ Rule 2a-7(c)(4)(i)(A).

¹⁰ Rule 2a-7(c)(4)(i)(C).

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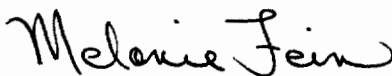
fund and tax-exempt funds are also subject to similar diversification requirements with respect to both first tier securities and second tier securities.¹¹

Finally, a MMMF is required under Rule 2a-7 to maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share.¹² More specifically, a MMMF generally may not acquire any instrument having a remaining maturity of greater than 397 calendar days and may not maintain a dollar-weighted average portfolio maturity of more than 90 days.¹³ The SEC has stated that the purpose of the maturity provisions of Rule 2a-7 is to limit the exposure of MMMFs to interest rate risk.¹⁴

* * *

Based on the foregoing, we urge the Commission to adopt the proposed change to Rule 1.25(b)(2)(i)(E) as proposed. Please do not hesitate to contact me or my colleague Jonathan Dinwoodey at (617) 570-1086 should you have any questions regarding this letter.

Sincerely,



Melanie L. Fein

cc: Phyllis Dietz, *Commodity Futures Trading Commission*
Eugene F. Maloney, *Federated Investors, Inc.*
Richard Recker, *Federated Investors, Inc.*

¹¹ Rule 2a-7(c)(4)(i)(A) and Rule 2a-7(c)(4)(C)(2).

¹² Rule 2a-7(c)(3)(i).

¹³ Rule 2a-7(c)(2). An exception to this rule is that a MMMF not using the amortized cost method (as defined in Rule 2a-7(a)(2)) may not acquire any government security with a remaining maturity of greater than 762 calendar days.

¹⁴ *Revisions to Rules Regulating Money Market Funds*, supra note 2, 61 Fed. Reg. at 13971.