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Federated

WORLD-CLASS INVESTMENT MANAGER®

February 11, 2004

Mr. Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

RE: COMPLIANCE PROGRAMS OF INVESTMENT COMPANIES AND INVESTMENT ADVISERS; FILE NO. S7-03-03

Dear Mr. Katz:

This letter presents the comments of Federated Investors, Inc. ("Federated")[1] regarding certain aspects of Investment Company Act Rule 38a-1, which was recently promulgated by the Securities and Exchange Commission ("Commission") to govern compliance procedures and practices of certain investment companies (the "Compliance Programs Rule"). Although the Commission has approved the Compliance Programs Rule, the Release announcing that action (the "Release")[2] seeks comment on certain provisions that the Commission added which are "designed to promote the chief compliance officer's independence from fund management while still maintaining her effectiveness."

In this regard, the specific provisions of Rule 38a-1 include the following. The fund's board of directors must approve the designation and compensation of the fund's chief compliance officer ("CCO"), and must have the sole power to remove the CCO from that position. The CCO must report directly to the board, and must meet with the independent directors in executive session at least annually. The Commission also added provisions designed to protect the CCOs by prohibiting persons from coercing or otherwise unduly influencing them in the course of their responsibilities.[3]

Federated's comments relate to three aspects of the new CCO provisions: the structure of the CCO's relationship to "the fund's board of directors;" the scope of the prohibition on undue influence; and an adviser's ability to cease employing a person who also serves as a fund's CCO. Our comments are detailed below.

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[1] Federated is one of the largest asset management and mutual fund firms in the United States. Through its subsidiaries, Federated manages total assets of more than $197 billion and serves as adviser for over 135 mutual funds, as of December 31, 2003.

[2] Release Nos. IA-2204; IC-26299, December 17, 2003.

[3] *See*, part II.F. of the Release.

The Compliance Programs Rule Should Permit an Independent Board Committee to Administer the Rule's CCO-Related Provisions.

As presently worded, Rule 38a-1(a)(4)'s provisions relating to the CCO's designation, compensation, removal, and reporting place responsibility on the fund's full board (including, in certain matters, a majority of the directors who are not interested persons of the fund – the "Independent Directors"). Federated urges the Commission to specifically allow any or all of these functions to be handled by a committee of the board that is comprised entirely of Independent Directors – an "Independent Board Committee."

As the Commission knows, many fund boards already have in place one or more Independent Board Committees, for example, the board's Audit Committee. In our experience, boards have found that use of committees can improve the overall workings of a fund's governance structure, and enable the board to more efficiently carry out its many important functions. Indeed, the Commission very recently issued a set of fund governance proposals that would include a requirement for a formal annual self-assessment by the board of, among other matters, its committee structures and functioning.[4]

We strongly believe that allowing use of an Independent Board Committee in connection with these CCO-related duties would have the same benefits. Moreover, and perhaps more importantly, such action would foster development of a very close working relationship between the members of such a committee (and, in particular, the Chairman of the committee) and the CCO. In our view, this would further promote the Commission's purpose in setting forth such provisions.

The Commission Should Clarify that the Undue Influence Provisions Should Not Impede Normal Working Relationships.

Federated is deeply concerned that, absent clarification from the Commission, the "undue influence" prohibitions of the Compliance Programs Rule could be applied in such a way as to inhibit, rather than promote, effective administration of a fund's compliance programs.

Our concern stems from the very broad sweep of the language of this provision, Rule 38a-1(c), which states that:

> No officer, director, or employee of the fund, its investment adviser, or principal underwriter, or any person acting under such person's direction may directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the fund's chief compliance officer in the performance of his or her duties under this section.

As the Commission must surely appreciate, the CCO's position will entail considerable contact with personnel of the fund's various service providers, and such activities as fact-finding, discussions, and deliberations. Indeed, it appears that the Commission would favor having the

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[4] Rel. No, IC-26323, January 15, 2004.

fund's CCO be an employee of the fund's investment adviser, so as not to be "divorced from all fund operations."[5] It therefore seems critical for the CCO to be able to conduct such activities in as frank and straightforward a manner as possible.

What we urge the Commission to recognize is that *frank discussions cannot be one-sided.* In order for a compliance program to be truly effective, the persons with whom the CCO will interact must also be able to speak plainly about compliance matters and to freely offer up their views. This may be most important where their views or interpretations diverge from those of the CCO. Arriving at the best course of action for the benefit of fund shareholders often entails airing of different views and examination of the arguments for and against a variety of possible approaches. However, absent clarification from the Commission, we fear that the wording of Rule 38a-1(c), particularly the prohibition against indirect coercion, could be interpreted so broadly as to have a severely counterproductive and chilling effect on such discussions, out of fear that advocacy could be read as coercion.

For these reasons, we urge the Commission to make clear that Rule 38a-1(c) is not intended to have any such harmful effects.

The Compliance Programs Rule Should Not Force an Adviser to Retain Its Employees.

As noted above, it is to be expected that a fund's CCO will often be employed by the fund's adviser, and thus the adviser would likely be responsible for providing that person's full compensation (subject to the final provisions of the Compliance Programs Rule). In such a situation, Federated is very concerned that, absent clarification or revision, the Rule could have the unprecedented result of forcing an adviser, against its will, to continue an employment relationship with such an individual.

Our concern stems from the wording of the relevant provision, Rule 38a-1(a)(4)(ii), which would require that:

> [A CCO] may be removed from his or her responsibilities by action of (and only with the approval of) the fund's board of directors, including a majority of the directors who are not interested persons of the fund.

Without clarification, we are concerned that this language could be interpreted to require fund board-level approval of an *adviser's* decision to terminate, *as one if its employees*, an individual who also serves as a fund CCO – in effect, forcing the adviser to continue an employment relationship that it wishes to end. Such a result is not only unprecedented and unfair to the adviser, but by putting the fund's board members in the position of having to approve an adviser's decision to terminate an employee of the adviser, it could expose the board members to the possibility of wrongful termination charges by the (former) employee.

To avoid these undesirable results, Federated urges the Commission to make clear that in such a situation, it would be acceptable for the adviser to notify the board (or, as recommended above,

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[5] *See*, Release at notes 88 and 89, and accompanying text.

an Independent Board Committee) of its intention to terminate its employment relationship with the individual who also serves as the fund's CCO, and to proceed with such action after the board has had an opportunity to consider the matter, but without requiring board-level approval of that action. The board could then decide whether it also wishes to terminate the individual's services as fund CCO, or whether it wishes to retain the person in that capacity. Of course, in the latter event, the board would also have to make direct arrangements for compensating the individual (the cost of which is likely to be borne by the funds), who would now be an "outsider" to the adviser's organization. Although this would admittedly be awkward, it may be the only alternative to putting an adviser in the untenable position of not being able to terminate the employment of its own personnel.

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Federated very much appreciates having the opportunity to comment on these matters. If you would like to discuss these comments or any other aspects of the Compliance Programs Rule with us, please contact the undersigned by phone at (412) 288-7496 or by e-mail at jneuman@federatedinv.com. Thank you very much.

Very truly yours,

Jay S. Neuman
Corporate Counsel