



Securities Industry Association

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Via Electronic Mail Delivery

May 9, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0506

Re: Mutual Fund Redemption Fee Release No. IC-26782,
File No. S7-11-04

Dear Mr. Katz:

The Securities Industry Association's ("SIA")¹ Investment Company and Operations Committees ("Committees") appreciate the opportunity to comment on the above referenced release adopting Rule 22c-2. The rule requires fund boards, with certain exceptions, to make a determination as to whether a fund should impose a redemption fee. It also requires funds to enter into written agreements with intermediaries that hold shares on behalf of other investors to provide certain shareholder identity and transaction information at the funds request to facilitate, among other things, proper application of redemption fees.

The release also requested comment on whether the Commission should establish uniform standards for application of redemption fees under the rule.

General Comment

Well before the issuance of the release, SIA and ICI assembled a distinguished group of members of the broker-dealer, fund and retirement plan recordkeeping communities to address the challenges posed in implementing and effectively administering redemption fee policies. In particular, the group focused on whether uniform standards could positively contribute to the administration of such policies, while

¹ The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

minimizing unintended consequences for innocent investors. Because of the myriad ways in which mutual fund orders are initiated and processed, effective solutions for these issues are extremely elusive. Therefore, we believe it was wise of the Commission to leave it up to the discretion of fund boards as to whether redemption fees should be imposed. It is also wise to seek out public comment on whether uniform standards would be useful.

It is against this backdrop that we offer the following observations and recommendations.

A. Intermediary Agreements

While we generally agree with ICI that the operational burdens on funds of entering into agreements with intermediaries would be substantial, those burdens are no less substantial for broker-dealers and other intermediaries.

In the first instance, it must be recognized that intermediary relationships are often multi-layered and therefore, broker-dealers and other intermediaries, whether they process mutual fund transactions on an omnibus basis or otherwise, may not, in many circumstances, be in any better position than the fund to determine whether an underlying account is acting in an individual or an intermediary capacity. Thus, it would be equally unfair to contractually impose an obligation on a broker-dealer or other intermediary that it may not be able to meet, particularly given the potential variations in redemption fee policies. This does not mean, however, that funds and intermediaries should not work cooperatively to enhance the flow of shareholder information. In fact, we believe that significant strides are being made in that regard.² As pointed out in ICI's comment letter,³ there are better ways to address shareholder identification issues, including applying a presumption that an underlying account is an individual, absent information to the contrary. That will clearly encourage intermediaries and the fund's transfer agents to further investigate their underlying accounts.

Additionally, we are exploring with ICI the possible development of prototype contractual terms and approved methodologies for transmission of fund transactions data between intermediaries and funds. We believe that share lot history information is a necessary staple to facilitate a new recordkeeper's ability to properly implement the fund's redemption fee policy (as well as enhance the ability to track breakpoint entitlement).

We strongly believe this market-based approach offers a much better opportunity for accurately identifying accounts to which redemption fees should apply, than do mandatory contractual requirements. Mandatory requirements may actually have the perverse effect of either discouraging funds from implementing redemption fee policies,

² Much of this progress flows from the recommendations of the NASD Breakpoint Task Force, of which SIA and ICI were both members.

³ Letter from Elizabeth Kretzman, ICI General Counsel to Jonathan G. Katz, SEC Secretary, regarding Mutual Fund Redemption Fees, May 9, 2005.

even where they otherwise make sense, or discourage intermediaries from distributing certain funds that have administratively challenging redemption fee policies.

Cost-Benefit Analysis

We share the concerns of ICI regarding the Commission's cost-benefit analysis, and the possible underestimate of the costs that may be incurred by funds and intermediaries and ultimately borne by fund shareholders in implementing redemption fee programs. However, such an analysis, even if accurate, is incomplete, in that it fails to consider the possibly very considerable implementation costs coupled with the unintended costs of application of formulaic fees to shareholders who have no intention of violating fund redemption fee policies. We believe that the inherent difficulty of developing a redemption fee policy that will avoid significant unintended consequences for innocent shareholders is one of the major reasons why neither funds or distributors (as more fully discussed below) are able to reach consensus on most standardization proposals.

We understand that the actual implementation of redemption fees is at the discretion of fund boards, and indeed, in numerous circumstances a redemption fee policy is critical to avoiding significant dilution, or impairing a fund's ability to implement its investment strategy. However, there may be other less critical situations where fund boards nonetheless feel inclined to impose a redemption fee due to the significant media and regulatory focus on abusive short-term trading. Therefore, we believe that the Commission's cost-benefit analysis should have included not only actual cost estimates of dilution and other adverse economic consequences to the fund and its shareholders from short-term trading, but also an estimate of the costs that might be imposed on innocent investors ensnared in a formulaic redemption fee policy.

B. Standardization

As noted in ICI's comment letter, ICI and SIA members were not able to reach a consensus on many of the possible parameters of a uniform redemption fee program on which the Commission has requested comment. We wish to make it clear that this lack of consensus was not, to any significant degree, a reflection of opposing views between broker-dealers, other intermediaries and funds, but rather the by-product of shared concerns that many of the standards would create overwhelming operational implementation complexities, and could exacerbate, rather than ameliorate, inequities in applying redemption fees. Put another way, given the enormous variability in the way mutual fund transactions are initiated and processed, the actual application of a so-called uniform redemption fee policy may be anything but uniform. For example, there is little disagreement that many employee benefit plan transactions, such as loans, systematic pre-arranged purchases or withdrawals, and other "involuntary" transactions, pose no short-term trading risk to a fund. Nonetheless, the ability of recordkeepers to codify a consistent group of definitions, and to identify and then track such transactions on a cost-effective basis (particularly for smaller plans and recordkeepers) varies widely. Such

ability is further compromised when the data must flow through layers of other intermediaries during the processing cycle.

Thus, on balance, the Committees believe that rather than implementing specific exceptions, which may not, in practice be implemented on an equitable or uniform basis, other measures should be employed that will effectively exclude many transactions where there is no investor intent to engage in short term trading. For example, use of a first in, first out (“FIFO”) accounting method will cause fewer pre-arranged systematic transactions to be captured within a redemption fee period. Similarly, by permitting (though not requiring) funds to include a de minimis exemption in their redemption fee program, many systematic (including rebalancing) transactions, which tend to be modest in size, will avoid being subjected to a redemption fee⁴.

Therefore, the Committees strongly urge that the Commission defer action on standardization of other features until there has been an opportunity to more fully assess the effectiveness of FIFO accounting and voluntary de minimis exceptions in ameliorating unintended consequences. During this assessment period the Commission, in consultation with industry participants, could also seek to determine whether there is a need to standardize the level of the de minimis exemption.

C. Fund Board Consideration In Adopting Redemption fees

SIA recognizes that certain types of funds have more exposure to short-term trading risk than others by virtue of the nature of their investments, which is an important factor in determining whether to implement or continue a redemption fee program. However, we believe the process does not end there, and fund boards should perform an analysis of the impact on the imposition of redemption fees for each fund. This would include carefully weighing the costs of short-term trading to the fund and its shareholders against the potential cost of unintended consequences to fund shareholders who have no intention of engaging in short-term trading.

Once a decision has been made to implement a redemption fee program, it is equally important for the Board to consider what parameters should be included in the program to assure that the fund and its intermediaries can reasonably administer its provisions, and shareholders can clearly understand the circumstances under which they may become subject to redemption fees.

We note that shortly after concerns about mutual fund breakpoint entitlement surfaced, the then SEC Division of Investment Management Director was asked whether he viewed fund boards as having any responsibility for the problems that had occurred with respect to breakpoints. His response, in substance, was that having reviewed the breakpoint policies of a number of funds, he questioned how those fund boards could

⁴ It appears that SIA members are generally capable of handling different de minimis levels that may be established by funds, and thus we are not proposing that a standardized de minimis level be required. Nonetheless, various members have expressed concern that a lack of uniformity may be confusing to investors.

have reasonably concluded that the fund's breakpoint policies could be properly administered⁵. We trust that fund boards will consider such comments in shaping their redemption fee policies as well.

Finally, given the fact that it is probably not possible to implement any redemption fee policy without creating some unintended consequences, SIA believes that it is incumbent upon fund boards to fully explore all other options, including fair-value pricing, to address short-term trading concerns, before implementing a redemption fee program.

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Again, the Committees appreciate the opportunity to comment and hope the Commission will find our letter constructive and otherwise helpful. Any questions regarding its content may be addressed to Michael Udoff, SIA Associate General Counsel at 212-618-0509.

Sincerely,

D. Stuart Bowers
Chairman, SIA Operations Committee

Martin G. Byrne
Chairman, SIA Investment Company Committee

The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid
Meyer Eisenberg Acting Director, Division of Investment Management
William C. Middlebrooks, Jr., Senior Counsel
Hunter Jones, Assistant Director, Office of Regulatory Policy
Elizabeth Krentzman, General Counsel, Investment Company Institute.

⁵ Remarks of Paul F. Roye, 2003 ICI Mutual Funds and Investment Management Conference.