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24 May 2004

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20459

Re: Mandatory Redemption Fees for Redeemable Fund Securities (File No. S7-11-04)

Dear Mr. Katz:

The U.S. Advocacy Committee (USAC) of CFA Institute[1] appreciates the opportunity to comment on the SEC's proposal that would require mutual funds, with limited exceptions, to impose a two percent redemption fee on shares redeemed within five days of purchase. The USAC is a standing committee of CFA Institute charged with responding to new regulatory, legislative, and other developments in the United States affecting the investment profession, the practice of investment analysis and management, and the efficiency of financial markets.

Summary Position

We support the efforts of the SEC, through this proposal, to reduce the incidence of market timing by penalizing those who engage in short-term trading. In general, we agree with the proposed scope of the rule--that it not apply to money market or exchange-traded funds. In response to questions posed in the proposal, we believe the rule should *require*, not just *permit,* funds to charge a redemption fee on securities redeemed within a short period of time. In addition, we think that a five-day holding period is a reasonable time upon which to base the imposition of a redemption fee. However, we also support allowing funds to set a longer period, as long as (1) that period is adequately disclosed to shareholders, and (2) the full amount of the redemption fee is returned to the fund's assets.

We discuss these positions in greater detail below.

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[1] With headquarters in Charlottesville, VA and regional offices in Hong Kong and London, CFA Institute (formerly, the Association for Investment Management and Research®) is a non-profit professional association of 70,000 financial analysts, portfolio managers, and other investment professionals in 115 countries of which 57,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 129 Member Societies and Chapters in 50 countries and territories.

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Discussion

As stated in our recent letter on the SEC's market timing proposal[2], we believe that while not illegal under current regulations, market timing trading is detrimental to long-term shareholders in mutual funds. Thus, we support measures that will help curtail market timing practices.

Fundamental to our comments on the specifics of this proposal, however, is our strong call for the education of investors to improve their understanding of all of the risks involved in investing in mutual funds, as well as other investment vehicles. In seeking to fulfill their investment objectives, we believe it is essential that investors fully consider which, among numerous investment alternatives, best suit their unique circumstances and constraints. Investors who either do not fully understand their investment options, or who have not adequately planned for contingencies, often discover later that the investment vehicles they have chosen contribute little toward meeting their investment objectives, or fail to provide the liquidity needed in times of emergencies. As a result, these investors may consider themselves penalized by a rule like this that assesses fees for the redemption of their fund shares.

Mandatory or Permitted Redemptions

The proposed rule would impose a mandatory redemption fee on shares redeemed within a certain time period after purchase (proposed to be five days or less). The proposal asks, however, whether funds should be required, or just permitted, to impose a redemption fee. We believe that a redemption fee should be required.

One of the underlying objectives of the proposed rule is to curtail the practice of market timing. Given this objective, we strongly urge the SEC to make the redemption fee mandatory. While we agree that a redemption fee alone will not stop all market timing, it will decrease the profitability of this practice. We believe that should the funds be given the discretion of deciding whether to impose a redemption fee, it will undermine the effectiveness of the proposed rule in combating market timing as well as provide them with a potentially new opportunity to exert marketing leverage. We believe that to be fully effective, redemption fees must be required uniformly across the fund industry.

Moreover, we urge the SEC to set the redemption fee level at two percent, rather than allow funds the discretion to set their own fees (whether higher or lower). We agree with the SEC staff who reason that a two percent fee reflects a balance between two competing policy goals—preserving the redeemability of fund shares and reducing or eliminating market timing trades. Moreover, the proposal also reflects staff's view that two percent would be the maximum amount that would be consistent with provisions of the Investment Company Act of 1940 that require mutual fund shares to be redeemable. We concur with the view that a higher fee would run counter to the redeemability of fund shares, while a lower fee would not serve as an effective deterrent.

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[2] See February 23, 2004 letter from James W. Vitalone and Linda L. Rittenhouse to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission on Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings (File No. S7-26-03).

Five-Day Holding Period

Generally, we support the proposed use of a minimum five-day holding period for triggering the redemption fee; however, we urge that the final rule clarify that this holding period is five *business* days, calculated from the trade date. Five days may seem like an untenably long time to those who seek to take advantage of market timing and, therefore, should be effective in curtailing that type of trading.

Under the proposal, funds would retain the flexibility to institute a holding period longer than five days. We do not oppose this approach, as long as the holding period is clearly and prominently disclosed in the fund's prospectus and the entire redemption fee is returned to the fund's assets, rather than being appropriated by fund management.

Unanticipated Financial Emergency

In an effort to reduce the burden on smaller investors who redeem fund shares due to unanticipated personal reasons, the proposal provides three exceptions to the imposition of a redemption fee: (1) using the first in, first out method (FIFO) for determining the time period that shares have been held; (2) requiring funds to impose redemption fees only when the amount of the redeemed shares exceeds $2,500; and (3) providing for a waiver of redemption fees in the case of an "unanticipated financial emergency, upon written request of the shareholder." In this latter case, the fund would be required to waive fees on redemptions of $10,000 or less, but would be permitted to waive fees on redemptions over $10,000 in such emergencies.

We appreciate the SEC's sensitivities to the plight of the smaller investor through these exceptions. However, we have some concerns about the applicability of the "financial emergency" exception. First, given the speed with which most emergencies occur, requiring the shareholder to provide a written request may not be practical under those circumstances. Instead, we suggest the creation of a procedure that would allow the shareholder to redeem the necessary shares and then be reimbursed at a later date the amount of any redemption fee that was assessed. Second, we strongly urge the SEC staff to define the circumstance(s) that would constitute an "unanticipated financial emergency." Without such a definition, this exception not only becomes unmanageable from a fund's standpoint, but also opens itself up to abuse.

Conclusion

We support uniform and mandatory application of a two-percent redemption fee, with the qualifications noted in our discussion above. We would also like to reiterate our position that investor education is a critical step in enabling each investor to assess his or her risk and return objectives in the context of unique financial needs, circumstances and constraints, including appropriate planning for emergencies through investments in short-term vehicles.

If we can provide additional information, please do not hesitate to contact James W. Vitalone at 704.904.1694, jwvitalone@carolina.rr.com or Linda Rittenhouse at 434.951.5333, linda.rittenhouse@cfainstitute.org.

Sincerely,

/s/ James W. Vitalone, CFA *

James W. Vitalone, CFA
Chair, U.S. Advocacy Committee

/s/ Linda L. Rittenhouse

Linda L. Rittenhouse
CFA Institute Advocacy

cc: U.S. Advocacy Committee
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