April 10, 2006

Via Electronic Filing

Mr. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Re: File No. S7-06-06—Mutual Fund Redemption Fees

Dear Ms. Morris:

Charles Schwab & Co., Inc., along with its affiliates The Charles Schwab Trust Company and Schwab Retirement Plan Services, Inc. (collectively, "Schwab"),[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission") request for comment on its proposed amendments to Rule 22c-2 of the Investment Company Act of 1940 (the "Proposed Amendments").[2] In its current form, Rule 22c-2 requires most open-end investment companies ("Funds") to enter into agreements with broker-dealers, banks, trust companies and other financial intermediaries that maintain "omnibus" accounts with the Funds. These agreements require financial intermediaries to (i) provide shareholder and transaction information sufficient to allow the Fund to monitor and enforce Fund market-timing policies and (ii) restrict or prohibit further purchases of Fund shares by shareholders who have been identified by the Fund as having engaged in transactions that violate those policies. The Proposed Amendments would modify the definition of "financial intermediary" to exclude any intermediary that the Fund treats as an individual investor for purposes of applying the Fund's market-timing policies. The Proposed Amendments would also revise Rule 22c-2 to require Funds to enter into an agreement only with those financial intermediaries that submit purchases and redemptions directly to the Fund, its principal underwriter or transfer agent, or a registered clearing agency.

[1] Charles Schwab & Co., Inc ("CS&Co"), The Charles Schwab Trust Company ("CSTC"), and Schwab Retirement Plan Services, Inc. ("SRPS") are affiliates of each other and are each wholly-owned subsidiaries of The Charles Schwab Corporation ("Schwab Corporation"). Schwab Corporation is a leading provider of financial services, with more than 325 offices, 7.2 million client accounts, and $1.3 trillion in client assets. CS&Co is registered with the Commission as both a broker-dealer and as an investment adviser under the Investment Advisers Act of 1940, and offers a complete range of investment services and products, including an extensive selection of mutual funds through its Mutual Fund Marketplace®. Charles Schwab Corporate & Retirement Services provides services to retirement plan sponsors and participants through CS&Co, CSTC, and SRPS. These entities provide trustee, custodial, and/or pension recordkeeping services to over 100,000 qualified retirement plans, non-qualified deferred compensation plans, and individual retirement accounts with over $60 billion of assets under management.

[2] *See* SEC Release No. IC-27255 (February 28, 2006) (hereinafter, the "Proposed Amendments").

Schwab Strongly Supports the Proposed Amendments

Schwab strongly supports the Proposed Amendments. We believe the Proposed Amendments thoughtfully and effectively address Fund concerns regarding the substantial costs and administrative burdens associated with Rule 22c-2 compliance, while still achieving the objectives of the rule as originally adopted. By excluding from the definition of "financial intermediary" those accounts the Fund treats as an individual investor for purposes of applying its market timing policies, the Proposed Amendments eliminate a Fund's need to conduct an exhaustive and costly analysis of all shareholder accounts on its books and records to determine if any account-holder in fact meets that definition. This revision also recognizes the practical reality that despite best efforts, in many cases, a Fund may be unable to discern with absolute certainty whether a particular account-holder meets that definition, causing an unavoidable and inevitable violation of the rule.

Further, the Proposed Amendments clarify that a Fund needs to enter into shareholder information agreements only with financial intermediaries that trade directly with a Fund, its transfer agent or distributor, or a registered clearing agency. This revision relieves the Fund of any obligation to also enter into such agreements with so-called "second tier" or "indirect" intermediaries. A financial intermediary may be only one among a "chain of intermediaries". Requiring Funds to enter into shareholder information agreements with each intermediary within that chain would impose costly burdens of the Fund. Moreover, such an obligation is unnecessary given that first tier intermediaries will be required under their agreements with the Fund to obtain shareholder information from indirect intermediaries and to provide (or arrange to provide) that information to the Fund.

While Schwab strongly supports the Proposed Amendments, we are nevertheless concerned about the unintended adverse impact the amendments may have on financial intermediaries. Therefore, for the reasons discussed in greater detail below, Schwab recommends that the Commission (1) place limits upon a Fund's ability to treat a financial intermediary as an individual investor; (2) eliminate the requirement that financial intermediaries use best efforts to identify indirect intermediaries upon Fund request; and (3) extend the Rule 22c-2 compliance date. Each of the foregoing recommendations is consistent with the recommendations made by the Securities Industry Association ("SIA") in its comment letter to the Commission, which Schwab fully supports.[3]

The Commission Should Limit a Fund's Ability to Treat a Financial Intermediary as an Individual Investor

Under the Proposed Amendments, a Fund would not be required to enter into a shareholder information agreement with any person that it treats as an individual investor. Schwab believes, however, there are circumstances under which it would be inappropriate for a Fund to treat an account-holder as an individual investor. For example, it would be inappropriate for a Fund to treat Schwab, or other broker-dealers that maintain an omnibus account with the Fund for the benefit of its many brokerage customers, as an individual investor. If a Fund imposed a redemption fee on Schwab's omnibus account, it could unfairly result in certain long-term shareholders subsidizing the short-term trading activity of other Fund investors. The same inequitable result would occur in

[3] See Letter from Martin G. Byrne, Chairman , SIA Investment Company Committee to Ms. Nancy M. Morris, Secretary, SEC (April 10, 2006).

situations where a Fund treats retirement plans as individual investors (rather than charging redemption fees on the plan-participant level).[4]

While we do not expect that Funds would elect to treat known financial intermediaries such as Schwab as individual investors to avoid their obligations under Rule 22c-2, or seek to undermine the intent of the rule by inappropriately relying on that exception, the Proposed Amendments do not limit the Fund's apparent discretion to treat a person as an individual investor. The intent of this provision was to provide relief for Funds from the difficulties associated with identifying every account-holder that meets the definition of "financial intermediary"—particularly with respect to smaller intermediaries. We recognize the practical challenges of defining all circumstances in which a Fund must enter into a shareholder information agreement,[5] but, in Schwab's view, there are easily identifiable situations where the Fund should be required to enter into a shareholder information agreement with an account-holder—or, stated in the alternative, where a Fund should be prohibited from treating an account-holder as an individual investor.

First, a Fund should not be allowed to treat that account-holder as an individual investor if the Fund has a dealer agreement, selling agreement, services agreement, or similar type of agreement with the account-holder, either directly or with the account-holder's authorized agent,[6] pursuant to which the account-holder or its agent is authorized to make Fund shares available to

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[4] A Fund's decision to treat a retirement plan as an individual may raise regulatory issues for plan fiduciaries under ERISA. Specifically, if a Fund applies its redemption fee at the plan level, rather than the plan participant level, a plan fiduciary could conclude that allocation of the fee to all plan participants (rather than solely to those participants who engaged in the short-term trading in question) may result in a breach of its fiduciary obligation under ERISA. In the absence of specific guidance on the issue from the Department of Labor or the Internal Revenue Service, each plan fiduciary, with the advice of ERISA and tax counsel, would need to make an independent determination of how to apply redemption fees to the plan. If the plan fiduciary determines that it must be treated as a financial intermediary to meet its fiduciary obligations, and identifies the plan as such to the Fund, the Fund should not be permitted to treat the plan as an individual investor.

[5] For example, even if it were possible to define meaningful criteria that effectively distinguish between small and larger financial intermediaries for purposes of identifying those intermediaries excepted from the definition of "financial intermediary" (based on, for instance, asset size), Funds would nevertheless be faced with the burdens of conducting a review of a significant number of accounts. Further, Funds would still face the practical reality that, in some cases and despite best efforts, a Fund may be unable to discern with absolute accuracy which of those accounts meet the definition of "financial intermediary," thereby resulting in an unintended, though unavoidable, violation of the Rule. For this reason, Schwab believes the individual investor exception, revised consistent with Schwab's comments above, is the most effective and practical resolution of industry concerns.

[6] There may be some circumstances in which the account-holder has appointed an agent to effect transactions in the account and to provide recordkeeping and other administrative services. For example, a retirement plan may engage the services of a third-party administrator ("TPA") to oversee the daily administration of the plan, including the processing of plan participant transactions and other instructions, as well as the maintenance of plan records. In these instances, a Fund may have an agreement in place with the TPA instead of directly with the plan. Therefore, to the extent a Fund has an agreement with either the account-holder or an authorized agent, pursuant to which the account-holder or its agent makes Fund shares available for purchase, Schwab believes a Fund should not be allowed to treat the account-holder as an individual investor. For purposes of this letter, hereinafter any reference to "account-holder" should be deemed to include the account-holder's authorized agent.

investors through its omnibus accounts with the Fund.[7] Given the existence of an agreement between the Fund and the account-holder (or its agent), it should not be overly burdensome for a Fund to identify these intermediaries and amend its current contracts to reflect each intermediary's obligations under Rule 22c-2.

Second, if an account-holder identifies itself as a "financial intermediary," the Fund should not be allowed to treat that financial intermediary as an individual investor. In the Proposed Amendments, the Commission contemplates that to the extent a Fund treats an account-holder as an individual investor, and that account-holder is in fact a financial intermediary, imposition of Fund market-timing policies on the omnibus account would prompt the account-holder to self-identify.[8] It follows then that the Fund should not thereafter be able to continue to treat that account-holder as an individual investor.

These recommendations achieve a number of important ends. Specifically, the recommendations:

- provide some boundaries around the Fund's ability to treat known or reasonably known financial intermediaries as individual investors, thereby preventing a Fund from inappropriately relying on the individual investor exception, which was intended to provide relief with respect to small intermediaries that may be difficult to identify.

- limit the possibility that long-term shareholders trading through the omnibus account may unfairly subsidize the short-term trading activity of other Fund investors.

- help ensure consistent treatment of financial intermediaries across the industry; that is, it will help guard against (i) one Fund treating a financial intermediary as such, while another Fund treats the same financial intermediary as an individual investor, and (ii) a Fund treating similar financial intermediaries differently, thereby potentially benefiting one while harming the other. Any lack of consistent treatment could cause undue customer confusion, and, in any event, will add an unnecessary layer of complexity. For example, it would be confusing to plan participants of a retirement plan if one Fund treated the plan as a financial intermediary, while another Fund treated that same plan as an individual investor (not to mention the additional challenges plan sponsors would have in administering the plan under such circumstances). In addition, a lack of consistent treatment will greatly affect the costs a financial intermediary will incur in implementing or upgrading its systems to comply with Rule 22c-2. Those systems would need to be designed to account for application of fees at the plan as well as plan participant level depending on how the plan was characterized by the Fund.

- help ensure consistent treatment of financial intermediaries that are direct competitors of the Funds or their affiliates, when such affiliates are themselves acting in the role of a financial intermediary with respect to accounts and the Funds.

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[7] Certain dealer and other agreements between a Fund and a financial intermediary may contemplate establishing individual investor accounts via Networking. Schwab's recommendation is limited only to those instances where the financial intermediary places trades through its account on an omnibus basis.

[8] *See Proposed Amendments* at 10, fn. 25.

Both of the above recommendations are consistent with the intent of the Proposed Amendments and help place all financial intermediaries on a level playing field. Schwab strongly urges the Commission to revise Rule 22c-2 accordingly.

The Commission Should Not Require Financial Intermediaries to Identify Indirect Intermediaries upon Fund Request

As the Commission recognizes in the Proposing Release, Rule 22c-2 in its current form places substantial administrative and financial burdens on Funds. The rule would require an exhaustive analysis of all accounts on the Funds' books and records to determine whether each account-holder meets the definition of financial intermediary. The Proposed Amendments effectively mitigate those burdens by excluding from the definition of "financial intermediary" those account-holders that the Fund treats as an individual investor.

While Schwab applauds the Commission for appropriately relieving Funds of the substantial burdens imposed by Rule 22c-2, the Proposed Amendments unfortunately then impose those very same burdens on first-tier financial intermediaries. Section 22c-2(b)(5) defines a "shareholder information agreement" to mean a written agreement under which a financial intermediary agrees to, among other things, "[u]se best efforts to determine, promptly upon request of the fund, whether any other person that holds fund shares through the financial intermediary is itself a financial intermediary . . ." The practical effect of this provision is to require first-tier intermediaries, upon Fund request, to conduct an analysis of accounts on its books and records to determine whether an account-holder meets the definition of "financial intermediary"—the very same task that the Commission has agreed is overly burdensome on Funds. Schwab sees no justifiable basis for relieving the Funds of those burdens on the one hand, and imposing those same burdens on first-tier intermediaries on the other. Schwab therefore strongly supports the SIA's recommendation that the Commission revise the definition of "shareholder information agreement" to exclude the requirement that first-tier intermediaries use best efforts to identify indirect intermediaries.[9]

The exclusion of this requirement does not lessen in any way the effectiveness of the Proposed Amendments. Absent this provision, the first-tier intermediary must still provide (or arrange to provide) shareholder and transaction information pertaining to any account on its books and records held by an indirect intermediary that it does not otherwise treat as an individual investor. Consistent with Schwab's recommendations above, limits should be placed on a financial intermediary's ability to treat an account-holder as an individual investor. Thus, for any account-holder with which the first-tier intermediary has a dealer agreement, selling agreement, services agreement, or similar agreement (including a clearing agreement), and for any account-holder that self-identifies as a financial intermediary, the first-tier intermediary would be obligated to provide or arrange to provide, upon a Fund's request, the information required by Rule 22c-2. If the indirect intermediary does not provide that information, the first-tier intermediary by rule will be required to restrict or prohibit the indirect intermediary from purchasing the Fund's shares.

[9] We recognize this provision requires only that financial intermediaries use "best efforts" to identify indirect intermediaries. But a "best efforts" obligation is a high standard and it would require a financial intermediary to make every possible effort to identify indirect intermediaries. While the "best efforts" standard would relieve financial intermediaries of absolute liability, it still imposes on them a significant and burdensome obligation.

While the first-tier intermediary will not be required to provide shareholder and transaction information for an account-holder it treats as an individual investor, it will be required to restrict or prohibit that account-holder from purchasing Fund shares through its account if the Fund determines that trading in the account violates the Fund's market-timing policies and the Fund requests such a restriction. And if that account-holder is in fact an indirect intermediary, a restriction placed upon its account will likely induce the indirect intermediary to self-identify as such.[10]

Schwab believes the SIA recommendation establishes an equitable balance between the respective obligations and burdens of Funds and financial intermediaries under Rule 22c-2, without comprising its purpose and effect. We therefore urge the Commission to revise the rule consistent with that recommendation.

The Commission Should Extend the Rule 22c-2 Compliance Date

Schwab recommends that the Commission extend the compliance date a minimum of six months from the current October 16, 2006 deadline or from the date the Proposed Amendments are adopted, whichever is later. Given the uncertainty around key aspects of Rule 22c-2 as adopted, and the understanding that the Commission planned to provide clarity on those issues in the Proposed Amendments, most Funds and financial intermediaries prudently waited to initiate negotiations of shareholder information agreements and modifications to their systems required to support the provision of required data to the Funds. Depending on the final form of the Proposed Amendments, Funds and financial intermediaries may need to re-draft their forms of shareholder information agreements and their systems development requirements to reflect the final requirements of Rule 22c-2.[11]

Additional Considerations

There are two additional aspects of the Rule 22c-2 that the Commission may wish to monitor and at some point provide further guidance. Given the large number of transactions effected through various financial intermediaries, it may be overly burdensome on some financial intermediaries, including indirect intermediaries, to have to provide shareholder and transaction information for Fund requests covering substantially large periods of time. For example, if a Fund were to request all shareholder and transaction information for "the last calendar year" from a financial intermediary for the retirement plan account-holders on its books and records, each retirement plan would be required to provide a massive amount of information potentially at greater cost than if it were to provide that information in smaller amounts periodically throughout the year. The burden of handling such data would be even greater on the financial intermediary itself which may have hundreds or thousands of individual retirement plan account-holders for

[10] Schwab agrees with the Commission that to the extent a financial intermediary or indirect intermediary is treated as an individual investor and a purchase restriction is placed on the intermediary's account, that intermediary will most often thereafter identify itself as a financial intermediary. At that point, the restriction could be removed provided the intermediary is willing to enter into a shareholder information agreement (assuming it has a direct relationship with the Fund) or is willing to provide shareholder and transaction information to the first-tier intermediary (assuming it is an indirect intermediary).

[11] For financial intermediaries such re-drafting will likely require greater effort, as they will need to revise their form of agreements with the Funds as well as their form of agreements with indirect intermediaries. While Rule 22c-2 does not require the financial intermediaries to enter into agreements with indirect intermediaries, Schwab expects as a matter of best practice many financial intermediaries will do so.

which it would be required to provide the underlying plan participant data to the Fund.[12] While Schwab believes this concern can largely be addressed contractually between the Fund and financial intermediaries, it may be worth considering at some point limiting by rule the period of time for which a Fund may request Rule 22c-2 information (e.g., to no more than 90 days worth of data).

Also, Schwab recognizes that use of shareholder social security numbers (SSNs) under Rule 22c-2 at this time is the only practical means to track shareholder trading activity across multiple accounts and multiple financial intermediaries and achieve the overall objectives of the rule. Schwab agrees that the requirement to provide shareholder SSNs under Rule 22c-2 should not result in a violation of applicable privacy laws, rules and regulations. That said, however, our clients have expressed heightened concern over the safekeeping of the personal information they entrust to Schwab. While we have sought to address those concerns by limiting when feasible the use of SSNs as a unique identifier within Schwab, Rule 22c-2 will significantly expand Schwab's and other financial entities' use of SSNs for such purposes. This may only increase client concerns about the possibility that their personal information will be inadvertently exposed and the potential financial losses they could suffer as a result. Given the level of concern and associated risk of the wide-spread use of SSNs, it is Schwab's hope that the Commission and the industry can work together to develop an alternative means to identify shareholders for purposes of Rule 22c-2.
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Schwab appreciates the opportunity to comment on the Proposed Amendments. If you have questions about this letter, please contact the undersigned at (415) 636-3649 or at david.lekich@schwab.com.

Sincerely,

/s/ David J. Lekich

David J. Lekich
Vice President and Senior Corporate Counsel
CHARLES SCHWAB & CO., INC.

cc: Susan Ferris Wyderko, Acting Director,
Division of Investment Management

Robert Plaze, Associate Director for Regulation

[12] For example, for just one retirement plan with 10,000 plan participants trading the Fund twice per month in both their salary deferral and employer matching "account," the volume of transactions in a year would reach almost 500,000 plan participant level transactions.