INVESTMENT COMPANY INSTITUTE

20

Elizabeth Krentzman
GENERAL COUNSEL

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

202/326-5815 FAX: 202/326-5812
ekrentzman@ici.org

April 10, 2006

RECEIVED
APR 11 2006
OFFICE OF THE SECRETARY

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

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

Dear Ms. Morris:

The Investment Company Institute[1] strongly supports the proposed amendments to the redemption fee rule, Rule 22c-2 under the Investment Company Act of 1940.[2] We commend the Commission and its staff for their efforts over the past year to work with the industry to address the issues that came to light after the Commission adopted the rule. We are pleased that the proposed changes address many of the concerns raised by the Institute and, in particular, are designed to reduce the costs associated with the rule as originally adopted.[3] We are also pleased with the Commission's interest in learning on an ongoing basis about funds' experiences, including their costs and burdens, in complying with the rule. We will continue to monitor the rule's implementation and provide the Commission with feedback as appropriate.

The Institute supports the manner in which the Commission has proposed to address small nominee accounts and chains of intermediaries under the rule. The proposed approach will avoid funds having to execute shareholder information agreements with those nominee accounts they treat as individual accounts and with indirect intermediaries. It should reduce the costs and burdens associated

[1] The Investment Company Institute is the national association of the U.S. investment company industry. More information about the Institute is attached to this letter.

[2] *Mutual Fund Redemption Fees,* SEC Release No. IC-27255 (Feb. 28, 2006) (the "Release").

[3] *See* Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, SEC (May 9, 2005).

with the rule's implementation while still providing funds access to underlying shareholder information.

As discussed in more detail below, the Institute has two recommendations on the Commission's proposal. First, we strongly recommend that the compliance date be extended at least six months. Second, we recommend a technical revision to the rule's definition of "financial intermediary" to ensure that it includes persons that submit orders directly to the fund on behalf of a financial intermediary. We also seek clarification of certain issues raised by the proposed amendments.

Compliance Date

The Release seeks comment on whether additional time is needed beyond the October 16, 2006 compliance date to comply with the proposed amendments. From the date of the rule's adoption, the Institute has been active in assisting our members with its implementation. Our efforts have included, among others: (1) developing jointly with the Securities Industry Association "Model Contractual Clauses for Rule 22c-2" to provide our members and their intermediaries a form to use to meet the rule's contract requirements; (2) developing standardized data protocols that can be used by a fund to request and receive shareholder trading data under the rule; and (3) providing our members a "Sample Mutual Fund Agreement Package" to help funds communicate key information about the requirements of the rule to their intermediaries.

While much work has been done by funds and their intermediaries to meet the current compliance date, significantly more work remains to be done – particularly in the area of executing the required shareholder information agreements. Delays in obtaining executed agreements have resulted, in large part, from uncertainty regarding which financial intermediaries were required to execute agreements with the funds and the terms of those agreements. Shortly after the rule was adopted, Commission staff acknowledged that there were a variety of issues raised by commenters that needed to be resolved for the rule to operate as intended. Accordingly, we strongly encourage the Commission to extend the compliance date six months from the later of October 16, 2006 or the date the proposed amendments to the rule are adopted.

Shareholder Information Agreements

Under the Commission's proposal, a fund must execute a shareholder information agreement with any person that meets two conditions. The first is that the person is a financial intermediary – *i.e.,* the person holds an account in nominee name on the fund's books and records. The second is that the person submits trades "directly" to the fund. The Institute is concerned that these criteria create an unintended gap. Many financial intermediaries (*e.g.,* banks) do not transact business with the fund directly. Instead, they utilize the services of other entities that aggregate customer orders and submit them to the fund for processing. The accounts of these entities' customers are maintained on the fund's books and records in the name of the financial institution (*e.g.,* the bank as nominee – not in the name of the entity forwarding the trade to the fund for processing). In these cases, neither the entity forwarding the trade "directly" to the fund, nor that entity's customer (the bank), meets *both* criteria triggering the requirements for a shareholder information agreement with the fund.

To address this inadvertent gap in the rule, the Institute recommends that the Commission revise the definition of "financial intermediary" to include any person that, on behalf of a financial intermediary, submits purchase or sale orders directly to the fund.[4] This revision will assure that funds have access, through a shareholder information agreement, to a financial intermediary's trading data without regard to whether the intermediary submits orders to the fund directly or through another entity that transacts business directly with the fund on the intermediary's behalf.

Intermediary Agreements

The Institute supports the proposed provision that a fund must prohibit any financial intermediary that does not execute a shareholder information agreement with the fund from purchasing, on behalf of itself or others, securities issued by the fund. We recommend the Commission make it clear that, for these purposes, "purchase" does not include the automatic reinvestment of dividends. Market-timing transactions are properly thought to be shareholder-driven, and not the result of automatic reinvestments of dividends. Our requested clarification is consistent with the rule's goal of helping funds to monitor short-term trading and enforce their market-timing policies, while avoiding disruption to transactions that are automatic and thus not vulnerable to market-timing or other abusive practices. The clarification is also consistent with the Commission's long-standing view that the term "sale" in Section 2(3) of the Securities Act of 1933 does not include reinvested dividends.[5]

Foreign Shareholders

Under the rule, the shareholder information agreement must require intermediaries to provide funds, on request, a shareholder's taxpayer identification number (TIN). In some instances, foreign shareholders may not have TINs. For such foreign shareholders, we recommend that the Commission permit the use of another unique, government-issued identifier in lieu of a TIN (*e.g.,* an individual taxpayer identification number (ITIN), which is issued by the IRS to foreign nationals).

---

[4] We recommend that a new paragraph (c)(1)(iv) be added in the definition of "financial intermediary" as follows: "Any person that submits orders to purchase or redeem shares directly to the fund, its principal underwriter or transfer agent, or to a registered clearing agency on behalf of any of the foregoing persons."

[5] *See, e.g.,* SEC Release No. 33-929 (July 29, 1936) and *The Mony Fund, Incorporated,* pub. avail. April 14, 1975.

Privacy Issues

The Institute agrees with the Commission that privacy regulations under the Gramm-Leach-Bliley Act do not preclude intermediaries from providing to funds the shareholder identification and transaction information Rule 22c-2 requires. The Commission's determination is consistent with the advice of our outside counsel that disclosure of Social Security numbers and other information about individual shareholders mandated by Rule 22c-2 is consistent with federal and state privacy laws. A copy of outside counsel's memorandum is attached.

* * * *

We appreciate the efforts of the Commission and its staff to address concerns previously raised by the Institute and others with the rule as originally adopted. We look forward to providing the staff information on the rule's implementation. In the meantime, if you have any questions concerning our comments or would like additional information about them, please contact me at 202-326-5815 or Tamara Salmon at 202-326-5825.

Sincerely,

Elizabeth Krentzman

Elizabeth Krentzman
General Counsel

cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Annette L. Nazareth

Susan Ferris Wyderko, Acting Director
Robert Plaze, Associate Director for Regulation
C. Hunter Jones, Assistant Director, Office of Regulatory Policy
Division of Investment Management

Enclosures

About the Investment Company Institute

The Investment Company Institute's membership includes 8,606 open-end investment companies (mutual funds), 653 closed-end investment companies, 160 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately $9.207 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 89.5 million shareholders in more than 52.6 million households.

ALSTON&BIRD LLP

TO: Investment Company Institute

FROM: Alston & Bird LLP

DATE: March 13, 2006

RE: Privacy Implications of SEC Rule 22c-2

We have been asked to assess whether SEC Rule 22c-2 (the "Rule") is consistent with existing federal and state consumer privacy requirements.

The Rule makes it unlawful for a mutual fund ("fund") that issues redeemable securities,[1] to redeem them unless it has entered into agreements with each of its financial intermediaries to enable it to obtain taxpayer identification numbers and transaction information for each shareholder who buys or sells shares in the fund.[2]

Applicable federal and state privacy laws permit a financial institution to disclose otherwise confidential customer information if the disclosure is necessary to carry out transactions on behalf of the customer, to protect against fraud or other wrongdoing, to carry out risk management, or to comply with applicable legal requirements.[3]

Under the Rule, the financial intermediary cannot redeem fund shares unless it has agreed to disclose the specified customer information to the fund. The agreement to provide these disclosures is required to carry out transactions on behalf of customers, for the anti-fraud and risk management purposes of the fund with which it has the contractual relationship, and for the fund to meet SEC legal requirements. Accordingly, we conclude that provision of the customer information to the fund will not cause the financial intermediary making the disclosure to violate federal or state privacy law.

[1] The Rule excepts from this requirement certain funds as follows: money market funds, any fund that issues securities that are listed on a national securities exchange, and any fund that affirmatively permits short-term trading of its securities, if its prospectus clearly and prominently discloses that the fund permits short-term trading of its securities and that such trading may result in additional costs for the fund, unless the fund elects to impose a redemption fee (also defined in the Rule), in which case the exception does not apply.

[2] The Rule defines financial intermediary to include any broker, dealer, bank, or other entity that holds fund securities in nominee name, a unit investment trust or fund that invests in the fund in reliance on section 12(d)(1)(E) of the Investment Company Act of 1940, and the administrator or record keeper of a participant-directed employee benefit plan. 17 C.F.R. § 270.22c-2(c)(1).

[3] For federal law see 15 U.S.C. § 6802(e)(3)(B), (C), (5), (8); 17 C.F.R. § 248.15(a)(2)(ii), (iii), (4), (7)(i); for state laws see citations *infra*.

RULE 22C-2

Shares in a fund are not always held in the name of the individual shareholder. Instead, they may be held in an omnibus account that is held in nominee name by a broker-dealer, bank, plan administrator, or other financial intermediary that aggregates individual accounts. The use of omnibus accounts may impair the ability of a fund to determine whether an individual may be market-timing purchases and sales of fund shares held through such account. The Rule attempts to enable a fund to detect and redress the trading of its shares that is inconsistent with the fund's policies established for the purchase of eliminating or reducing any dilution of the value of the outstanding securities issues by the fund (*e.g.*, market timing). It does so by prohibiting a fund from redeeming its shares within seven days of the share purchase unless it has in place a written agreement with each of the financial intermediaries that hold an account with the fund. The contract must include two elements. The financial intermediary must agree to:

1) Provide, promptly upon request by the fund, the Taxpayer Identification Number of all shareholders that purchased, redeemed, transferred, or exchanged shares held through an account with the financial intermediary, and the amount and dates of such shareholder purchases, redemptions, transfers and exchanges;[4] and

2) Execute any instructions from the fund to restrict or prohibit further purchases or exchanges of fund shares by a shareholder who has been identified by the fund as having engaged in transactions of fund shares (directly or indirectly through the intermediary's account) that violate policies established by the fund for the purpose of eliminating or reducing any dilution of the value of the outstanding securities issued by the fund.[5]

PRIVACY REQUIREMENTS

The Rule directly applies only to the fund. However, its consequence is that the financial intermediary, not directly covered by the Rule, must provide nonpublic personal information about its customers, including Social Security numbers, to a non-affiliated financial institution – the fund.[6] Disclosures of customer information to non-affiliates, except for certain specified purposes, are generally prohibited under the privacy provisions of Title V of the Gramm-Leach-Bliley Act ("GLB") as well as by various state privacy laws. In the guidance accompanying the original adoption of the Rule, the SEC stated that a fund receiving shareholder information may not use it for its own marketing purposes.[7] The SEC did not directly address in the Release the question of whether the disclosure by the financial intermediary is permissible under GLB. Below, we address both federal and state privacy laws as they apply to the financial intermediary.

---

[4] *See* 17 C.F.R. § 270.22c-2(a)(2)(i). The other condition is that the fund's board of directors has determined whether to impose a redemption fee on shares redeemed within a certain time period. *See* 17 C.F.R. § 270.22c-2(a)(1).
[5] *See* 17 C.F.R. § 270.22c-2(a)(2)(ii)
[6] For the purpose of this memorandum, we assume that the Social Security numbers and other information involved constitute protected information under the applicable definitions in federal and state law.
[7] *See* 70 Fed. Reg. 13328, 13332 n.47 (Mar. 18, 2005) (the "Release").
[8] *See* 70 Fed. Reg. 13328, 13332 n.47 (Mar. 18, 2005).

Federal Requirements

Although Section 502 of GLB permits the sharing of any information among affiliates, it generally requires a financial institution to allow a customer to opt out of the disclosure of protected information to non-affiliates.[9] The SEC's Regulation S-P implements this requirement as to SEC-regulated financial intermediaries, including brokers, dealers, investment advisers, and investment companies.[10] Banks and other insured depository institutions that may act as financial intermediaries are subject to essentially identical rules imposed by their federal bank regulators.[11] Insurance companies are regulated at the state level, and nearly every state has enacted legislation that applies the section 502 requirements to them. Other financial intermediaries that are financial institutions for purposes of GLB are subject to the same requirements under rules promulgated by the Federal Trade Commission.[12]

Section 502 specifies a number of exceptions to the general prohibition on disclosure of customer information to non-affiliates. Relevantly, these exceptions permit disclosures of nonpublic personal information:

- "as necessary to effect, administer, or enforce a transaction requested or authorized by the consumer, or in connection with … servicing or processing a financial product or service requested or authorized by the consumer."

- "to protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability."

- "for required institutional risk control …."

- "to the extent specifically permitted or required under other provisions of law and in accordance with the Right to Financial Privacy Act."

- "to comply with Federal, State, or local laws, rules, and other applicable legal requirements."[13]

The purposes of the written agreement that the Rule requires of the fund, and of the disclosures that the agreement requires of the financial intermediary, fall under each of these exceptions. The Rule requires each fund subject to it to enter into a written agreement with each of its financial intermediaries. Such agreement must require the intermediary to disclose to the fund, upon request, customer information. For the fund, entering into such an agreement is necessary "to comply with Federal … rules." Similarly, a financial intermediary that wants to redeem shares from the fund (*i.e.,* provide a service to its customer) must agree to enter into a written agreement with the fund that meets the SEC requirements. Thus, for the intermediary,

---

[9] *See* 15 U.S.C. § 6802.
[10] *See* 17 C.F.R. § 248.10(a)(1).
[11] *See* 12 C.F.R. § 40.10(a)(1) (national banks); 12 C.F.R. § 216.10(a)(1) (state member banks); 12 C.F.R. § 332.10(a)(1) (state nonmember banks); 12 C.F.R. § 573.10(a)(1) (savings associations).
[12] *See* 16 C.F.R. § 313.10(a)(1).
[13] 15 U.S.C. § 6802(e)(3)(B), (C), (5), (8); *see also* 17 C.F.R. § 248.15(a)(2)(ii), (iii), (4), (7)(i).

entering into the agreement is "necessary to effect [or] administer … a transaction requested or authorized by the consumer."[14] Because a redemption within seven days can, as a practical matter, occur only if a fund and an intermediary have entered into the agreement, the financial intermediary's obligation under the agreement also is an "other applicable legal requirement," with which the financial intermediary must comply. Also, because the purpose of the disclosure by the financial intermediary is to enable the fund, in part, to protect against fraud, market manipulation and insider trading and to engage in risk control of trading in its securities, there are multiple grounds for determining that the disclosures by the financial intermediary to the fund are permissible under GLB.

The SEC has recently proposed amendments to the Rule that, if finalized in their current form, would clarify the responsibilities of mutual funds and financial intermediaries that effect transactions in fund shares through other financial intermediaries.[15] Specifically, the amendments would provide that if a financial intermediary fails to execute with the fund the written agreement required by the Rule, the fund must restrict or prohibit such financial institution from purchasing shares of the fund. The amendments also would require that, in the written agreement between the fund and a financial institution that is a "first-tier" intermediary, the first-tier intermediary make two commitments. First, it must agree that it will use its "best efforts" to determine whether any other person that holds fund shares through the first-tier intermediary is itself a financial intermediary (such an intermediary would be an indirect intermediary). Second, it must agree that, if an indirect intermediary declines to provide identification and transaction information about its individual customers, the first-tier intermediary, at the request of the fund, will restrict or prohibit the indirect intermediary from purchasing, on behalf of itself or others, securities issued by the fund.

Assuming that an indirect financial intermediary is itself a "financial institution" for purposes of the GLB, we believe two conclusions follow. First, if the first-tier and indirect intermediaries enter into a written agreement between themselves to ensure that the fund is provided customer information upon request, the same analysis above relating to the provision of information by a first-tier intermediary to a mutual fund, pursuant to an agreement, would apply. Second, in the absence of an agreement between the first-tier intermediary and its indirect intermediaries, the indirect intermediaries must comply with an information request from the first-tier intermediary or lose its purchasing privileges in the fund through the first-tier intermediary. Compliance is, in other words, a condition of continuing to do business with the first-tier intermediary in fund shares and thus is "in connection with … servicing or processing a financial product or service requested or authorized by the consumer" who has made trades in the fund's shares.

---

[14] The SEC previously has advised that the disclosure by an investment adviser to a broker of customer information in order to execute a transaction comes within the "necessary to effect" exception. *See* SEC Staff Responses to Questions about Regulation S-P, Q. 13 (updated Jan. 23, 2003) (www.sec.gov/divisions/investment/guidance/regs2qa.htm). Similarly here, unless an agreement for disclosure is in place, redemption within seven calendar days cannot lawfully be effected.

[15] *See* SEC Release No. IC-27255 (Feb. 28, 2006) ("SEC February Release"). Intermediaries that effect transactions directly with mutual funds are referred to herein as "first-tier intermediaries;" those that conduct transactions in fund shares through other intermediaries are referred to herein as "indirect intermediaries."

Additionally, the purpose of the disclosure by the indirect intermediary is (as was the case above) to enable the fund to protect against fraud, market manipulation and insider trading and to engage in risk control of trading in its securities. Thus, disclosures by indirect intermediaries under the circumstances set forth in the proposed rule are protected by a number of the GLB exceptions. The SEC's February 2006 Release, which did address privacy concerns about the Rule, noted the SEC's belief "that the disclosure of information under shareholder information agreements, and the fund's request and receipt of information under those agreements, are covered by [GLB] exceptions."[16]

If the indirect financial intermediary is not a "financial institution," as such term is defined in the GLB, the GLB's provisions would not apply to restrict or prohibit the financial intermediary's sharing nonpublic customer information with the fund either directly or through a first-tier financial intermediary.

GLB also requires each financial institution to provide a privacy statement annually to its customers, which includes a statement of entities to which the institution may disclose protected information, even if the disclosure itself is permissible.[17] Under the federal GLB regulations, an institution that makes disclosures under the exceptions identified above may meet this obligation by stating that it "make[s] disclosures to other nonaffiliated third parties as permitted by law."[18] Each financial intermediary must ensure that its privacy statement includes this or other language sufficient to meet this requirement.

State Requirements

Two categories of state laws are implicated by the Rule: those based on Section 502 of GLB and those that address Social Security numbers specifically.

State GLB-Related Laws

Nearly every state has in place a statute that applies the substance of the Section 502 requirements to that state's licensed insurers. These statutes contain the same exceptions as Section 502, including the exception for disclosures required by federal laws or rules. Two states, California and Vermont, have enacted laws that impose more onerous requirements – an opt-in rather an opt-out – on disclosures of consumer information to non-affiliates by financial institutions. Both state laws include an exception for disclosures required by federal law,[19] and accordingly do not prevent the disclosures intended by the Rule.

[16] *See* SEC February Release at n.16.
[17] *See* 15 U.S.C. § 6803.
[18] *See, e.g.*, 17 C.F.R. § 248.6(b).
[19] *See* Cal. Fin. Code § 4056; Vt. Stat. Ann. Tit. 8, § 10204(11).

State Social Security Laws

Thirteen states have legislation restricting the use Social Security numbers by private companies.[20] Each of these laws contains an exception for disclosures that are required or permitted by federal law.[21] Most of these states (other than Arkansas, Minnesota, and North Carolina) also exempt disclosures from any restriction where the release is for internal verification or administrative purposes.[22] Accordingly, the disclosures required by the Rule are lawful.[23]

CONCLUSION

For the foregoing reasons, we believe that the disclosures of Social Security numbers and other information about individual shareholders mandated by the Rule are consistent with applicable federal and state law.

Dwight Smith
Romulus Johnson

---

[20] Some states also have statutes that regulate the use of Social Security numbers by state agencies, but these are not relevant here.

[21] *See* Ariz. Rev. Stat. § 44-1373(B) (2005); Ark. Code Ann. § 4-86-107(c) (2005); Cal. Civ. Code § 1798.85(b); Conn. Gen. Stat. Ann. § 42-470(d) (2002); 815 Ill. Comp. Stat. 505/2QQ(b) (2004); Md. Code, Com. Law § 14-3402(b) (2005); Mich. Comp. Laws Ann. § 445.83(g) (2004); Minn. Stat. Ann. § 325E.59, subdiv. 2 (2005) (effective July 1, 2007); Vernon's Ann. Mo. Stat. § 407.1355 (2004); N.M. Stat. Ann. § 57-12B-3 (2003); N.C. Gen.Stat. Ann. § 75-62(b) (2005) (effective Oct. 1, 2006); Vernon's Tex. Code Ann. Bus. & C. § 35.38(e); Va. Code Ann. § 59.1-443.2 (2005).

[22] Exceptions in North Carolina also include disclosures to prevent fraud. *See* N.C. Gen.Stat. Ann. § 75-62(b) (2005) (effective Oct. 1, 2006).

[23] Although a New York consumer protection law has been construed to prohibit the disclosure of Social Security numbers between two private entities, this interpretation does not apply to disclosures required by statute or regulation. *See Meyerson v. Prime Realty Services, LLC*, 7 Misc.3d 911, 796 N.Y.S.2d 848 (Sup. Ct. 2005).