AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

World-Class Solutions, Leadership & Advocacy Since 1875

Sarah A. Miller
Director
& Chief Regulatory Counsel
Center for Securities, Trust and Investments
202-663-5325
Smiller@aba.com

April 14, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Mutual Fund Redemption Fees; File No. S7–06–06; 71 Federal Register 11351 (March 7, 2006).

Dear Ms. Morris:

The American Bankers Association[1] ("ABA") appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed amendments to Rule 22c-2. That rule currently requires most open-end investment companies ("funds") to enter into written agreements with financial intermediaries, such as banks and broker-dealers, which hold shares on behalf of other investors in omnibus accounts. The agreement would require intermediaries to: (1) provide mutual funds on request with Taxpayer Identification Numbers (TINs) of all shareholders that purchased, redeemed, transferred, or exchanged shares held through an account and the amount and dates of those transactions; and (2) execute any instructions it receives from the mutual 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 that violate the fund's market timing policies. The Commission has set October 16, 2006, as the date for which all affected parties should be in compliance with Rule 22c-2.

In light of comments received since the Rule's adoption in March of 2005, the Commission is now proposing further refinements to Rule 22c-2. Specifically, the Commission is proposing to: (1) limit the types of intermediaries with which funds must negotiate information-sharing agreements; (2) address the Rule's application when there are chains of intermediaries, and (3) clarify the

[1] The ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all types of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

effect of a fund's failure to obtain an agreement with any of its intermediaries. These amendments are designed to reduce the costs of complying with the rule and to clarify its application in certain circumstances.

DISCUSSION

As investors in mutual funds, either for our own portfolio or for that of our fiduciary and brokerage clients, the banking industry appreciates the Commission's efforts to protect investors and to restore confidence in mutual funds. However, Rule 22c-2 has revealed great complexity in industry operations. We, therefore, urge the Commission to consider the need for additional time for intermediaries and other affected parties to come into compliance with the Rule. Additional time is necessary for intermediaries and others to receive and to negotiate contracts with mutual funds, to revise various operational systems to allow intermediaries to interface with mutual funds in order to provide the requested information, to obtain the necessary regulatory assurances from the banking regulators and the Department of Labor, and to notify, where appropriate, clients of their contractual obligation to provide confidential information to unaffiliated third party mutual funds on request. The ABA would respectfully submit that the Commission, at a minimum, should extend the effective compliance date for an additional six months.

There are over 2500 banks, savings associations and trust institutions (hereinafter referred collectively to as "banks") offering fiduciary services to personal, charitable and employee benefit trust clients. On behalf of their fiduciary clients, each of these institutions interfaces daily with several hundred mutual fund companies. For some of our larger members, the number is significantly higher. Many banks have reported that as of just two days ago they have yet to receive agreements from the vast majority of the funds with which they do business. Rather most have received agreements from less than three percent of the funds in which they invest fiduciary assets. These institutions fear that they will receive the majority of the agreements shortly before the deadline, giving them very little time to negotiate its provisions.

In addition, there are a variety of agreements being presented to the banks and other intermediaries. For example, some fund agreements give bank intermediaries the option of using "reasonable efforts" to obtain assurance from second tier intermediaries that the required information will be provided to the mutual fund. Others direct bank intermediaries to provide or arrange to provide to the fund the requested information from second tier intermediaries. No "reasonable efforts" language is included in these agreements.[2] Understandably,

[2] The banking industry is also opposed to the notion that funds may notify intermediaries of their intent to revise the terms of their existing agreement via negative consent on or after October 16, 2006. As a result, any transaction submitted to a fund by an intermediary after October 16, would be deemed to be evidence of consent to the revisions. Negative consent limits an intermediary's ability to negotiate with the fund regarding the terms of shareholder information agreements. It is our understanding that negative consent language is used most frequently in agreements between

bank intermediaries are reluctant to agree to provide information that is not within their control but rather is in the control of another intermediary. This second tier intermediary is generally hired by the plan sponsor, not the first tier bank intermediary. Thus, there is rarely privity of contract between the two intermediaries. Finally, other bank intermediaries with affiliated mutual funds are drafting their own agreements that can be used by both their mutual funds and the funds' bank affiliates.

It is our understanding that negotiations with the few funds that have delivered agreements to banks are also continuing on such issues as the need to disclose the investment professional associated with the account. Many bank intermediaries are reluctant to disclose the name of trust investment professionals, especially as this is not a data point that is mandated under the Rule.

Once these agreements have been finalized, funds and intermediaries must still develop and test systems to exchange the required shareholder information. These systems must protect against inappropriate use, including hacking and theft, perhaps through sophisticated encryption software. All of these data security concerns warrant significant time to test the data exchange systems. We note that the Depository Trust & Clearing Corporation ("DTCC") has created a standard, automated facility for funds to request and receive shareholder trading information from intermediaries. This facility may provide institutions a viable and consistent means of sharing information, thereby significantly reducing compliance costs for all involved. However, this Standardized Data Reporting ("SDR") system is not scheduled to be pilot tested until this summer. After the pilot program and any further modifications identified during the pilot are completed, funds and intermediaries will need sufficient time to adopt the SDR facility.

The ABA understands that the SDR file formats, best practices and examples may also be applied as an industry standard to other processing mechanisms used outside of DTCC. While this may prove to be very beneficial, the ABA understands that little to no work has begun on addressing a solution for funds and intermediaries not utilizing the DTCC's National Securities Clearing Corporation ("NSCC") Networking service.

Given the fractured response by the funds, intermediaries, and their utilities to the requirements of Rule 22c-2, the ABA strongly believes that it would be in the best interests of the investors and the fund industry to further delay the compliance date. To reduce needless expense in modifying these systems and agreements, particularly as the Commission is still revising, as appropriate, the requirements of the Rule, we request the Commission announce this extension of time immediately. Moreover, in connection with any extension of time, the ABA would request that the Commission direct all fund companies to deliver all agreements to intermediaries sufficiently in advance of the Rule's

---

mutual funds and smaller financial intermediaries. We believe all intermediaries, not just the larger players, should have the ability to negotiate these shareholder information agreements.

compliance date to allow all parties a sufficient period of time in which to negotiate fairly the terms of these agreements.

In addition and as we more fully explain below, ABA strongly believes for the system envisioned under Rule 22c-2 to work successfully that the Commission should consult with the bank regulators and the Department of Labor on certain privacy and ERISA issues raised under the Rule. A delayed compliance date will allow the Commission staff sufficient time to work through some of these thorny regulatory issues with their sister regulators and provide impacted parties with the necessary guidance. It will also give bank and other intermediaries sufficient time to inform their customers about Rule 22c-2 and its impact on the ability of bank and other intermediaries to shield confidential customer information from requesting mutual funds.

Financial Intermediary Definition

The Commission has proposed to except from the definition of "financial intermediary" any intermediary that the fund treats as an individual investor for purposes of its anti-dilution policies. This provision is intended to ease the burden on funds to contract with numerous small business retirement plans that hold mutual funds on behalf of a few employees.

The ABA supports the proposed revision. More importantly, the ABA appreciates the Commission's responsiveness to unintended consequences of the rule that are both costly and burdensome. We urge the Commission to consider additional exceptions to address other unintended and costly consequences of the rule. In particular, we would like clarification that the term "financial intermediary" could exclude other intermediaries that the fund treats as an individual investor for these purposes. While defined benefit plans, defined contribution plans that are not participant directed, foundations, endowments, and other charitable funds are not small, their investments are generally directed by investment professionals, such as banks, investment advisers and broker-dealers. In these situations, the fund should be permitted to treat the plan as a single customer and not require additional information about the underlying beneficiaries. Arguably, these funds fit under the proposed exclusion from financial intermediary but it would be helpful if the Commission were to confirm this point.

The rule should also explicitly define "purchase" to exclude certain transaction types that pose no risk of market timing by the underlying shareholders. Such an exception should cover periodic retirement plan contributions, routine re-balancing of investments held in the plan, automatic distributions, rollover transactions, transactions associated with plan participant loans, employer-directed changes in investment options, and automatic dividend reinvestment.

Lastly, the Commission should consider creating a de minimus exception to collected redemption fees. Under some circumstances, it may be more costly to track and receive payment than the redemption fee is worth. Although having a choice of whether to impose a fee, the funds may conclude that they are expected to uniformly execute their policy regardless of the amount.

Chains of Intermediaries

The second proposed amendment limits the number of intermediaries with which the fund must enter into a shareholder information agreement. The funds need only enter into this agreement with the first-tier intermediary which submits the purchase and redemption orders to the fund. With this proposed amendment, the burden of the rule has effectively been passed from the fund to the first-tier intermediary that places the trade orders with the fund. For those of our members that do not place participant directed orders with mutual funds, this proposed revision is a significant improvement as it eliminates the requirement for the bank intermediary to sign a shareholder information agreement. Of course, if this same intermediary places omnibus orders with mutual funds for its personal, charitable and other non-participant directed employee benefit plan clients, the bank intermediary would be required to sign the agreement.

First-tier bank intermediaries that place trade orders with the funds are not relieved from signing shareholder information agreements. In these situations, the first-tier intermediary and not the fund is now responsible for using best efforts to provide or arrange to provide the requested shareholder information from indirect intermediaries. If the requested information is not forwarded to the mutual fund by either the first tier or second-tier intermediaries, the first-tier intermediary must restrict or block the second-tier intermediary from purchasing further fund shares.

As noted in the beginning of our letter, many funds are presenting first-tier bank intermediaries with agreements that do not correspond to the Commission’s proposal. Specifically, some state that the first-tier intermediary must obtain the information from the second-tier intermediary. No option is given to have the second-tier intermediary provide the information directly to the fund, as would appear to be permitted under the Commission’s proposal. Other agreements do not allow the first-intermediary to retrieve this information on a “best efforts” basis as permitted under proposed Rule 22c-2(c)(5)(iii).

Bank intermediaries often do not have any leverage to force plan recordkeepers to provide the requested shareholder information to either the fund or to themselves, as first-tier intermediaries. The plan sponsor, not the bank intermediary, has hired the recordkeeper. Thus, it is imperative that these shareholder information agreements permit first-tier bank intermediaries to use best efforts and to have the option of arranging for the recordkeeper to provide the information directly to the fund.

Effect of Lacking an Agreement

The third amendment prohibits a fund from trading with any financial intermediary with which it does not have a shareholder information agreement.

The Commission has proposed this amendment to make clear that failure to obtain an agreement with all intermediaries does not preclude a fund from redeeming <u>any</u> of its shares within seven days. This provision of Rule 22c-2 has raised concerns among some that prohibiting intermediaries from trading in certain funds may trigger application of Department of Labor ("DOL") rules[3] requiring certain disclosures before a "blackout" in trading can be put into effect. It would be helpful if the Commission were to enlist the DOL to issue an opinion on whether cutting off an intermediary's ability to enter trade orders for fund shares triggers blackout notifications under ERISA.

Similarly, it would be helpful if the DOL were to give assurances that plan sponsors will not be deemed to have violated ERISA any time an intermediary executes a fund's instruction to restrict or prohibit a particular participant from purchasing or exchanging fund shares. Concerns have been raised that preventing a participant from trading in a particular fund may result in a violation of Section 404(c) of ERISA. That Section provides plan sponsors of participant-directed accounts a fiduciary safe harbor if the plan sponsor provides the participant an adequate number of investments. Further, the participant must be able to trade "with a frequency which is appropriate in light of the market volatility to which the investment alternative may reasonably be expected to be subject."[4] By limiting the options of a particular participant through its agent-intermediary, a plan sponsor may be held liable for not complying with 404(c). We urge the Commission to seek explicit acknowledgment from the DOL that this fiduciary safe harbor is not compromised in these situations.

Under the proposed amendment, if a fund has not entered into a contract with its financial intermediary, the fund must prohibit the intermediary from purchasing securities, on behalf of itself and others. This prohibition would seem to affect all transactions entered by the intermediary, including those that are fully disclosed and not subject to Rule 22c-2. Many banks hold fund shares for their customers as a custodian, in the name of the beneficial owner. For some of these banks, only a small portion of their fund positions involve omnibus accounts or other accounts held in nominee name. We, therefore, request clarification that this prohibition does not affect those arrangements outside of the purview of Rule 22c-2. It does not seem fair to innocent investors who are fully disclosed to the fund to be shut off from trading.

<u>Privacy</u>

The ABA has previously suggested to the Commission that the Rule's requirement to have financial intermediaries contractually bound to provide confidential customer information to requesting mutual funds raises significant privacy issues and shareholder communication compliance issues. The

---

[3] <u>See</u> Section 101(i) of the Employee Retirement Income and Security Act, 29 USC 1021; 29 CFR Part 2520 (implementing regulations).

[4] 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C).

Commission addressed our significant concerns in footnote 16 by noting that privacy laws applicable to banks and broker-dealers alike contain exceptions from the notice and opt-out requirements of Title V of the Gramm-Leach-Bliley Act.[5] For example, the Commission noted that its privacy rules do not require broker-dealers to provide customers with notice and opt-out when sharing information with nonaffiliated third parties if the disclosure of the information is "'necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes,' which includes a disclosure that is '[r]equired, or is a usual, appropriate, or acceptable method…[t]o carry out the transaction or the product or services of which the transaction is a part…'" The Commission suggested that this exception, as well as an equivalent one provided by the federal banking laws, would cover any disclosure of confidential customer information under Rule 22c-2.

The ABA would submit that the Commission may be correct that the privacy exceptions under the federal banking laws adequately protect bank intermediaries from liability for disclosing confidential information to mutual funds without giving customers the requisite notice and an opportunity to opt-out. It would be far preferable, however, if the federal bank regulators as enforcers of the consumer privacy laws applicable to banks were to opine on this issue. The ABA would urge the Commission to work with the bank regulators to issue the necessary guidance to the banking industry.

We also note that the Commission has suggested because many financial institutions often state in their privacy policy notices that the institution makes "disclosures to other nonaffiliated third parties as permitted by law," no requirement exists for bank intermediaries to give new privacy notices or opt-out opportunities to their customers in order to comply with Rule 22c-2. This statement unfortunately ignores the fact that many bank intermediaries feel that in order to maintain good customer relations with their clients, it will be necessary for them to alert customers to the requirements of Rule 22c-2 and the fact that the banks are contractually bound to provide certain confidential information to mutual funds on request. After all, many bank clients have instructed the banks NOT to disclose confidential customer information to requesting issuers, including mutual funds, under the shareholder communication rules. When the Commission first adopted those rules in the mid-1980's, it made clear that issuers could use any confidential customer information legally provided by banks and broker-dealers to communicate with company investors on matters that fell outside the context of proxy solicitations.

CONCLUSION

In conclusion, the ABA appreciates the opportunity to offer our comments on Rule 22c-2. We strongly encourage the Commission to delay the October 16, 2006 compliance date to allow all affected parties to get things right. Should you have any questions or comments with respect to the issues raised in this letter,

---

[5] 15 USC 6801-09, 6821-27.

please do not hesitate to contact either the undersigned at 202-663-5325 or Phoebe Papageorgiou at 202-663-5053.

Sincerely yours,

Sarah A. Miller

cc: The Honorable Christopher Cox, Chairman
The Honorable Cynthia Glassman, Commissioner
The Honorable Paul Atkins, Commissioner
The Honorable Roel Campos, Commissioner
The Honorable Annette Nazareth, Commissioner
Robert Plaze, Associate Director, Division of Investment Management
C. Hunter Jones, Assistant Director, Office of Regulatory Policy
Thoreau Bartmann, Staff Attorney