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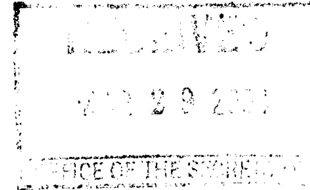

March 13, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-06-04

Your efforts on behalf of reform in the Fund industry are greatly appreciated. There is, however, one critical issue that you have still missed (even though it has been brought to your attention repeatedly in communications from this office). I will make yet another attempt to clarify this very simple point as much as I possibly can.

The issue at hand is the calculation of load and 'offering price' as related to Class A shares. You have, once again, simply restated the long-standing industry method for calculating 'load'. This method, due to its use of an incorrect formula, results in load being charged upon load. This causes the investor to pay excessive load and, more importantly, causes his purchased share count to be lower than it should be.

This is a VERY simple premise. Please take a minute and follow my thoughts.

There is only ONE rate charged against NAV as 'load'. There should be only ONE rate advertised in the prospectus as 'load'. If, after that rate is applied and the transaction takes place, the fund company wishes to DESCRIBE the completed transaction by using other methods to calculate load relative to other items, that is fine. The key is that any other calculations are ONLY descriptive....they should never be used in any other way. Although you have suggested requiring the prospectus to 'require disclosure of loads as a

percentage of net asset value' (footnote 71 in your proposal), you provide no correct and definitive guidelines regarding how load is to be calculated. In fact, in footnote 155 you actually provide a method that results in the exact same problem we have been trying to solve all along. You call for the calculation of 'offering price' using the formula NAV/(1.00-rate). Then using the resultant 'offering price' to calculate the number of shares purchased. This formula is not descriptive....it is the heart and soul of the transaction as EVERYTHING that follows is based on it. The problem here is that NAV/(1.00-rate) is not how you add a given percentage to the NAV. To do that you would need to use NAV x (1+rate). This is NOT equivalent to your formula as witnessed by this example using your numbers from Attachment 1:

This table is based on the 4% load stated in footnote 71 but omitted from Attachment 1 (this rate should be PROMINENTLY displayed)

NAV	Offering Price	Amount Paid	Shares Bought/Sold	Load
18.17	18.93	8000	422.610	321.18

This is how it looks when you correctly calculate offering price using NAV x (1.00+rate).

NAV	Offering Price	Amount Paid	Shares Bought/Sold	Load
18.17	18.90	8000	423.280	308.99

As you can clearly see, there is a difference of $12.19 in load paid and a resultant .670 share shortage to the investor.

These are significant numbers and are absolutely NOT a result of any 'rounding error'. The error / difference is due completely to the use of two different formulas. One correctly adds the advertised percentage of load to the NAV. The other, effectively calculates load based upon an already loaded number. This yields what can euphemistically be referred to as a shortfall for the investor and a windfall for the industry.

To reassert my core premise: The critical issue is the initial calculation of load on NAV. This calculation must apply ONLY the advertised rate to the NAV. The resulting offering price may then be used to calculate the number of shares purchased. It must be made very clear that any other references to rates relative to gross sales amount, or anything else, are simply descriptive. They may in NO WAY be used in, nor do they relate to, the critical initial calculation.

This and all other communications regarding this matter from this office dating back to October 2003 are to be in the Public Domain.

Thank you for your consideration of this critical issue,

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5060 Orcutt Avenue
San Diego CA 92120
619-582-5850
619-229-9258 fax

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▶ MUTUAL

CONTINUED FROM PAGE C1

SEC chief admits that problems were overlooked

before next year. Some lawmakers have filed bills, but Sen. Richard Shelby, R-Ala., who heads the Senate banking committee, has said he is not convinced of the need for new laws.

In a letter to Shelby and his counterpart in the House, Treasury Secretary John W. Snow and Alan Greenspan, the chairman of the Federal Reserve, urged Congress to ensure that mutual fund fees are "fully subject to the competitive tests of the marketplace." They also said that any new disclosure requirements for the funds "should be designed to provide investors with real value rather than serve mainly to increase costs and decrease returns."

Donaldson said that on Dec. 3, the commission would consider a proposal by its staff to end late trading by setting what he called a "hard 4 o'clock cutoff," after which any purchase or sale orders would be priced the next day. And the commission probably will adopt a measure requiring mutual funds to spell out their policies on certain kinds of quick trading, or market timing, and strong com-

86.67 **DOW JONES** Closed at 9,624.16 | 27.86 **NASDAQ** Closed at 1,881.75 | 9.48 **S&P 500** Closed at 1,034.15 | 4.53 **RUSSELL 2000** Closed at 521.68

BUSINESS

WEDNESDAY
November 19, 2003

THE SAN DIEGO UNION-TRIBUNE

STOCK MARKET

Mutual funds overhaul urged

More independent directors sought by SEC chairman

By Stephen Labaton
NEW YORK TIMES NEWS SERVICE

WASHINGTON — The chairman of the Securities and Exchange Commission told Congress yesterday that he supported a plan for a major overhaul of the way mutual funds govern themselves, forcing their chairmen and three-quarters of their directors to be independent.

Responding to a crisis both in the mutual fund industry and at the commission, which until recently never looked for trading abuses in the industry, William H. Donaldson, the chairman, outlined proposals beyond those he unveiled Friday.

The proposals would require more independent directors — 75 percent of the board, up from the current 50 percent. The proposals would require directors of funds to perform annual evaluations of the funds' effectiveness and would permit them to hire their own staff so they would not rely too heavily on the funds' investment advisers. They also would require funds to disclose more details about their fees.

Donaldson's plan did little to discourage some lawmakers from pushing legislation that would go beyond the steps being considered by the commission.

Rep. Richard Baker, R-La., who heads a subcommittee of the House Financial Services Committee, said he expected that the House would soon take up a measure he has sponsored that would tighten regulation.

Donaldson said that in two weeks, the commission would vote on proposals to end after-hours trading in mutual funds and to require greater disclosure of fund policies on quick market-timed trades.

"We all — regulators, legislators, investment advisers, mutual fund managers, broker-dealers, the financial press and investors — have spent much time lately wondering how the current abuses could have happened," Donaldson said in testimony before the Senate Committee on

SEE **Mutual, C5**

"Clearly, we can improve the effectiveness of the way we go about doing things," SEC Chairman William Donaldson told Congress yesterday. *Alex Wong / Getty Images*

▶ **MUTUAL**

CONTINUED FROM PAGE C1

SEC chief admits that problems were overlooked

Banking, Housing and Urban Affairs. "A significant reason is because the industry lost sight of certain fundamental principles — including its responsibilities to the millions of people who entrusted their confidence, the fruits of their labor, their hopes and dreams for the future to this industry for safekeeping."

Donaldson also acknowledged the commission had failed to find problems early enough. None of the current cases against a dozen mutual fund firms came about as a result of inspections by the SEC.

Officials say the inspectors were never assigned to look for abusive trading practices like those that have been revealed, although a recent industry survey by the commission found that such practices might be pervasive.

While Baker pushes his bill in the House, the Senate is not expected to take up a measure before next year. Some lawmakers have filed bills, but Sen. Richard Shelby, R-Ala., who heads the Senate banking committee, has said he is not convinced of the need for new laws.

In a letter to Shelby and his counterpart in the House, Treasury Secretary John W. Snow and Alan Greenspan, the chairman of the Federal Reserve, urged Congress to ensure that mutual fund fees are "fully subject to the competitive tests of the marketplace." They also said that any new disclosure requirements for the funds "should be designed to provide investors with real value rather than serve mainly to increase costs and decrease returns."

Donaldson said that on Dec. 3, the commission would consider a proposal by its staff to end late trading by setting what he called a "hard 4 o'clock cutoff," after which any purchase or sale orders would be priced the next day. And the commission probably will adopt a measure requiring mutual funds to spell out their policies on certain kinds of quick trading, or market timing, and strong compliance programs, including a chief compliance officer, for the funds, he said.

In the Senate, lawmakers questioned Donaldson about how the commission had missed the problems in the industry and had been overshadowed by state regulators. He acknowledged the agency's shortcomings while defending it against criticism from state officials.

Democrats and Republicans on the committee asked Donaldson whether the agency had sufficient resources and expertise to find and fix market problems. He replied that the commission was preparing to open a unit to anticipate new areas of market problems.

"Clearly, we can improve the effectiveness of the way we go about doing things," he said. "We did not inspect for late trading and market timing. Nor has the commission inspected for that for many years.

"The extent of this has come as a surprise to us."

Donaldson tried to deflect criticism from state officials, such as New York Attorney General Eliot Spitzer and William F. Galvin, secretary of the commonwealth of Massachusetts, that the commission has been too quick to settle complaints of wrongdoing.

Sen. Christopher Dodd, D-Conn., pressed Donaldson about the relationship between the SEC and state regulators.

"We can't have you and Mr. Spitzer and the guy in Massachusetts screaming at each other in a public forum every day," Dodd said. "What are we going to do about that? How are you going to solve that? Let's get right to it. What are you going to do?"

"We're doing everything in our power to work with state regulators and that includes all of them," Donaldson said. "Unfortunately, we can't control what certain state regulators decide they want to say publicly. I believe that it's very counterproductive."

> "The extent of this has come as a surprise to us."
> **WILLIAM H. DONALDSON**

In a brief telephone interview after the hearing, Spitzer said that he had criticized the recent settlement between Putnam and the commission "because it was not a deal that I substantively agreed with."

"We are on the same team and working together," he said. "But the lack of us being on the same page resulted from the fact that we were not consulted prior to the settlement. This was not the paradigm of the way things should work."