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May 20, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Mandatory Redemption Fees for Redeemable Fund Securities, File No. S7-11-04, 69 Federal Register 11762 (March 11, 2004).

Dear Mr. Katz:

The American Bankers Association[1] ("ABA") appreciates the opportunity to comment on the proposal recently issued by the Securities and Exchange Commission ("Commission") to require mutual funds (with certain limited exceptions) to impose a two percent fee on the redemption of shares purchased within the previous five days. The redemption fee would be retained by the fund and is designed to require short-term shareholders to reimburse the mutual fund for costs incurred when they use the fund to implement short-term trading strategies, such as market timing.

As investors in mutual funds, either for our own portfolio or for that of our fiduciary and brokerage clients, we applaud the Commission's recent efforts to protect mutual fund investors and to restore investor confidence in mutual funds. And, while we believe a mandatory redemption fee will help to reimburse long-term investors whose shares have suffered some dilution in value as a result of these trading strategies, as well as discourage short-term trading of fund shares by reducing the profitability of these trades, the ABA believes that other tools are available to curb market timing. These other tools would include fair value pricing to eliminate or, at a minimum, reduce pricing inefficiencies and more complete disclosure regarding funds' market timing policies. In this regard, we note that the Commission has recently adopted final rules requiring funds to

[1] The American Bankers Association brings together all elements of the American banking community 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 institutions, trust companies and savings banks—makes ABA the largest banking trade association in the United States. The views in this letter are also endorsed by the ABA Securities Association ("ABASA"). ABASA is a separately chartered trade association and non-profit affiliate of the ABA whose mission is to represent before the Congress, the federal government and the courts the interests of banking organizations engaged in underwriting and dealing in securities, proprietary mutual funds and derivatives.

describe fully their market timing policies and the risks frequent purchases and redemptions of fund shares may present for other shareholders. The Commission has also adopted rule amendments to require mutual funds to explain in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing. Hopefully, these and other efforts the Commission may undertake will collectively serve to stop the abusive market timing activities that have recently come to light.

With respect to the instant proposal, we would like to address the impact the proposed rule will have on our services as intermediaries and the need for uniformity with respect to various aspects of the proposed rule. We would also suggest that certain types of automated transactions in employee benefit plans do not warrant assessment of a redemption fee and should be excepted from the rule.

DISCUSSION

Impact on Intermediaries

As the Commission recognized in the proposing release, many investors' holdings in mutual funds are held through omnibus accounts generally denominated in the name of the broker-dealer, bank, insurance company, or retirement plan intermediary. Many of our members or their affiliates serve as broker-dealers, bank and thrift fiduciaries and retirement plan recordkeepers. For example, over 2,000 bank, thrift and trust companies serve as fiduciary for over 20 million accounts collectively valued to hold assets in excess of $22 trillion.[2] Of that $22 trillion in assets, the largest proportion of assets is invested in equities and mutual fund shares. Obviously, this proposal is of great interest to these members.

To address some of the unique issues involved with these omnibus accounts, the Commission has proposed three alternatives for assuring that the appropriate redemption fee is imposed. The first alternative would require the fund intermediary to transmit to the mutual fund or its transfer agent at the time of the transaction the account number used by the intermediary to identify the transactions, thus allowing the fund to match the current transaction with previous transactions by the same account and assess the redemption fee when it is applicable. The second would require the fund intermediary to enter into an agreement with the fund requiring the intermediary to identify redemptions of account holders that would trigger the application of the redemption fee, and transmit holding and transaction information to the fund or it transfer agent sufficient to allow the fund to assess the amount of the redemption fee. Finally, the third alternative would require the fund to enter into an agreement with a financial intermediary requiring the intermediary to impose the redemption fees and remit the proceeds to the fund.

[2] Federal Financial Institutions Examination Council, Trust Assets of Financial Institutions –2000, Tables A-1 and A-2 (available on-line at www2.fdic.gov/structur/trust/00trustdata.asp).

As the Commission recognizes, the second alternative requires substantially less data to be transmitted to the fund than the first alternative, while the third method eliminates the requirement for intermediaries to transmit shareholder account and transactional information to the funds on a transaction-by-transaction basis. Significantly, the proposal leaves to each fund the ability to select which alternative it will use.

It is this last aspect of the proposal that our members find quite troubling. Bank trust departments and their affiliated broker-dealers offer customers daily access to several hundred funds from a wide variety of sponsors. Because there would be no assurance which method any one of these funds would choose to employ, banks, broker-dealers and other intermediaries would be forced to develop and implement three separate systems and programs in order to comply with the proposed rule. We are strongly opposed to any requirement that would require us to build and maintain three separate programs to police investors' market timing activities.

Instead, we believe that the selection of which alternative to employ should rest with the intermediary. The intermediary would be spared the cost and burden of building and maintaining three separate programs. While we cannot assure the Commission that all trust institutions will opt to choose the third alternative, it is our general sense that the majority will, despite the fact that the third alternative will require intermediaries to set up and support an extensive infrastructure to age securities, review trading reports, assess applicable fees based on the best available information, and remit collected fees to the appropriate funds.

Several of our members have noted that the sharing of certain customer information with the fund could cause the intermediary to breach its contracts with both institutional and personal trust customers. In addition, many of our larger members have off-shore trust and broker-dealer offices where they service both U.S. and foreign clients. Many of the jurisdictions in which these offices are located, e.g., the U.K., would not permit client specific information to be shared with the funds.

Privacy reasons also force us to oppose that aspect of the proposal that would require a weekly data feed from the intermediary to the fund. Specifically, proposed Rule 22c-2(c) requires the financial intermediary to provide the fund with the Taxpayer Identification Number ("TIN"), and the amount and dates of all purchases, redemptions, or exchanges for each shareholder within an omnibus account. The disclosure of TIN numbers is particularly troublesome and would be prohibited under the strict privacy laws of many countries.

The Need for Uniformity

In reviewing the Commission's proposals with our members, the overarching theme that emerged was the need for uniformity. Thus, we support the Commission's proposal to require the two percent redemption fee to be both mandatory and uniform. We also believe uniformity is needed with respect to setting a holding period before an investor could redeem its shares without triggering the two percent redemption fee. Many of our members noted that some funds are currently suggesting that a two percent redemption fee should be levied for a roundtrip purchase and redemption occurring within five business days but that roundtrips occurring within 30 business days should be assessed a fee at something less than two percent. Lack of uniformity in the holding period and redemption fee increases systems and compliance cost to which we are strongly opposed.

The Commission has suggested that it may be appropriate to exempt certain de minimis transactions from being assessed a redemption fee. While many of our members appreciated the Commission's sensitivity to small investors who may be forced to redeem their shares shortly after they purchase them because of unanticipated personal financial circumstances, our members are against any de minimis exception that would allow, but not require, funds to forego the assessment of a redemption fee.[3] Systems and compliance costs would increase because each fund would have the flexibility to determine whether a de minimis exception was appropriate. Consequently, if the Commission were to determine that a de minimis exception was appropriate,[4] we would urge that that exception be mandatory.

The proposal would permit a waiver of redemption fees in the case of an unanticipated financial emergency, upon written request of the shareholder. We would encourage the Commission to conform its definition of an unforeseeable emergency to the standards for hardship withdrawals set by the Internal Revenue Service for 401(k) plans. Because intermediaries that service retirement plans have a long history with the IRS's hardship withdrawal standards, uniformity in this regard would also reduce regulatory compliance costs associated with complying with proposed Rule 22c-2.

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[3] The Commission's proposal to assess redemption fees on a "first in, first out" ("FIFO") method will also minimize the impact this rule might have on small investors who are forced to redeem their shares. This is so because the FIFO method would trigger redemption fees when large portions of an account are rapidly purchased and redeemed, which as the Commission notes, is a characteristic of abusive market timing transactions, but not when small portions of an account held over a longer period are redeemed.

[4] Some of our members suggested that the de minimis transaction amount should be raised, while others suggested that there should not be any de minimis exception at all. This latter group suggested if the two percent redemption fee is aimed at putting transaction costs on those investors who incurred the costs, rather than eliminating altogether market timing, then no need exists to exempt de minimis transactions as even small transactions create costs.

The Need for Further Exceptions

We note that the Commission has excepted money market and exchange-traded funds from the requirement to assess a mandatory redemption fee. In addition, certain funds that promote themselves as permitting market timing would be excepted. We support these exceptions and would urge the Commission to consider excepting certain transaction types as well.

Specifically, employee benefit transactions either not initiated by the participant-investor or where the participant has no control over the timing of the transaction should be excepted from the proposal. 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, and employer directed changes in investment options.

CONCLUSION

The ABA appreciates the opportunity to offer our comments on this important proposal. We would note that because Rule 22c-2, when adopted, will require the development of additional systems and compliance programs, sufficient lead time is needed before the rule goes into effect. We would suggest a minimum of a one-year delayed effective date. If you have any questions or wish to discuss this matter further, please do not hesitate to contact the undersigned.

Sincerely yours,

Sarah A. Miller

cc: C. Hunter Jones
Shaswat K. Das