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Hewitt Associates LLC
100 Half Day Road
Lincolnshire, IL 60069
Tel (847) 295-5000
Fax 847-883-8002

www.hewitt.com

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May 9, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Subject: Comment on final rules governing redemption fees for redeemable fund securities—File No. S7-11-04

Dear Mr. Katz:

Hewitt Associates is a global outsourcing and consulting firm that delivers a complete range of human capital management services to companies, including outsourcing of defined contribution plan administration. We are the second largest employee benefits consulting firm in the world. We are the largest independent recordkeeper——i.e., not an affiliate of an investment management organization——for 401(k) retirement plans. In that capacity, Hewitt serves 5.5 million defined contribution participants, representing $200 billion in assets.

Hewitt respectfully submits this comment letter in response to “Mutual Fund Redemption Fees; Final Rules” File No. S7-11-04, published on March 18, 2005.

Summary

Hewitt commends the Commission for its efforts to protect the interests of long-term mutual fund investors from the actions of short-term traders. For many years, Hewitt has worked with our plan sponsor clients and their fund managers to deal with this issue. Consistent with our previous comments on the initial proposed rules, and in response to the SEC’s questions on this topic, we and our plan sponsor clients believe the need for consistency in the application of redemption fees is critical, particularly in the defined contribution retirement plan environment. Accordingly, the following comments relate specifically to the impact on the retirement plans that will apply redemption fees in accordance with the final rules.

In addition to the comments requested, Hewitt also asks that the Commission provide some guidance around data privacy in cases where intermediaries are asked to share underlying trade data with the fund provider.

Uniform Parameters

In regard to the question posed in the release as to the need for uniform parameters in the application of redemption fees, Hewitt finds that each parameter must be looked at individually. For each parameter, we suggest that the following three questions be answered to determine the need to mandate consistency:

Given that the majority of participant transactions within a defined contribution plan are payroll contributions and individually initiated exchanges, is there an approach that is far superior, from an effectiveness and fairness standpoint, than all others?

Can a uniform parameter meet the needs of all funds given each fund’s unique characteristics and trading styles?

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility?

If the answer to all or most of these questions is “Yes”, we would recommend mandated uniformity on the specific parameter. However, if the answer to all of these questions is “No,” then we would suggest allowing for flexibility.

Hewitt’s analysis of the application of the above-listed questions to the individual parameters on which the Commission has requested comments is detailed below.

Transactions Subject to Redemption Fees Should be Uniform

For the given parameter, is there an approach that is far superior, from an effectiveness and fairness standpoint, than all others? Yes.

In the defined contribution marketplace, money movements can be classified into two basic types. One is the group of transactions that represents participant money being placed into or taken out of plans. For example, money moves into the plan for periodic payroll contributions, and money can be taken out of the plan for distributions and loans. Such events occur either on a regularly scheduled basis or, due to plan-design and IRS limitations, on an infrequent basis. While all short-term trading can pose harm, these types of transaction generally can not be used to engage in ongoing short-term market timing behavior in the defined contribution market place.

The other type of money movement is the trading of participant money within the plan. This represents transfers of dollars from one fund option to another. This is the type of activity that participants can use (and have used) to engage in harmful market timing behavior. These are the types of transactions that should be subject to redemption fees.

Hewitt strongly believes a superior approach would be to only apply redemption fees to participant-initiated transfer/exchange activities, rather than unfairly imposing redemption fees on transactions totally unrelated to market-timing, e.g., payroll contributions and loans.

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Can a uniform parameter meet the needs of all funds given each fund's unique characteristics and trading styles? Yes

A large majority of the asset movement in defined contribution plans, and nearly all instances of excessive trading, occur through participant-directed transfer activities. Therefore, a uniform requirement that redemption fees apply only to participant-directed transactions will help all funds reduce market timing activity, whereas the application of fees on all other types of transaction will have minimal benefit for any fund.

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility? Yes

In a defined contribution environment, many plan sponsors are concerned that the ability for fund companies to dictate the types of transactions to which redemption fees would apply could be disastrous from a participant communication perspective. The communication efforts required to explain these differences would be immense and participant understanding would be limited, especially in circumstances where a plan offers a variety of investment fund options.

The cost of administering unique rules for each fund company in regards to transaction type in the defined contribution marketplace will be high. The costs of implementing multiple sets of rules, communicating them, and administering them will be far greater than if there was a consistent approach in the market.

Organizations are also concerned that without uniformity, plan sponsors may be forced to limit the availability of certain funds because of the costs associated with accommodating a potentially limitless array of approaches created by fund companies. As a result, their choices among investment options may be limited.

Additionally, certain diversification tools provided by plan sponsors typically are not used to market time. These tools include automatic rebalancing transactions, which are performed based upon a pre-arranged instruction (i.e., monthly or quarterly frequency). On an ongoing basis, automatic rebalancing transactions should not be considered participant-initiated, and therefore should not be subject to redemption fees.

Another such tool is a "fund of funds" or a "lifestyle/target maturity" fund where a fund is combined with other funds to create a truly diversified fund that invests in several different asset classes. Each of the underlying funds could potentially be offered by several different fund companies, each with different trading restrictions. If these investment approaches are subject to transaction restrictions, then the administration of the redemption fees becomes significantly more complex, especially when each of the underlying fund companies has its own redemption fee rules and parameters, and some fund companies utilize additional trading restrictions such as lock-outs/purchase blocks (such as American Funds and Vanguard) and roundtrip limits.

Conclusion: Hewitt recommends mandatory uniformity on this parameter. In the defined contribution marketplace, redemption fees should only apply to participant-directed transfers/exchanges.

The Accounting Approach Used Should be Uniform

For the given parameter, is there an approach that is far superior, from an effectiveness and fairness standpoint than all others? Yes.

First in, first out (FIFO) is currently the dominant approach in the industry in regard to redemption fees, as well as other fees that are prevalent in the marketplace. It is the fairest approach, as it allows participants to trade money that has been invested in a fund for the required holding period without penalty.

Can a uniform parameter meet the needs of all funds given each fund's unique characteristics and trading styles? Yes

We know of no unique characteristics of a fund that would require the use of any accounting approach other than FIFO.

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility? Yes

Allowing different parameters for the accounting approach can result in additional communication needs and participant confusion issues. A single plan holding funds using both FIFO and LIFO approaches would increase the communication burden for plan sponsors. Given that FIFO tends to be the more intuitive approach, it is easier for participant to understand.

Conclusion: We recommend mandating uniformity on this parameter by using FIFO as the mandated approach.

The Holding Period/Redemption Fee Amount Should Not be Mandatorily Uniform

For the given parameter, is there an approach that is far superior, from an effectiveness and fairness standpoint, than all others? No

There is no conclusive research to indicate a particular holding period length or a redemption fee amount that is most effective in curbing market timing.

Can a uniform parameter meet the needs of all funds given each fund's unique characteristics and trading styles? No

Different funds, based on the nature of their investments, are more susceptible to market timing than others. In addition, market timing can be more harmful to some funds than others. For example, international funds tend to be far more susceptible to market timing due to time zone arbitrage opportunities. Market timing in small-cap funds can be detrimental due to the transaction costs of trading in this asset class. Thus, different funds may require different parameters, given their unique investment approach and style.

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility? No

While it is true that a uniform approach would be easier for participants to understand, this is a parameter where many investors are already used to seeing differences among funds. Communicating different holding period and redemption fee amounts does not pose significant communication issues. It is similar to communicating different expense ratios for the different funds in a line-up.

From an administration standpoint, this is a parameter that can be easily tailored to each unique fund.

Conclusion: Similar to the Commission's recognition that some funds may decide that they do not require redemption fees to combat short-term trading, we believe that flexibility should be provided for each fund to determine the appropriate holding period and redemption fee amount that would be most effective for its approach.

If Applied, de Minimis Rules Should be Uniform

For the given parameter, is there an approach that is far superior, from an effectiveness and fairness standpoint, than all others? Yes

Small traders will eventually become large traders, and the case for a de minimis rule does not seem warranted. The uniform standard should not apply a de minimis rule; however, if one is applied, because there is no definitive guidance as to what threshold would be viable, a uniform de minimis amount should apply to all funds.

Can a uniform parameter meet the needs of all funds given each fund's unique characteristics and trading styles? Yes

We know of no unique characteristics of a fund that would require the use of a certain de minimis threshold over any others.

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility? Yes

While not significant, communicating different de minimis rules could create some confusion as well as mixed messages for the participant.

While there is some complexity required if different funds have different de minimis rules, the effort is not significant.

Conclusion: We recommend that a de minimis rule not be incorporated into the regulations. If the Commission makes this available, we would then suggest a uniform threshold.

If Allowed, Financial Emergency Waivers Should be Uniform

For the given parameter, is there an approach that is far superior, from an effectiveness and fairness standpoint, than all others? Yes.

As outlined previously, should the transactions subject to these rules include only participant initiated fund transfers/exchanges, the need for such a provision is clearly eliminated since participants would be able to satisfy the financial emergency through a withdrawal or hardship distribution without incurring redemption fees.

In the alternative to limiting redemption fees to participant initiated fund transfers/exchanges, we support the intent for the allowance of waivers for financial emergencies. Therefore, if the transaction set is not limited we contend that applying redemption fees to participants in a financial emergency is unfair.

Can a uniform parameter meet the needs of all funds given each fund's unique characteristics and trading styles? Yes

We know of no unique characteristics of a fund that would require one to use a different financial emergency standard than others.

Will flexibility result in additional administrative and participant communication issues that outweigh any benefits to allowing flexibility? Yes

If each fund had its own hardship definitions and approaches, application and communication of these rules would be a great issue for administration and participant understanding.

It is unclear who would determine whether an event can be classified as a financial emergency. If the intermediary is required to make this determination, this could pose significant administration issues.

Conclusion: We see little need for a financial emergency waiver from the redemption fee requirements. The lack of clarity around how the financial emergency would be

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defined and determined could cause significant issues and could leave the door open for abuse. Therefore, we suggest that such a waiver not be allowed. In the alternative, we recommend that any such waiver be uniform across all funds and based on the prevailing 401(k) hardship provisions.

Confidentiality

While we recognize that the need for transparency will require intermediaries, such as record keepers, to supply participant trading data to the fund company upon request, we are concerned that the sharing of Social Security/Tax Identification Numbers (SSN/TINs) could result in confidentiality issues. Given the heightened concerns about security in the marketplace today, we would ask that the SEC permit other unique identifiers to be provided to fund companies which would allow them to conduct the same monitoring of trade activity but would still protect the identity of the trader. Hewitt anticipates the likelihood of sequenced trading mediums that would include retirement plan accounts to be low, and therefore outweigh the privacy issues associated with passing SSN/TINs. Today, Hewitt already shares trade activity with fund companies upon request and to-date, all have agreed to receiving unique internal identifiers as opposed to actual SSN/TINs.

Sincerely,
Hewitt Associates LLC

Sean D. Andersen
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