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May 9, 2005

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

Emailed to: rule-comments@sec.gov

Re: File No. S7-11-04

Commissioners:

I am writing as the president of a firm registered as an investment advisor since 1981, employing over 80 individuals and managing approximately $1 billion in mutual fund and variable annuity sub-accounts. I practiced as a securities law attorney for twenty years and was a founder and past president of the National Association of Active Investment Managers ("NAAIM") formerly known as SAAFTI (the "Society of Asset Allocators and Fund Timers, Inc.").

NAAIM is an industry trade group formed in 1989 that represents practitioners of both strategic and tactical asset allocation. It is a nationwide organization of registered investment advisors working with mutual fund accounts of mostly small investors. The organization represents over 200 registered investment advisory firms managing in excess of $15 billion, most of which is invested in mutual funds.

This letter is in response to the Mar. 11, 2005 SEC release of its final rule on Mutual Fund Redemption Fees (IC-26782) and its request for additional comment. While some commentators have expressed the desire for uniformity of the redemption fee rates and the requisite holding period, we applaud the Commission's reassertion of the basis for its past policies allowing exceptions to the free exchangeability of open ended investment company shares only when necessary to recoup fund costs. However, given the disagreements in the academic community over the appropriate measures of "dilution," the expansion of the exception to allow efforts to eliminate dilution is a new concern. As we have pointed out in past comments, the fund industry is not required to publicly divulge all the information necessary to ascertain the effects of dilution. Studies to date have had to rely on partial disclosure of information obtained through private sources.

As our securities laws are founded on a basis of disclosure and to a great extent investor self-regulation through the courts, the Commission's addition of the "dilution" justification for redemption fees should be accompanied by the required disclosure of the information necessary to ascertain the effects of such dilution to allow both SEC and investor self-policing of the redemption fee actions taken. See Jason Greene & Charles Hodges, "The Dilution Impact of Daily Fund Flows on Open-End Mutual Funds," 65 J. Fin. Econ. 131 (2002).

Similarly, the judgment of whether a redemption fee is merely the recouping of costs can be difficult to ascertain. A detailed explanation of the costs that can be considered or the provision of uniform standards for making the determination that the redemption fees are necessary and the holding periods are reasonable would give investors and funds more guidance, reduce the SEC's regulatory burden and encourage self-policing by investors.

In the same vein, the actual imposition of redemption fees and restrictions on share exchange requires greater disclosure to investors. We believe that a uniform disclosure of the fees prominently displayed on the prospectus cover is necessary to distinguish those funds that no longer support the free exchangeability of their shares. Furthermore, if the recouping of unwanted costs of investors were the rationale for the imposition of the fees and holding periods, a requirement that director decisions regarding redemption fees be ratified by the shareholders affected would seem to be required. The fund is, after all, the instrument of its shareholders. They may not be as concerned with retaining assets in a particular fund's asset base as the directors and officers. Nor may they believe that the costs of the redemption fees are a fair exchange for the restrictions imposed upon their investments.

As we have pointed out in past comment letters, the subject of redemption fees and holding periods is rife with conflicts of interest between the shareholders and the fund officers and directors. Everything possible should be done to minimize these conflicts. For example, management companies are compensated by the funds based on the funds' assets under management (AUM). The new rule requires that recouped redemption fees be added to the assets of the fund. This increases the compensation paid to management companies and some fund officers and actually adds to the costs to the shareholders. Instead, a uniform rule requiring that such fees not be included in AUM for fee calculation purposes would eliminate this conflict.

The same applies to performance reporting. The receipt of redemption fees can artificially inflate returns. Funds should be required to exclude such fees from their return disclosures or separately account for the redemption fee portion of their performance.

Beyond disclosure, uniformity in administrative procedures is necessary in the wake of the Commission's ruling on redemption fees. First and foremost, the correction of errors should be provided for. There is no financial software or procedure that is free of at least human error. When errors occur in fast moving markets it is critical that they be corrected as soon as they are discovered. The SEC should not put advisors, brokers and intermediaries in the position of trying to decide whether to correct the error at once and incur a redemption fee or wait for the redemption-holding period to expire to avoid it.

Already our members report that many of the redemption fees being paid by their clients arise during the error correction process. As these errors are often on the funds' part, the imposition of redemption fees is especially inappropriate. Even when the funds are not totally to blame, ascertaining the cause of the miscommunication resulting in an exchange error can be particularly difficult. Often, the causes are the actions of multiple parties. The resolution should not be further complicated by the imposition of redemption fees in the process of curing the error.

Secondly, one of the most complicating factors caused by redemption fees is the lack of uniformity in their calculation and imposition. Some firms use a first in - first out (FIFO) standard and others use a last in - last out (LIFO) approach. When intermediaries and advisors are dealing with many platforms and fund families, sorting out the requirements of each is a tremendous burden on the industry, adding costs that are simply passed on to investors.

NAAIM, most of the fund industry and the SEC in its initially proposed rule have supported the uniform use of the FIFO approach. Many of the unfair applications of redemption fees seem to stem from applying LIFO rules, as they impact all automatic, periodic deposit and withdrawal plans, fee liquidation withdrawals, and can even cause imposition of such fees in the case of quarterly rebalancing of passively managed asset allocation strategies. These actions are not of the sort that gave rise to the mutual fund scandals nor the types of costs shareholders would not expect to be absorbed as a normal cost of doing business.

Furthermore, the confusion resulting from the non-uniformity of the application of these standards increase shareholder costs and makes more likely the inadvertent imposition of the fees. For example, one large variable annuity company presently offers sub-accounts of mutual funds that have always required FIFO application of redemption fees. However, the variable annuity imposes its redemption fees on a LIFO basis. Not only is this confusing to investors, but it is hard to square with the rationale for the redemption fee's imposition in the first place. If the funds have determined that FIFO reasonably recoups the costs to their shareholders, how can a third-party variable annuity company reach a different conclusion and require LIFO with respect to the same underlying investments?

The proliferation of redemption fees at the platform level makes this a real possibility in the brokerage and trust company world as well. Uniformity and the rationale for the redemption fee exception should demand that the fee calculation between the platform and the funds at least be consistently applied. But more appropriately, a fee at both levels should be prohibited.

Another area demanding uniformity, without which the imposition of redemption fees is at odds with the rationale for the exception to free exchangeability of shares, relates to pre-approved, periodic transactions. These should, at a minimum, include advisor fee liquidation, automatic deposit, payroll deduction and periodic or systematic withdrawal plans. Imposing redemption fees on such transactions has no relationship to market timing or the mutual fund scandals. If a fund allows such pre-programmed additions and withdrawals, their costs should be considered within the normal costs of doing business. No redemption fee should arise from such transactions.

Our members continue to be concerned that those investors most likely to be impacted by redemption fees are those investors least able to afford them. Hardship provisions should be both uniform and mandatory on the fund companies. While we believe that the proliferation of regulations inherent in permitting redemption fees is yet another reason for the SEC to avoid going down that road, since it has chosen that path, regulations similar to the IRA tax provisions defining the requisite hardships would seem essential. Alternatively, a de minimis exception should be created to lessen the hardship. This exception should be the larger of $10,000 or 10% of the account's value to best address investors of varying circumstances and hardships.

Finally, it has come to our attention that the SEC staff is not enforcing the Commission's April 19, 2004 SEC Release No. 33-8408 (Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings), which directly confronts the issues that are at the heart of the recent mutual fund scandals. This Rule went into effect in December 2004, yet prospectuses issued since that time have not reflected with specificity the fund policies on active trading. Instead, many prospectuses are being filed that contain the same subjective, non-specific language in describing the types of trading the funds have presumably determined are detrimental to remaining shareholders. Without the required specificity, we are left with the same dilemma that allowed for the mutual fund scandals that were the predicate for the Rule.

Market timing is not easy to define. It means different things to different individuals and institutions. Every investor buys and sells. The holding period varies. The cost varies as the market in which the trade occurs varies. Investors need, and have a right, to know "with specificity" what the directors of their funds believe is market timing that adversely affects their shareholders. They need to know this before they invest and before they become susceptible to redemption charges. SEC Release No. 33-8408 was a significant step forward in requiring the communications of these policies while at the same time allowing for individual differences among the funds as to what constitutes adverse trading. The Commission, at the height of the scandal, passed it unanimously with much publicity. Now it is not being enforced. Why?

Thank you for giving us the opportunity to address these concerns.

Very truly yours,

Jerry C. Wagner

President