NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

NASAA

10 G Street N.E., Suite 710
Washington, DC 20002
202/737-0900
Telecopier: 202/783-3571
E-mail: info@nasaa.org
Web Address: http://www.nasaa.org

May 10, 2004

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 5th Street, NW
Washington, D.C. 20549-0609

RE: Release No. IC-26375A; File No. S7-11-04, Mandatory Redemption Fees for Redeemable Fund Securities; Proposed Rule

Dear Mr. Katz:

This letter is submitted in response to the above-referenced release ("Release"). We appreciate the opportunity to comment on certain aspects of the Release, as detailed below.

A. Short-term trading is an unfair cost for long-term investors

Long-term investors pay, indirectly, the costs related to short-term trading. A fund is forced to incur excessive brokerage costs as it adjusts its portfolio of assets in order to meet the purchase or redemption demands of short-term traders. These excessive costs are also described in the Commission's Release No. IC-26356, regarding directed brokerage.

The administrative and trading costs of performing redemptions are borne by the fund, then passed on to the remaining fund holders. This is an unfair burden on long-term investors that should be eliminated by requiring a minimum holding period for mutual funds.

B. A 2% redemption fee will not fix the problem

Though well-intentioned, the proposal to impose a 2% redemption fee is not the solution for market-timing abuses. A better way to address the problem would be to impose a minimum holding period for mutual fund purchases. The minimum holding period should be long enough to prevent market-timing, but should not be so long as to impose an undue restriction on transferability or liquidation of an investor's securities.

NASAA recommends the Commission consider a defined holding period, subject to reasonable exceptions as described below. There currently are alternative investment products that permit investors who desire to trade on a short-term basis the opportunity to do so.

A defined holding period may not be popular with all segments of the fund industry. However, it merits exploration by the Commission. It was the reluctance of funds to make procedural changes that set the stage for the market-timing abuses that we currently face.

C. The Release provides relief for small investors

The *de minimis* exception described under the redemption fee proposal would be a good starting point for adopting exceptions to the defined holding period. Investors should be allowed to trade within the defined holding period under extenuating circumstances, and for minimal investment amounts. The market abuses we have seen have not been widespread for small investments.

NASAA believes an exception is appropriate to avoid penalizing small investors effecting *de minimis* transactions that do not result in a cost to long-term investors. The exception sufficiently distinguishes harmful rapid trading from occasional transactions that involve a purchase followed by a redemption. The exception should not only give investors flexibility in terms of amounts withdrawn, but should allow for short-term transactions in exigent circumstances. If warranted, the Commission should also consider providing guidance on the number of such "round trips" over a specific period of time.

D. The five-day holding period may not be sufficient

The proposed five-day holding period may be insufficient to discourage short-term traders from "gaming" the Rule. The short-term trader's exploitation of pricing disparities in fund shares could occur even if shares are held for five days. The Commission should carefully explore whether the adoption of a longer holding period is warranted.

E. Waiver for unanticipated financial emergencies should be expanded

Assuming the Commission determines that it is appropriate for funds to charge a redemption fee, the exception for unanticipated financial emergencies should be expanded to include situations described in the Release, i.e., purchases made in error and automatic investment or reinvestment programs. This would provide relief for human error and unintended consequences of account structures. This exception should be mandatory and defined in accord with 26 CFR 1.457-6(c)(2)(i), allowing a degree of flexibility, but not entirely open-ended. The same waiver provisions should be made available as an exception to the defined holding period we suggest above.

F. Shareholder accounts through intermediaries should be addressed

The rule should require funds to match shareholder purchases and redemptions that occur through multiple accounts or intermediaries. Otherwise, omnibus accounts could be structured to circumvent the redemption fee mandate. To assist the funds in this endeavor, firms should be required to retain agreements with intermediaries as part of their record-keeping requirements.

G. NASAA Questions the need for the Commission to impose redemption fees

A clear and convincing argument has not been articulated as to why the Commission believes it needs to set redemption fees. Under the current regulatory structure, the responsibility for controlling market timing rests with the funds themselves. It may not be good public policy for government to impose mandatory fees to curtail market timing when nothing stands in the way of mutual funds imposing their own fees or taking other appropriate steps to limit such conduct.

NASAA is concerned that the same thing could happen with redemption fees that previously happened with 12b-1 fees: i.e., public investors will be disadvantaged through the imposition of additional charges, with the benefits accruing to the funds. Market timing arises from stale pricing. NASAA believes it is more appropriate to address the underlying cause of the problem, inefficiencies in pricing. By attacking the underlying problem directly, there should be no need for a redemption fee fix.

Thank for your consideration of NASAA's views on these issues. If you have any questions regarding the comments contained in this letter, please do not hesitate to contact me or Denise Voigt Crawford, Texas Securities Commissioner and Chair of NASAA's Corporation Finance Section.

Sincerely,

Ralph A. Lambiase

Ralph A. Lambiase
NASAA President and
Director, Connecticut Division of Securities