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May 9, 2005

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

Re: Mutual Fund Redemption Fees
Release No. IC-26782; File No. S7-11-04

Dear Mr. Katz:

The NDCC/SPARK Institute ("SPARK"), which was recently created by the merger of the National Defined Contribution Council ("NDCC") and The SPARK Institute, Inc., submits this comment in response to the Securities and Exchange Commission's request for comments on certain issues regarding mutual fund redemption fees.[1] SPARK represents the interests of a broad based cross section of retirement plan service providers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. SPARK members include most of the largest service providers in the retirement plan industry and the combined membership services more than 95% of all defined contribution plan participants. Our members are the intermediaries that would be primarily responsible for applying the mutual fund redemption fee rules and collecting such fees on behalf of the funds for a substantial majority of the employer sponsored retirement plans that hold mutual funds.[2,3]

SPARK and the NDCC commented separately to the Commission regarding the mandatory redemption fee rules proposed on March 5, 2004. We commend the Commission for responding to industry concerns by finalizing a voluntary redemption fee rule instead of making such fees mandatory.

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[1] "Mutual Fund Redemption Fees," Release No. IC-26782 (March 11, 2005), 70 Fed. Reg. 13327 (March 18, 2005).

[2] At the end on 2003, retirement plan assets invested in mutual funds was $2.7 trillion, representing 36% of all mutual fund assets (ICI – Mutual Funds and the Retirement Market 2003).

[3] SPARK's position stated herein represents the consensus position of the substantial majority of its members.

I. Summary of SPARK's Position

A. The Commission Should Adopt Uniform Industry Standards With Respect To The Assessment Of Redemption Fees Against Employee Retirement Plan Investments.

Employer sponsored retirement plans and the day to day investment activity within such plans are unique and extremely complex relative to retail and direct investments in mutual funds. For that reason, among others that are described in greater detail herein, SPARK's position is that to the extent that a fund company determines for itself that redemption fees are appropriate or necessary to prevent or deter market timing or excessive trading, the redemption fees should be imposed according to uniform industry standards consistent with those described herein.

Uniform industry standards will likely encourage retirement plan service providers to accommodate mutual funds that impose such fees. Additionally, uniform industry standards will significantly reduce the administrative burdens, costs and complexity associated with the limitless approaches that are being developed by mutual fund companies. SPARK urges the Commission to adopt a uniform industry standard that allows for the assessment of redemption fees only on "participant-initiated exchanges."

B. The Commission Should Adopt Uniform Industry Standards For Redemption Fee Collection And Information Reporting For Retirement Plan Investments.

SPARK urges the Commission to adopt uniform requirements and standards that would require the entity that maintains the retirement plans participant records to assess the redemption fees. SPARK also urges the Commission to work with industry groups to develop uniform standards with respect to the types of information that can be requested of financial intermediaries by the funds and the format the intermediaries must use to provide that information to the funds.

These positions are discussed in detail in the following sections.

II. Uniform Industry Standards for Redemption Fees

A. Retirement Plan Complexities and Implications

As mutual fund companies have reviewed and reconsidered their policies and procedures regarding the application of redemption fees and how such fees should be applied with respect to employer sponsored retirement plans, SPARK members have had first hand experience with the myriad of complex issues raised by such fees. We are concerned that the following consequences will result unless the Commission adopts uniform industry standards.

1. **Unfair Assessment of Redemption Fees** - The vast majority of retirement plan transaction activity consists of automatic and systematic activity (e.g., payroll contributions), and transactions that are subject to specific retirement plan rules and regulations that do not create the potential for market timing abuses. In the interest of fairness, it is essential that redemption fees not be assessed on retirement plan transactions where there is no possibility of market timing or excessive trading abuses. Although the Commission has recognized that redemption fees can be used by mutual funds to recoup trading costs, fund companies have historically exempted employer sponsored retirement plans from such fees because (1) the costs associated with assessing and collecting such fees in retirement plans would likely exceed the amounts collected

and outweigh the benefits of such fees, (2) the trading costs that would otherwise be attributable to retirement plan accounts are mitigated by the fact that such accounts are maintained by the retirement plan service provider and traded on a consolidated net basis, and (3) the unwillingness of service providers to accommodate such fees because of their complexities. Fund companies have historically recognized these concerns and have been willing to waive redemption fees for retirement plans in order to receive the steady, and therefore beneficial cash flows into their funds from such plans.

2. **Administrative Complexity and Participant Confusion** – Retirement plan administration will become more complicated and plan participants who must manage their own retirement accounts will be confused by the almost limitless array of current and future redemption fee policies created by each fund company. As a result, plan participants who are not engaged in market timing or excessive trading may be charged redemption fees as a result of confusion about the redemption fee rules.[4] Participants may also suffer by not making otherwise permissible changes to their account investment allocations because of confusion about the rules that apply to them and the possibility of triggering a fee or lock out.

3. **Increased Costs** - The lack of uniformity will likely increase the administrative costs associated with retirement plans. Such higher costs could arise through higher plan administration costs (e.g., participant education and communication costs, and increased service provider costs). Higher service provider costs will result from the increased costs associated with initially complying with and ongoing administration of special approaches for individual fund companies, including significant systems reprogramming. These higher costs will ultimately be borne by either plan participants or their employers. Moreover, such costs may exceed the amounts ultimately collected by service providers on behalf of the funds for little or no perceived benefit for participants. We are unaware of any evidence that multiple redemption fee approaches that vary from fund company to fund company provide any added protection or benefit in deterring market timing or excessive trading abuses in retirement plans. SPARK believes that the goals of redemption fees can be accomplished through clear and consistent uniformity in the application of such fees to retirement plan transactions, but to do so would require uniform industry standards that take into account the complexities of retirement plans.

4. **Limited Investment Choices** - Plan service providers may limit the availability of certain funds because of the costs associated with accommodating a potentially limitless array of approaches created by fund companies. Several of our members have reported to us that they have already restricted the availability of certain funds because of the manner in which such funds would apply redemption fees to retirement plan transactions. The reasons cited by our members for taking such action include the reasons cited above. More specifically, redemption fees would be imposed on participant transactions where there is no risk of market timing or excessive trading abuses, and the increased costs associated with initially complying with and on going the administration of special approaches for individual fund companies.

These concerns stem from the fact that employer sponsored retirement plans are unique and extremely complex relative to retail and direct investments in mutual funds. Retirement plan

[4] Participants will also have to keep track of and understand fund specific excessive trading policies (e.g., round trip limits and lock outs) that will add to their confusion.

transactions are subject to extensive and complicated rules and regulations promulgated by the Internal Revenue Service ("IRS") and the Department of Labor, as well as rules established by the plan sponsor (i.e., employer) in the documents governing the plan. As a result of the general structure of retirement plans and the limits on account activity under such rules and regulations, most plan transactions do not create any opportunity for market timing or excessive trading abuses.

Participant Level Transactions

The complexity of typical day-to-day retirement plan activity should be considered in the context of redemption fees.[5] Such activity includes, but is not limited to:

1. Full account distributions (paid directly to the participant or rolled over to another retirement account)
2. Partial account distributions (paid directly to the participant or rolled over to another retirement account)
3. Hardship withdrawals
4. In-service withdrawals
5. Participant loans
6. Required minimum distributions (age 70 ½ distributions)
7. Qualified domestic relations orders
8. Death benefit payments
9. Contribution amounts returned due to IRS annual plan compliance testing rules
10. Recurring participant payroll contributions[6]
11. Recurring participant loan repayments[6]
12. Participant level systematic account rebalancing[7]
13. Total loan payoffs
14. Rollover contributions from other plans

The foregoing plan transactions are subject to complex rules and regulations that eliminate the possibility for market timing and late trading abuses, regardless of whether the participant has any control over the timing or initiation of the transaction. For example, a participant could be

[5] The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and rules and regulations promulgated by the IRS and Department of Labor govern the ability of participants to contribute to and withdraw from their retirement plan accounts based on specific parameters and limits. In many instances, these transactions are also subject to withdrawal hierarchies that dictate the order in which such funds are removed from the plan. In the case of participant distributions, detailed rules apply and participants are generally unable to contribute such amounts back to the plan.

[6] Participant purchases made in connection with transactions other than exchanges (e.g., contributions and loan repayments) are made in connection with standing elections and are subject to extensive rules and regulations. The periodic nature of these purchases, coupled with their relatively small size, do not create a meaningful risk or opportunity for market timing or excessive trading abuses.

[7] Some plan recordkeeping systems permit participants to perform a rebalancing transaction on any business day, and in that event, any exchanges that result from the rebalancing could be subject to redemption fees. Where a rebalancing transaction is performed according to a standing instruction provided by the participant in advance, however, redemption fees should not apply since this would not be the type of instruction that could involve market timing abuse.

required to pay a redemption fee on the shares purchased in his or her retirement plan through payroll contributions when he or she is terminated and requests a complete distribution of his or her account before the holding period for all mutual funds elapses. In this instance it would be unfair to either impose a redemption fee or require the participant to wait for the holding period to elapse before taking a distribution.

Plan Level Transactions

In addition to the foregoing transactions, there are other types of common plan transactions and plan activities that participants have no control over that could also be subject to redemption fees. The initiation and timing of most of these activities are determined by the employer, another plan fiduciary, a plan service provider, including a plan record keeper, or a fund company. Such transactions include, but are not limited to:

1. Transfer of all plan assets from one service provider to another in connection with a sponsor decision to change record keepers
2. A merger or consolidation of plans in connection with corporate acquisitions
3. Dividend reinvestments
4. Plan sponsor decision to eliminate a fund as an investment choice
5. Plan level reallocation or rebalancing of participant accounts
6. Force out distribution of terminated employee with low account balance
7. Forfeiture of unvested amounts in the account of a terminated participant
8. Sales made from participant accounts in connection with the allocation of plan expenses and assessment of fees by a service provider[8]

Whenever a plan sponsor either changes record keepers or the investment options under a plan the imposition of redemption fees will either result in the unfair imposition of redemption fees on participant accounts or require plan activity freezes on participant accounts and other disruptive measures to avoid such fees. For example, whenever a plan sponsor makes a change to a plan all payroll contributions, employer contributions, loan repayments, and rollover contributions, made during a mutual fund's holding period would be subject to redemption fees.[9] Because the types of purchases described in this example occur on a regular basis this is an issue that will likely

[8] Plan sponsors (e.g., employers) and plan service providers (e.g., record keepers) typically charge administration and record keeping service fees to participant plan accounts. These include, but are not limited to audit fees, plan record keeping fees, loan fees, distribution fees, etc. In such circumstances, participants have no ability to control the initiation or timing of such transactions. Uniform industry standards should prevent "taking a fee on a fee." Therefore, such transactions should be exempt from redemption fees.

[9] Where a plan fiduciary directs transactions for a participant's account and directs both the purchase and redemption transactions that would result in a redemption fee, SPARK believes that it may be appropriate to assess a redemption fee. It is important that transactions directed by a plan fiduciary, however, are not "matched" with transactions directed by participants for purposes of assessing a redemption fee. Thus, for example, where a plan fiduciary (*e.g.*, in connection with a change in plan investment options) directs amounts in a participant's account to be invested in a mutual fund, and the participant then directs the reallocation of such amounts to another plan investment option, no redemption fee should apply to the redemption of shares resulting from the participant instruction. Similarly, if a participant reallocates his or her account balance and, subsequently, the plan fiduciary directs that such amounts should be invested in another mutual fund, no redemption fee should apply upon the redemption of shares caused by the plan fiduciary's direction.

exist almost anytime a plan sponsor makes a needed change to its plan. Additionally, plan sponsors will likely be confronted with complaints from participants who are assessed redemption fees for reasons outside of their control.

Because the foregoing transactions do not create any meaningful risk or opportunity for market timing or excessive trading by plan participants, such transactions should not be subject to redemption fees. However, absent uniform industry standards, participants will be assessed redemption fees in connection with some or all of these activities. Additionally, because of the number of different transaction types and the fact that retirement plan record keeping systems have not been built to accommodate these types of fees and the potentially limitless approaches developed by the fund companies, retirement plan intermediaries will either limit their investment choices, replace mutual funds with other investment vehicles, or incur significant costs to accommodate every scenario.[10] Such costs will ultimately be borne by plan sponsors and participants in exchange for little or no perceived benefit.

Many retirement plans allow participants to initiate exchanges or transfers among the investment options within a plan.[11] The retirement plan investment options are selected by a "fiduciary" of the plan (frequently the plan sponsor or employer). In such case, the plan sponsor must select and monitor the plan's investment options in compliance with ERISA prudence and fiduciary standards.[12] As participant-directed retirement plans have developed and expanded over recent years, it has become common and beneficial for plan sponsors to select from a menu of mutual funds from different fund complexes under an "open architecture" model.[13] This approach allows plan fiduciaries to select from a broad range of mutual funds to obtain the best combination of investment performance and cost for plan participants. As a result of the open architecture aspects of the retirement plan industry, the implementation and ongoing administration of the redemption fees and the information reporting requirements under the rule is expected to result in

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[10] The imposition of redemption fees on retirement plans by some fund companies has already resulted in significant new plan administrative burdens, including reprogramming of participant recordkeeping and trading systems, extensive participant communications requirements, and significant participant confusion.

[11] In a participant-directed plan, participants generally direct a plan fiduciary or designated service provider how their contributions and account balances should be allocated among the investment options available under the plan.

[12] Private sector 401(k) and similar plans are subject to ERISA, which requires (among other things) that plans are operated in accordance with governing plan documents naming one or more "fiduciaries" charged with the management and operation of the plan. *See* ERISA §402. These fiduciaries include an "administrator," "trustee" and other "named fiduciaries." Under ERISA §3(16), the "administrator is responsible for the overall administration of the plan and the employer plan sponsor is the administrator unless the plan names a different plan administrator. A professional plan record keeper or administrator is almost never named as a fiduciary administrator of a plan; in fact, in most cases, professional plan record keepers and administrators do not perform any functions that could cause them to be "fiduciaries" of a plan. The plan "trustee" is responsible for management and control of plan assets. *See* ERISA §403(a). Plans often provide for a separate "named fiduciary" that is responsible for plan investment matters, such as the selection and monitoring of plan investment alternatives. Other persons may become plan fiduciaries, if they perform one or more "fiduciary" functions, as defined by ERISA §3(16).

[13] Open architecture plays an important role in allowing plan sponsors to offer a diversified array of quality investment options and to diversify their overall risk. Today most plan record keepers, including those that are affiliated with large mutual fund complexes will offer their competitors' mutual funds to their retirement plan clients.

substantial costs. These costs will be further magnified if mutual funds are allowed to impose a limitless array of procedures for imposing redemption fees and other restrictions to curb market timing.

Although participant initiated exchanges do not involve the addition or withdrawal of money to the plan, the opportunity to exchange money within the plan among investment options could be used in connection with a market timing or excessive trading strategy. Therefore, SPARK urges the Commission to adopt uniform industry standards with respect to the application of redemption fees to employer sponsored retirement plans that is limited to participant initiated exchanges, as set forth below. SPARK believes that these uniform industry standards will reduce the costs and administrative burdens on retirement plan intermediaries and encourage them to cooperate with fund managers by collecting redemption fees.

B. Elements of a Uniform Redemption Fee

The Commission should adopt a uniform industry standard that allows for the assessment of redemption fees only on "participant initiated exchanges." More specifically, redemption fees should only be permitted to be assessed on redemptions in connection with a participant initiated exchange of shares that were acquired by the participant in connection with a prior participant initiated exchange.

The SPARK approach of limiting the applicability of redemption fees would be consistent with other rules issued by the Commission with respect to participant-directed plans where the Commission has concerns about potentially abusive trading. Specifically, Rule 16b-3(c) under the Securities Exchange Act of 1934 ("Exchange Act") exempts from the short-swing profit recovery provisions under section 16 of the Exchange Act transactions by participants under "tax-conditioned plans" (including tax-qualified 401(k) and similar plans) other than "Discretionary Transactions" such as "fund-switching" or intra-fund transfers.[14] Additionally, this approach would provide substantial relief to plans (and also to mutual funds) from the administrative costs and other burdens of redemption fees because it would substantially reduce the number of transactions that need to be monitored for purposes of assessing redemption fees.

SPARK has the following recommendations with respect to the uniform industry standards on which the Commission requested additional comment:

> 1. Share Accounting. Uniform industry standards should mandate the use of the first-in-first-out ("FIFO") method. The FIFO method is the method commonly employed by funds and is the only administratively workable approach for retirement plans since record keepers and fund companies have already expended vast resources to enhance their recordkeeping and trading systems to be able to assess the fees on a FIFO basis.

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[14] 17 C.F.R. § 240.16b-3. Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-37260 (May 31, 1996), 61 Fed. Reg. 30376 (June 14, 1996). The exemption was premised on the view that adequate safeguards exist against "speculative abuse" when a plan satisfies conditions imposed under the Internal Revenue Code and ERISA, and therefore, "routine" plan transactions (such as periodic contributions and distributions in connection with death, disability, retirement or termination of employment) should be exempt. This point is discussed in greater detail in the comment letter submitted by The SPARK Institute, Inc. on May 10, 2004, pages 8-9.

2. *De minimis* Waivers. The Commission should prohibit waivers for *de minimis* redemption fees (waiver of fees on redemptions of a certain dollar limit or less). Although the *de minimis* waivers may appear to provide more flexibility for plan participants, such waivers will create needless complexity. Moreover, such waivers would not be needed if the Commission adopts a rule that limits the assessment of redemption fees to participant initiated exchanges as suggested herein. *De minimis* waivers would allow participants to market time in amounts just under the *de minimis* threshold. Under the uniform rule proposed by SPARK hereunder, such transactions would have to be participant initiated exchanges in order to be subject to a redemption fee so there is no apparent basis for exempting such *de minimis* transactions from such fees. Accommodating these waivers will result in additional costs (e.g., system programming costs of intermediaries, ongoing administration, collection, and monitoring costs, and fund company costs) that will likely be borne by plan sponsors and other participants. This is an unfair result in order to accommodate such transactions. SPARK believes that a more equitable and cost effective approach would be to limit the assessment of redemption fees to participant initiated exchanges as noted above and to impose such fees regardless of the amount of the transaction.

3. Financial Emergencies. Specific waivers for "unanticipated financial emergencies" in respect to defined contribution plans should not be permitted. Moreover, if the Commission adopts a rule that limits the assessment of redemption fees to participant initiated exchanges as suggested herein, a specific emergency waiver would not be needed. Any withdrawal from a plan to accommodate an emergency would be governed by existing plan rules and regulations for hardships. Such withdrawals by definition are outside the scope of a participant-directed exchange under SPARK's recommended rule. This approach would be equitable and simple, and avoids the need for additional complex rule making.[15]

4. Amount of Redemption Fee; Length of Holding Period. Each fund's board of directors should determine whether to impose a redemption fee on a certain fund, and if so, the time period and amount of that redemption fee.

C. Other Special Rules on Redemption Fees

In addition to our recommendation that only participant initiated exchanges be subject to redemption fees, SPARK requests that the Commission issue rules or other guidance addressing how redemption fees may be applied in connection with certain types of transactions that may occur in connection with participant-directed plans.

1. "Fund of Funds" Transactions. Plan fiduciaries may sometimes establish plan investment options that are investment portfolios comprised of more than one mutual fund. For example, plan fiduciaries may use this approach to create a "balanced fund" or

[15] The Commission has not defined an "unanticipated financial emergency" and to the extent it is not the same as the Internal Revenue Code definition of "hardship" or "unforeseeable emergency" applicable to defined contribution plans, it will cause significant participant confusion. I.R.C. §401(k)(2)(B)(i)(IV); Reg.§1.401(k)-1(d)(2)(i) and I.R. C. §457(d)(1)(A)(iii); Reg. §1.457-6(c)(1). Additionally, the Commission has not identified whether the mutual fund or the financial intermediary would be responsible for verifying whether such an emergency had actually occurred. Such a determination would require tremendous resources.

one or more so-called "life-style" funds under a plan. If such a "fund of funds" is established by a plan fiduciary, a participant investment election to invest in the fund of funds would generate plan purchases of shares of each of the mutual funds comprising the fund, and when the participant elects to allocate his or her account balance to another plan investment option, those mutual fund shares would be redeemed by the plan. Since the participant does not control the allocation of assets invested in the fund of funds among the underlying mutual funds, redemption fees should not apply to any transactions involving the fund of funds.

2. Non-Qualified Plan Transactions. Many employer plan sponsors maintain "non-qualified" deferred compensation plans that provide certain officers and other highly-compensated employees the opportunity to defer a portion of their compensation until termination of employment or retirement. Benefits payable under these plans may be determined based on the investment return of investment options selected by the participants. It is common that these investment options "mirror" the investment options available under tax-qualified 401(k) or other participant-directed plans offered by the employer plan sponsor.

Some employer plan sponsors maintain assets to pay benefits under these plans under so-called "rabbi trusts" or similar arrangements. In the event of insolvency of the employer plan sponsor, these assets would be available to pay claims of the employer plan sponsor's general unsecured creditors. The assets, however, may still be invested consistent with the investment elections of the plan participants and, in practice, these plans may be administered very similarly to tax-qualified 401(k) and similar participant-directed plans.

Accordingly, SPARK requests that the Commission clarify that redemption fees would be determined in the case of these types of plans following the same rules that would apply in the case of a participant-directed tax-qualified plan.

II. Information Reporting Requirements

SPARK urges the Commission to adopt uniform requirements and standards that would require the entity that maintains the retirement plan's participant records to assess the redemption fees. SPARK also urges the Commission to work with industry groups to develop uniform standards with respect to the types of information that can be requested of financial intermediaries by the funds and the format the intermediaries must use to provide that information to the funds. SPARK believes that it would be appropriate to limit the information reporting requirements with respect to retirement plans to only those transactions that create an opportunity for market timing and excessive trading abuses (e.g., participant initiated exchanges). Uniform industry standards will minimize the costs associated with compliance, and facilitate better compliance.

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We hope that these comments are helpful. We welcome the opportunity to discuss these issues with you further in order to answer any questions you may have and to provide any additional information that may be helpful to you. Please feel free to call me at 860-658-5058 if we can be of any further assistance to you.

Respectfully submitted,

Robert G. Wuelfing

cc: Robert Plaze
Hunter Jones