PROFIT SHARING / 401k COUNCIL OF AMERICA
UNITED STATES CHAMBER OF COMMERCE

COMMENTS ON SECURITIES AND EXCHANGE COMMISSION FINAL RULE AND REQUEST FOR ADDITIONAL INFORMATION ON REDEMPTION FEES FOR REDEEMABLE FUND SECURITIES

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Jonathan G. Katz
Secretary
Securities and Exchange Commission
Washington, DC
Submitted electronically

The Profit Sharing/401(k) Council of America (PSCA)[1] and the United States Chamber of Commerce[2] appreciate this opportunity to comment on the Commission's final rule and request for additional comment on mutual fund redemption fees. We provided initial comments regarding the proposed rule on May 10, 2004.

While the final rule does provide more flexibility than the proposed rule, we note that a concern raised in our initial comments remains relevant. The Commission should reinvigorate an enforce

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1 The Profit Sharing/401(k) Council of America (PSCA) is a non-profit national association of employers who sponsor defined contribution retirement plans for their workers. For over fifty-five years, PSCA has identified and shared best practices with its members, represented their interests in Washington, and provided analysis and reportage on the latest regulatory changes. PSCA members range in size from very small independent businesses to firms with hundreds of thousands of employees. Our members believe that profit sharing, 401(k), and related savings and incentive programs strengthen the free-enterprise system, empower and motivate the workforce, improve domestic and international competitiveness, and provide a vital source of retirement income.
2 The United States Chamber of Commerce is the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region, with substantial membership in all 50 states. The Chamber of Commerce is committed to strengthening the retirement security of all Americans and believes that the employer-provided retirement system is a vital factor in retirement security. As such, the Chamber and its members strive to improve participation in and accessibility to the employer-provided retirement system.

an effective fair value pricing requirement that will eliminate stale net asset value prices that permit time zone arbitrage before implementing other market timing remedies.
We remain concerned about the requirement in the final rule for intermediaries to provide information to the fund, by Taxpayer Identification Number, of transactions by "shareholders." Any approach that requires recordkeepers to transmit data to a fund family in order to process a purchase or redemption request provides an unfair advantage to mutual fund families that also are retirement plan recordkeepers. It will always be easier and significantly less costly for those recordkeepers to communicate with a fund family than it would be for "intermediary" retirement plan recordkeepers. We also note that the final rule does not clearly identify the obligations of funds to use this data to identify market timing.

ADDITIONAL COMMENTS:

The following comments respond to specific questions raised in the final rule. The questions are repeated in italics.

We are requesting comment on whether we should adopt a uniform redemption fee for those funds deciding to impose such a fee and, if so, the terms of such a fee. A uniform fee may be less costly for the thousands of fund intermediaries to collect, and may result in greater willingness on the part of these intermediaries to collect the fees.

We urge the Commission to adopt a uniform redemption fee. The more flexibility that the rules give to funds to impose differing redemption amounts, the more difficult it will be for retirement plan recordkeepers to communicate the differing rules to participants, and the more difficult it will be for participants to understand these rules. This will discourage saving for retirement

Uniformity in the amount of the fee would make it easier for retirement plan recordkeepers to program their systems to track and collect the fee.[3] Tiered fees would cause a great deal more difficulty than flat fees.

Unless various "nondiscretionary" and other retirement plan transactions (see below) are exempted, the higher the amount of redemption fee that is charged, the more punitive the effect on unsuspecting plan participants.

In addition to adopting rule 22c-2, we request additional comments on whether we should establish a set of uniform standards that may facilitate intermediary assessment of redemption fees on shares held through omnibus accounts. We are requesting further comment on what any such standards should be, including the method for determining the duration of share ownership and exceptions from the application of the redemption fee. Although we received comment on these issues during the initial comment period, those comments were offered in the context of a mandatory redemption fee. We also request comment on any other aspects of the rule in light of the additional solicitations for comment. For example, as funds begin to implement rule 22c-2, including entering into written agreements with financial intermediaries, we request comment on implementation of the rule's requirements.

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3 . We are assuming – as has the Commission – that in the overwhelming majority of cases, fund families will direct responsibility for determining whether redemption fees apply and collecting them to intermediaries.

The flexibility that the rule gives to funds to determine the length of the holding period would make it more difficult for retirement plan recordkeepers to program their systems to meet each fund family's rules. Each fund family, or even funds within fund families, could impose different rules. It would be difficult to communicate to participants the different holding periods for different funds. Participants will be likely to become confused as to when a redemption fee will or will not apply and therefore be less likely to save for retirement. The cost of programming to apply different holding periods that vary by fund family, or even by fund, could be significantly higher than if uniform holding periods apply, particularly if tiered holding periods were to apply, and recordkeepers would need a longer period of time to implement the various fund's holding periods. The cost of programming would be likely to be passed on to the participants. On a sliding scale, the more flexibility permitted to fund families to adopt disparate rules, the more difficult it will be for programming by recordkeepers to implement.

We request comment on whether rule 22c-2 should require that, if a fund imposes a redemption fee, the fee be determined by the use of FIFO, or alternatively by the use of some other method.

The FIFO method is the best approach because it would have the least effect on small investors. A "last in, first out," or LIFO, rule, especially without an exception in place with respect to certain "non-discretionary" retirement plan transactions will penalize retirement plan investors, who often have small account balances, and who will have their retirement savings diminished, even when there has not been any intent on the part of the participant to trade excessively or time the market.

But note that even under a FIFO approach, absent an appropriate exception for retirement plan transactions other than participant-initiated exchanges and transfers, retirement plan intermediaries will still have to build a system that examines every single transaction – which will be significantly more costly to build and go far beyond what is necessary to address the policy goals articulated by the Commission as the justification for the final rule.

We are considering requiring that the redemption fee not be charged if the amount of the fee would be fifty dollars or less. We request comment whether the rule should permit, or require, funds to waive redemption fees under a certain dollar amount.

There should be a uniform de minimis rule. It should be mandatory – at a minimum, it should be mandatory for redemptions made in the context of a retirement plan. The more flexibility that the rules give to funds to impose differing de minimis rules, the more difficult it will be for retirement plan recordkeepers to communicate the differing rules to participants, and the more difficult it will be for participants to understand these rules. This will discourage saving for retirement. The de minimis rules should also apply for purposes of determining whether a transaction needs to be reported to a mutual fund family. Clearly, dividend reinvestments should not be treated as purchases to be matched with redemptions for purposes of this final rule.

We are considering whether the rule should require that any redemption fee charged by a fund be limited to transactions initiated by investors. Under such an approach, redemption fees would not be assessed with respect to (i) shares purchased with reinvested dividends or other distributions, and (ii) shares purchased or redeemed pursuant to a prearranged contract, *instruction or plan, such as purchases, redemptions, transfers, or exchanges that are not discretionary transactions for employee benefit plans. We request comment on the need for such an exception. Is it necessary if we provide for FIFO accounting for share holding periods and a de minimis exception that addresses complete redemptions? Can funds identify which transactions (other than those made in connection with retirement plans) would qualify for this exception? If not, should the rule make such an exception mandatory only with respect to shareholders who hold through retirement plans? Alternatively, should we make such an exception voluntary? Such an approach would not require all funds to provide the exception, but would leave it to funds and their intermediaries to work out the terms of such an approach.*

The only retirement plan transactions to which redemption fees should apply are participant-initiated exchanges or inter-fund transfers because these are the only transactions that permit market timing within a retirement plan. All other redemptions, such as those triggered by distributions and loans, should not trigger a redemption fee because they do not present the opportunity for abuse that redemption fees are intended to address. In addition, various purchases of shares should not be matched with redemptions.

Unlike retail accounts, in retirement plans accounts, the reason (or triggering event) for the transaction generally can be easily identified, such that those transactions that can be identified as not providing the opportunity for abuse should be exempted.

The following describes the three categories of retirement plan transactions (i.e., all of those other than participant-initiated exchanges and transfers) that we believe should not be subject to redemption fees because they can be easily identified as not being prone to abuse:

- The first would be those falling outside the definition of "discretionary transaction" as defined in Rule 16b-3 under the Securities Exchange Act of 1934.[4]

- The second would be transactions unique to retirement plans, where the transaction is discretionary, the transaction does involve a redemption, but is other than a participant-initiated inter-fund transfer or exchange between a plan's investment alternatives. In each of these situations, investment gain is not the primary purpose of the redemption; rather, the redemption occurs because the participant exercises a plan right.[5] PSCA and the U.S. Chamber believe that the imposition of a fee with respect to redemptions in connection with these transactions would be unfair to participants, would be burdensome and costly for recordkeepers to implement and would not serve the intended purposes of imposing a redemption fee.

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4 Nondiscretionary actions would include elective deferrals, employee contributions, rollover contributions, and employer contributions into a plan; trust-to-trust transfers into a plan on a participant's behalf; employer-initiated trust-to-trust transfers out of a plan; regular loan repayments, loan prepayments; distributions on death, termination of employment, disability, or retirement, which should be clearly defined to mean any distribution occurring on account of any of these events, regardless of the time lag; cashouts; required minimum distributions; reinvestment of dividends on any plan investment; legally required corrective distributions (ADP, ACP, 415 excess, 402(g) excess); any distribution made under the Internal Revenue Service's EPCRS program.

5 These transactions would include hardship withdrawals; in-service withdrawals; loans; conversions between recordkeepers; and, payments pertaining to qualified domestic relations orders, among others.

- The third would be inter-fund transfers as a result of automatic account rebalancing, where elected by the participant to occur on a pre-scheduled, recurring basis.

We note that many of the foregoing transactions are made at the direction of the plan administrator, plan sponsor, or other plan fiduciary, not the participant, and others are mandated by law. Examples of the former are the assessment of plan expenses against participants' accounts, conversion of the plan to a new recordkeeper and the de-selection of funds because of poor investment performance. An example of the latter is minimum required distributions. It would be unfair to assess redemption fees upon participants' accounts with respect to these transactions.

We request additional comment whether the rule should require funds to waive redemption fees in the case of unanticipated financial emergencies. We request comment whether such a provision would discourage funds from adopting redemption fees – an issue that we did not address in our proposed rule because it provided for mandatory redemption fees. We also seek comment on what circumstances should constitute a financial emergency.

An "unanticipated financial emergency" exception may be exceedingly difficult for recordkeepers and funds to handle. If the only retirement plan transactions that are subject to redemption fees are exchanges between funds within the plan and inter-fund transfers, this exception becomes irrelevant, because exchanges and transfers within a plan (i.e., not resulting in the proceeds being distributed to the participant) should never be engaged in because of an unanticipated financial emergency. If all other retirement plan transactions are not exempted, the following concerns and issues will arise in connection with implementing the unanticipated financial emergencies exception with respect to retirement plans:

- The proposed regulation's unanticipated financial emergency exception is somewhat similar to, but significantly different from, the "hardship withdrawal" provision permitted under section 401(k) of the Internal Revenue Code. This is problematic from a retirement plan administration and recordkeeping perspective.

- The financial emergency exception in the proposed regulation is not the same as the standards for a hardship withdrawal as set by Internal Revenue Service regulations for 401(k) retirement plans. The IRS provision is arguably much narrower in one sense, in that the safe harbor definition covers very specific sorts of hardships. On the other hand, the IRS withdrawal provision is arguably broader, in that a financial obligation might be a hardship but not necessarily an "unanticipated financial emergency."

We request further comment on whether the rule should limit the ways that redemption fees may be assessed to promote greater uniformity in the enforcement of redemption fees across funds and their intermediaries. Should we retain all three options to accommodate, for example, the small intermediary that does not have the capability to collect and transmit redemption fees? If we retained these options, which entity should determine the option used to assess redemption fees?

Under the first method proposed for the imposition of redemption fees in the Commission's proposed regulation, the recordkeeper would be required to transmit to the fund at the time of the transaction the account number used by the intermediary to identify the transaction and the fund would assess the fee. Under the second approach, the recordkeeper would enter into an agreement with the fund requiring the recordkeeper to identify redemptions by participants that would trigger a redemption fee and send holdings and transaction information to the fund sufficient to allow the fund to assess the redemption fee. Under the third approach, the recordkeeper assesses the fee.

The first approach seems unworkable and cumbersome. To prepare plan-level purchase or redemption requests, the recordkeeper would have to communicate the transaction request to the fund; the fund would calculate the fee, and then send an adjustment to the transaction request back to the recordkeeper. This would significantly disrupt the recordkeeper's nightly system processing cycle. Instead, the fund family might require purchase and redemption requests to be forwarded at the participant level. This would exponentially increase transaction costs, which would ultimately be passed on to the plans and participants. It is not clear what account number would be used- certain participant identifiers, like social security numbers, may raise confidentiality/privacy concerns (see below).

As discussed above, under the first and second approaches, the fund will need to communicate back to the recordkeeper what redemption fee has been assessed. The recordkeeper's system would then have to process the redemption fee as a separate transaction, thereby significantly holding up processing of the nightly cycle. The second approach shares this flaw with the first, making it equally problematic.

Of the three approaches, therefore, the third approach is much preferable, and the only one that is truly workable. Recordkeepers either need the option to choose which of the three approaches will apply, or will need a uniform approach. Once again, programming time and costs will multiply if multiple approaches will apply fund family by fund family or fund by fund.

Under the first approach, the only viable way to match transactions is not at a plan level, but at a participant level. In this regard, with respect to the first approach, passing participants' social security numbers to the fund family is troubling from a confidentiality of client data viewpoint (note that the owner of the fund position is the plan; participant data belongs to the plan and recordkeeping agreements provide that recordkeepers agree to keep participant data confidential). We suggest that report be monthly in any case, which should be sufficient.

If the Commission were to require funds (or recordkeepers) to match shareholder purchases and redemptions that occur through multiple accounts or intermediaries, such a comparison on a daily basis would be a virtually impossible task, because of the overwhelming number of participants, transactions and accounts that would have to be compared. This would not permit funds to delegate to recordkeepers completely the assessment of redemption fees. The recordkeeper would be responsible for matching inter-fund purchases and redemptions, and then the fund family would have to do a second check. How could the recordkeeper inform the participant up front that the transaction would be subject to a redemption fee? The fund would have to assess the fee, and inform the recordkeeper that the fee would apply on the back end. It is not clear how tax withholding on plan distributions would be calculated. Depending on how this issue is resolved, it could cause difficulty for the recordkeeper in calculating tax withholding on the distribution, and could delay or disrupt the nightly processing cycle. It also could mean that we could have calculation errors, resulting in assets erroneously leaving the trust, corrective amounts coming back into the trust – a lot more activity leaving plan records more prone to error, making recordkeeping more complex and costly.

Thank you again for this opportunity to share our concerns with the Commission. If you have any questions, or if we can be of any assistance, please call David L. Wray at 312-419-1863 or Randel Johnson at 202-463-5448.

Sincerely,

David L. Wray	Randel Johnson
President	Vice President - Labor, Immigration, & Employee
Benefits	
Profit Sharing/401(k) Council	Unite States Chamber of Commerce