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February 26, 2004

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Paul F. Roye, Director
Division of Investment Management
US Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Mutual Fund Mandatory Redemption Fee Proposal (Press Release 2004-23) S7-11-04

Dear Mr. Roye:

I believe that the 2 percent mandatory redemption fee for mutual fund is unnecessary and may cause adverse affect to the mutual fund industry:

First, the proposed short term redemption fees have little effect on addressing market timing activities. Small timers are waived for the fee. Large timers can hold their position longer enough to avoid the fee while hedging their mutual fund positions[1]. The reason for trading mutual fund is its valuation inefficiency not the daily liquidity.

Second, it will be costly to implement this rule. The costs will eventually pass to the average fund investors.

Third, two percent fee is unfair because it is well above actual "user fee" caused by the redemption. Does SEC allow third party to provide swaps for investors to avoid this redemption fee[2]?

Forth, 5-day period may be interpreted as the definition of short-term. Therefore it may legitimate tradings in and out longer than five days even it may have the same detrimental effect on long-term share holders.

This proposed regulation is unnecessary and will drive up the compliance costs, which will bear by every investor. This proposed regulation also against general market trend moving towards to less fees, more liquidity and free market.

I believe that SEC should give more emphasis and clearer guidance on fair value, which is much more effective than redemption fees and trading restrictions in dealing with mutual fund market-timing activities. Fair value is subjective in nature. But there are things SEC can do such as providing <u>objective</u> fair value measures to minimize the problem. I have made my comments on the fair value in my previous letter to you dated January 28, 2004[3]. I will make additional comments about fair value in a separate letter.

Sincerely yours,

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Bin Zhou, President
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Cc: Douglas Scheidt, Associate Director
Gene Gohlke, Associate Director, Office of Compliance Inspections and Examinations

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[1] A simple trading strategy is that when one buys a mutual fund expecting NAV below the fair value, hedge the position using liquid securities that are highly correlated to the fund. The hedged position will be purchased at fair value so that one can lock the valuation difference. Hold on these positions for at least five days until one expect the fund NAV above the fair value then square the positions to gain on the valuation discrepancy again..

[2] A mutual fund investor bought a mutual fund on day 1 and decides to sell it on day 2. Instead sell back to fund, he "sells" or swap to a third party using a derivative product and then sell shares back to the fund on day 5 to avoid two percent fee. It is perceivable such swap could cost much less than two percent fees.

[3] See http://www.fairvalueresearch.com/fair%20value%20sec.pdf

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