May 10, 2004

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:

Steve Blumenthal
SAAFTI Chairman
CMG Capital Management Group, Inc.
(610) 989-9090
steve@capital-management.us

Ann Miller
SAAFTI President
A. Miller Investment Advisors, LP
(713) 238-6730 ✱ amiller@amiller.com

Steve Landis
SAAFTI Vice President
Landis Financial & Investment Services
(614) 436-8926
steven@stevendlandis.com

Paul Schatz
SAAFTI Treasurer
Beneficial Capital, Inc.
(203) 389-3555 ✱ paul@bcmoney.com

Mark Pankin
SAAFTI Secretary
MDP Associates
(703) 524-0937 ✱ mark@pankin.com

Directors

Jim Applegate
Applegate Investment Management, LLC
(239) 489-3346 ✱ jim@aimria.com

Sam C. (Bo) Bills, Jr.
Bills Asset Management
(615) 371-5928 ✱ b.bills@comcast.net

Sam Jones
The J. Group Advisors
(303) 837-1723 ✱ sam@rejones.com

John Lyons
J. Lyons Fund Management
(847) 317-4949 ✱ jlyons23@aol.com

Peter Mauthe
Spectrum Financial, Inc.
(757) 463-7600 ✱
peter@spectrumfin.com

John Rhoads
Rhoads Lucca Capital Management
(214) 373-9771
john.rhoads@rhoadslucca.com

Renee Toth
Flexible Plan Investments, Ltd.
(248) 642-6640
fundrelations@flexibleplan.com

Clint Wyckoff
Strategis Financial Group
801-373-1100
clint@strategisfinancial.com

I am writing as the president of a firm registered as an investment advisor since 1981, employing over 80 individuals and managing more than $1 billion in mutual fund and variable annuity sub-accounts as of March 31, 2004. I practiced as a securities law attorney for twenty years and was a founder and past president of the trade association known as SAAFTI (the "Society of Asset Allocators and Fund Timers, Inc.").

SAAFTI 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. For years it has encouraged proactive mutual fund relations and has eschewed international arbitrage techniques.

In November 2003, prior to the enactment of the many proposed rules dealing with mutual fund reforms, we submitted a comment letter directed at some of the reforms being discussed at that time. In that letter, we supported many of the rules that have been proposed and are especially pleased by the final rule adoption concerning fund disclosures of market timing practices, along the lines suggested in our November correspondence. While we addressed the matter of redemption fees in our earlier letter, I wanted to address some specific concerns arising from Release No. IC-26375A: "Mandatory Redemption Fees for Redeemable Fund Securities."

The central question that requires comment is whether or not the Investment Company Institute has made the case that mandatory redemption fees are justified. This is an extremely important question because the adoption of a mandatory redemption fee is a gross departure from the regulatory course taken by the SEC since its formation.

I. Abandoning Disclosure

It is a departure in two significant areas. First, our country's securities laws are founded upon a respect for the free markets, rejecting government interference in favor of government facilitation of the free flow of information, enabling investors to make their own, fully informed decisions. This policy fosters

disclosure as its fundamental regulatory instrument, not mandated investment policy. Yet, the mandatory redemption fee proposal does not rest upon disclosure; it mandates a new fee to penalize a group of investors most likely to be the most needy and least informed.

If the fear is that redemptions may injure long-term shareholders (whether well-founded or, as we have previously submitted, ill-founded), the traditional SEC response would be to require the funds to disclose sufficient information to allow the investor to decide whether or not there are such costs and, even where they are found to exist, whether the other attributes of the fund justify an investment in it.

This policy of disclosure is embodied in the April 19, 2004 SEC Release No.: 33-8408 (Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings), hereinafter referred to as the "proposed rule, " which directly confronts the issues that are at the heart of the recent mutual fund scandals. Yet it does not go into effect until December 2004, and there has been no opportunity to appraise its effectiveness before leaping into the untested waters of fee increases.

Furthermore, the disclosure approach, despite all its time-tested virtues, <u>has not even been attempted</u> regarding the redemption issue. For example, many financial advisors operate under the belief that the expense ratio of a fund is a key factor in their decision making, yet the prospectus reported ratio does not include transaction related expenses. These are not available within the prospectus. They should be if this cost issue is so important. Secondly, the cost of liquidity is not calculated and provided to investors, which would allow them to understand this dimension to their investment before they invest. Nor is it required that the fund's daily inflow and outflow numbers in the aggregate be reported to allow an informed investigation of these costs across the entire industry – only about 20% of these numbers are available through private sources. Finally, the fund's costs of purchases (inflow) and sales (outflow) are not disclosed in the prospectus. This should include, to allow quantification of investment versus administrative performance, the total redemption fees collected (in fact, the very imposition of a redemption fee is hidden away in a footnote to the prospectus expense table).

Shouldn't the SEC do a survey of the existing collections of redemption fees before we impose yet another round of cost increases on investors? If the SEC does not wish to entertain such a study, disclosing the information would allow third parties the ability to assess the cost of redemption fees.

Additional disclosure to allow investors to be better informed in their investment decisions should at least be tried before we mandate a trading tax upon investors. If the above information is disclosed, investors, not regulators, can sort out which types of funds they prefer to use and at what cost. Isn't this the approach that the SEC has used successfully since its inception? Why are we so quick to abandon it on this issue?

From a policy-making viewpoint, such disclosure is essential in the determination of whether larger regulatory steps (like redemption fee issues) are even necessary. A review of the footnotes of the proposed rule indicates that at the present time the Commission would be acting on little or no evidence that such a drastic step, a mandatory redemption fee, is needed. At footnote 3 the proposed rule cites two studies, Greene and Edelen, for the proposition that "excess trading occurs at the expense of long-term investors, diluting the value of their shares." Yet neither article fully supports that statement nor suggests redemption fees as the solution.

The Greene study does estimate a negative dilution effect from <u>international</u> fund arbitrage as the footnote points out, but finds no evidence of such dilution in <u>domestic</u> bond and stock funds. In fact,

Dr. Greene's analysis of trading within such funds suggests a positive contribution to longer-term shareholders, not a negative one![1] The mandatory redemption fee proposal would ignore this distinction and impose its costs on all types of funds.

While Greene estimated that the dilution cost to passive investors in international funds was $420 million during the 26-month period study, if the same level of trading activity used in the study to generate that number were assessed a 2% redemption fee, those fees would have totaled $6.9 billion! Since the Greene study was of a 20% sample of the mutual fund industry, one could extrapolate the redemption fees to a $34.7 billion cost versus a dilution effect of just $2.1 billion. The punishment does not fit the crime. (See additional discussion of this study and calculation spreadsheet in our original November 2003 comment letter.)

The Edelen study is cited for the proposition that liquidity costs one to two cents per dollar of trading activity. Yet, this is the least reliable of the information from the article in that it reflects trading costs in the study's time frame of 1985-1990.[2] It's hard to imagine that these costs would be even this high in today's markets, whereas we pointed out in our initial comment letter costs of trading have declined sharply, and the even cheaper alternatives to trading (utilizing derivatives and loans) have increased enormously. In fact, since writing this article Dr. Edelen appears to have been instrumental in introducing yet another less costly alternative to trading costs with the services of Reflow LLC, "… a back-office solution that substantially eliminates the problems – and costs – associated with servicing liquidity." (www.reflow.com)

The power of these lower costs and alternative methodologies to the costs of liquidation is illustrated by the recent experience at Putnam Funds. As a result of the backlash to the disclosures of the mutual fund scandals, Putnam experienced unprecedented net redemptions from its funds. In 2003's fourth quarter alone, Putnam had net redemptions of $53.7 billion. In the midst of these redemptions, Putnam reassured its remaining shareholders with a memo that concluded as follows: "In general, redemptions should not have a significant impact on a fund's NAV or on performance." According to Putnam's December 4, 2003 FAQ posting on its website entitled "Q&A on Market Timing at Putnam" (https://www.putnam.com/individual/index_pass.html), this was possible because "…funds typically maintain a 1%-3% cash balance sufficient to meet redemptions and, if appropriate, some portion of the cash position may be invested in futures to "equitize" the cash holdings (i.e., maintain market exposure). In addition, funds usually have additional cash available from the normal turnover of portfolio securities." (See attached p.11. of the Putnam release.)

More important conclusions from the Edelen study are also omitted. For example, throughout the period studied the trading cost (volume) of purchases far outstripped the cost (volume) of redemptions. This leads to the conclusion that, as we pointed out in our initial position paper, redemption costs are most often netted out against fund purchases, causing little net cost of redemptions to shareholders.

A second Edelen finding was that the percent of transactions caused by short-term (less than six-month holding period) shareholders was quite small. Edelen found that approximately one-half of the average fund's assets are redeemed in the course of a year and over two-thirds of the average fund's assets arrive as new inflow in the previous year. In an average one-year period, 33% of the dollars invested in the fund enter and leave within six months, i.e., one-third of the two-thirds being invested, or about 22% of the trading activity can be related to shares held less than six months. Obviously, those assets being held less than five days are an even smaller fraction!

Thus, while ten to fifteen years ago the costs of a dollar of trading activity would have been one or two cents, in the aggregate only 22% of such costs would have been caused by short-term shareholder activity, a negligible amount compared to the 78% that would have been derived from the purchase and redemption activity of longer-term (greater than six month) shareholders. It appears that the short-term shareholders are subsidizing the trading activity of the far larger group of long-term shareholders. While long-term shareholders trade less frequently, they so dwarf the short-term traders in numbers that even their infrequent trading generates greater costs than those associated with the shorter-term traders!

This is supported by the ICI study cited at footnote 24 of the proposed rule.[3] It cites studies that frequent traders are less than five percent of the total shareholders. As such, frequent traders would have to trade an enormous number of times in very large sums to offset the trading costs of both 1) the larger number of less frequent traders within the fund (about 23% long-term versus 3% trading more than six times) and 2) the net inflow of purchase transactions documented for most funds. While the industry argues that these figures show that redemption fees would only impact a small number of shareholders, they can't have it both ways and then say that this tiny percentage of traders has a larger impact on costs than the combination of 1) the larger number of transactions caused by the less frequent traders and 2) by investors entering the fund.

While one can understand that the disclosure of a fund's liquidity cost would be helpful to investors, it's hard to understand the proposed rule's reliance upon the Edelen calculation to justify a mandatory 2% redemption fee. Are the proposed rule's authors suggesting that there should be no liquidity costs to mutual funds? If so, that would fly in the face of Dr. Edelen's introductory remarks in which he characterized the "… act of providing a liquid equity position to investors at low cost…" as "…arguably the primary service of an open-end mutual fund…"[4] Are they unrealistically suggesting that this primary service should come without costs, or that the 1985-90 era costs were too high? And why ignore the evidence that most of the cost came from longer-term shareholders?

Finally, there should have also been some reference made to a more recent study co-authored by Dr. Edelen using 1998-99 data.[5] While his earlier study was limited to monthly data, the more recent study was able, like Greene, to study daily inflows and outflows. It found that the cost of abnormal inflow- or outflow-induced trading in terms of fund returns was 25 basis points (whether it was caused by inflows or outflows). The data further found that while this effect was evident the day after the fund flow, its effect was insignificant thereafter. Obviously, this study is not supportive of a mandatory 2% redemption fee for trading activity within a five-day trading period. A 2% redemption fee overstates the cost of each trade by a factor of eight, the combined buy and sell by a factor of four, the period affected by a factor of five, and completely ignores the finding that after one day unexpected flow "has no systematically, significant relation to returns."[6]

II. Reversing The Downward Pressure On Investor Costs

The second departure from past SEC policy that the proposed rule creates is the move from promoting lower costs in the trading markets to imposing higher costs. In the past the SEC has led the way in facilitating greater market efficiencies and lower trading costs. With the proposed rule, the SEC embarks on a different path, one that requires the imposition of higher costs of trading on investors. It does this without a shred of research indicating that expenses avoided would offset the costs imposed on investors. In fact, all of the evidence is to the contrary.

Focusing simply on the SEC estimates of the proposed rule's administrative cost burden yields an estimated cost to investors of $2.323 billion the first year and $836 million each year thereafter (proposed rule, fn 102). Those figures do not even include the cost of the redemptions fees that investors may inadvertently stumble into paying! Using the Greene study's data we were able to estimate that for every 1% of fund flow from non-traders who inadvertently incur the redemption fee, the cost to redeeming shareholders would total over $845 million per year (see calculations supplied with our November comment letter). In addition, we pointed out that for every 1% of fund outflow that generates a redemption fee, the collection of these fees would increase the fund's AUM. The resulting management fees payable on this increase would add another $8 million in investor costs.

If these are the costs of the proposed fee increase, are there any benefits? If one applies the Greene study cited by the proposed rule, even extrapolating the results found in his 20% study to the entire fund industry (although the study found no evidence of dilution costs to domestic stock and bond investors), ending frequent trading only generated a cost savings in dilution avoidance of $2.1 billion over the 26-month period studied. That works out to $969 million per year. Yet in just the first year, the administrative costs alone would exceed these cost savings ("benefits") by over 100%. Yearly administrative costs thereafter would nearly equal them again, and redemption fees collected would equal them yet again. Thus, the costs of the proposed rules to investors could easily exceed the maximum investor dilution cost savings by two to three times every year!

The minimal impact of frequent trading is confirmed by a review of the shareholder restitution occasioned by the five mutual fund scandal settlements to date:

Restitution in the Five Scandal Settlements to Date:

Mutual Fund Company	Settlement Period	Restitution	AUM	Restitution As % Of AUM	% Of AUM PerYear
BankAmerica	1998-2003	$25 Mil.	$194 Bil.	0.012%	0.0024%
Alliance	1999-2003	$150 Mil.	$4.89 Bil.	3.067%	0.767%
MFS	1999-2003	$175 Mil.	$40 Bil.	0.437%	0.109%
Putnam	1998-2003	$10 Mil	$227 Bil.	0.0044%	0.0008%
Janus	2001-2003	$31.5 Mil.	$150 Bil.	0.021%	0.0105%

(Information derived from press releases on each mutual fund company's website, as well as SEC releases.)

How big a problem is "frequent trading?" Even focusing on those funds that could be construed as the worst offenders, the restitution portion of the settlements totals $104 million per year within the settlement periods for fund families with a total of $616 billion in assets under management – 0.0169%!

There are less expensive alternatives available to deal with the specific problem. In addition to every mutual fund already having the right to impose redemption fees to protect long-term investors by recouping costs of abusive trading, the funds have a wide range of alternative trading policies available to them, as detailed in footnote 7 of the proposed rule. Furthermore, since the studies show the problem to be essentially one of international fund arbitrage, SAAFTI believes the better solution is fair value pricing where the specific cause of the abuse can be targeted without affecting the savings of non-abusive shareholders.

It should be apparent that it is unlikely that the benefits in any cost reduction brought about by the mandatory redemption fee will offset even the administrative costs of the proposal, let alone the costs

generated to unwary or needy investors by the fee itself. Thus, the proposed mandatory redemption fee will reverse decades of SEC-inspired downward pressure on trading costs and result in a net increase in those costs to investors, whether they actually pay the fees or not and despite the existence of less expensive and more targeted alternatives.

III. Other SAAFTI Objections

There are a number of problems inherent in the concept of a government agency imposing fees upon investors.

(1) Short-term, "frequent" trading is not illegal. There is nothing in the Investment Company Act that indicates the government should give greater preferences to long-term versus short-term investors. While Section 22 of the Investment Company Act allows for measures to address dilution in value or unfairness to other shareholders caused by purchase, redemption or sale, the determinant should be the actual quantifiable unfairness or detriment, not a classification of the investor as short-term or long-term. For that reason the SEC in the past has required a showing of financial detriment to longer-term shareholders to justify a redemption fee on their shorter-term brethren. It should not abandon this remedy focused on the problem for one that is arbitrary and applied across the board without any finding of harm done in the individual fund. There are NO studies that show that this is a problem in every fund!

(2) A 2% redemption fee will not stop short-term trading. Experts, including Mercer Bullard, president and founder of Fund Democracy, Inc. and Assistant Professor of Law at the University of Mississippi School of Law, have testified that redemption fees will not stop short-term arbitrage trading.[7] When the disparity in pricing exceeds redemption fees, short-term traders will still move to profit from the opportunity. As the Wall Street Journal today editorialized in what could be construed as a *de facto* comment letter to the proposed rule:

> Take the rule to impose a 2% redemption fee on investors who redeem their shares within five days of purchase. This rule is meant to stop trading on stale prices. But academic studies have shown that it will, at best, only discourage such trading, not end it, since stale-price trading would still be profitable after big market moves even after netting out the penalty fee. Worse, this fee would whammy innocent investors who have unexpected liquidity needs or even experience a change of mind. [8]

(3) Arbitrage opportunities can be resolved through fair value pricing. Fair value pricing builds in expectations for how the overseas markets will react into the end-of-day pricing of the U.S. market to moderate or eliminate the catch-up gain or loss the next day when the overseas markets open. This is the solution to abusive trading uniformly recommended by academics and other authorities that have studied the problem. The increase in recent years of the number of domestically traceable derivatives of foreign indexes and ADR's of overseas companies makes this more practical than it was even five years ago. The growth of third-party fair value pricing concerns also makes it more affordable and objective. Finally, while some argue that it too may be subject to "gaming, " the level of sophistication necessary would limit its application and the small but necessary element of subjectivity remaining would act as a further deterrent.

(4) A redemption fee is a very blunt weapon. While investment professionals can easily avoid its imposition, the proposed rule will catch many investors unaware. Further, it cannot discriminate

between short-term trading and genuine need. Investors who have an unexpected need for their monies will end up paying for a solution designed to punish so-called abusive trading. The ICI study cited in footnote 24 of the proposed rule notes that "Among those who redeemed shares, approximately 45% cited needing the money as the reason for selling shares."[9] The hardship relief "suggested" by the rules does not solve the problem for most investors. An investor with $50,000 to $100,000 in retirement savings is not a wealthy investor, yet one slip and they would be looking at a $1,000 -$2,000 redemption fee deduction from their limited nest egg. This is a very significant sum to such investors.

(5) Redemption fees discourage investors from limiting risk in their portfolios. And that risk is real. In our study of the S&P 500 over the past ten years, there have been 404 occurrences where an investor waiting five days to avoid a 2% redemption penalty would have experienced a greater than 2% loss. 46 occurrences would have resulted in losses from 5 to 10%, while five of these instances would have resulted in a loss of greater than 10%.

(6) Mandatory redemption fees will limit the ability of Registered Investment Advisors to manage client accounts effectively. Both new clients and terminating clients would be subjected to the fee regardless of whether the advisor's strategy was long or short term. To avoid incurring a redemption fee in a client's account through rebalancing or responding to changes in market conditions, the advisor will have to track or limit when investments to and withdrawals from the fund can be made. This will be prohibitively time consuming and costly for advisors to administer. These costs are not accounted for in the proposed rule's cost analysis.

(7) The Background section of the proposed rule ends with the statement that "If adopted the proposal would allow funds to recoup some, if not all of these costs." Yet mutual funds already have the ability to impose redemption fees of up to 2% to recoup costs for whatever time period they choose. **What the proposed rule does is require them to collect a fee whether they determine that they have such costs or not!**

(8) On a philosophical basis, the redemption fee proposal is a move by a government agency to give long-term shareholders greater rights than short-term investors. Already one insurance company, reacting to the increased SEC concerns, has given account holders without financial advisors greater rights than those utilizing financial advisors. Without regard to the frequency of trading or the holding period of investments, it has determined that only account holders utilizing Registered Investment Advisors will be prevented from making same-day trades. If a client has an investment advisor, they are denied access to the firm's electronic trading mechanism, and forced to use the mails instead, costing a day to trade if trading less than $1 million, or additionally required to give three days' prior notice if the advisor's aggregate accounts exceed that amount. They are even imposing the one-day delay on trades of Rydex Funds, which are designed to be traded every day. Stale pricing is effectively forced on the advised clients versus all other variable annuity account holders and 401(k) participants who are allowed to obtain today's price. All this is done outside the prospectus and irrespective of the substantial surrender fees that would be imposed on account holders seeking to escape these *ex post facto* rules.

(9) It is very likely that the mandatory redemption rule will give a green light to the proliferation of redemption fees with much longer holding periods. While only 10% of funds had redemption fees before the proposed rules (conversely, 90% had determined that such fees were not appropriate for

their fund in light of the SEC standard requiring that such fees be justified by a finding that they did no more than recoup costs), many more funds have instituted redemption fees since the mandatory fee rule was proposed. There is a real fear that once a redemption fee is mandatory, it will be the start of further "redemption fee creep. " Fees will become widespread and will require longer and longer holding periods. After all, the longer the funds can hold on to the investor's money, the more they get paid. Already there is one fund – Royce Select – that imposes a 2% redemption fee if shares are not held for at least three years! Any mandatory redemption fee rule should continue the "no higher than actual cost" standard, or in lieu of that, should counterbalance it by also requiring maximum holding periods so as to continue the liquidity and redeemability feature inherent in investment companies.

(10) The SEC should not punish investors for the crimes of a few fund companies and add insult to injury by benefiting those same companies with increased fees and better performance numbers.

(11) The proposed rule suggests that the fees have to be mandatory to remove competitive pressure and simplify administration.[10] Yet, competitive pressure is all that currently holds the lid on redemption fee costs. Mandatory fees will take away much of the stigma of such fees and allow for their greater use. The fees already differ widely and intermediaries are coping with their imposition because the fees are removed at the fund level of accounting by each fund where the rules can be individualized to match the fund policies. If there be merit to the "uniformity for simplicity of administration" argument, then the appropriate remedy, if the SEC is going to impose its 2% mandatory redemption fee, would be to require that its five-day redemption fee be the only redemption fee imposable by the funds.

IV. Corrections That Should Be Made Regardless

1) The exception provision needs a great deal of expansion:
    a) 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 five-day period to expire to avoid it.
    b) The $2,500 and hardship exceptions are currently within the fund company's prerogative. They should be required if they are to have any meaning. And, while we believe that the proliferation of regulations inherent in mandating redemption fees is yet another reason for the SEC to avoid going down that road, if it chooses that path, regulations similar to the IRA tax provisions defining the requisite hardships are essential.
    c) Pre-approved, periodic transactions should not be subject to the fee. These should, at a minimum, include fee liquidation, automatic deposit, payroll deduction and periodic withdrawal plans.

2) The first-in, first-out rule for counting the holding period, rather than the last-in first-out rule, should be retained to avoid an administrative nightmare. This is already a major problem with existing redemption fee policies, with some firms specifying FIFO and others LIFO. Most of the unfair applications 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. If the SEC imposes mandatory redemption fees on our clients, it should take the opportunity to impose uniformity and require that the imposition of any holding periods always be governed by FIFO rules. Without that requirement, it is easy to envision a fund having mandatory fees imposed on a FIFO basis, while existing redemption fees with longer holding periods are imposed on a LIFO basis.

3) Redemption fees should be disclosed in large bold type on the front cover of every prospectus to reduce the chance of investors stumbling into the mandatory fees and to keep some semblance of competitive pressure on fund companies to avoid "redemption fee creep. "

4) Funds should be required to break out redemption fee proceeds from growth in asset value. Including redemption fees in performance would obfuscate the investors' view of manager performance and provide the unintended benefit of improved performance returns unrelated to management expertise for the very industry that brought us the scandal.

5) SAAFTI remains committed to further disclosure by intermediaries to the fund industry. While our members report that the trading platforms that they are working with seem to have direct links to the funds (many members report daily contemporaneous communications from the funds after trades are placed with trust companies, for example), they are aware that this is not always the case in the 401(k) participant world. We would support the SEC's efforts to formalize this communications and bring uniformity to the various trading platforms.

Linking these needed improvements to mandatory redemption fees is not the answer, however. Instead, if the SEC needs a means to bring regulation to the financial intermediary industry, rather than attach the information provision requirements to redemption fees, these requirements could instead be included in a new "soft" four o'clock close rule proposal. Failing that, the SEC should seek Congressional action to bring all financial intermediaries within the ambit of its jurisdiction. Imposing a new "tax" on the least knowledgeable and most needy investors is not the appropriate means to gain jurisdiction over the financial intermediary industry.

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

Very truly yours,

Jerry C. Wagner

Footnotes:
[1] Jason Greene & Charles Hodges, "The Dilution Impact of Daily Fund Flows on Open-End Mutual Funds, 65 J. Fin. Econ. 131 (2002).
[2] Rodger M. Edelen, "Investor Flows and the Assessed Performance of Open-end Mutual Funds," 53 J. Fin. Econ. 439 (1999)
[3] Investment Company Institute, "Redemption Fund Activity of Mutual Fund Owners'" Fundamentals (March 2001)
[4] Edelen, *supra.*
[5] Rodger M. Edelen & Jerold B. Warner, " Aggregate Price Effects of Institutional Trading: A Study of Mutual Fund Flow and Market Returns," 59 No. 2 J. Fin. Econ. 195 (2001)
[6] Edelen & Warner, *supra.*

[7] Mutual Funds: Who's Looking Out for Investors? , Testimony of Mercer E. Bullard, Assistant Professor of Law, University of Mississippi School of Law, before the Subcommittee of Capital Markets, Insurance, and Government-Sponsored Enterprises, Committee on Financial Services, U.S. House of Representative (Nov. 4, 2003) at p. 37-38
[8] "Headline Risk at the SEC," The Wall Street Journal, A16, (May 10, 2004)
[9] Investment Company Institute, *supra.*
[10] Proposed Rule, p. 11764

See page below from Putnam website.

THE IMPACT OF REDEMPTIONS

From a trading perspective, can Putnam handle redemptions that could result from these developments? How will this impact performance?

To date, Putnam has found that there has been sufficient liquidity in the market to manage client withdrawals and redemptions without any increase in portfolio transaction costs. In addition, we believe that the market impact of terminating institutional clients will not be significant for the following reasons:

- Approximately 70% of our terminations have been handled as "transfers-in-kind" (i.e., no securities will be sold by Putnam).
- Institutional clients' portfolios are generally positioned in large, highly liquid stocks. For example, in a typical institutional account, approximately 82% of the portfolio is held in companies whose total market capitalization exceeds $10 billion.
- The total market cap of the MSCI EAFE Index is $6.7 trillion. On a base of approximately $40 billion in international equity client assets (Putnam's starting base at the beginning of these issues), we would represent just 0.6% of the market.
- Putnam has a world-class trading capability that uses state-of-the-art techniques to execute trades optimally. Our trading desk uses program trading, transaction cost forecasting, and real-time transaction cost and cash monitoring to execute our trades.

How do redemptions affect the funds' net asset value or performance?

A fund's net asset value (NAV) is calculated by dividing total net assets by the number of shares outstanding. In general, redemptions should not have a significant impact on a fund's NAV or on performance. This is because funds typically maintain a 1% – 3% cash balance sufficient to meet redemptions and, if appropriate, some portion of the cash position may be invested in futures to "equitize" the cash holdings (i.e., maintain market exposure). In addition, funds usually have additional cash available from the normal turnover of portfolio securities. As a general rule, redemptions can impose the transaction costs of liquidating positions.