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Via Electronic Mail to Rule – Comments@sec.gov May 10, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0506

Re: Proposal to Apply Mandatory Redemption Fees for Redeemable Fund Securities, (File No. S7-11-04)

Dear Mr. Katz:

The Securities Industry Association ("SIA")[1] appreciates the opportunity to comment on the above referenced proposal which would require most mutual funds to impose a two percent redemption fee on shares purchased and redeemed within a five business day period.[2] The proposal is designed to prevent abusive market timing and reimburse funds for the costs incurred due to short-term trading strategies.

I. OVERVIEW

Since evidence of abusive market timing surfaced in late 2003, the Commission has taken a number of significant steps to address the situation. These include the recent adoption of rules requiring funds to disclose in their prospectuses the risks to shareholders of short-term trading and the fund's policies and procedures with regard to such trading,[3] as well as the adoption of requirements for funds to have written compliance programs administered by a chief compliance officer.[4] Additionally, the Commission, as well as a number of funds, have taken strong action

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

[2] SEC Release No. IC-26375A.
[3] SEC Release No. 33-8408, "Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings," (April 16, 2004).
[4] SEC Release No. IA-2204, "Compliance Programs of Investment Companies and Investment Advisers, (December 17, 2003).

against individuals within fund organizations who have either permitted market timing in contravention of fund policy, or engaged in it themselves. We believe that these collective measures have had, and will continue to have, a significant deterrent effect on market timing and other short term trading practices, and that the current proposal will complement those measures.

While SIA does not normally favor regulatory fee setting, we support the current proposal as it will apply a more uniform standard, and eliminate discretion from the process of determining whether short-term trading is within or outside the scope of a fund's stated market timing policy. We do have a number of suggestions, discussed below, which will help avoid unintended consequences, and assure that the costs of implementation and application of the rule will not exceed the dilution and other costs associated with short-term trading. Furthermore, before determining to proceed with final adoption of the proposal, we strongly encourage the Commission to thoroughly examine whether fund fair value pricing mechanisms can be implemented which will ameliorate the need for a rule with the potential to cause unintended consequences. If such mechanisms prove untenable for the present, we recommend that the Commission revisit the issuer periodically. The Commission's ultimate goal should be to require funds to price their portfolios using a fair-value pricing system, and this redemption fee approach should only be viewed as a stopgap measure until that goal can be achieved.

II. CALCULATION METHODOLOGY

The proposed rule would apply a first in, first out ("FIFO") methodology for calculating those fund purchases and sales which are subject to the mandatory redemption fee.[5] Given the 5 business day measurement period provided for in the proposal,[6] we believe that, on balance, FIFO is preferable to a last in, first out ("LIFO") approach. Having observed the deliberations of the NASD Omnibus Task Force, we believe this is one of the most difficult issues it confronted, and one on which no clear cut consensus was reached, because there are benefits and detriments to either methodology.

While it is reasonable to conclude that a LIFO method might capture more abusive short term trading, it is also likely to have the consequence of capturing more non-abusive activity such as that associated with periodic purchase plans or retirement account programs. This would be most unfortunate, in that these are just the type of programs in which investors should be encouraged to participate to fund retirement, college tuition costs, or the acquisition of a home. Although, it's possible that a rule could be crafted to try to "carve out" these, and other instances of non-abusive trading, it would add significant cost and administrative complexity to the process,[7] especially since other systems already in use, such as those used to calculate contingent deferred sales loads, employ the FIFO method. We note that even under the FIFO method the SEC estimates start-up and ongoing costs of implementing the rule proposal to be more than $1 billion.[8]

III SPECIAL CONSIDERATIONS FOR EMPLOYER-SPONSORED PLANS

Any measures to address market timing should consider ways to mitigate the negative impact on retirement plan investors. Uniformity in the fees and timing of the fee would reduce the complex systems changes that will be required under the proposal. Further, the Commission

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[5] See proposed rule 22C-2(d).
[6] See proposed rule 22c-2(a).
[7] See proposing release at 13.
[8] See proposing release at 17.

should strongly consider a higher de minimis amount, such as $10,000 and a carve out for most transactions that are effected by retirement plan investors such as payroll contributions, loans, hardship withdrawals, periodic participant rebalancing, and plan level rebalancing.

IV. INTERMEDIARIES/OMNIBUS ACCOUNTS

As a threshold matter, we recognize that the major shift in fund distribution from funds to intermediaries, many of whom process fund transactions on an omnibus or other bulk basis, has complicated the process of identifying underlying account owners at the fund level – particularly in contexts such as determining breakpoint entitlement and assessing redemption fees. However, it is just as important to recognize that omnibus accounts and other similar arrangements have engendered significant operating efficiencies and investor benefits.[9] Therefore, it is helpful that the proposal offers several alternatives to facilitate identification of transactions subject to the redemption fee which would not significantly compromise these benefits. We believe that a significant number of intermediaries and funds have already implemented arrangements which fall within one or more of the alternatives set forth in the proposal, and we are hopeful that all parties can reasonably accommodate at least one of the alternatives within their processing models at reasonable cost. We believe the Commission should also be open to additional alternatives which other commentators may offer that are consistent with the purposes of the proposal.

However, SIA strongly opposes having the fund, rather than the omnibus processor select the alternative to be utilized. This would essentially require omnibus processors to support (at great cost) all three alternatives, since it would be at the mercy of each fund family in terms of what alternative would have to be utilized. On the other hand, regardless of what alternatives were selected by the omnibus processor, the fund would be performing essentially the same redemption fee activities which it is already performing in a non-omnibus context.

SIA also strongly opposes the provision in the proposed rule that would require, regardless of which of the three alternatives are utilized, that each intermediary provide every fund on at least a weekly basis with complete transaction information including taxpayer identification numbers for every fund transaction executed.[10] We believe that the three alternatives set forth in the proposal already provide intermediaries and funds with the tools necessary to capture transactions to which redemption fees should apply. The additional and redundant requirement for a weekly data feed, rather than adding value to the process, will enormously increase costs to both intermediaries and funds, and more fundamentally undermine the significant efficiencies that have evolved through omnibus and other forms of bulk processing of fund transactions. While at some point, certain of the information included in a weekly transmission feed might assist in the identification of qualifying breakpoint transactions across financial institutions, development of such a program is, at best, in an embryonic stage, and its ultimate effectiveness is not known.

We also note that under the previously referenced compliance programs rule, which became effective in February, 2004, fund companies are required to have reasonable policies and procedures in place to detect violations of the federal securities laws, including the instant proposal, if adopted. Therefore, we believe that the better approach is to permit each fund,

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[9] These include, but are not limited to, sharply reduced processing costs, consolidated customer statements the availability of a broader array of funds, and collection of fund distributions to investors through a single entity.

[10] See proposed rule 22c-2(c).

consistent with its obligations under the compliance programs rule, to determine which of the three alternatives it should implement, and how it should be monitored. Appropriate policies and procedures can address not only how the fund interacts with intermediaries to assure capture of transactional information, but also the proper administration of redemption fees at the fund level itself.

V. CONCLUSION

SIA supports the adoption of a rule requiring most mutual funds to apply a mandatory 2% redemption fee on fund purchases and redemptions occurring within a 5 business day period. SIA also support use of a FIFO methodology to calculate the applicability of the redemption fee. But as stated at the outset, we hope that this approach will only be a temporary regulatory solution, ultimately replaced by a fair-value portfolio pricing methodology.

Additionally, SIA supports the provisions in the rule which offer funds and intermediaries a number of alternatives for assuring that transactions subject to the fee are properly identified, and urges the SEC to consider any additional alternatives presented which may be consistent with the purposes of the proposal. SIA does not support the requirement for the transmission of mandatory weekly transaction feeds by intermediaries to funds. Such data feeds would be extremely costly for intermediaries and funds to maintain, and would undermine significant operating efficiencies that have evolved in mutual fund transaction processing.

Thank you again for the opportunity to comment. Questions regarding this letter should be directed to Michael D. Udoff of SIA staff at 212-618-0509.

Very truly yours,

Michael D. Udoff
Vice President
Associate General Counsel and Secretary

cc: The Hon. William H. Donaldson, Chairman, SEC
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