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April 2, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-11-04 – Comment Letter on Proposed Rule: Mandatory Redemption Fees for Redeemable Fund Securities

Dear Mr. Katz:

At Section II.F (Page 11) of the proposed rule, comment is requested in respect to mandatory second-day pricing. My comment letter in respect to File No. S7-26-03 provides a step-by-step summary discussion and recommendation in favor of requiring such pricing. I believe this would relieve the necessity for the proposed mandated redemption fee and allow fund directors to impose redemption fees for such times as they deem it advisable in their own judgment. I am therefore appending to this letter (Appendix A) a copy of that comment letter which is, in my judgment, a good summary of the logic and reasons for adopting this "tool" above all.

I would add two exceptions to the mandatory second-day pricing:

(1) Funds which require fair pricing of their portfolios would be able to do fair pricing in lieu of second-day pricing. These are funds which, under Section 2(a)-41 of the Investment Company Act, must fair price. These include many, if not most, corporate bond funds and perhaps other funds for which there is chronic limited and sporadic market quotations. I remain surprised that the release continues to add the parenthetical "(or is unreliable)" in footnote 63. The word "unreliable" is not in Section 2(a)-41, is subjective and ambiguous as to meaning, i.e., the real time quotes are not correct in the management's view or the real time quotes should not be used because they do not reflect what might be the "right" price because of the events in the real world elsewhere.

Again, one of the important advantages I pointed out before is that the second-day pricing follows the law without subjective interpretations. Fair pricing, as also pointed out in your footnote 65, is highly subjective and often expensive. A recently reported SEC study showed that use of fair value is sporadic, uncertain, providing conflicting results on individual values and generally flawed (*Wall Street Journal*, page C1, March 24, 2004). I would add that if fair pricing is arrived at by a rigid system, then it also can be "outguessed" by timers who have the means and intellectual or technical know how.

Further, as pointed out before, all that fair pricing attempts to do is to <u>replicate tomorrow's closing price</u>. Why is that not "unreliable" compared to the real thing – the second-day closing price?

(2) There may be an exception if a fund "permitting short-term investing" decides to be the kind of fund that is the subject of an exemption under paragraph (e)(2)(iii) of the proposed rule. Thus, it would be easy for investors to know whether a fund is for "investment" – the long or longer term – or what is defined in that paragraph as a fund suitable for short-term investing.

The use of second-day pricing for most funds is not perfect. It is in my judgment simply the best solution. There is no perfect solution. It does diminish promptly effecting investment decisions. But, as noted in my accompanying previous comment, since most sales and redemptions are made through intermediaries, most trades under the proposed "hard close" rule would end up as being priced on the second day anyway. This creates a two-tier trading system most unfair to many smaller investors who utilize a 401(k) platform and the like.

The advantage of second-day pricing is that it is uniform, applies equally to the smallest and largest investor and is easy to effect simple compliance at the fund level without complicated, expensive, unreliable or imperfect intermediary compliance procedures.

In respect to the mandatory redemption proposal, I have the following comment:

If someone wanted to time and established a $100,000 account for six days and then purchased $100,000 more shares, what prevents shares from the first order from being redeemed immediately? On the other hand, last-in-first-out can punish the longer term investor. This is just one of its complexities. For the funds to try to be the intermediaries' "keeper" is asking too much. The various choices and the need for identity information is complex, not easy to effect the desired compliance. Further, if the funds, at minimum, must have (for example) each individual investor and plan participant tax identification number (and other information, if an alternative is selected), why does this not void the fund's exemption from anti-money laundering and related CIP requirements on omnibus accounts and accounts of regulated entities? These complications would cause significantly increased fund and transfer agency costs and compliance problems. The whole proposal is filled with complexities, unknown compliance problems and costs, especially related to intermediary trades.

Paul Roye, Director of the SEC's Division of Investment Management put it well in his Congressional testimony on the problems inherent in providing personalized investor level information (specific cost figures), paraphrased in *Ignites* on March 12, 2004:

> "But Director of the SEC's Division of Investment Management Paul Roye has his doubts about the practicality of such an approach. The problem with it stems from the fact that most fund accounts are owned through advisors.
>
> "Those advisors give their clients consolidated statements, so having personalized, dollar-amount fund-fee disclosures would force fund firms to send thousands upon thousands of fee amounts to thousands of brokers, said Roye. Calculating, transmitting and aggregating that amount of information in a short amount of time could prove prohibitively difficult and costly, he said.
>
> "At the same time, the SEC is actively working on ways to make fund disclosure documents clearer and more useful to investors, said Roye."

The problem on the mandatory redemption fee for intermediary accounts is the same except in the opposite direction. For the funds to try to (and perhaps be at liability risk if there is failure) police thousands of trades for timing abuse at other levels of distribution is an invitation to "gotcha" governmental or litigious enforcement.

The use of second-day pricing would eliminate the complex compliance problems, centralize the compliance in one place – at the fund level – and allow the most equal and fair treatment of investors.

There is here an opportunity for a government agency to unify together the two overriding, and often conflicting, strands of American Governmental policy – liberty and equality – into one seamless and effective regulation. The use of second-day pricing is the best method of assuring compliance with a hard close applicable to all without complex and uncertain compliance procedures, i.e., the most accomplished with the least governmental and private rules and enforcement. It also provides equal treatment for the smallest investor who purchases through their intermediate 401(k) plan as well as for the largest hedge fund that invests directly into the mutual fund. This is an opportunity to accomplish a great deal for less at all levels.

Very truly yours,

Sheldon R. Stein

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January 16, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-26-03 – Comment Letter on Proposed Rule: Disclosure Regarding Market Timing and Selected Disclosure of Portfolio Holdings

Dear Mr. Katz:

The following represents my own personal views and are not necessarily those of my company or colleagues. It does, however, reflect the views of some other attorneys with significant experience in mutual funds.

I have been involved in the mutual fund industry in various capacities for over 45 years beginning as an attorney with the Securities and Exchange Commission (the "Commission") in an early scandal (Managed Funds) in the late 1950s. In proposing remedial rules, there are important, seminal principles that I believe should be followed, to the extent possible, to achieve a clear, positive compliance result. Remedial rules:

APPENDIX A

1. should adhere to and reflect existing statutory law – or be the subject of a necessary exemption following the statutory criteria;

2. should be clear and enforceable, which normally means having as few as possible compliance points of responsibility;

3. should be capable of being enforced equally with equal effect on the funds and their customers, thus avoiding discriminatory adverse effects; and

4. should (obviously) be pinpointed to undo or prevent the problems or abuse involved.

<u>The "Hard" Closing Proposal</u>

This proposal clearly meets all the criteria except for equal treatment. We are universally told that 70% to 80% of all fund transactions are made through intermediaries. These range from broker-dealers, which are subject to statutory self-regulatory bodies and the Commission to retirement plan administrators, which are without any regulation in this respect. There are thousands of these intermediaries, which often require somewhat lengthy and complex processing so that in many, if not most, cases this would result in the "hard" trade being effected the next day. This may be exacerbated by the needs of back offices of securities firms and the electronic transmission system (whether NSCC "Fund Serve" or other clearing firm systems). The Commission release and other press discussions recognize this problem.

It can be argued that fund investments should be "long term" and, therefore, to object to a day's delay is not a strong argument, especially for a retirement investment. Still, "why me" is a reasonable answer. Are those investors whose trades are treated differently in practice to be ignored? The aim here should be compliance coupled with equality of practical treatment.

<u>The "Timing" Proposal</u>

The "timing" matter I believe needs re-working. In my view, it has problems in important areas of compliance.

First, there is no way to ensure that timing does not occur in the hundreds or thousands of intermediaries. Even if there was a requirement for expensive audit review letters or SAS70 reports, these would not assure any fund that there was not some timing occurring somewhere in an omnibus account process. The concept of pinpointing the compliance and related responsibilities is clearly a problem here.

Second, the proposal requires each fund to disclose answers to several compliance questions such as: "How do you protect against intermediary timing?" This could end up with more or less meaningful boilerplate or require significant outlays of money by funds to make sure they have all up-to-date methods to cover timing reports. This could lead to either a race for costly "macho" disclosure and related procedures or some consistently followed boilerplate. It again misses the principle of pinpointing the problem with the remedy and leads to inequality and competition among funds. There should be a simple, pinpointed compliance. The alternatives being considered are:

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1. **Mandatory Redemption Fees.** This is so complex. It requires that the intermediaries enforce the redemption and pay it over. It involves not only significant enforcement uncertainty, but also puts the funds in the collection business.

2. **Fair Value Pricing.** On the surface, fair value pricing seems to solve the problem of the information gap that invites timing abuse. However, it again does not fit certain important principles:

    a. Section 2(a)(41) provides that value is to be at a market quotation if readily available. Only if these are not "available" is fair value to be used. The statute does not provide for an added parenthetical ("or reliable"). If such parenthetical condition is necessary, a properly adopted exemption ought to be part of the rule (cf. the "interval" rules regarding the definition of Redeemable Security). Bonds (except U.S. Government) generally trade sporadically. This market requires fair pricing. International funds generally do not. Further, everyone can have their own brand of fair pricing – anything to avoid "market quotations" – some kind of computerized formula, handwritten guess work, use of ADRs or futures prices, etc. These are all guesstimates of tomorrow's market quotations. This not only adds complexity and avoids simplicity of compliance, it can be gamed. Possible timers (if any now exist) can probably figure the system and guess what the price could be. Further, it is to be noted that one of the fund groups alleged to have a serious problem was publicized previously by the *Wall Street Journal* as having a good computerized "fair value" automatic operating system.

So what is the answer to all of this? It is the time to think "outside the box." Fair value pricing is just an attempt to replicate tomorrow's quoted price. The Commission staff has previously granted no-action letters for the funds to do delayed second day or more exchanges (letter to ICI of November 13, 2002, though based on other grounds). Section 2(a)(41) gives the Commission the authority to determine the time of valuation, i.e. pricing.

If the Commission adopted mandatory, universal second day pricing, it would meet the requirements of principled compliance regulation:

1. It would comply with the statute.

2. It would be enforceable at the fund level with no need for any other.

3. It would apply equally to retirement administrators, dealers, individuals – everyone is treated equally. All trades that are today transmitted after NYSE close (and clearing prior receipt) will be priced the same as all other trades at the close the day after receipt by the fund. The funds are then able to truly be the focus of compliance.

4. It is pinpointed to solve both problems. No disclosure competition, no high cost compliance machinery, no ambiguous language in disclosures and, best of all, the true "fair value" not the ersatz replications of systems falling all over the map.

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The Commission should reconsider and make compliance simpler, exacting and in strict accordance with the statutory requirements. It should mandate that all trades be priced at the close on the day after receipt. The change is as necessary to do a complete compliance job as forward pricing was to undo the problems and "games" of backward pricing.

Very truly yours,

Sheldon R. Stein