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Insurance and Investments

May 10, 2004

Mr. Jonathan G. Katz
Secretary, Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609
VIA electronic mail transmission to rule-comments@sec.gov

Re: Release No. IC-26375A; File No. S7-11-04

Dear Mr. Katz:

The Union Central Life Insurance Company is a mutual life insurance company headquartered in Cincinnati, Ohio. We offer a broad product line of life, annuity and disability insurance products, including variable annuity, variable life, and exempt group variable annuity products ("nonretail products"). We appreciate the opportunity to provide comments on your proposed Rule 22c-2 of the Investment Company Act of 1940 (the "mandatory redemption fee" rule).

We can summarize our comments on the proposal as follows: the Commission should standardize the redemption fee, holding period, de minimis standard, method of collecting fees and method of reporting transactions to mutual funds, based on the relationship of the investor to the mutual fund. We believe a standardized approach will enable us to help our customers understand the regulations and comply with them, and to file variable insurance contract forms with state insurance departments that contain clear and comprehensive disclosure so the redemption restrictions will be legally enforceable against excessive traders. We also believe the costs associated with providing discretion to the mutual funds as described in the proposed rule will greatly exceed your estimates.

For mutual funds that sell their shares to retail purchasers, it may be appropriate for each fund to have the flexibility to set its own standards within the Rule 22c-2 guidelines. Those retail purchasers could read the fund's policies in regard to redemption fees and holding periods in the fund prospectus or statement of additional information and make an informed, personal decision to buy the fund shares. On the other hand, for individuals who invest in mutual funds through variable insurance products or retirement plans ('nonretail investors"), the investment options are determined by the issuer of the variable insurance product or the retirement plan sponsor. We address the needs of our primary customers, the nonretail investors, in our comments.

1. **Redemption Fee**. Nonretail investors will understand a single, non-tiered redemption fee, with a standard de minimis exemption. Because it is simple and predictable, it is easily disclosed in a nonretail product prospectus or profile prospectus. Simplicity becomes especially important because many nonretail products offer between 30 and 100 underlying mutual funds from various investment managers. If you permit funds to create individual redemption policies to curtail excessive trading, disclosure about those disparate policies will be difficult for nonretail investors to find and understand.

For individual variable insurance products, those who prepare Form N-4 or Form N-6 registration statements face uncertainty about how to incorporate this additional potential fee information. If the Commission follows its current requirement for underlying fund expenses, nonretail investors would find disclosure of a range of potential redemption fees and a reference to the underlying fund prospectuses for more information. We feel it is unreasonable to expect a nonretail investor to review more than thirty fund prospectuses (or Statements of Additional Information) to determine the potential cost to transfer among the nonretail product's subaccounts. Similarly, retirement plan participants often have access to less information about the underlying fund options in their plans than owners of individual variable insurance products, making it even more difficult for them to know the potential costs prior to making a transfer among their available investment options.

In order to bring stability to the nonretail investor's marketplace, we ask you to change the rule to require a flat 1% redemption fee, with a de minimis exemption for redemptions of $10,000 or less. We believe that setting the redemption fee and de minimis exemption at this level will create a predictable environment for nonretail product providers and investors, enhancing our ability to explain these fees and exemptions to nonretail investors and the investors' ability to understand and abide by the rules. Having rules that are easy to understand and implement will enhance nonretail investor confidence in the nonretail products they rely on for their retirement savings and will aid the underlying funds, nonretail product providers and other intermediaries in their efforts to protect average nonretail investors from the harmful effects of market timing activity.

We believe that the proposed 2% redemption fee, applied to all redemptions, will lead to a windfall for the mutual funds unrelated to the costs of excessive trading. We have seen no persuasive evidence that there is a relationship between a 2% fee and the actual costs of excessive trading to a fund and its long term investors. We feel that mandatory collection of such fees as described in your rule proposal will create a substantial new source of income for mutual funds. If you determine that 2% is the appropriate level for these fees, we urge you to require reporting from mutual funds over a period of two or three years to determine whether the funds are profiting from the redemption fees collected. As the funds profit from collecting the fees, we, on behalf of our investors, would expect the fund's expenses to decrease accordingly.

In addition, we feel that the de minimis exemption should represent a fixed dollar amount rather than a percentage of fund assets or, in the case of the nonretail product market, a percentage of subaccount assets or even the nonretail investor's account assets. A fixed dollar amount is simple to administer and explain. For nonretail product providers, administering the de minimis exemption as a percentage of fund assets would be nearly impossible. We do not currently receive that information on a daily basis from our underlying funds. If we did receive it, we would have to make major systems modifications to integrate that information with our transaction processing software.

Our experience has been that our underlying funds contact us when they detect hundreds of thousands of dollars moving in and out of their funds, indicating a threshold that is appropriate for funds that contain hundreds of millions of total investment dollars. A de minimis exemption of $2,500 is lower than necessary to stop excessive traders, and it is likely to flag as excessive trading the sort of transactions that nonretail investors engage in regularly, like making semiannual or annual premium payments into a variable life contract or annual contributions to an IRA or rollover contributions from a previous employer's retirement plan, followed by an automatic portfolio rebalance or a dollar cost average transaction that coincidentally moves the premiums soon after the payment. We do not believe that applying FIFO analysis to these movements would eliminate significant manual review of transaction reports at the lower figure of $2,500 per transaction.

We also request that you consider making an explicit exemption in the final rule for fund substitutions in registered variable insurance products, so that no redemption fee applies to a nonretail investor who allocates premiums to an underlying fund that is replaced within the replaced fund's holding period. Otherwise, all issuers requesting substitution orders will have to request relief from Rule 22c-2 as part of their substitution request, or cut off allocations to the fund being replaced far enough in advance to accommodate the replaced fund's redemption fee holding period.

2. **Holding Period**. We request a standard thirty day holding period to trigger the redemption fee charge for nonretail investors. This would provide the benefits of: adequate transaction flexibility for nonretail investors, clear disclosure in contracts, prospectuses and marketing and agent training materials, and clear guidance to computer programmers who implement processing software, all of which will result in either better compliance on the part of the nonretail investors or easier automated detection of excessive traders.

This holding period should apply only to owner or participant-requested withdrawals or transfers among underlying funds. Nonretail products offer automatic transaction features, such as dollar cost averaging, portfolio rebalancing, and reallocation of interest earned on guaranteed accounts into underlying funds. They also offer systematic minimum required distributions for qualified accounts, loans, and qualified plan hardship withdrawals. To limit excessive trading so nonretail investors can understand the limits, you should identify the type of transactions that are subject to the fee rather than try to describe exceptions like "unanticipated financial emergencies". Nonretail investors are unlikely to engage in excessive trading through systematic reallocations or withdrawals. These investors are encouraged by financial advisers to use features like dollar cost averaging or portfolio rebalancing to maintain their investment's diversification. You would discourage this widely-acknowledged investment advice if you subject the investors to fees intended to stop excessive trading.

Nonretail product providers and intermediaries are concerned about automating the review of transactions. Monitoring one standardized holding period will facilitate automation. It will also cut down on the amount of time spent manually reviewing reports to determine whether a nonretail investor had an unlucky confluence of events, like a rollover 401(k) deposit being allocated to his individual IRA or new employer's 401(k) plan the day before he transferred among investment options for the first time in six months. Devoting resources to this sort of review will add to the costs of the products.

3. **Reporting to Funds/Collecting the fees**. We request that you impose one standard method for product providers and intermediaries to communicate with mutual funds about trading activity and collect the fees. If each investment manager chooses her own approach from the three outlined in your release, nonretail product providers and intermediaries will have to comply with some funds using all three methods. Multiplying our communication and fee collection mechanisms will inflate nonretail product costs.

We are concerned that, unless you provide a specific mechanism in the rule for paying the collected redemption fees to the funds, nonretail product providers and other intermediaries will face a multitude of ways of performing that function. We are concerned that some funds will expect us to remit the fees with our daily net purchase or sale remittances, some will want the redemption fees remitted separately, and each fund may adopt its own approach of how the fees will be applied to fund assets, thereby changing our calculations of accumulation unit values for our products. We would like you to establish one approach for how the income from remitted redemption fees will be added into the net asset value calculations daily by the funds, or treated as a separate item like dividends, so there is a predictable manner in which the funds will communicate this information back to the nonretail product providers that use the funds' net asset value information to prepare daily valuations of accumulation unit values.

We believe there are legal and compliance risks for nonretail products associated with collecting fees from nonretail investors because they have no direct or contractual relationship with the funds. Nonretail product contracts generally do not provide nonretail product providers or other intermediaries the right to charge the contract owners any fees other than those described in the contract. This is a basic tenet of state insurance law and regulation. If the funds determine that a nonretail investor owes a redemption fee, and they have no contractual relationship with the nonretail investor, they could charge the nonretail product provider, with whom the funds do have a contractual relationship. However, in many cases, the provider has no explicit contractual right to charge the nonretail investor the redemption fees imposed by the funds for excessive trading. Some state insurance departments specifically forbid such language from being included in variable contracts. Assuming providers have no contractual right to charge the nonretail investor, but they do have a contractual responsibility to the fund to collect the fee for excessive trading, the nonretail product provider will either have to pay the redemption fee to the fund from its general assets or risk the costs of a lawsuit by charging the nonretail investor without a contractual right to do so.

If Rule 22c-2 mandates that funds must require nonretail product providers or other intermediaries to collect these fees, we expect that the funds and the nonretail product providers will be sued and will pass those costs on to the innocent nonretail investors. While any one redemption fee may be only a couple of hundred dollars, and therefore an unlikely source of a lawsuit from a nonretail investor, the opportunity for a class action suit would be a concern. Clearly, any such resulting litigation will increase costs for all nonretail investors, rather than imposing the penalty on the excessive trader.

We are concerned that nonretail product providers may end up in a redemption fee spiral, where deducting the fee from the underlying investments of a large contract, either pro rata or all from the underlying fund to which the nonretail investor moved their account value in the transaction that resulted in the redemption fee, may trigger another redemption fee from the fund(s) from which the first redemption fee was deducted. We would like your guidance as part of this rulemaking as to what happens if a fund charges a redemption fee and the nonretail investor successfully challenges the fee, because the underlying facts indicated that the fee was misapplied. We assume that the inappropriately charged fee would be returned by the fund, possibly affecting a change in its net asset value that would have to be reported to all companies using that fund as an underlying investment, and that it would be re-deposited in the affected nonretail investor's account. We expect that participation agreements will be revised to include a set of rules for who makes up the market loss, if any, to the affected nonretail investor for the days during which the fee was deducted. If such issues are negotiated in participation agreements, their outcome will affect the pricing structure of nonretail products.

Because of the changes we expect to have to make to participation agreements and variable annuity and variable life insurance contracts, and because of the time it will take to assist the various state insurance departments to understand the need for contracts to include reservations of rights to charge these fees, we request a two-year phase in period to allow nonretail product providers the time needed to file new contracts with state insurance departments that provide the right to make these charges. We also request the Commission to waive compliance with Rule 22c-3 for existing contracts that do not provide the right to charge these redemption fees unless all state insurance departments will cooperate and allow insurance companies to modify existing contract forms to permit their collection.

4. **Costs to our company**. We are certain that the cost to comply with this new rule will be greater than you estimated in your cost-benefit analysis. Given that we offer variable annuities, variable life, and group annuity retirement plan products, we have at least three major computer systems in our company to modify to comply with Rule 22c-3. We expect the cost, including the time of the information systems employees to implement and test the systems, as well as the opportunity cost related to having to devote the systems time to this project rather than improvements to the products (not unlike the situation in 1998 and 1999 while companies diverted resources to address Y2K issues), to be close to $1,000,000 for our company, and that cost will increase greatly if you enact the rule as proposed because we will have to build in the specifications at the individual fund level and each fund would have the ability, under the proposed rule, to change its policies over time.

We estimate the costs related to time that will be spent revising participation agreements with our underlying fund managers, creating materials to explain the rules to our agents and our existing and prospective nonretail investors, and filing new contract forms so that we have the right to charge redemption fees for excessive trading, at an additional $200,000. We cannot at this time estimate the costs of litigation that will arise when we charge these fees to an existing nonretail investor whose contract does not explicitly provide us that right.

We expect that these expenses will be passed along through our products in the form of higher charges, and that other nonretail product providers will do the same, so ultimately the nonretail investors who do not trade excessively will pay the costs associated with detecting and dealing with those who do.

If you have any questions or would like to discuss these issues further, please feel free to call me at (513) 595-2919. Thank you for your consideration of our position.

Sincerely yours,

Theresa M Brunsman

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Assistant Counsel

cc: John H. Jacobs
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