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Comments on Proposed Rule on Mutual Fund Redemption Fees for Redeemable Fund Securities Release No. IC-26782 File No. S7-11-04

May 9, 2005

Securities and Exchange Commission

17 CFR Part 270

On behalf of the American Society of Pension Professionals and & Actuaries (ASPPA), we thank you for this opportunity to respond to the recent request by the Securities and Exchange Commission (Commission) for additional comment in connection with the adoption of Rule 22c-2, relating to redemption fee programs.[1]

ASPPA represents more than 5,500 retirement plan professionals who assist employers in establishing and maintaining tax-qualified 401(k) and similar defined contribution retirement plans (plans), including senior representatives of "third party administrators," banks, trust companies and insurance companies providing recordkeeping and other plan administration services (plan recordkeepers and administrators[2]). Because retirement plans offered to America's workers invest through mutual funds, the operation of redemption fee programs is an important issue for ASPPA's membership.

Rule 22c-2 requires mutual fund company boards of directors to consider whether redemption fees are needed, but does not mandate imposing redemption fees. As you know, however, a substantial number of mutual fund company boards already have imposed redemption fees and more are likely to do so. ASPPA's members (many of which are "financial intermediaries" described by Rule 22c-2) and the retirement plans they serve already face significant administrative burdens and costs as mutual fund companies adopt and enforce redemption fee programs. Based on this experience, ASPPA urges the Commission to consider the following as it considers additional amendments to Rule 22c-2.

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[1] Mutual Fund Redemption Fees, Release No. IC-26782 (March 11, 2005), 70 Fed. Reg. 13328 (March 18, 2005) (final rule; request for additional comment) (hereinafter, "Final Rule Release").

[2] Third party administration firms providing services to retirement plans are often referred to as "administrators." However, as generally used in the retirement services industry, and in this comment letter, these administrators are almost never the "administrator" of a plan as described by section 3(16)(A) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

Flexible Methods for Omnibus Accounts Are Essential

The Final Rule Release under Rule 22c-2 provides fund companies and financial intermediaries with much-needed flexibility to determine the appropriate methods for imposing omnibus account redemption fees. This flexibility is essential to the retirement plan services industry, given the variety of arrangements under which plans receive services and plan investment transactions are processed. ASPPA urges the Commission to maintain this flexibility, which is particularly important for smaller-sized plan recordkeepers and administrators that may not have the resources to impose redemption fees for fund companies.

Fund/Intermediary Written Agreement Requirements Should be Clarified

Rule 22c-2(a)(2) requires fund companies or their principal underwriters to obtain written agreement from financial intermediaries to ensure the fund's access to shareholder information and enforce fund policies and procedures where shares are held in omnibus accounts. This requirement may be unnecessarily complicated and burdensome. For example, plan recordkeepers and administrators may submit mutual fund orders through another financial intermediary. For Rule 22c-2(a)(2), fund companies should be able to require the "first-tier" financial intermediaries to obtain written agreements from other intermediaries (including plan recordkeepers and recordkeepers). Also, fund companies should be able to meet the written agreement requirement if the fund's transfer agent, administrator, adviser or other service provider enters into a written agreement with a financial intermediary that addresses the Rule 22c-2(a)(2) requirements.

Redemption Fees Should Have Uniform Standards

ASPPA members' experience with redemption fee programs is that non-uniform redemption fee requirements complicate and increase the costs of implementing redemption fee programs, administering redemption fees, and communicating about such fees to plan participants. Therefore, ASPPA strongly urges the Commission to establish uniform redemption fee rules, including the following—

- For participant-directed plans, restricting the application of redemption fees solely to participant-directed exchanges and transfers. These are the only transactions participants could use to engage in abusive "market-timing" activities;
- Adopting the FIFO share accounting method (treating shares held longest as redeemed first) as a uniform method for determining redemption fees;
- Imposing a <u>mandatory</u> *de minimis* rule providing that redemption fees may not be applied if the value of the redemption fee is less than $50;
- Prohibiting mutual fund companies from imposing redemption fees that vary by rate, based on the time period shares are held; and
- Establishing a limited set of holding periods that fund companies may adopt for redemption fees (*e.g.*, 7, 30, 60 and 90 days), which would improve uniformity while still allowing funds flexibility.

The following is a more detailed discussion of ASPPA's position.

I. Flexible Procedures for Omnibus Accounts Are Essential

In its earlier redemption fee rule proposal, the Commission proposed three alternative methods for assuring that redemption fees are imposed where mutual fund shares are held in omnibus accounts.[3] Rule 22c-2 does not impose any specific method, but the Commission requested comment on whether it should limit the ways redemption fees are assessed to promote uniformity.[4] Some commenters recommended that the Commission should require all financial intermediaries to impose redemption fees and remit the proceeds to funds because most fund companies and intermediaries would use this method and it will be burdensome for fund companies to accommodate other methods.

ASPPA strongly opposes rules that would require plan recordkeepers and administrators to impose and remit redemption fees. Instead, the Commission should continue to allow fund companies and financial intermediaries (including plan recordkeepers and administrators) the flexibility to determine what methods for imposing redemption fees in omnibus accounts are appropriate to their particular circumstances. Some recordkeepers and administrators will be able to impose redemption fees and remit the proceeds to fund companies, but many small businesses that provide plan administration and recordkeeping services may not have resources to develop this capability. Requiring all financial intermediaries to impose and remit redemption fees may force these small-plan administrators and recordkeepers to exit the business. Requiring all intermediaries to impose such fees creates a barrier to entry into the retirement plan services business, thereby reducing industry competition and innovation.

Moreover, no single standardized approach could reasonably accommodate the variety of service models used in connection with retirement plans. For example, a plan recordkeeper maintaining participant records for a participant-directed plan would typically maintain the participant transaction information, but usually could not collect or remit the redemption fees because it does not hold the plan's assets. Rather, the recordkeeper would report to the plan trustee or custodian that holds the plan's assets (or to the fund itself) about what redemption fees should be imposed. In another example, where plan recordkeepers and administrators use computer systems and procedures provided by vendors providing "turn-key systems", the vendor (rather than the recordkeeper) may undertake responsibility for imposing the redemption fees. It would be difficult, if not impossible, to establish a single rule that clearly establishes responsibility for imposing redemption fees in these differing circumstances.

Accordingly, ASPPA urges the Commission to maintain the flexibility currently provided by Rule 22c-2, which does not mandate any specific methods for imposing and remitting redemption fees where mutual fund shares are held through omnibus accounts.

II. Fund/Intermediary Written Agreement Requirements Should be Clarified

Rule 22c-2(a)(2) would require each fund company, or its principal underwriter, to enter into a written agreement with each fund's intermediary, under which the intermediary must agree to (a) under Rule 22c-2(a)(2)(i), provide on request certain information about each fund

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[3] *See* Mandatory Redemption Fees for Redeemable Fund Securities, Release No. IC26375A (March 5, 2004), 69 Fed. Reg. 11762 (March 11, 2004).

[4] Final Rule Release, 70 Fed. Reg. 13336.

shareholder that effects transactions in the fund through an account with the financial intermediary, including transaction information, and (b) under Rule 22c-2(a)(2)(ii), execute instructions from the fund company to restrict or prohibit further purchases or exchanges of fund shares by a shareholder identified as engaging in trading in violation of the fund's policies. ASPPA requests that the Commission review and clarify these parts of Rule 22c-2, so that (in addition to entering the written agreement as currently required) funds would meet this requirement if —

- The fund company is a beneficiary of a written agreement between financial intermediaries under which the financial intermediaries agree to comply with Rule 22c-2(a)(2), or
- The fund company's transfer agent, administrator, adviser or other service provider enters into a written agreement with a financial intermediary that includes the provisions of Rule 22c-2(a)(2).

The written agreement requirement under Rule 22c-2(a)(2), as currently adopted, is confusing and unnecessarily burdensome because it does not recognize the "multi-level" process through which plan participant investment instructions are ultimately transmitted to mutual fund companies. In this regard, it is possible that several financial intermediaries, as defined by Rule 22c-2(c)(1), might be identified with a single participant-directed plan.[5]

For example, in a typical situation, the plan administrator [as described by section 3(16)(a) of the Employee Retirement Income Security Act of 1974, as amended (ERISA)] is an employer (Employer). The Employer engages a plan recordkeeper responsible for maintaining the plan's participant records (Recordkeeper). The Employer also may engage a bank to serve as plan trustee or custodian (Bank), and the Bank would hold the plan's assets, including shares of mutual funds owned by the plan in nominee name. The Recordkeeper may transmit plan participants' investment instructions to mutual fund companies by a variety of processes, including—

- Directly (or through NSCC's Fund/Serv) to the transfer agents of mutual fund companies;
- To a broker, or bank or other entity, which then transmits the orders to the fund's transfer agent (directly or through Fund/SERV);
- To the Bank, which may transmit the orders to mutual fund companies (either directly or through Fund/Serv), or alternatively, the Bank may transmit the orders to a broker or another bank that, in turn, then transmits the orders to the fund company's transfer agent (directly or through Fund/SERV).

All of the following could be a "financial intermediary" in the above situation — the Employer [which is the plan administrator as defined by ERISA section 3(16)(A)], the Recordkeeper (which maintains the plan's participant records), the Bank (which holds shares of the mutual funds for the plan in nominee name), and one or more of the brokers or banks

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[5] Rule 22c-2(c)(1) defines financial intermediaries to include (as here relevant): (a) brokers, dealers, banks, or other entities holding the fund's securities in nominee name, and (b) in the case of participant-directed plan, the plan administrator as defined by section 3(16)(A) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") or any entity that maintains the plan's participant records.

through which the plan's orders may be transmitted to the mutual fund companies, if they are holders in nominee name. (In connection with certain trading platforms, some banks and brokers may maintain omnibus positions with mutual funds, and a single omnibus position could represent shares owned beneficially by plans or other clients of other banks or brokers that are in turn maintaining an omnibus positions with the first bank or broker, as well as shares owned beneficially by plans or other clients of the first bank or broker that maintains the omnibus position on the fund's records.)

Applied to this scenario, Rule 22c-2 might be interpreted to require the fund (or its principal underwriter) to enter into written agreements with the Employer, Recordkeeper, and Bank, and any other brokers or banks or other entities acting as financial intermediaries for the plan's mutual fund transactions. Such agreements would be extremely burdensome and perhaps impossible for fund companies to accomplish.

ASPPA proposes that fund companies should only be required to enter into the written agreements per Rule 22c-2 with the "first-tier" intermediaries that are security holders of record on the fund company's books. A fund company's agreement with any first-tier intermediary must, however, require the first-tier financial intermediary to obtain written agreements with all "second-tier" financial intermediaries providing orders to the first-tier intermediaries. The second-tier intermediaries would agree to (a) provide promptly on request the shareholder information required by Rule 22c-2(a)(2)(i), (b) execute the fund company's instructions as required by Rule 22c-2(a)(2)(ii), and (c) obtain similar contractual agreements for the fund company's benefit from any "third-tier" financial intermediary providing orders to that second-tier financial intermediary.

Under this approach, a fund would have access to shareholder information and could enforce fund company policies and procedures because the fund company would be a third party beneficiary of written agreements between financial intermediaries. This approach would substantially reduce the burden on fund companies of meeting the written agreement requirement under Rule 22c-2 and would recognize the multi-level process that may be used in processing of retirement plan transactions in shares of mutual funds.

Of course, to the extent that a fund company (or its principal underwriter) may otherwise enter into a written agreement with financial intermediaries, including plan recordkeepers and administrators, ASPPA agrees that those agreements should include the provisions required by Rule 22c-2(a)(2). In this regard, ASPPA notes that plan recordkeepers and administrators may contract with fund company transfer agents, administrators, advisers or other fund service providers rather than principal underwriters. Accordingly, ASPPA recommends that fund companies should be allowed to rely on written agreements made by any of these other fund company service providers for the fund company's benefit.

III. Redemption Fees Should Have Uniform Standards

A. Need for Uniform Standards

For fund companies that choose to impose a redemption fee, ASPPA strongly urges that the Commission establish uniform standards. Under the "open-architecture" model common today in the retirement plan industry, participants of participant-directed plans often may select among plan investment options that include mutual funds from different fund complexes. While the open-architecture approach provides plans and plan participants access to a broader range of mutual fund investment choices, it increases the likelihood of non-uniform redemption fee policies and procedures, raising significant issues in applying redemption fee programs to retirement plan transactions.

For example, non-uniform redemption fees increase the complexity and cost of communicating about redemption fees to plan participants and increases the likelihood that participants will find the information confusing and frustrating. Further, the implementation of redemption fees requires reprogramming order taking systems (*e.g.*, automated voice response and Internet order taking systems), and trade processing systems. It also requires the development of new processes for communicating between recordkeepers and trustees or custodians for the collection and remittance of redemption fees. These tasks become more difficult and more expensive where systems must accommodate non-uniform redemption fee rules. In addition, maintaining plan recordkeeping, order taking and trade processing systems to support non-uniform requirements will be more expensive and errors are more likely to occur, further increasing administrative costs and the liability risk of service providers.

Moreover, non-uniform mutual fund redemption fees could ultimately contribute to changes in services available to retirement plans and their participants. Since it is obviously simpler and less expensive to implement redemption fee policies of a smaller universe of mutual funds, plan service providers and plan sponsors may be encouraged to limit participants' investment options. To the extent that non-uniform redemption fees increase the administrative burdens of recordkeepers and administrators, they may be forced to exit the plan services business, reducing industry competition.[6]

Establishing uniform redemption fee standards would minimize adverse consequences and would facilitate cooperation among recordkeepers, administrators and fund companies in applying redemption fees.[7] Accordingly, ASPPA urges the Commission consider certain uniform standards be applied where mutual fund companies adopt redemption fees, as discussed below.

B. Limit Redemption Fees to Participant-Directed Exchanges and Transfers

In the case of participant-directed plans, redemption fees should only apply to exchanges and transfers among plan investment options (where the options are funded by mutual funds) when directed by participants for amounts in their individual accounts.

First, this approach would generally prevent plan participants from engaging in abusive short-term trading because it would restrict the specific type of plan transactions that

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[6] We have discussed these concerns in more detail in a comment letter provided to the Commission in October 2004. *See* Comment Letter of the American Society of Pension Actuaries (Oct. 8, 2004).

[7] Indeed, the Commission already recognizes that a lack of uniformity in redemption fee programs has made it costly for intermediaries to assess redemption fees and this may have discouraged the cooperation of financial intermediaries, including plan recordkeepers and administrators, in cooperating to implement funds' redemption fee programs. Final Rule Release, 70 Fed. Reg. at 13333.

participants' may "time." In this regard, as described in ASPPA's previous comments[8] participant-directed retirement plans may purchase and redeem mutual funds shares for a variety of reasons, including purchases of fund shares when the plan receives new contributions or loan repayments, redemptions of fund shares when participants take distributions, withdrawals or loans, and purchases and redemptions directed by a plan sponsor or other plan fiduciary when there is a replacement of one or more plan investment options. All of these transactions are governed by specific plan rules and are subject to specific requirements under ERISA and the Internal Revenue Code of 1986, as amended (IRC).

However, of all of these types of transactions, only participant-directed exchanges and transfers provide participants the opportunity for abusive frequent or excessive trading. For example, participants do not have the capability to "time" mutual fund share purchases with contributions or loan repayments made by payroll deduction or where the employer controls the timing of employer contributions. Further, a participant's rollover contribution or a loan repayment typically requires at least one or more days processing time upon receipt by the plan, making it impossible for the participant to "time" share purchases. Further, although participants might determine when to take a loan, withdrawal or other distribution, these transactions do not provide opportunities for market timing abuse because plan rules and IRC requirements limit when participants can request these transactions. Also, to the extent that plan transactions are directed by a plan fiduciary (*e.g.*, to effect changes in the plan's investment alternatives),[9] a participant does not provide a direction and could not "time" share purchases or redemptions.

Second, limiting redemption fees to participant-directed transfers and exchanges is important to address concerns about "fairness." For example, redemption fees often apply for up to a 90 day period; if a participant elects to take a loan or perform routine account rebalancing and the transaction results in a redemption of shares purchased by payroll contributions within the previous 90 days, the participant would be subject to redemption fees. In another scenario, a plan fiduciary directing a change in plan investment options could trigger redemption fees imposed on participants who invested within the prior 90 days in that fund by payroll contribution, rebalancing or other exchange. In both cases, the participant may view the imposition of a redemption fee (even in *de minimis* amounts) as unfair, given that the participant did not intend to engage in short-term trading.

Third, and perhaps most important, applying redemption fees only to participant-directed exchanges and transfers would provide substantial relief from the administrative burdens that plans, recordkeepers and mutual fund companies would incur. As we previously noted, participant-directed exchanges and transfers represent only a small portion of the investment transactions,[10] thereby significantly reducing the administrative costs of administering them.

[8] Comment Letter of the American Society of Pension Actuaries (April 21, 2004).

[9] Our discussion of "fiduciary-directed" transactions in this letter refers only to transactions directed by a plan sponsor or other plan fiduciary responsible for operating a plan and determining the plan's investment options available to participants. It does not include transactions directed for a participant's account by an investment adviser or other consultant engaged by the participant.

[10] ASPPA's comment letter to the Commission, dated April 21, 2004, noted one recordkeeping firm's report that, of the 1 billion participant "events" (*i.e.*, contributions, loans, withdrawals, etc.) that it processes annually, only about 16 million (1.6%) involve exchanges or transfers. We believe that this report

Some commenters view redemption fees solely as a mechanism to recover mutual fund companies' short-term trading costs (whether or not that trading is intended to be abusive) and on this basis, argue that exceptions for routine or periodic transactions are unnecessary and not appropriate.[11] This argument ignores important cost and benefit considerations. Routine investment transactions, such as the investment of new contributions or withdrawals upon employment termination, generally should not involve "short-term" trading that would increase funds' costs. If these transactions generally do not result in short-term trading, the amount of redemption fees collected on these transactions may not be more than *de minimis*.

In this context, the potential benefit to fund companies of monitoring *all* transactions in participant-directed plans in order to apply redemption fees (*i.e.*, recouping no more than *de minimis* costs of short-term trading) does not appear to justify the additional administrative cost of this monitoring as compared to the less burdensome expense of monitoring the far fewer participant-directed exchanges and transfers. If the Commission further takes into account that imposing redemption fees on plan transactions other than participant-directed exchanges and transfers does not discourage abusive short-term trading and is likely to be perceived as "unfair," redemption fees should only apply to participant-directed exchanges and transfers.

C. Other Proposed Uniform Standards

In addition to establishing a rule that would limit redemption fees to participant-directed exchanges and transfers, ASPPA encourages the Commission to consider the following uniform standards.

1. Require the FIFO Share Accounting Method

ASPPA encourages the Commission to adopt the FIFO method (*i.e.*, treating shares held longest as redeemed first) for determining redemption fees. This method makes it less likely than other methods to result in fees being imposed on ordinary redemptions. In addition, uniform rules for share accounting are critical since it will be extremely difficult to administer redemption fee programs with non-uniform share accounting methods and the FIFO method will be less burdensome to implement on a uniform basis because it is already used by a number of mutual fund companies.

2. Require Waiver of *De Minimis* Redemption Fees

The Commission proposed requiring or permitting funds to waive *de minimis* redemption fees of, *e.g.*, less than $50. This would allow redemptions of small amounts without redemption fees, *e.g.*, up to $2,500 from a fund imposing a 2% redemption fee.[12]

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continues to reasonably reflect the significant reduction in the number of transactions that would be required to be monitored if rules limit redemption fees in participant-directed plans to participant-directed exchanges and transfers, resulting in significant savings to plans, plan participants, and mutual funds.

[11] Final Rule Release, 70 Fed. Reg. at 13333 n.60 and accompanying text.

[12] Id., 70 Fed. Reg. at 13334.

ASPPA urges the Commission to adopt a *de minimis* provision because it is unlikely that redemption transactions of *de minimis* size involve the potential for harm. Further, the administrative burdens and costs of monitoring and collecting redemption fees on small redemption transactions would likely exceed the value of any redemption fees collected.

3. No Varying of Redemption Fee Rates Based on Holding Period

ASPPA agrees with the Commission's suggestion that mutual funds should be prohibited from varying redemption fee rates by the time period for which fund shares are held.[13]

4. Establish a Limited Set of Holding Periods

The Commission indicated that it is not contemplating establishing a uniform holding period beyond the seven day minimum specified in Rule 22c-2 because it believes that fund company boards should have flexibility to address their company needs.[14] However, ASPPA requests that the Commission consider providing additional uniformity for holding periods by requiring fund companies to select among a limited set of permitted holding periods (*e.g.*, 7, 30, 60 or 90 days) because plan recordkeepers could more easily program and administer a limited number of variations in holding periods. Fund company boards would still have flexibility to determine an appropriate holding period for their programs.

5. Hardship Withdrawal Exception

If the Commission does not adopt a rule limiting the application of redemption fees for participant-directed plans to participant-directed exchanges and transfers, the Commission should at least consider requiring mutual fund companies to waive redemption fees incurred in connection with hardship withdrawals. Hardship withdrawals are governed by specific IRC rules. As a result, an exception for hardship withdrawals would not be an "open-ended" exception that could be abused.

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Thank you for your consideration of these additional comments. We appreciate the ongoing efforts of the Commission and its staff to address the problem of abusive market timing, while still recognizing and taking into account the concerns of the retirement plan industry. We are available to discuss these comments and any other questions that may arise as you continue to consider these issues.

Sincerely,

/s/
Brian H. Graff
Executive Director/CEO

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[13] Id.

[14] Id.