



INVESTMENT COMPANY INSTITUTE

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May 9, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Mutual Fund Redemption Fees;
File No. S7-11-04

Dear Mr. Katz:

The Investment Company Institute¹ is writing to express our serious concerns regarding the recently-adopted mutual fund redemption fee rule.² Redemption fees can be an important tool in curbing harmful short-term trading.³ We strongly support measures that will facilitate their application in all channels in which fund shares are sold. We are deeply concerned, however, that the rule is fundamentally flawed in two significant respects.

First, the rule fails to impose responsibilities equally on funds and intermediaries. While funds and their intermediaries serve investors in different capacities, they share the same strong commitment to protecting long-term investors against abusive short-term trading. The Commission has adopted a rule under which funds singularly bear all of the responsibilities and liabilities associated with imposing redemption fees. The rule is silent with respect to the obligations of intermediaries (including those maintaining omnibus accounts with a fund and being compensated by the fund for their recordkeeping activities) to impose, or facilitate the imposition of, redemption fees. We believe that the better approach is for regulatory responsibilities to be appropriately shared by funds and intermediaries, and we urge the Commission to carefully consider whether and how such an approach might be implemented.

Second, the contractual requirement under the rule is completely unworkable. Interested parties did not have an opportunity to comment on the problems associated with this requirement because it was not part of the original proposal. The requirement appears to be

¹ The Investment Company Institute is the national association of the U.S. investment company industry. More information about the Institute is attached to this letter.

² *Mutual Fund Redemption Fees*, Inv. Co. Act Rel. No. IC-26782, 70 Fed. Reg. 13328 (March 18, 2005) (the "Release").

³ See, e.g., Gregory Kadlec, "On Solution to the Mutual Fund Timing Problem" (August 30, 2004). The paper is available at http://www.ici.org/issues/timing/wht_04_mkt_time_solutions.pdf.

based on the incorrect assumption that funds typically have written agreements with all of the entities broadly defined as “intermediaries” in the rule. As a result of this misconception, the Commission grossly underestimates the challenges, costs and burdens associated with the contract requirement. In many instances, very significant costs will be incurred with no countervailing investor protections, because the rule requires contracts for funds that do not impose redemption fees and for funds that can control market timing in other ways. Equally troubling is that funds are left without any guidance as to the steps funds should take if an intermediary refuses to agree to the required terms or if funds are otherwise unable to obtain the required contracts. It is unclear whether the Commission expects funds to freeze these accounts by refusing to accept purchase orders from the intermediaries, forcibly redeem the accounts, or take some other action.

In view of the significant issues that the contractual requirement raises, it is critical that the Commission modify the rule as soon as possible. We recommend assembling a group of industry representatives to help address these difficult issues. We would be happy to assist the Commission in this regard.

Our detailed comments, as well as our response to the Commission’s request for additional comment, are set forth below.

CONTRACTS WITH INTERMEDIARIES

By October 16, 2006, every fund subject to rule 22c-2 is required to enter into a written agreement with *each* of its financial intermediaries. Under these contracts, intermediaries must agree to: (i) provide the fund with certain information upon request; and (ii) execute any instructions to restrict or prohibit further purchases or exchanges by a shareholder who has been identified by the fund as having engaged in transactions that violate the fund’s short-term trading limits. When a contract is necessary to address abusive short-term trading, we support requiring these contract provisions.

The term “financial intermediary” is broadly defined under the rule to include, among other things, *any* entity that holds shares in nominee name or maintains records for a participant-directed retirement plan.⁴ As a result, any account not registered specifically for a natural person potentially could be held by an intermediary for purposes of the rule. The contract requirement raises a number of significant issues for mutual funds as outlined below.

The Necessity of the Contract Requirement

First and foremost, we seriously question the need for a fund to enter into an agreement with *each* of its financial intermediaries. There is no obvious policy justification to require funds to obtain a contract with an intermediary when the fund does not impose redemption fees or when a contract is not necessary to address abusive short-term trading. A rule that requires

⁴ We recommend that the Commission clarify that the definitions of “intermediary” and “shareholder” are for purposes of rule 22c-2 only. Extending the broad definitions of these terms to other contexts could have serious unintended consequences.

funds to do so – as this rule does – imposes unnecessary compliance costs and involves funds in a pointless paper chase that the Commission does not seem to fully appreciate.

To comply with the contract requirement, funds will have to first identify their universe of “intermediaries.” This is no small task. Two large fund complexes have informed us that they *each* have over 1.3 million accounts with registrations that are not in the name of a natural person and thus could be held by an intermediary for purposes of the rule. Another complex estimates 3.9 million accounts with registrations that are not in the name of a natural person. These estimates are preliminary and many of the accounts are likely held by entities trading on their own behalf rather than as nominees such that the entities will fall outside the rule’s definition of financial intermediary. Nevertheless, if just three fund complexes estimate that they will have to evaluate 6.5 million accounts, it is clear that the fund industry as a whole will have to evaluate tens of millions of accounts to determine the scope of the term “intermediaries” for purposes of the rule.⁵

After each fund identifies its universe of intermediaries, the fund will have to either modify any existing agreements or enter into new agreements containing the terms required by the rule. While it will be burdensome for funds to modify hundreds (and for some fund complexes, thousands) of existing agreements, this task will be dwarfed by the effort that will be required with respect to accounts for which there are no written agreements.⁶ Our members have indicated that there may be thousands of intermediaries (as defined by the rule) with whom funds do not have existing agreements. Contrary to the Commission’s apparent expectations, funds do not always enter into agreements with entities holding shares in nominee name. Accounts may be associated with small retirement plans (*e.g.*, a dentist who maintains a retirement plan for herself, two hygienists and a receptionist), small businesses, limited partnerships, trusts, bank nominees, and other “intermediaries” holding shares on behalf of investors. In contrast to a broker-dealer that distributes fund shares, these other “intermediaries” establish relationships with funds through the account opening process and are not likely to have entered into a contract with a fund unless they are being remunerated for distribution, recordkeeping, or other services.

Significantly, the extraordinary effort that will be undertaken by funds and intermediaries to enter into contracts is not necessary to achieve the purposes of the rule. The contract requirement is designed to enable funds to identify and restrict harmful short-term trading in their shares. Funds can identify and restrict harmful short-term trading by treating the intermediary as the shareholder (*i.e.*, by monitoring trading in the nominee account and applying short-term trading limits based on transactions effected by the intermediary). By the very nature of an intermediary’s role – executing trades on behalf of multiple investors – intermediaries trade more frequently than individual investors. As a result, in almost all cases, short-term trading limits applied at the intermediary level will result in greater restrictions on frequent trading than short-term trading limits applied at the individual investor level.

⁵ Based on Institute statistics, the three fund complexes represent approximately fifteen percent of the assets and eleven percent of the accounts in the mutual fund industry.

⁶ Compliance with the contract requirement will impose significant burdens on intermediaries as well. Many intermediaries distribute the shares of hundreds of fund complexes, resulting in a multiplication of efforts to comply with this requirement.

We strongly recommend that the Commission modify the rule to require a fund, its principal underwriter, or its transfer agent⁷ to obtain a contract with an intermediary when it determines that doing so is necessary to address abusive market timing. The rule should continue to require any such contract, as well as any other written agreement with an intermediary that will be in force on or after the rule's compliance deadline, to include terms requiring intermediaries to provide funds with information upon request and execute instructions from the fund to restrict or prohibit further purchases or exchanges.

In taking the approach we recommend, the Commission should address the factors that funds should consider in determining whether a contract with a particular intermediary is "necessary to restrict market timing." A clear discussion of the factors to be considered will provide guidance to funds to meet the rule's objective of assuring that appropriate steps are taken to address market timing. At a minimum, we recommend that funds consider flows, account size and transaction history with an intermediary to determine whether a contract is necessary to restrict market timing. These factors currently are used by funds to identify and analyze market timing activity.

Good Faith Efforts to Obtain Contracts

There likely will be instances when funds are not able to enter an agreement with an intermediary as required by the rule, notwithstanding the fund's good faith efforts to do so. For example, an intermediary may refuse to enter into the agreement or simply may not respond to efforts made by a fund by the October 16, 2006 compliance deadline. The Commission did not address what will happen in these instances, leaving it unclear whether funds should freeze accounts by refusing to accept purchase orders from the intermediaries, forcibly redeem accounts, or take some other action.

Read literally, the rule imposes strict liability on funds to obtain contracts with all intermediaries by the compliance deadline. Rule 22c-2(a) makes it "unlawful for any fund . . . to redeem a redeemable security . . . within seven calendar days after the security was purchased" unless it complies with the provisions in the rule. If a fund fails to obtain a contract with even *one* intermediary, it will fail to comply with the rule and will be prohibited from redeeming securities as required under section 22(e) of the Investment Company Act. As the rule is drafted, it places funds that have not contracted with *all* intermediaries in the untenable position of having to choose whether to violate section 22(e) or rule 22c-2. It cannot comply with both unless it is absolutely certain that it has a contract with *every* intermediary.

The Commission certainly did not intend this absurd result. The Commission should modify paragraph (a)(2) of the rule (the contract requirement) by incorporating a good faith standard to ensure that funds that make reasonable efforts to obtain contracts with intermediaries will not violate the rule.

⁷ The rule currently requires the fund or its principal underwriter to enter into a contract with each financial intermediary. Funds often have servicing agreements between their transfer agent and a financial intermediary, particularly in the case of agreements with retirement plan recordkeepers. Therefore, we recommend that the Commission modify paragraph (a)(2) of the rule to include transfer agents.

Chain of Intermediaries

By defining “financial intermediary” to include any entity that holds fund shares in nominee name, the rule unnecessarily (and we believe inadvertently) creates problems when an intermediary holds shares in nominee name for another intermediary. For example, it is not unusual for a broker-dealer to hold fund shares as nominee for a retirement plan (or its recordkeeper), effectively creating a “chain of intermediaries,” each of which hold fund shares in nominee name.

The rule requires funds to obtain written agreements with each intermediary in the chain. This puts funds in impossible situations, given that a fund only has a relationship with the first link in the chain – the broker-dealer in the above example. Accordingly, we strongly recommend that the Commission modify the rule so that the requirement to obtain a contract is limited only to intermediaries with which the fund has a direct relationship.

Intermediaries Holding Shares on Behalf of Single Investors

It is clear from the Release that the Commission intended to target omnibus arrangements with the rule’s contract requirement. The rule’s definition of intermediary, however, appears to apply with equal force to an entity holding shares in nominee name on behalf of one investor. This could be the case, for example, with solo-401(k) plans or similar retirement savings vehicles.

There is obviously no need for a contract giving the fund the ability to “look through” this arrangement. We recommend that the Commission clarify that contracts are required only when necessary to restrict abusive short-term trading and only for true omnibus accounts, where an intermediary is acting on behalf of multiple investors.

Variable Insurance Products

The definition of intermediary specifically includes a unit investment trust or fund that invests in underlying funds in reliance on section 12(d)(1)(E) of the Investment Company Act. The Release explains that this provision is intended to include insurance companies that sponsor registered separate accounts organized as unit investment trusts in order to offer variable insurance products.

The contract requirement under the rule will be impossible to satisfy for a number of funds underlying variable insurance products. These products are offered to the public through insurance contracts. Amending these contracts is extremely difficult, as any amendment is subject to approval by state insurance commissioners in every state in which the contract is offered.

Insurance companies cannot sign agreements with funds that would force them to violate the terms of existing variable insurance contracts, and most existing contracts specifically address permissible charges and the frequency with which contractholders may make exchanges. As a result, insurance companies will not be able to do what the rule requires – they cannot agree to enforce specific instructions from the fund to restrict or prohibit

transactions by specific contractholders, if doing so is not permitted in the insurance contract.⁸ Going forward, new variable contracts presumably could include a provision allowing insurance companies to execute a fund's specific instructions to enforce short-term trading limits. The problem is with outstanding contracts.⁹

The Commission must address the problems faced by funds in applying short-term trading limits to insurance company separate accounts. Variable annuity contracts alone account for more than \$963 billion in assets, and as the Commission recognized in the Release, market timing may be a greater problem with variable insurance products than with retail mutual funds. We understand that the only possible solution may be to impose a direct obligation on separate accounts to apply funds' short-term trading limits.¹⁰ If the Commission is unwilling to take this step, it should at least carefully study this issue to find an alternative that will assist funds in limiting or eliminating market timing through variable insurance products.

COST-BENEFIT ANALYSIS

The Commission is required by statute to undertake an analysis of the time and monetary burdens of every rule that it adopts. To meet the statute's objective, the Commission should conduct a rigorous assessment of whether the costs of the new regulatory requirement outweigh its benefits and whether less burdensome alternatives are available. For the reasons expressed below, we submit that the Commission has grossly failed to meet its obligations with respect to the contract requirement in rule 22c-2. This failure, coupled with the fact that the contract requirement was incorporated into the final rule without the benefit of industry comment, raises serious questions as to whether the Commission has satisfied its obligations under the Administrative Procedures Act in adopting rule 22c-2.

Overall Costs and Benefits

The benefits to shareholders of adopting the redemption fee rule arise from eliminating or reducing excessive trading. The Release estimates that the rule's potential benefits range substantially from \$194 million per year to \$40 billion per year. We believe that the \$40 billion

⁸ Similar issues can arise in the retirement plan context. Retirement plans governed by ERISA must be administered in a manner consistent with the terms of the plan. The imposition of restrictions on plan participants that conflict with a particular plan's terms could violate ERISA and raise issues under ERISA section 404(c). Determining compliance with a plan's terms can be made only by plan sponsors and will depend on the particular facts and circumstances relating to the plan. See Statement of Assistant Secretary Ann Combs, U.S. Department of Labor (February 17, 2004) (permitting redemption fees and short-term trading limits that are reasonable, allowed under the terms of the plan, and clearly disclosed to participants).

⁹ The Commission is aware of the problems that a contract requirement creates for funds underlying variable insurance products. Indeed, the Commission rejected comments that the application of proposed rule 22c-2 would have presented an insuperable conflict with state insurance laws when a redemption fee is imposed on transactions by holders of existing variable annuity or variable life insurance contracts. Release, at n.62.

¹⁰ Given that the problem is with outstanding variable insurance contracts, the Commission could make the rule prospective with respect to insurance company separate accounts. While this would solve the contractual issues described above, it would enable – and could even encourage – market timing in existing insurance contracts. We strongly recommend against this approach.

figure is unrealistically high and based on a misunderstanding of the academic research cited by the Commission.¹¹

All costs of complying with the rule — whether incurred by funds or intermediaries — ultimately may be borne by fund shareholders.¹² As estimated by the Commission, direct costs to funds will be \$162 million for one-time initial capital costs and \$10.8 million per year for ongoing maintenance costs. For intermediaries, the Commission estimates initial capital costs to be \$949.5 million and annual costs of \$379.8 million. Using the Commission's figures (which substantially understate the true costs of the rule for reasons explained below) and assuming that all costs ultimately become fund expenses, shareholders' returns will be reduced by an average of at least \$630.9 million per year for the first three years after the adoption of the rule.¹³ Clearly, a more careful and detailed cost-benefit analysis is critical to assure that shareholder returns are not unnecessarily reduced as a result of the rule.

Analysis of Specific Costs and Benefits

It will be considerably more time consuming and expensive than the Commission has estimated to: (1) obtain written agreements with intermediaries; and (2) obtain data from intermediaries. Our analysis of these costs is outlined below.

Written Agreements. The Release estimates that this requirement will create a one-time burden of 4.5 hours per fund (4 hours of in-house counsel time, .5 hours of support staff time) for a total burden of 12,150 hours, at a total cost to the industry of \$745,173.¹⁴ The Commission's

¹¹ The \$40 billion figure is based initially on the work of Gary Gastineau in *Financial Analysts Journal* (2004) and ultimately on the work of Roger Edelen in *Journal of Financial Economics* (1999) (the "Edelen paper"). The Edelen paper is not about the costs imposed on long-term investors by abusive short-term trading. Rather, it studies how *all* fund flows, both short- and long-term, affect mutual fund returns. Thus, the results in the Edelen paper do not apply here. Furthermore, these studies were conducted when redemption rates — a measure indicative of market timing — were high, particularly for international funds. The twelve-month moving average of redemption rates in international funds peaked at over 85% in September 2002. Since then, redemption rates on international funds have dropped to a little over 20%, the lowest level since early 1986. We believe that increased use of fair-value pricing, redemption fees, and short-term trading limits have contributed to the sharp decline in trading activity of short-term investors.

¹² Intermediaries most likely will try to recoup their costs from funds. If they are able to do so, this could increase the total aggregate cost of compliance to shareholders. Fund advisers or underwriters also may choose to bear some of these costs.

¹³ The Commission omitted the one-time cost of obtaining written agreements in its total cost calculation. If such costs were included, the weighted average annual cost burden would be \$631.1 million, using the corrected figure discussed in footnote 14 below.

¹⁴ The Commission seems to have made a mathematical error in footnote 108 of the Release by multiplying the total cost per fund of the estimated 4.5 hours of time (\$275.99) by the number of total hours (12,150) to come up with a total industry burden of \$3,353,278.50. Based on its estimate, the Commission should have multiplied the total cost per fund by the number of funds (2,700), for a total industry burden of \$745,173.

That being said, the Commission understates the total number of funds affected by the rule. Our statistics show that as of March 2005, Institute members managed 7,085 long-term mutual funds (excluding money market funds and exchange traded funds, neither of which is subject to the rule). The Commission may have used the number of Commission registrants to come up with its total of 2,700 funds. As the Commission is well aware, a single registrant may have several series of shares, each of which is a separate fund for purposes of the Investment Company Act.

estimate of \$745,173 grossly underestimates both the time involved in obtaining contracts as required by the rule and the cost of that time.¹⁵

To comply with the contract provision in the rule, funds will have to first identify the universe of affected intermediaries and then modify existing distribution agreements with thousands of intermediaries. Unless the Commission modifies the rule as we recommend, funds also will have to seek out and enter into new agreements with thousands more. The Commission has not even considered the one-time cost of revising account applications to identify financial intermediaries with omnibus accounts and revising related prospectus disclosures for these entities.

The task of simply determining the intermediaries associated with existing accounts will be substantially greater than the *total* time and cost the Commission estimates. Indeed, as noted above, three large fund complexes estimate that, in the aggregate, they have approximately 6.5 million accounts that will have to be examined. Given that kind of figure, the Commission's estimate that the contract requirement can be satisfied based upon an afternoon's efforts – 4.5 hours of work – is completely unreasonable. In fact, one large fund complex estimates that it will spend more than twice the time complying with the contract requirement in rule 22c-2 than the Commission estimates for the entire fund industry.¹⁶

We also disagree that the contractual obligations will be a one-time cost. The economy is not static. Intermediaries can change the funds in which they invest and, particularly small intermediaries, frequently enter and exit the economy. Each time a fund deals with a new intermediary, a contract will have to be drafted, the terms negotiated, and an executed agreement obtained. When a relationship with an intermediary is ended, the contract will have to be voided. The costs associated with the continual monitoring of written agreements are in addition to the already substantial costs for both funds and intermediaries of complying with the rule.

Obtaining Financial Intermediary Data. We believe the Commission has grossly underestimated, and in some cases overlooked, the costs and technical difficulties in transmitting data from intermediaries to funds as contemplated by the rule.

Funds will need to evaluate and develop policies and procedures regarding financial intermediary data, including the frequency and level of detail to be requested. Funds also must establish processes for contacting intermediaries regarding data requests to work out the specifics of each transmittal – whether periodic or related to specific circumstances. Until standardized reporting formats and transmission protocols are developed, funds will have to

¹⁵ The SEC has substantially underestimated the hourly labor cost of an attorney in the mutual fund industry by using figures that exclude attorneys based in New York. Major mutual fund complexes are primarily based in large metropolitan cities, such as Boston, New York, San Francisco, Los Angeles, and Chicago, where no doubt salaries for quality legal talent are substantially higher than the \$66.31 per hour the Commission assumed in its analysis.

¹⁶ The fund complex has 890 existing intermediary agreements and estimates that it will have to enter into 4,000 additional contracts as a result of rule 22c-2. The complex estimates that it will take 28,550 hours to draft, negotiate, and finalize such agreements.

accept data requested from intermediaries in various formats generated from many different systems.¹⁷ Reformatting such data to make it useful will be labor intensive and costly.

The Release estimates the initial capital costs to establish systems for the collection, transmittal, and processing of the information to be \$100,000 per fund and \$150,000 per financial intermediary for total aggregate capital costs of \$1.1 billion. The Commission's estimate might be reasonable with respect to the hardware that funds will be required to obtain to receive, store, and process the information, but it fails to take into account the substantial software costs that funds will incur to support and translate multiple software platforms. In essence, funds will have to create a flexible shadow recordkeeping system to house the data and create specific programs and reports to analyze the data. Costs to funds will escalate rapidly as they purchase expensive software client licenses, train employees in their use, and build an overarching software system that integrates the many different file formats they expect to receive from intermediaries. Much of this work is labor intensive and could require funds to contract with outside information technology professionals.

The capital cost estimates in the Release are only a small portion of the costs funds and intermediaries will incur, and there are a number of sizeable ongoing costs that do not appear to have been contemplated in the cost-benefit analysis. For example, there will be costs associated with maintaining and improving computer systems, collecting and analyzing the data received from intermediaries, reporting the results of that analysis to operations and compliance personnel, and notifying and working with intermediaries as issues arise. The Commission's estimate of ongoing annual costs of \$6,640 per fund (\$10.8 million in the aggregate) significantly understates the costs of these tasks, which will involve many hours of work and substantial expenditures.

Finally, other ongoing costs of compliance may arise as a result of the receipt of information from intermediaries pursuant to rule 22c-2 contracts. For example, funds soon will be required to monitor transaction information for suspicious money laundering activity, and the receipt of transaction information may increase the cost of compliance under that rule.¹⁸ Funds also must maintain the privacy of tax identification numbers and other customer information pursuant to Regulation S-P and applicable state privacy laws. Funds that deal entirely through intermediaries currently have no customers for these purposes and, therefore, will have to build systems and implement processes for the first time in order to request tax identification numbers from intermediaries as contemplated in the rule.

We are seriously concerned that the Commission has failed to conduct a realistic assessment of the rule's costs. Its cost-benefit analyses should be more rigorous, both in deciding how to proceed with this rulemaking and with respect to future rulemakings.

¹⁷ Funds and intermediaries can be expected to move toward standardization, but this effort will take time and certainly will involve substantial start-up costs.

¹⁸ The mutual fund suspicious activity reporting (SAR) rule was proposed in January 2003. Treasury staff members have indicated recently that it is expected to be adopted in 2005.

STANDARDIZATION

The Commission requested comment on whether it should establish a set of uniform standards that may facilitate the assessment of redemption fees by intermediaries on shares held through omnibus accounts. We share the Commission's concern over whether intermediaries will assess redemption fees and agree that standardization will facilitate the imposition of these fees.

Over the past few months, ICI and its members have been working with members of the Securities Industry Association (SIA) and the retirement plan recordkeeping community to determine whether there are standards that would be acceptable in both the retail and retirement plan marketplaces. Clear support emerged from those meetings for the use of a "first in, first out" (FIFO) accounting methodology and the mandatory transfer of "share aging histories."¹⁹ Clear opposition emerged to exceptions for unanticipated financial emergencies. We failed to reach consensus on the issue of standardization in the context of retirement plan transactions.

While not unanimous, the vast majority of our members support limiting application of redemption fees to "participant-directed exchanges" in retirement plans, as recommended by many of the comment letters filed to date by retirement plan sponsors.²⁰ We have additional recommendations with respect to two of the standard exceptions proposed in these letters. First, the letters recommend an exception for "rebalancing" transactions performed in accordance with standing instructions submitted by the participant. This type of exception also is warranted in retail accounts that have automatic rebalancing features, such as wrap accounts. Second, the letters recommend an exception for "funds of funds" or "lifestyle" funds. While we agree in principle with an exception for lifestyle funds, such an exception is not appropriate for all funds of funds.²¹

We strongly urge the Commission to act quickly and definitively. The rule requires fund boards to decide whether and how to impose redemption fees. Boards may delay making that decision, and intermediaries and fund service providers may hesitate to take the steps necessary to handle redemption fees, until the final parameters of the rule become clear.

¹⁹ "Share aging histories" (sometimes called "share lot histories") include the dates and amounts of each transaction relating to accounts. If there has been a change in recordkeeper because, for example, an investor changes broker-dealer firms or a retirement plan sponsor changes plan administrators, the new recordkeeper needs share aging information to avoid inappropriately assessing redemption fees.

²⁰ See, e.g., Form Letter Type D, available at <http://www.sec.gov/rules/proposed/s71104/s71104typed.htm>.

²¹ We reiterate the recommendation in our comment letter on proposed rule 22c-2 that any exception for funds of funds be limited to funds relying upon section 12(d)(1)(G) of the Investment Company Act, which is often used for asset allocation funds that periodically allocate and reallocate investments in other funds in the same complex. We recommend against extending a funds of funds exception to funds relying on section 12(d)(1)(F) of the Investment Company Act, which provides for unaffiliated funds of funds. From the perspective of the underlying (acquired) fund, redemptions by funds of funds relying on section 12(d)(1)(F) should be treated just like redemptions by any other shareholder. See Letter from Amy B. R. Lancellotta, Acting General Counsel, Investment Company Institute, May 7, 2004, at n.22.

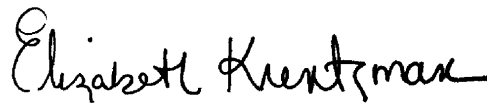
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In the meantime, the Institute will continue to work with the SIA and the retirement plan community on other ways to further enhance the effective implementation of redemption fees and rule 22c-2. These may include working on model contractual clauses and standard conventions for data transmissions between funds and intermediaries.

* * * *

We urge the Commission to act on our recommendations. If you have any questions about our views or would like additional information, please contact me at 202-326-5815, Amy Lancellotta at 202-326-5824 or Bob Grohowski at 202-371-5430.

Sincerely,



Elizabeth Krentzman
General Counsel

cc: The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid

Meyer Eisenberg, Acting Director
Robert Plaze, Associate Director for Regulation
Division of Investment Management

About the Investment Company Institute

The Investment Company Institute is the national association of the U.S. investment company industry. Its membership includes 8,512 open-end investment companies (mutual funds), 650 closed-end investment companies, 143 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$7.959 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 87.7 million shareholders in more than 51.2 million households.