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MEMORANDUM

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TO: Public Comment File No. S7-27-03

FROM: Adam B. Glazer
Office of Regulatory Policy
Division of Investment Management ("IM")

DATE: April 20, 2004

On April 14, 2004, representatives of The SPARK Institute, Inc. ("SPARK"), Delta Data Software, Inc. ("Delta"), and Wachovia Corporation ("Wachovia"), met with staff members of the U.S. Securities and Exchange Commission to discuss issues relating to the Commission's proposed rule amendments concerning the pricing of investment company shares in Investment Company Act Release No. 26288 (Dec. 11, 2003) ("Late Trading Proposal"). The following Commission staff members attended the meeting: Paul Roye, Director, IM; Robert Plaze, Associate Director, IM; C. Hunter Jones, Assistant Director, IM; Penelope Saltzman, Branch Chief, IM; Brian Bullard, Chief Accountant, IM; and Adam Glazer, Attorney, IM; and Victoria Silver, Securities Compliance Examiner, Office of Compliance Inspections and Examinations.

The SPARK, Delta, and Wachovia representatives discussed their alternative approach to the Late Trading Proposal. The alternative approach would allow intermediaries (including a fund's transfer agent) to obtain same-day pricing for orders they receive by 4 p.m. and transmit to fund companies after 4 p.m. as long as the intermediary meets specific requirements, including (i) a comprehensive system of operational controls, policies and procedures to protect against late trading, and (ii) independent auditor review of the effectiveness of intermediary controls and policies, as described in the attached outline.

The SPARK, Delta, and Wachovia representatives also outlined their objections to the central clearinghouse alternative proposed in a comment letter submitted by Fidelity Investments. In particular, they emphasized that most of their concerns regarding the Late Trading Proposal (including elimination of omnibus accounts) applied to the clearinghouse alternative as well. SPARK representatives provided staff with an outline of their objections to the clearinghouse approach, a copy of which is attached.

Attachments

THE
SPARK
Institute, Inc.

The SPARK Institute continues to urge that the proposed "hard" 4 p.m. rule for pricing mutual fund shares should be rejected in favor of an alternative approach, the "SPARK Solution," developed in response to a meeting with Commissioner Glassman. The SPARK Solution would allow intermediaries to process orders after hours if certain conditions are met, including that the intermediary must adopt periodically audited internal controls and procedures to protect against unlawful late trading.

A. Adverse Impacts of "Hard" 4 p.m. Close

1. A "hard" 4 p.m. close will subject American workers who participate in 401(k) and other defined contribution plans to earlier "cut-off" times for their plan investment instructions, putting them at a disadvantage compared to "retail" fund shareholders. Participants are sensitive to the time at which their plan instructions are priced, especially when making changes to preserve principal, or taking plan loans, withdrawals or distributions.

2. Industry impacts will increase participant costs; reduce competition and choice.
   - Significant systems modification and plan administrative costs are expected.
   - Some plan recordkeepers will exit the industry, reducing competition.
   - "Unbundled" or "open architecture" service models will be disadvantaged.
   - There will be new opportunities for abuse.
   - No same-day exchanges, substantial market risk exposure.

3. The proposed NSCC clearinghouse is not an "alternative." It does not resolve adverse impacts of the "hard" 4 p.m. close — early cut-off times will still be required.

4. Because investigations identified fund managers and other regulated entities who accepted late orders, the proposed "hard" 4 p.m. close does not meet the objective of preventing all late trading. Industry energy must be targeted at developing "tamper proof" time stamping technology and other operational controls that will protect funds and shareholders against future late trading, rather than implementing a "hard" 4 p.m. close.

B. Alternative Approach The proposed "SPARK Solution" includes —

1. A comprehensive system of operational controls, policies and procedures designed to ensure against late trading by providing —
   - same-day control measures that align systems processing, transaction and order processing, exception processing, and layers of management with segregated duties providing oversight; and
   - immediate "red-flag" controls to identify and alert to any late trading or other abuse as it occurs.

2. Independent auditor review of effectiveness of intermediary controls and policies and procedures, written chief operating offer certification of no late trading, written contract requirements including intermediary agreement to indemnify fund and shareholders against losses for any late trading or other abuses.

A more detailed version of the proposal will be submitted.

THE SPARK Institute, Inc.

Clearinghouse Proposal Comments

SPARK believes that the proposed NSCC clearinghouse is not a viable "alternative." It does not resolve the adverse impacts of the "hard" 4 p.m. close or satisfy the SEC objective to eliminate the potential for late trading in shares of mutual funds.

- Early cut-off times for participant instructions will still be required.
  - Plan participants will be at a disadvantage compared to "retail" fund shareholders. Plan participants are sensitive to the time at which their purchase and redemption orders are priced, especially when making changes for principal preservation, taking plan loans, withdrawals or distributions.
  - Noon (Eastern Time) trade cut-off likely; claims of no early cut-off cannot be supported.
  - Extremely burdensome for West Coast plan participants.
  - Change will require substantial participant communication effort; may still cause significant participant confusion.

- Would not eliminate the potential for late trading.
  - Trading directly through transfer agents would still be subject to abuse.
  - Would require additional exception processing, increasing potential for abuse.

- Disrupts level playing field.
  - Bias in favor of large fund complexes providing trading services for plans that select a "bundled services" product.
  - Discourages diversification among plan investment options to obtain "best in class."

- Substantial cost and time to implement.
  - Expensive and complex trading system changes for all intermediaries and NSCC.
  - Additional costs to change to plan documents, procedures and communications materials.
  - Advocates estimate 18 months or longer.
  - Increased volume of data transfer through a single untested platform could further delay implementation and trading risks for plan participants.
  - Costs of intermediaries, clearinghouse and mutual funds will be borne by participants.
  - Too costly for all but the largest recordkeepers, reducing industry competition.

- Needlessly complex.
  - Substantial cost and complexity for only marginal benefit over "hard" 4 p.m. close.
  - Creates convoluted system for transferring data, increasing possibility of errors.