

MEMO# 6916

May 5, 1995

SUMMARY OF APRIL 28,1995 MEETING

May 5, 1995 TO: TRANSFER AGENT ADVISORY COMMITTEE No. 30-95 RE: SUMMARY OF APRIL 28,1995 MEETING

The following is a summary of the Transfer Agent Advisory Committee meeting on April 28, 1994 at the Investment Company Institute. Cynthia Jones, Chair of the Committee commenced the meeting with introductions of attendees. A list of the attendees is attached.

1. TAX DEVELOPMENTS

a. Expanded IRAs Joe Canary, ICI Assistant Counsel-Pension, updated the committee on the status of proposed IRA legislation. The House of Representatives has approved the "Contract with America Tax Relief Act of 1995" (H.R. 1215) which incorporates the IRA provisions originally introduced in H.R. 6 and H.R. 8. H.R. 1215 incorporates two new IRA provisions not part of the original bills. One new provision allows non-wage-earning spouses to make a full \$2000 deductible contribution to a front-end IRA. The other change clarifies that the non-deductible tax-free IRA (or back-end IRA) replaces the current law provisions on nondeductible contributions to front-end IRAs. In response to a question from a committee member, Canary commented on the "Baker bill" proposal which will allow participants to take a loan from their IRA as opposed to taking pre-retirement withdrawals for home purchase, education, etc. Canary stated that the Institute's general position is that retirement savings should be the main objective for IRAs and the loan withdrawal provision of an IRA may be better than withdrawals but would create serious administrative problems. The ICI, however, has not take a public position on that issue. Some discussion took place regarding the various proposals currently under consideration. In general, the Institute has taken an aggressive approach to IRA legislation. Canary responded to a question from Cynthia Jones by stating that at this time it is difficult to determine which direction the Senate will take in considering this legislation.

b. Source State Taxation Source state taxation is a concern because of the possibility that state taxing authorities could require third party payors, such as mutual funds, to withhold and report on pension distributions for individuals residing in a different state than the one in which they "earned" their pension prior to retirement. The Institute's position is that third-party payors typically do not have access to the information that would be needed to comply with source state withholding and reporting laws, and that to create a system to comply with would be very costly and burdensome. Currently, representatives from Nevada (Senator Harry Reid and Congresswoman Barbara Vucanovich) have introduced companion bills in the House and the Senate to end source state taxation. An alternative measure has been offered by a Virginia Congressman which would place a complicated 2cap on the first \$30,000 of retirement income received in a calendar year that would be exempt from source state taxation. The Institute is supporting the bills that would ban source state taxation as the surest solution to our concerns about withholding and reporting. Alternatively, we are urging that any measure in this area contain a provision protecting third party payors from source state withholding and reporting obligations. The Institute believes if there is a source

state tax, the tax compliance duty should clearly be that of the taxpayer. c. IRS Levies on Retirement Accounts. This issue was originally raised in the ICI's Pension Committee. In response to an IRS levy, a mutual fund company redeemed shares in a shareholder's IRA and sent the proceeds to the IRS. The shareholder sued the mutual fund company stating that a certificate should have been issued rather than a check to allow the IRS to auction the certificate. Joan Dowd of BFDS noted that a recent IRS levy specifically requested a certificate rather than cash. Also discussed was the fact that certificate issuance may be a taxable event and could generate a 1099R if issued. Committee members discussed current procedures with respect to IRS levies. It was generally agreed that certificate issuance to the IRS for levies is burdensome. The committee agreed to form a joint subcommittee with the Pension Committee to develop guidelines and recommendations which will be submitted to the IRS. Representatives from the Transfer Agent Advisory Committee on this joint- subcommittee are Wayne O'Melia, T. Rowe Price; Joan Dowd, Boston Financial Services and Peggy Schooley, American Funds Services. d. Capital Gains Indexing As a follow-up to our last meeting, Keith Lawson-ICI Associate Counsel - Tax - discussed the current status of capital gains indexing. The House of Representatives approved tax legislation (H.R.1215) that incorporates two capital gains provisions from the "Contract With America." (See memo to TAAC 20-95.) One important difference between H.R. 1215 and the Contract is that indexing would apply only for purposes of calculating gains. Also, indexing would apply only to assets held for more than three years. Additionally, indexing would apply only to assets acquired after December 31, 1994. e. NRA Withholding Last year, the IRS announced that it was issuing a proposal to require that non-resident alien investors acquire United States tax identification numbers. The Institute strongly opposed such a measure as it posed unduly burdensome procedures for mutual funds to track and verify these TINs. To date, the IRS has not issued such a proposal. Keith Lawson also asked Committee members about their experiences with the TIN matching program. Some members expressed disinterest with this program when they learned that the IRS would require disclosure at the time of the new account establishment stating that the mutual fund company would be matching the investor's tax identification number with IRS records.

2. CURRENT SEC MATTERS a. Status of 10b-10 Proposed No-Action Letter Withdrawal Last year the Division of Market Regulation sought comment from the Institute on a proposal to withdraw the Institute's 1979 no-action letter under Rule 10b-10. Withdrawal of the no-action letter would require disclosure of mutual fund sales charges on confirmations. Funds and brokers opposed withdrawal of the no-action letter and the Institute submitted comment letters to the SEC staff stating its opposition. While final decision on withdrawal of the no-action letter has effectively been delayed, the staff still feels that some form of disclosure is required. The Institute is currently involved in preparing information for the staff on the operational costs, impact and problems which will occur if mutual funds are required to disclose sales charges on confirms. Several members of the Transfer Agent Advisory Committee have been working with the Institute in providing this information. b. Non-SIPC Disclosure Last year, the SEC amended Rule 10b-10 to require a broker or dealer that is not a member of Securities Investor Protection Corporation (SIPC) to disclose its non-SIPC status on confirmations. The ICI objected strenuously to the proposal as it related to fund and unit investment trust underwriters. Since the adoption of the rule, the ICI has maintained a continuing dialogue with the Commission staff urging reconsideration of the rule. At the Institute's recommendation, the SEC has delayed the effective date of the amendment from April 3, 1995 to October 3, 1995, and is expected to eliminate the disclosure requirement for mutual fund and unit investment trust underwriters. c. Rule 19a-1 Disclosure Section 19(a) of the Investment Company Act provides that: "it shall be unlawful for any registered investment company to pay any dividend, or to make any distribution in the nature of a dividend payment, wholly or partly from any source other

than (1) such company's accumulated undistributed net income, determined in accordance with good accounting practice and not including profits or losses realized upon the sale of securities or other properties; or such company's net income so determined for the current year; unless such payment is accompanied by a written statement which adequately discloses the source or sources of such payment." Rule 19a-1 provides that every written statement made pursuant to Section 19 by or on behalf of a management company shall be made on a separate paper and shall clearly indicate what portion of the payment per share is made from net income for the current or preceding fiscal year, or accumulated undistributed net profits from the sale of securities, or paid in capital. The SEC recently received a request for exemption from the requirements of Section of 19(a) and Rule 19a-1 from a member of the Investment Company Institute that would permit the applicant to include the information concerning the source of such dividends in the quarterly statement provided to shareholders instead of when paid and in lieu of providing a separate written statement. As your know, funds are permitted under the terms of an ICI no-action letter, to send quarterly confirmations for reinvested dividends in satisfying the requirements of Rule 10b-10 of the Exchange Act. The SEC staff contacted the ICI and suggested that the ICI consider submitting an industry no-action letter. The staff noted that it would likely be inclined to grant the relief for reinvested dividends but not cash dividends. The ICI expects to have further discussion with the SEC staff regarding questions about cash distributions. The Committee discussed current procedures with respect to this requirement. Jan Clifford of MFS indicated that this request had been made previously by MFS, however the SEC declined their request. MFS noted its support for any efforts by the ICI to submit a no-action letter for the ICI's members. 4After discussion, members expressed the general opinion that in preparing a no-action letter the ICI should include in the request both cash and reinvested dividends and not just reinvested dividends. Some committee members expressed concern that cash and reinvested dividends would be treated differently and cause further investor confusion. Also, it was noted that not all cash dividends would receive a check; cash distributions are also made by electronic funds transfer and dividends payable to another individual or institution. Committee members suggested that information for these forms of dividend payments should be provided on a quarterly statement as well and should be included for consideration as part of the no-action request.

d. Multiple Class/CDSC Rule Adopted The SEC has recently amended its rules to permit mutual funds to create multiple class structures without an SEC exemptive order. The Commission also adopted Rule 6c-10 to permit mutual funds to impose contingent deferred sales charges without the need for an exemptive order. The Institute has since received comments from some of its members expressing concern with the wording of Rule 6c-10 and the lack of specific wording in the rule acknowledging the acceptability of both current methods used to calculate CDSC - either by share (share lot) or by dollars (purchase accumulation method). During the Commission's rulemaking period, however, the Institute held discussions with the staff and provided documentation to them outlining these two methodologies. The information provided to the SEC was submitted to the ICI by members of the Transfer Agent Advisory Committee. In response to members' concerns, the ICI has contacted SEC staff members involved in drafting the rule proposal. They responded that the SEC did in fact consider both methods in the rule proposal and have agreed that either is acceptable.

e. Proposed Amendments to Transfer Agent Rules The Institute determined that it would not respond to SEC proposed amendment to transfer agent rules as the release was more specifically related to the practice of corporate stock transfer agents and not mutual fund transfer agents.

3. TRANSFER AGENT ADVISORY COMMITTEE INITIATIVES Prior to the meeting, Cynthia Jones asked committee members to provide some ideas for initiatives which were of broad interest and would impact either the mutual fund industry in general, mutual fund operations or improve shareholder services. Based upon the

discussions of the Committee at the meeting, task forces were formed for the following:

Market Closings A task force will be formed to review current practices with respect to days in which the markets or banks close due to a government declared holiday that is not a scheduled holiday or state-specific holiday. Linda Gunn stated that inconsistencies in which markets and banks close during these holidays and the manner in which mutual funds adjust their business may cause confusion and have an impact on operations and shareholder services. This group will study current industry practices for those occurrences. Practices with respect to pricing and processing will be studied and a review of prospectuses will be made. Members of the task force include: Linda Gunn, SunGard - Chair Kevin Maloney - NSCC 5Mike DeNofrio - TSSG Jan Clifford - MFS Telephone Redemptions for IRAs In response to increasing efforts to provide ease of doing business for shareholders, some fund companies are considering allowing shareholders the capability to redeem IRA accounts over the telephone. Others are also considering offering the capability to allow checkwriting on an IRA account. This task force has been formed to consider these initiatives and determine the best methods and procedures to handle them. The following committee members volunteered for this task force or will assign a designee. They include: Jim Nugent, Vanguard - Chair Cynthia Jones - Colonial Mary Crooks - Oppenheimer Wayne O'Melia - T. Rowe Price Jan Clifford - MFS Roger Rainville - Pioneer Joe Pollaro - Prudential

Conversion from B shares to A shares This task force will study current industry practices with respect to the conversion from B to A shares. The task force will develop a "best practices" white paper for use by the industry. Task force members or their designees include the following: Mary Crooks - Oppenheimer - Chair Cynthia Jones - Colonial Ed Falvey - Keystone Tom Lanio - Van Kampen American Capital Michael Collins - Rochester Funds Charles Hawkins - PNC Financial Services Jan Clifford - MFS

Some discussion on the part of members took place regarding an issue raised by Charles Hawkins of PNC Financial Services. He stated that there are a number of state tax reporting requirements which should be standardized in one format. He suggested that the ICI pursue this issue with the states. Don Boteler stated that various committee of the North American Securities Administration Association (NASAA) routinely pursue the development of unified procedures for the states. He agreed to invite either one of the Institute's attorneys that specializes in state legislation and/or an ICI tax attorney to the next meeting to discuss these issues with the group. Roger Rainville noted that when compiling information and conducting surveys, task forces should consider going beyond their own group and develop a matrix of information for all funds. The Transfer Agent Advisory Committee could keep an ongoing and updated record of "best practices" which summarizes the practices of all fund groups and which will be of interest and value throughout the industry. Committee members agreed with this idea. Cynthia Jones requested that all task force chairs be prepared to provide a presentation at the next Transfer Agent Advisory Committee meeting on July 27.

64. ABANDONED PROPERTY/LOST SHAREHOLDER LOCATION EFFORTS Last year, a Transfer Agent Advisory Committee task force chaired by Cynthia Jones, developed a study of lost shareholder location efforts in response to a concern raised by Rep. Ron Wyden on the lack of transfer agents efforts to proactively search for shareholders. The study determined that mutual fund transfer agents are in fact aggressive and proactive in their search for lost shareholders. Concurrently, the STA was preparing guidelines for lost shareholder location efforts and the Institute contacted the STA by letter to indicate its willingness to participate in the development of such guidelines. The STA has never responded to its request. Additionally, one committee member noted that the SEC had contacted them with respect to their lost shareholder location efforts, in particular with regard to the payment of interest for uncashed checks. This was prompted by a visit to the SEC by former Congressman Robert N. Shamansky who has targeted transfer agents and their efforts to notify shareholders of outstanding uncashed checks. Mr. Shamansky was a shareholder in one of

their funds and stated that he did not receive a dividend check and was never notified until the check was going to be escheated. He requested interest compensation for the time in which the check remained uncashed. Most mutual funds do not compensate shareholders for interest for the time period in which checks remained uncashed unless there was an error on the part of the transfer agent. While the SEC has not taken any position on the issue, one member commented that it was their understanding the SEC was considering issuing a directive in the area of lost shareholder location efforts. In response to these issues, the Committee decided to form a task force to study the industry's current practices with respect to lost shareholder location efforts and accounts which have been determined to be "abandoned". The task force may as a result prepare guidelines for ICI members and their mutual fund transfer agents. Task force members include the following (or their designee): Joan Dowd, BFDS - Chair Angela Mitchell - American Funds Services Joanna Johnson - MFS Dave Rainville - Federated Mary Crooks - Oppenheimer Joe Pollaro - Prudential Charles Hawkins - PNC

5. GIFTS OF SHARES At the last Committee meeting, a task force was formed to review current industry practices with respect to the gifting of shares from individuals to charitable institutions. Marjorie Houston of Brown University addressed the committee at the last meeting and expressed some of the frustrations that charitable institutions encounter with these transactions and the hope that the industry could work with her organization, the National Committee on Planned Giving, in developing standardized procedures. Roger Rainville, task force chairman, reviewed the matrix compiled by the task force which listed each firm's current procedures. One step which would significantly reduce the timing of this transaction would be to automate the process. Roger Rainville had discussed this proposal with the DTC who were reluctant to get involved with mutual fund trades. Kevin Maloney of the NSCC stated that this type of project is one in which the NSCC would be interested in reviewing. He offered to provide a presentation to the Committee on the feasibility of this proposal at the next committee meeting.

7The next step for the task force is to develop a form which could be used by transfer agents for these transactions. Wayne O'Melia discussed a generic form he and his staff at T. Rowe Price have developed for industry-wide use. The form would provide shareholder and account information as well as address two important pieces of information that must be included; what is being transferred and who is transferring the shares. The form would be filled out by the donor and sent to the university first, not the mutual fund first. The university would complete the form, include the W-9 and a corporate resolution and then forward the form and documentation to the transfer agent. The transfer agent would then transfer the shares from the donor's account to the new account in the name of the university, and redeem the shares on the same day. One question raised by Jan Clifford was whether a corporate resolution would really be necessary if all the transactions took place in one day. The task force agreed to address this issue for the next meeting. Also, the form developed by Wayne O'Melia will be presented to the task force for review and presented to the Committee at its next meeting.

6. TRANSFER OF ASSETS AND 401(k) CLEARINGHOUSE The requests for information submitted for the Transfer of Assets clearinghouse have been reviewed and several candidates were selected to provide additional information to the Institute. A task force has been formed to review this information and will be meeting in late June to review the responses and make a recommendation to the Institute. Five firms responded to the 401(k) clearinghouse request for information. These responses are currently under review.

7. NSCC UPDATE In response to a request by several committee members, the NSCC has now been added to the Transfer Agent Advisory Committee membership. Cynthia Jones introduced Kevin Maloney and James Kiernan to the committee and they provided an update on NSCC activities. Over the past twelve months, the NSCC has seen a decline in settlement dollars of about 10%. However, broker/dealer participation is up 25%. There was some discussion with respect to ACATS transfers and the issue some funds have with

receipt of invalid registrations from the broker dealers. Some firms are spending significant time scrubbing this information to correct the registrations. If the invalid registrations are not changed they result in mail returned to the complex as undeliverable. Several committee members asked if the NSCC could possibly install some sort of filter to determine if the registration is valid prior to its transmission to the mutual fund. Kevin Farragher of the ICI indicated that this issue has been raised at Broker/Dealer Advisory Committee meetings before and would ensure that it is discussed at its next meeting on May 4 in Boston. NSCC begins its T+3 testing begin May. If any members wish to use the test system, contact either Kevin Maloney or James Kiernan. Also, a filing with the SEC for approval of same day funds on a next day settlement basis for no-loads and money markets has been made and NSCC is waiting for a response from the SEC. Once the SEC approves, the NSCC expects to see an increase in the number of no-loads using NSCC. Finally, the NSCC is developing an automated system for the processing of annuities; anyone interested they should contact the NSCC. Several members commented on the current process for submitting requests for system enhancements. Some concern was expressed with communication between the NSCC and its users. 8One idea was to develop a subcommittee of the Transfer Agent Advisory Committee to discuss NSCC enhancements. However, it was also discussed that the Broker/Dealer Advisory Committee currently has an enhancement committee. Since not all Transfer Agent Advisory Committee members firms' have representatives on this committee some may not be receiving updates on the requests currently under consideration by the Broker Dealer Advisory committee. Kevin Farragher agreed to send minutes to the Transfer Agent Advisory Committee as well as provide updates at the Transfer Agent Advisory Committee meetings on the current issues the Broker Dealer Advisory Committee is addressing. 8. ICI OPERATIONS DEPARTMENT PROJECTS a. Transfer Agent Trends and Billing Practices Survey Planning for the 1995 Transfer Agent Trends and Billing Practices Survey is currently underway. At the Operations Committee meeting in March, members agreed to consider major modifications to the survey process. Several controls will be put in place to ensure the quality of responses and timeliness of receipt from survey participants. In addition, the survey will be evaluated to update and delete sections that are no longer of relevance to participants. A subcommittee was formed by the Operations Committee which will meet with Coopers & Lybrand and the ICI sometime in July to go over proposed changes. Solicitation for the survey participation will begin in August and survey materials will be distributed in November. b. Fraud and Loss Control Workshops The Institute sponsoring a one day workshop on Fraud and Loss Control in four cities during June. Details regarding the survey were listed in TAAC Memorandum 27-95. If there are any questions regarding the workshop, please contact Justine Phoenix. Please contact me at 202/326-5850 if you have any revisions to the minutes. The next meeting of the Transfer Agent Advisory Committee will be held on Thursday, July 27 at the offices of the Investment Company Institute. A meeting notice will be mailed in advance of the meeting. Justine Phoenix Director - Operations/ Transfer Agency