MEMO# 16983

January 22, 2004

ICI LETTER TO DOL ON MARKET TIMING IN RETIREMENT PLANS

[16983] January 22, 2004 TO: PENSION MEMBERS No. 3-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 4-04 RE: ICI LETTER TO DOL ON MARKET TIMING IN RETIREMENT PLANS The Institute submitted the attached letter to the Department of Labor on market timing in participant-directed retirement plans. The letter requests guidance that will assist plan sponsors in responding to participant market timing activity determined to be harmful by mutual funds offered under retirement plans. The letter generally describes market timing as a trading strategy that involves frequent purchases and sales of securities (with the securities often held for only very short periods) in an effort to anticipate changes in market prices. Whether, and at what level, certain trading activity may be harmful to fund investors is a question of facts and circumstances; the fund or its manager typically would be in the best position to make this determination. Where market timing activity in a mutual fund has been determined by a fund to be harmful to the interests of other fund investors, participants that invest in that fund through a retirement plan are likewise harmed. The letter observes, however, that the tools utilized to restrict harmful market timing have limited effect in the context of retirement plans. A fund generally does not have access to participant-level trading information or know the identities of plan participants, as it receives one purchase or sale order for each plan after the plan recordkeeper or third-party administrator "batches" investment instructions received from participants. Moreover, even where a fund company becomes aware of a participant that is engaged in harmful market timing, the fund's ability to restrict only the participant (and not the entire plan) is limited -- as the plan is the record owner of the fund shares. Thus, to provide guidance to plan fiduciaries and thereby protect plan participants from any negative impact that timing activity may have on them, the letter urges the Department to issue clarifying guidance in this area. Among the recommendations are the following. • First, the guidance should clarify that nothing in ERISA prohibits plan fiduciaries from restricting the activities of participants who engage in market timing of plan investment alternatives. 2 • Second, the guidance should clarify that a plan sponsor should take into account and, under ordinary circumstances, be entitled to rely upon a determination made by an investment vehicle (or its manager) that certain trading activity is harmful to the interests of other shareholders (and, therefore, other plan participants). • Third, the guidance should clarify that it is consistent with ERISA's fiduciary rules for a plan sponsor to take reasonable steps to facilitate the application of any restrictions imposed at the fund level to plan participants. • Fourth, the guidance should clarify the continued availability of section 404(c) relief for plan fiduciaries who select an investment option that imposes measures to restrict market timing and apply such restrictions to individual participants. Finally, the letter recommends that the Department's guidance in this area be prospective in scope, provide for a reasonable implementation period, and apply to the entire range of

pooled investments (e.g., mutual funds, bank collective trusts, separate accounts) that have instituted policies to limit market timing activity. Thomas T. Kim Associate Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 16983, or call the ICI Library at (202) 326-8304 and request the attachment for memo 16983.

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