The Asset Management Industry
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ICI RESPONSE TO WALL STREET JOURNAL ARTICLE

[17264] March 22, 2004 TO: BOARD OF GOVERNORS No. 22-04 CEOS INVESTMENT COMPANY DIRECTORS No. 14-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 29-04 SEC RULES MEMBERS No. 44-04 SMALL FUNDS MEMBERS No. 35-04 RE: ICI RESPONSE TO WALL STREET JOURNAL ARTICLE As you may have seen, today's Wall Street Journal includes an article suggesting that Institute staff were aware, or should have been aware, of "deals" between mutual funds and market timers that facilitated abusive short-term trading well before September 3. This assertion is entirely inaccurate, as noted by the response we provided that was included in the article. Beginning in 2000, ICI staff held a series of meetings and conference calls with members to address concerns about abusive short-term trading by suspected market timers. The sole focus and purpose of all ICI efforts throughout this period was to identify effective ways to restrict the activities of suspected market timers. Among the issues considered was whether the ICI should ask the SEC to provide funds with additional tools to more effectively restrict suspected market timers. The ICI staff who were involved in these meetings do not recall any discussions concerning arrangements to accommodate or facilitate market timers or market timing activities. The only arrangements or "deals" that were discussed were those that some members had implemented to restrict suspected market timers, including denying suspected market timers the ability to invest in certain funds, limiting the number of roundtrip trades, requiring suspected market timers to provide prior notice of intended transactions, and forcing investors who failed to comply with such restrictions to redeem their investments. Whether it was described by a meeting participant as an arrangement, restriction, limitation, method, technique, or deal, they meant the same thing: ways to protect long-term investors from the abuses of short-term trading. Consistent with the purpose of these meetings, in January 2001, the ICI submitted a draft no-action letter to the SEC explaining what mutual funds were doing to combat abusive short- term trading and asking that mutual funds be allowed to deter suspected market timers by delaying exchanges for certain funds. The ICI and the SEC had extensive discussions about the 2 underlying regulatory considerations following the submission of the draft letter. A formal ICI request followed in late 2002, and the SEC granted the requested relief shortly thereafter. All of this information was provided to the Journal before the article was published. Additional background information about the ICI's efforts in this area are attached. Please feel free to contact me directly if you have any questions about this matter. Matthew P. Fink President Attachments (1) Press Release: ICI President Comments on Inaccurate Media Report (2) Chronology of ICI Actions re Abusive Short-Term Trading By Suspected Market Timers (3) Link to Correspondence Between the ICI and SEC Regarding the Issue of Delayed Exchanges – http://memos.ici.org/getMemoPDF.do?file=17264 FOR IMMEDIATE RELEASE John Collins 202/326-5864 collins@ici.org Chris Wloszczyna 202/326-5889 chris@ici.org

James Doyle 202/326-8317 jdoyle@ici.org ICI President Comments on Inaccurate Media Report Washington, March 22, 2004 – In a speech to a mutual fund legal conference in California this morning, ICI President Matthew P. Fink characterized as "entirely inaccurate" the suggestion in a Wall Street Journal article today that the ICI may have been aware of arrangements to facilitate abusive market timing in mutual funds. Fink said the article's additional insinuation, that the ICI failed to share its knowledge with the SEC – was also was "completely untrue." Fink noted that both of the article's suggestions were belied by the ICI's consistent efforts to find ways to restrict and deter suspected market timers. "The purpose of the November 2000 conference call -- and many other ICI efforts like it -- was to identify effective ways to restrict market timing, not facilitate it. One of the major subjects discussed was whether the ICI should ask the SEC for legal authority to impose additional restrictions on market timers. In fact, we made this request to the SEC ten weeks later." Fink said that during the call, "ICI members described a number of steps they had implemented to restrict market timers and prevent or deter abusive short-term trading. These included denying suspected market timers the ability to invest in certain funds, limiting the number of roundtrip trades, requiring suspected market timers to provide prior notice of intended transactions, and forcing investors who failed to comply with such restrictions to redeem their investments." Most important, Fink said, "Whatever words members used -- arrangement, restriction, limitation, method, technique, or deal -- they meant the same thing. Everyone was discussing ways to protect long-term mutual fund investors from the abuses of short-term traders." Fink made it clear that the ICI reported everything it learned about market timing to the SEC. Fink said a January 16, 2001 letter to the SEC stated: "Fund groups have sought to employ a number of methods to try to deter market timing, such as imposing redemption fees, limiting frequent trading, and restricting exchange privileges." In short, Fink said, "at no point during these conference calls did any ICI staffer or ICI member suggest or imply that market timing or market timers were being accommodated, or should be accommodated. Indeed, the entire purpose of these discussions was to find forceful and effective ways to combat abusive short-term trading." Fink said it is "sadly paradoxical to see serious and sincere efforts to combat abuses recast as an attempt to facilitate them. The ICI remains fully committed – today and tomorrow, as in years past – to focusing on serving the interests of fund shareholders and working constructively with policymakers to achieve those objectives." ICI-04-40 The Investment Company Institute's Record In Addressing Abusive Short-Term Trading By Suspected Market Timers ____ As We Have Stated Publicly, The ICI Was Entirely Unaware of Agreements or Understandings That Allowed Abusive Market Timing ICI Chairman Paul Haaga and ICI President Matthew Fink have both stated in testimony before the U.S. Congress that the Institute was entirely unaware that any mutual fund employees, let alone some senior executives, had agreements or understandings with hedge funds or any other clients that permitted abusive short-term trading in fund shares. This is the case whether or not the mutual fund had an express policy discouraging or restricting such practices. As We Have Stated Publicly, The ICI Was Aware of Research Indicating That Abusive Short-Term Trading Was Occurring In Overseas Funds The ICI was aware of research indicating that short-term market timing in overseas mutual funds was occurring, and was working actively with its members and the SEC to find ways to restrict such trading and deter those responsible for it. For example, this research was highlighted and discussed at an ICI-sponsored academic research conference in September 2000 that was led by ICI Chief Economist John Rea. Academic researchers who participated in the ICI conference included most of the authors of relevant studies on abusive short-term trading at that time, and the potential effectiveness of various possible responses was discussed extensively. As We Have Stated Publicly, The ICI Repeatedly Expressed Concern About Abusive Short-Term Trading to the SEC Over the last five years, the ICI has repeatedly called on the SEC to give mutual funds additional tools to restrict abusive short-term trading and thus protect long-term shareholders. These efforts are reflected in speeches by the ICI's President and General Counsel, in meetings with SEC staff, in discussions held in ICI-sponsored legal and academic conferences, and in formal correspondence with the Commission. For example, in December 2001, ICI General Counsel Craig Tyle expressed his strong hope that the SEC staff would look at ways to restrict suspected market timers "from the perspective of long-term shareholders and [allow] mutual funds to take prudent steps to safeguard their interests." As We Have Stated Publicly, The ICI Formally Asked the SEC Give Mutual Funds the Authority To Combat Market Timing More Effectively In November 2002, after more than two years of discussions with the Institute, the SEC staff agreed with the ICI and decided that mutual funds should be allowed to "delay exchanges" to deter suspected market timers. The ICI had urged the SEC to recognize that the use of delayed exchanges could be a targeted and effective weapon in the effort to combat abusive short-term trading. A chronology of ICI activities related to restricting abusive market timing follows. Chronology of ICI Activities and Statements Regarding Abusive Short-Term Trading and Related Issues Since at least 1995, the ICI has been addressing the valuation methods mutual funds use to price their shares each day. In addition to strengthening valuation procedures, the ICI advanced proposals to deter abusive short-term trading by asking the SEC (a) to permit fund to delay exchanges between funds and (b) to permit funds to impose short-term redemption fees exceeding two percent. As the list below demonstrates, the ICI discussed these issues on a frequent and ongoing basis with academics, practitioners, regulators and its members. Among the specific ICI actions that occurred during this time are the following. 1996 ICI surveys members regarding valuation procedures used to meet legal pricing requirements for mutual funds' portfolio securities. May 1996 ICI memo to members summarizes SEC guidance on statutory pricing requirements for mutual funds in light of emergencies that disrupted global markets and may have affected securities valuations. February 1997 ICI publishes and distributes 54-page mutual fund valuation, liquidity and pricing compliance paper. March 1997 ICI distributes memo prepared by outside counsel to its members summarizing SEC enforcement actions and court cases regarding mutual fund valuation issues. October 1997 Stock market crashes in the US and Asia, particularly in Hong Kong, raise valuation issues for mutual funds. Some market timers that sought to take advantage of sharp market movements subsequently complained to the SEC that mutual funds fair valued their portfolios. December 1997 At ICI securities law procedures conference, SEC Investment Management Director Barbash addresses mutual fund pricing duties and describes results of special SEC pricing inspections. June 1998 ICI proposes modification of SEC rule to provide for uniform mutual fund pricing standards in the event that trading markets close early. February 1999 SEC Chairman Levitt convenes Roundtable on Role of Independent Fund Directors, which includes a panel on mutual fund valuation and liquidity issues. ICI members participate. September 1999 Crisis in Malaysian financial markets leads ICI to convene series of conference calls and meetings with members regarding valuation of Malaysian securities in particular, and later, overseas valuation procedures generally. Group later organized formally as ICI Valuation Procedures Task Force. December 1999 SEC staff letter to ICI regarding mutual funds' duties to value and price shares "during emergency and unusual situations." June 2000 ICI forms the Foreign Securities Valuation Working Group to discuss the issues that arise in valuing foreign securities in mutual fund portfolios. September 2000 Major part of ICI conference for academics and practitioners focuses on identifying and remedying abusive short-term trading and fair valuation. Academic researchers who participated in the ICI conference included most of the authors of relevant studies on abusive short-term trading at that time (e.g., Gregory B. Kadlec, Virginia Tech; John Chalmers, University of Oregon; William Goetzmann and Geert

Rouwenhorst, Yale University). October 2000 ICI staff and members meet with SEC to address valuation and abusive short term trading. November 2000 ICI conference call with members to discuss ways to restrict abusive short-term trading and suspected market timers, including by asking the SEC for authority to delay exchanges. December 2000 ICI conference call with members regarding abusive market timing. Group decides to have the ICI pursue efforts to secure authority from the SEC to delay exchanges. January 2001 ICI submits first draft of letter to the SEC requesting that, to help combat abusive short-term trading by market timers, mutual funds be permitted to delay exchanges in certain funds. April 2001 Second SEC staff letter is sent to the ICI providing further commentary and guidance on a mutual funds' duties to value and price shares. May 2001 ICI reconvenes Foreign Securities Valuation Working Group to help prepare a supplement to the ICI's 1997 white paper on the valuation of mutual fund portfolio securities. May 2001 ICI's globalization conference includes a morning workshop on how and when to price an international fund portfolio. May 2001 SEC Investment Management Director Paul Roye, speaking at the ICI's annual meeting, states that the SEC "is very aware of the problems of arbitrageurs and market-timers" and is willing to consider innovative ideas to address the problem. June 2001 At an ICI conference, SEC Director of Inspections and Compliance Lori Richards gives speech addressing valuation, trading and disclosure issues. August 2001 SEC Investment Management Director Paul Roye addresses mutual fund pricing and valuation issues in an extensive interview in The Investment Lawyer. October 2001 ICI staff and members meet with SEC regarding valuation and abusive short term trading. November 2001 ICI distributes to its members a summary of a court decision dismissing a market timer's lawsuit that a mutual fund had illegally restricted his attempt to make frequent exchanges between funds. December 2001 ICI General Counsel Craig Tyle's opening speech at ICI's securities law procedures conference asks the SEC to give mutual funds the authority to protect long-term shareholders by restricting abusive short-term trading. January 2002 ICI submits to the SEC a legal memo prepared by ICI's outside counsel describing why the SEC should provide mutual funds with the authority to delay exchanges. March 2002 ICI completes and distributes 26-page supplement to its 1999 white paper on mutual fund valuation and pricing compliance issues. March 2002 In a speech at the ICI's annual legal conference, ICI President Matthew Fink calls upon SEC to permit funds to impose additional restrictions on suspected market timers whose activities are harmful to long-term fund shareholders. May 2002 ICI's globalization conference includes full panel discussion of valuation issues, including problems created by abusive short-term trading in international funds. May 2002 ICI submits to the SEC series of proposals to improve investment company regulation, including changes that would allow mutual funds to restrict market timers who make short-term exchanges between funds. October 2002 ICI publishes Frequently Asked Questions brochure about mutual fund pricing. October 2002 ICI formally asks the SEC to grant mutual funds the legal authority to delay exchanges between certain funds where abusive short-term trading is found or suspected. November 2002 SEC staff responds to the ICI, and says that mutual funds can delay exchanges. December 2002 SEC Investment Management Director Paul Roye acknowledges continuing problems caused by market timers, expressing hope that recent SEC response to ICI will provide funds with helpful tools. February 2003 In a published article reviewing mutual fund developments in 2002, ICI economist Brian Reid notes the continuing disruptive impact of market timers on mutual funds with a large concentration of overseas holdings. June 2003 SEC responds to congressional inquiries about a number of mutual fund issues, including pricing and valuation procedures. October 2003 ICI urges the SEC to impose a mandatory, minimum two percent redemption fee that applies to all non-money market mutual fund sales not held for at least five days. March, 2004