

MEMO# 18808

April 28, 2005

DRAFT INSTITUTE LETTER ON THE REDEMPTION FEE RULE AND SEC REQUEST FOR ADDITIONAL COMMENT ON THE NEED FOR FURTHER STANDARDIZATION OF REDEMPTION FEES

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [18808] April 28, 2005 TO: BROKER/DEALER ADVISORY COMMITTEE No. 17-05 OPERATIONS COMMITTEE No. 8-05 PENSION COMMITTEE No. 14-05 PENSION OPERATIONS ADVISORY COMMITTEE No. 13-05 SEC RULES COMMITTEE No. 31-05 SMALL FUNDS COMMITTEE No. 16-05 TRANSFER AGENT ADVISORY COMMITTEE No. 19-05 RE: DRAFT INSTITUTE LETTER ON THE REDEMPTION FEE RULE AND SEC REQUEST FOR ADDITIONAL COMMENT ON THE NEED FOR FURTHER STANDARDIZATION OF REDEMPTION FEES Last month, the Securities and Exchange Commission adopted a new redemption fee rule (rule 22c-2) and requested comment on whether certain aspects of redemption fees should be standardized.¹ Attached is the Institute's draft comment letter on the rule and the request for additional comment, which is briefly summarized below.

SUMMARY OF COMMENTS The draft letter expresses significant concern over the rule as adopted, focusing primarily on the rule's requirement that every fund obtain a contract with each of its intermediaries. The letter makes five comments with respect to this part of the rule:

1. **New Contracts.** The letter highlights the significant operational difficulties in obtaining contracts with intermediaries with whom funds do not have existing agreements, such as small retirement plans. The letter strongly recommends that the

¹ See Memorandum to Broker/Dealer Advisory Committee No. 8-05, Compliance Advisory Committee No. 23-05, Operations Members No. 4-05, Pension Members No. 12-05, SEC Rules Members No. 38-05, Small Funds Members No. 25-05, and Transfer Agent Advisory Committee No. 9-05 [18647], dated March 18, 2005. Comments are due to the Commission by May 9th. Please provide any comments you have on the draft to either Bob Grohowski (202-371-5430; rcg@ici.org) or Amy Lancellotta (202-326-5824; amy@ici.org) no later than the close of business on Monday, May 2, 2005.

2. **Commission modify the rule to require a fund to obtain a contract with an intermediary when it determines that doing so is necessary to address abusive market timing.** The letter concedes that the rule should continue to require any intermediary agreement that will be in force on or after the effective date of October 16, 2006 to include the required terms. In talking to members

about this rule, it has become clear that obtaining contracts with intermediaries is a major operational hurdle. We are particularly interested in member feedback on the Institute's recommendation in this section of the letter. Is the standard that we propose appropriate? Is there a different standard that we should recommend?

2. Chains of Intermediaries. The draft letter identifies a potential problem with the application of the rule's definition of "intermediary" to situations where an intermediary holds shares in nominee name for another intermediary (effectively creating a "chain of intermediaries"). The letter recommends 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.

3. Intermediaries Holding Shares for Single Investors. The draft letter recommends that the Commission clarify that the rule is meant to require contracts only in true omnibus situations, where an intermediary is acting on behalf of multiple investors. The definition of "intermediary" in the rule does not distinguish between these situations and instances where an intermediary is holding shares in nominee name for a single investor.

4. Variable Insurance Products. The draft letter points out that funds underlying variable insurance products may not be able to obtain the required contracts with insurance companies, due to conflicting provisions in existing insurance contracts.

5. Cost-Benefit Analysis. The letter is critical of the Commission's cost-benefit analysis. The letter argues that the Commission's estimate of the costs associated with the contract requirement is unrealistically low, and that the Commission understates the ultimate impact to of the rule's costs to fund shareholders by allocating much of the expense to intermediaries, rather than funds. The draft letter also addresses the standardization of the types of transactions subject to redemption fees, indicating that we do not believe that the Commission should seek standardization at this time. Instead, the letter recommends that the Commission study the implementation of redemption fees after some reasonable period of time and determine then whether regulatory standards are necessary.

Robert C. Grohowski Associate Counsel Attachment (in .pdf format)