

VIA EMAIL

rule-comments@sec.gov

February 5, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Comment on proposed amendment to rules governing pricing of mutual fund shares; File No. S7-27-03.

Dear Mr. Katz:

The American Benefits Council (the "Council") appreciates the opportunity to express our concern about the impact on millions of participants in qualified retirement plans of the proposed "hard 4 p.m. Eastern Time (ET) close" contained in Release No. IC-26288 (proposed amendment to rules governing pricing of mutual fund shares). Before promulgating a final rule, we urge the Securities and Exchange Commission (the "Commission") to consider the disparate impact that such a rule would have on these millions of retirement plan investors as well as the substantial additional costs associated with implementing this rule. This letter expands on views expressed in our December 1, 2003 letter to Mr. Paul Roye of the Commission's Division of Investment Management and also suggests alternative solutions we believe will address the problems without disadvantaging retirement plan participants.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. Accordingly, we are keenly interested in this issue, not only from the perspective of the firms that provide retirement plan investment products and services, but primarily from the perspective of companies that sponsor retirement programs on behalf of their employees and retirees.

The Council commends the Commission for its efforts to protect mutual fund investors and to restore investor confidence in mutual funds. Nevertheless, the Council is concerned that the hard 4 p.m. close will disadvantage retirement plan participants.

We understand the hard 4 p.m. close proposal is designed to address late-trading abuses by requiring mutual fund trade orders to be received by (1) the mutual fund, (2) the fund's principal transfer agent, or (3) a registered clearing agency, by the time set for calculating the fund's net

asset value (NAV) in order to receive that day's price. Most funds calculate NAV when the major U.S. stock exchanges close at 4 p.m. ET, hence the nickname "hard 4 p.m. ET close." The Council is concerned that the hard 4 p.m. ET close rule will require trades for retirement plan participants to be cut off much earlier than trades of other investors, causing significant problems for retirement plans where participants direct investments such as 401(k), 403(b) and 457 plans. In addition, the Council is concerned that very substantial costs will be incurred to modify processes, procedures and systems to meet these new trade requirements thus increasing the costs associated with such plans to both plan sponsors and participants. We believe that such costs are disproportionate given the limited risk for abusive late trades within the retirement plan marketplace. Finally, the Council is concerned that these new requirements will cause extensive confusion for plan participants.

Effects of Proposed Hard 4 p.m. ET Close on Employer-Sponsored Retirement Plans

Imposition of a hard 4 p.m. ET close will significantly burden employer-sponsored retirement plans, participants in those plans, companies that provide services to those plans, and the employer plan sponsors themselves. The significant burdens will include (1) delayed trading for plan participants compared to other investors (resulting in an uneven playing field), (2) significant confusion for retirement plan participants including confusion in statements (including internet accessed statements) for both employer plan sponsors and participants, (3) difficulty in processing common plan transactions, (4) the potential elimination of valuable plan features currently available to participants, (5) substantially increased costs of sponsoring and maintaining retirement plans that will likely be passed along to plan participants, and (6) the potential reduction in competition in the recordkeeping and third party administrator (TPA) industry. Each of these is discussed in more detail below.

Delayed Trading for Retirement Plan Participants

Over the past 10-12 years, mutual fund companies, intermediaries and plan recordkeepers have invested in technology in order to make "seamless" same-day trading within retirement plans a reality. Today, a participant's contribution can be invested in multiple investment options from different investment providers on the day the cash contribution is received. A participant can transfer from one investment option to several others with all transactions priced as of the same day. A participant can take loan proceeds on a pro-rata basis across all the investment options in his/her account. A participant can reallocate or re-balance the way in which assets are allocated to multiple investment options. All of these transactions are properly reflected on the participants account as business opens the following morning. The Council is concerned that all of these improvements and efficiencies would be negated if the revisions to Rule 22c-1 are finalized as proposed. Millions of retirement plan participants may be relegated to next day (or later) trading if transactions must be provided to the mutual fund itself (rather than a third-party intermediary) by 4 p.m. ET.

Today, participants typically place their retirement plan trades through recordkeepers or TPAs prior to 4 p.m. ET. These intermediaries perform significant administrative activity after trades are closed to participants, and before they are forwarded to mutual fund families, to ensure that the myriad of statutory and regulatory requirements associated with qualified retirement plans

are met. These functions include validating that transaction requests comply with plan rules and verifying that loan and distribution requirements are satisfied. In addition, significant administrative activity associated with omnibus accounts generally is also performed including the consolidation of transaction instructions from multiple sources such as web sites and telephonic voice response systems, verifying cash availability for contributions, balancing and reconciliation processes and procedures and development of net trade instructions for the omnibus account. Today, these functions are performed after 4 p.m.

However, because these administrative steps are necessary before a transaction is actually processed, it has been estimated that the trading deadline for participants may need to be made as early as 10 a.m. or 12 noon ET in order for the intermediary to meet a mutual fund's hard 4 p.m. ET deadline. In addition, the Council believes that processes will need to be developed to address accounting issues that will arise from the SEC's proposal, including the proper accounting of a fund's dividend/capital gain distributions within each participant's retirement plan account.

The impact of a hard 4 p.m. close becomes even more complex for plans utilizing investment options from more than one mutual fund family. Over the past decade, an "open architecture" of investments has become more and more prevalent allowing participants to trade among funds across several different mutual fund companies with all trades priced as of the close of business on the day the trade is received. However, to properly effect and post such transactions, the recordkeeper or TPA needs the funds' calculated NAV before processing transactions and updating participant accounts during each day's batch cycle. Under the present system, the recordkeeper or TPA processes and bundles all trades submitted to them by 4 p.m., updates its systems utilizing the NAVs provided after the 4 p.m. close, and transmits net transactions for the omnibus account overnight. These processes and the applicable timetables are established in agreements between the recordkeepers and TPAs and the various mutual fund companies, allowing the recordkeepers or TPAs to take transaction requests and investment instructions from participants as the mutual funds' agent until the 4 p.m. deadline, and then provide investment instructions to the mutual fund at a later deadline. However, under the proposed hard 4 p.m. ET rule, a participant investment instruction involving multiple fund families that is placed with a recordkeeper or TPA after the morning deadline would take a minimum of three days to execute. An example illustrates this problem:

Participant X, who lives in Los Angeles, places an order at 9:15 a.m. Pacific Time (PT) on Friday with the plan's recordkeeper to sell all of Funds A and B that he has in his retirement plan account and use 50 percent of the proceeds to purchase Funds C and 50 percent of the proceeds to purchase Fund D. Under current rules, Participant X's shares of Funds A and B would sell at Friday's 4 p.m. ET closing price and Funds C and D would also be purchased at Friday's 4 p.m. ET closing price (after the recordkeeper or TPA calculates the proceeds from the sale of Funds A and B).

Using the same facts with a hard 4 p.m. ET close rule imposed, the plan cuts off participant transaction requests and investment instructions at 12:00 noon ET in order to meet the 4 p.m. deadline. Because Participant X placed the order at 9:15 a.m. PT (which is the equivalent of 12:15 p.m. ET), Participant X's Funds A and B would not be sold

until Monday when it would be sold at Monday's closing price. Because the closing price of Funds A and B is not known until after 4 p.m. ET Monday, the order for the purchase of Funds C and D cannot be placed until Tuesday. The purchase of Funds C and D would take place at the Tuesday closing price for Funds C and D.

The Council is very concerned that trades, such as the one described above, will stretch out over several days, greatly disadvantaging plan participants. If major events affect the value of significant holdings within a particular mutual fund after trade deadlines for retirement plans but before the 4 p.m. close, retail investors will likely be advantaged because they will likely still have time to place their trades for execution the same day. However, by the time the retirement plan participant's order is executed (on the next day at best), the price of the fund holding(s) could move more extensively, causing (depending on the type of news) either a loss or a reduced gain to the retirement plan participant versus the retail customer.

Confusing Reports and Statements

While the proposed rule requires that transactions be received by the mutual fund, its primary transfer agent or a registered clearing agency by 4 p.m. ET, as noted above, other intermediaries will be required to establish earlier deadlines. Thus, different parties, such as recordkeepers, TPAs, broker-dealers and bundled plans with a single mutual fund company, will all have different cutoff times. In fact, it is likely that the trading deadline will be different for different investment options within the same plan. This will lead to confusion for all and inappropriate competitive advantages for certain plan designs and certain intermediaries.

In addition, in many instances a participant's statement of account will be inaccurate or incomplete until all steps of a requested transaction have been completed. In the preceding example where the participant requests the trade on Friday, his statement of account could not reflect the entire purchase and sales transaction until the following Wednesday, at the earliest. Part of the transaction would be "pending" or "outstanding" and might be reflected as an interim cash position. It is likely that, at the time of any given paper statement (e.g., quarterly), there may be outstanding trades that have not been fully executed and are not reflected in the statement of account for that period. In today's environment where participants expect (and often obtain) statement information immediately over the internet, these instant statements would be consistently incomplete and confusing.

Under the current system, these "pending" transactions are avoided. Because transactions are processed after NAVs are calculated, recordkeeping processes are virtually transparent to participants – the recordkeeping system accurately reflects all trades through the close of business as of the end of the period covered by the statement. This helps to ensure that statements of account and plan sponsor reports are easy to read and to understand. The hard 4 p.m. close would upset the transparent nature of reporting available to participants and plan sponsors, replacing it with information that is hard to understand and often perceived to be incomplete.

Difficult to Process Common Plan Transactions

There are a number of common plan transactions that require the recordkeeper or TPA to calculate exact account balances, sometimes by individual funds, before the transaction can be processed. The Council is concerned that a hard 4 p.m. close will make it impossible to complete these transactions accurately resulting in compliance violations, fines, penalties and, perhaps, plan disqualification. One simple example of this is a participant loan from the retirement plan.

Federal statutes require that participant loans from retirement plans cannot exceed certain limits. Very simply stated, the loan cannot exceed the lesser of \$50,000, or 50 percent of the participant's account balance reduced by the highest outstanding loan balance in the preceding 12 months. Generally, participants request the maximum loan for which they qualify rather than a specific dollar amount.

While a hard 4 p.m. ET close creates a number of loan processing issues, the first processing problem is simply calculating the maximum amount of the loan. To establish the loan, assets in the account are "sold" generating the proceeds for the loan amount. Because the sell order to fund the loan must be placed before 4 p.m., the maximum loan calculation can only be based on the previous day's closing valuation. If yesterday's NAV is higher than today's, the plan may well exceed the statutory loan limits (the lower NAV today will mean there is less in the account). In many cases, plans may reduce the maximum amount of loan available to an amount less than that permitted by statute in order to partially address this problem. If yesterday's NAV is lower than today's, the participant may complain that he/she did not receive the maximum loan available.

Even assuming the amount of the loan can be properly calculated, the plan still must fund the requested loan by selling mutual fund shares. The plan's administrative procedures set forth the hierarchical order in which assets are sold. If the first fund is insufficient to fund the entire loan, assets of a second fund are utilized and so on. As noted above, these transactions will also need to be estimated based on yesterday's closing NAV. The following example illustrates the complexity that will result if a hard 4 p.m. ET close is established.

Participant X, who had \$50,000 in the retirement plan as of Monday's market close, requests the maximum loan amount available. Participant X has not had an outstanding loan in the past 12 months. Participant X's \$50,000 is evenly divided between Funds A and B (\$25,000 in each Fund as of Monday's close). The loan is processed on Tuesday. Under the plan's administrative procedures, loan amounts are first taken from Fund A and then from Fund B. At Tuesday's close, the value of Participant X's shares in Fund A has decreased to \$20,000 and the value of his shares in Fund B has increased to \$27,000.

In the current environment, the plan's recordkeeper generally would process a loan of \$23,500 (half of \$20,000 + \$27,000) and sell all of Fund A and \$3,500 of Fund B at Tuesday's closing price.

With the hard 4 p.m. close imposed, the recordkeeper might process a loan for \$25,000 (based on the value of the account at Monday's close) which would exceed the statutory limit. If the plan sets the maximum amount below the statutory limit to try to address this problem, such as 90 percent of the maximum, the recordkeeper would process a loan for \$22,500 and then enter a sale order for \$22,500 of Fund A. However, on Tuesday, the value of Fund A decreased to \$20,000. Thus, the assets of Fund A would be depleted leaving \$2,500 to raise to fund the loan. Perhaps a subsequent sale order of \$2,500 of Fund B would be entered on Wednesday when the closing price of Fund B results in Participant X's shares being worth \$24,000. However, the statutory limit for the maximum loan amount has also changed. Assuming Fund A's value is unchanged, the statutory limit would now be \$22,000 (half of \$20,000 + \$24,000). Therefore, even though \$2,500 of Fund B would be sold, the participant can now only take out a loan of \$22,000 under the statutory limit, resulting in the sale of \$500 too much of Fund B. Would the recordkeeper then enter a purchase order to buy \$500 of Fund B on Thursday? All of this would be very difficult to explain to Participant X.

This example becomes even more complicated to administer and to explain if loan proceeds are created by processing pro-rata across all investment options in the participant's account.

As noted below, additional common plan transactions also increase in complexity. These include orders for hardship withdrawals, minimum required distributions and to rebalance asset allocations.

Elimination of Valuable Plan Features

A popular innovative transaction used by plan participants is a rebalancing or an automatic rebalancing feature. With the automatic rebalancing feature, the participant elects to allocate plan assets in a specified manner (such as 20 percent each in five different funds) and authorizes the plan's recordkeeper or TPA to automatically rebalance the account at pre-set intervals (e.g., monthly, quarterly, annually). This tool enables plan participants to maintain a consistent asset allocation investment strategy without ongoing monitoring and multiple transactions.

If the hard 4 p.m. ET close is imposed, rebalancing orders would become unduly complicated. First, a rebalancing order could only be structured based upon estimated account values using the prior day's closing NAVs. Thus, either the participants' understanding of the rebalancing process itself would need to be modified or additional sales and purchases would need to be executed (again, based on inexact estimates using the prior day's closing NAVs). The latter could be a never-ending cycle of transactions thus increasing costs to plan sponsors and participants.

Rather than face a re-education process, a nightmare of continuous sales and purchases to try to get the percentages right, or tedious explanations to participants of the inexact rebalancing, plans may well eliminate this feature.

Long-Term Investors Should Not Be Disadvantaged

Some have argued that the trading delays for retirement plan participants caused by the hard 4 p.m. close do not significantly disadvantage these participants because their investments are long-term investments for retirement. However, long-term investors are not necessarily committed to an individual fund for the long term. Studies do conclude that being out of the market even for just a few days periodically can result in a significant decrease in return. Retirement plan participants are concerned about being out of the market, even for one day, and have come to expect that the trades they place before 4 p.m. ET today will all be effected overnight without delay or an intervening cash position. Many investors, inside and outside of retirement plans, perform strategic asset reallocation periodically and those investors justifiably expect same day trading. The Council firmly believes that purposely disadvantaging an investor with a longer time horizon is not good investment policy.

In addition, studies consistently demonstrate that nearly all mutual fund investors consider themselves to be long-term investors. According to a 2001 study by the Investment Company Institute (2001 Profile of Mutual Fund Shareholders), almost all mutual fund investors agree that they are investing for the long term. The study found that 97 percent of mutual fund investors strongly or somewhat agreed with the statement “My mutual fund investments are savings for the long term.” For mutual fund shareholders who own mutual funds only outside of defined contribution plans, 96 percent strongly or somewhat agreed with this statement. The long-term nature of the investor’s time horizon is therefore not a reason to distinguish between retirement plan and other investors and should not be used as a justification for different trading deadlines.

Increased Costs and Reduction in Competition

As noted above, currently, retirement plan recordkeeping processing consistently occurs after the NAV for each investment option is set and posted to the recordkeeping system. However, under the proposed hard 4 p.m. ET rule, the mutual funds’ NAV will not be available at the time investment instructions must be forwarded to the funds. As a result, virtually every aspect of the recordkeeper’s and TPA’s business will need to be changed. These changes will affect not only technological recordkeeping systems but will also dramatically alter relationships with plan sponsors, plan participants and other business partners, including institutional trustees and mutual fund complexes. Significant expenditures will be required to redesign recordkeeping systems, investment transaction processing systems, agreements and arrangements with fund families, participant-interactive systems, participant education and communication materials as well as the contractual agreements with plan sponsors. This is not just a matter of changing the deadline to an earlier deadline – it will require a whole new way of doing business for an industry that has already invested millions of dollars to construct the systems, operations, and complex business relationships that have enabled the 401(k) plan to become the dominant retirement savings vehicle that it is today.

The Council believes that these changes will result in dramatic and significant increased costs to the recordkeepers and TPAs, costs that will be passed along to the plan sponsors and plan participants. Some recordkeepers and TPAs will proactively make a decision to exit from this business of ever narrowing profit margins. Others (perhaps locked into contracts that preclude

passing these costs along) may be unable to continue. Ultimately, a decrease in competition could lead to increased fees.

Alternative Solutions

Technology Solution

The Council believes that Potential late trading abuses can be addressed through technology while avoiding the adverse consequences for retirement plan participants described in this letter. The solution proposed by the U.S. House of Representatives in the Mutual Funds Integrity and Fee Transparency Act of 2003 (H.R. 2420), which passed the House in November 2003 on a 418 to 2 vote, would address many of the mutual fund industry problems including late-trading issues.

H.R. 2420, as passed by the House, has specific language designed to remedy the harm that will otherwise occur to plan participants under the hard 4 p.m. close approach. The language directs the Commission to issue rules preventing after-hours trading but states the rules are to include an exception for broker-dealers, retirement plan administrators and other intermediaries using procedures:

- Designed to prevent the acceptance of trades by such intermediaries after the time at which net asset value was determined, and
- Subject to an independent annual audit to verify that the procedures do not permit the acceptance of trades after the time at which such net asset value was determined.

Technology exists today that will time stamp trades placed with most recordkeepers and TPAs. These systems, which could be subjected to outside audit, could be modified quickly to provide the protections that investors and the SEC are seeking.

The Council recommends a technology solution with automatic time stamping in lieu of imposing a hard 4 p.m. ET close. The technology could be made subject to an outside audit that would provide a backup review to ensure no trades are being placed after the close. Most of the recordkeepers and TPAs that provide this service are currently subject to outside audit (in the case of smaller recordkeepers, it may be that the system used for the trades is provided by a third party that is subject to the outside audit). This existing outside audit could be modified to carefully review the processes and procedures that are designed to eliminate the ability to process late trades in order to ensure that no late trades have taken place. In addition, senior managers could be required to certify that policies and procedures are in place and no late trading has occurred. Because it is subject to audit and would have an audit trail, the technological solution we propose would provide even greater assurance than a hard 4 p.m. close that late trading would be stopped.

We understand that the Commission is concerned it may not have jurisdiction over all of the recordkeepers and TPAs providing this service. An informal survey of the Council's recordkeeper and TPA membership indicates that the vast majority are registered with the Commission in some capacity (Transfer Agent, Broker/Dealer or Investment Advisor), and those

that are not are generally subject to extensive regulation by other government agencies (e.g., banks). While some smaller recordkeepers may not be registered, in many cases they place their trades through a registered entity. The Council believes it is unlikely the Commission would have a problem enforcing new rules.

Expansion of “Order” Definition

The Council commends the Commission on expanding the definition of the “order” (that must be received by 4 p.m.) in the proposed rule and encourages the Commission to consider further expansions of the definition. Although an expansion of the definition of “order” by itself will not eliminate the problems that will be faced by retirement plan participants under the hard 4 p.m. close, it could help alleviate some of the multiple day execution and exact amount distribution problems discussed above. Even with an expanded definition of “order”, significant modifications to the processes, procedures and systems used by retirement plan recordkeepers and TPAs would be necessary.

Under the proposed rule, the definition of “order” would include the direction to purchase or sell (1) a specific number of shares of a fund (e.g., all the shares held in the account) and (2) an indeterminate number of shares of a specific value (e.g., \$10,000 of shares of the fund). In addition, the definition of “order” would include a direction to purchase securities of a fund using proceeds of a contemporaneous order to redeem a specific number of shares of another fund.

The proposed change in the definition of “order” would alleviate the simple trade example provided by the Council in its December 1 letter to the Commission. The letter provided an example of a participant selling all of his/her Fund A shares and using the proceeds to buy shares of Fund B. Because this would be a contemporaneous order to purchase securities of one fund with the proceeds from the sale of another fund, it should be facilitated by the change in the definition of “order.”

Under current rules, both trades take place on the day the participant places the transaction, so long as it is placed before 4 p.m. With a hard 4 p.m. close without the “contemporaneous order” exception, the purchase of Fund B would not take place until the third day because the order to buy Fund B cannot be placed until the proceeds from the sale of Fund A are known (which would be after the 4 p.m. deadline for trades). Thus the “contemporaneous order” exception helps to maintain “same day pricing” for transfers between investment options as long as the participant places the transactions before the deadline established by the recordkeeper.

However, the “contemporaneous order” exception described above would not cover trades involving multiple funds nor would it allow for rebalancing as described earlier in this letter. The Council advocates further changing the definition of “order” to include all orders that can be properly calculated once the applicable NAVs are determined. This would enable transactions involving multiple investment options.

The revised definition of “order” is also helpful in processing a request for a distribution in a specific dollar amount. For example, a participant may request a loan in the amount of \$15,000

resulting in a sale of one or more mutual funds to fund the loan proceeds. If the loan is funded from the sale of one mutual fund, the existing proposed definition of “order” should facilitate the transaction. In many cases, however, a loan will require the sale of more than one mutual fund to fund the loan proceeds. However, the recordkeeper or TPA will need to know the proceeds from the sale of Fund A before the remaining proceeds to be raised from Fund B are determined. As noted above, this could result in multiple transactions over several days unless the definition or “order” is further modified.

Clearinghouse Approach

An alternative proposal has been made to provide an exception for mutual fund trades processed through a registered clearinghouse which would time stamp the orders. Orders submitted to the clearinghouse by the 4 p.m. close would be processed at that day’s price. The trade information would be provided in “raw data form” (participant-directed transactions would be submitted without editing, bundling or netting) prior to 4 p.m., followed by more specific information when NAVs become available.

The Council supports continued investigation of this proposal (along with the expansion of the definition of “order” contemplated above) as a viable alternative because it could lessen the early closing disadvantage for plan participants. However, many details of this approach still need to be worked out before it will be clear whether such a clearinghouse approach is feasible.

Increased Costs

The Commission requested comments on the expected costs of the proposed hard 4:00 close. The analysis required to produce reliable cost information associated with system modifications of this magnitude is costly and burdensome in itself. It should be noted that the changes involved would necessitate testing and validation across the industry, and between recordkeepers and TPAs and trustees and fund families. Members consistently advise that the anticipated costs are very substantial, easily exceeding several million dollars per recordkeeper or TPA. One Council member indicated they spent considerable time and resources to analyze the costs, and estimate the total cost for their company of the changes necessary to be implemented to accommodate a hard 4:00 close would be approximately \$8.8 million. The Council’s members indicate that the necessary changes would be extremely substantial and the costs would be enormous. As more exact cost projections from members becomes available, the Council would be happy to share that information with the Commission.

Based on our preliminary information, we believe the proposed one-year transition period is insufficient. In order to place plan participants in as fair a position as possible under the proposed rule, a transition period of at least 2 to 3 years would be necessary. Although it might be possible for recordkeepers and TPAs to perform internal changes within a one-year period, as mentioned above, those changes must be tested and validated across the industry (tests involving more than one company). This would take more time.

As described above, the changes caused by the proposed rule would be substantial and would negatively affect plan participants in a multitude of ways. Should the Commission decide to

implement the hard 4 p.m. close rule now and offer a technology solution later, TPAs and recordkeepers would face significant costs both now and in the future (potentially doubling their cost). As we noted above, increased costs are typically passed along to plan sponsors and plan participants.

We appreciate the opportunity to provide further input to the development of potential rules in this area, and to comment on such rules. We believe that the American Benefits Council brings an important and unique perspective – the employer sponsors of retirement plans – and are pleased to make this information and perspective available to the Commission. If additional information from us would be helpful, please do not hesitate to contact me at 202-289-6700.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jan Jacobson
Director of Retirement Policy