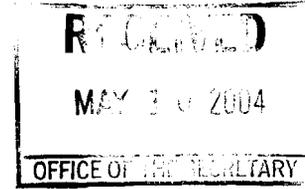


MEMORANDUM

TO: Public Comment File No. S7-27-03
FROM: Penelope W. Saltzman *Penelope W. Saltzman*
Office of Regulatory Policy
Division of Investment Management



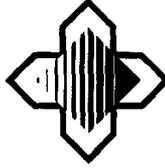
DATE: May 7, 2004

On May 4, 2004, representatives of the National Defined Contribution Council, Hewitt Associates, Charles Schwab & Co., Inc. and Schwab Corporate Services, Delaware Investments, AMVESCAP, Automatic Data Processing, and J.P. Morgan (collectively, the "Representatives") met with staff members of the U.S. Securities and Exchange Commission to discuss issues relating to the Commission's proposed rule amendments concerning the pricing of investment company shares in Investment Company Act Release No. 26288 (Dec. 11, 2003) ("Late Trading Proposal"). The following Commission staff members from the Division of Investment Management attended the meeting: Paul Roye, Director; Robert Plaze, Associate Director; C. Hunter Jones, Assistant Director; Penelope Saltzman, Branch Chief; and Shaswat Das, Senior Counsel.

The Representatives reviewed concerns regarding the Late Trading Proposal that were raised in comment letters, as well as concerns with the clearinghouse approach described in the comment letter from Fidelity Investments. These concerns included competitive issues among funds and fund intermediaries, and the time and cost involved to implement operational and technological changes and educate plan participants.

The Representatives also discussed an alternative approach to the Late Trading Proposal. The alternative would permit intermediaries to obtain same-day pricing for orders they receive by 4 p.m. and transmit to fund companies after 4 p.m. as long as the intermediary meets specific requirements. The elements of this approach include an (i) an unalterable time stamp; (ii) auditable order trail; (iii) annual certification by an executive of the intermediary; and (iv) annual independent audit. The Representatives described the characteristics of an unalterable time-stamp and audit trail, and provided the staff with an outline of those characteristics, a copy of which is attached.

Attachment



Characteristics of an Unalterable Time-stamp and Audit Trail

Order Receipt and Capture

- System time should be synchronized with the atomic clock no less than once a day/week/month to ensure the integrity of the system clock
- Orders should be automatically time-stamped at the point of entry into the system using the synchronized system time with no human intervention. System users should not be able to set or choose a time-stamp for any order or over-write an existing time-stamp.
- Order entry systems should automatically assign a unique “sequence number” to an order at the point of entry into the system with no human intervention. System users should not be able to set, alter, or over-write an existing sequence number.
- Order databases that retain current and historical order records should be secured and protected from unauthorized modification, corruption, or deletion. This data should be retained for X years.
- Order databases should be replicated real time to a back up system or be backed-up no less frequently than every XX minutes/hours.
- Systems should have the appropriately redundant secondary or back-up systems with comparable functionality in the event of an outage of the primary system.
- Each order record should capture a unique ID identifying “who” entered the order in addition to all critical data elements of the order (what), and the date/timestamp (when). Critical data elements of the order are action (buy/sell/exchange), fund (cusip), quantity or dollar amount,
- Systems should have the capability to handle planned (e.g. early market closures on Christmas Eve, etc.) and unplanned events where the order cutoff time may be earlier (or later) than 4:00PM EST.
- System should be designed such that no orders can be entered in the system after 4:00PM for current day’s price.
- Systems should have security and controls that prevents existing orders entered before 4:00PM from being modified after 4:00PM.
- Systems should have security to ensure only authorized individuals have the ability to enter new orders or cancel existing orders.
- Systems should require that existing orders requiring modification (which have already been time-stamped) be cancelled and a new order re-entered with a new time-stamp.

- Cancellations of orders should be captured and retained with their own time-stamp and sequence number, separate from the order they are canceling.
- Orders should never be deleted from the system. In the event that a bad record must be deleted to resolve a system issue there should be procedures and controls to retain a record of what was deleted and to ensure that the deletion is properly authorized by the appropriate control individual who is not directly involved in the trading process.
- Trading systems should have intelligent editing capabilities that prevent the acceptance/entry of orders and time-stamping of orders that are “not in good order”.
- Trading systems should have functionality to systematically block purchase orders from clients who have been restricted by fund companies.
- Systems should have reporting or other detective controls to identify any changes, new orders, or cancellation of existing orders that occurs after 4:00PM. These controls should be monitored and supervised by a duly authorized control person no less frequently than daily. Exceptions identified through these tools should be researched, documented, and appropriate action taken.
- Detective controls should generate automated communications (e.g. emails) to appropriate management and compliance personnel altering them of trading exceptions. Exceptions would include orders entered after 4:00PM for the current day’s price and cancels after 4:00PM of orders entered prior to 4:00PM.
- Customer orders should never be time-stamped until entered and accepted by the system.

Street-side Placement & Execution

- Systems must be designed to operate automatically, without human intervention, to ensure that orders time-stamped after 4:00PM are segregated from orders received prior to 4:00PM.
- Systems must be designed to ensure that orders received after 4:00 PM are not transmitted to the fund for an execution price other than what the order is entitled to.
- Systems must be designed to ensure the orders executed based on the confirmation (provided by the fund) are not executed at a price other than the next calculated one.
- Systems should be designed to handle legitimate cancellations of purchase orders after 4:00PM that are the result of fund company decisions to rejection a purchase order. Access to handle such cancellations should be systematically controlled, limited to the minimum number of authorized employees, supported with written documentation from the fund company or its transfer agent. These cancellations should generate automated communication to the appropriate management/control/compliance personnel.
- Systems should have daily compliance reporting to capture all pre-4:00PM orders that are cancelled after 4:00PM. Report should generate automated communications (e.g. emails) to the appropriate management/control/compliance personnel. This report must be reviewed, retained, and signed off by an appropriately designated control or compliance person.