Your letter dated July 1, 1997 requests our concurrence with your interpretation of Rule 22c-1 under the Investment Company Act of 1940 ("1940 Act"). Specifically, you have asked whether a registered investment company ("fund") may, in compliance with Rule 22c-1, price an order for the purchase or sale of fund shares based on the fund's net asset value per share ("NAV") next computed after the order is placed with a third party, when the order is not transmitted to the fund until after NAV has been computed.

Facts

Charles Schwab & Co., Inc. ("Schwab"), a registered broker-dealer, sponsors The Schwab Mutual Fund Marketplace® and the Schwab Mutual Fund OneSource® Programs (the "Programs"). The Programs enable customers to purchase and redeem shares of participating funds ("Funds") through Schwab. Under the Programs, Schwab accepts customer orders to purchase and redeem Fund shares each business day that the New York Stock Exchange is open up until 3:00 p.m. Eastern Time ("Daily Deadline"). Schwab aggregates all Program customer orders received prior to the Daily Deadline into a single omnibus purchase order and a single omnibus redemption order and transmits the daily orders to each Fund, the Fund's transfer agent or another Fund-designated agent ("Fund Agent") through accounts established in Schwab's own name for the benefit of Program customers. Any Program customer orders that Schwab receives after the Daily Deadline are not included in the omnibus orders for that day, but instead are included in the orders for the next day. 1/

You state that, because most funds calculate their NAV at 4:00 p.m. Eastern Time ("Pricing Time"), Schwab's current procedures for handling Program customer orders disadvantage Program customers because they must place their orders with Schwab an hour earlier than investors who place their orders directly with the Funds, the Funds' transfer agents or Fund Agents. To eliminate this disadvantage, Schwab proposes to amend its existing agreements with each Fund or the Fund's transfer

1/ You state that Schwab usually transmits the daily orders prior to the time that most Funds calculate their NAV. Schwab may transmit orders after that time, however, due to unforeseen circumstances such as computer system failures, natural catastrophes or other emergencies, or human error. You state that, on these rare occasions, the Fund, the Fund's transfer agent or Fund Agent usually permits Schwab to transmit the orders at a later specified time.
agent or Fund agent ("Agreements") to authorize Schwab or an entity designated by Schwab ("Sub-designee") to accept Program customer purchase and redemption orders for a Fund each day up until the Fund's Pricing Time. 2/ Each Agreement also will authorize Schwab to aggregate all Program customer orders that it has accepted that day into omnibus orders, and transmit the omnibus orders to the Fund, the Fund's transfer agent or Fund Agent at a later agreed upon time. 3/ You represent that each Agreement will provide that (1) Schwab and, if applicable, its Sub-designee, is authorized to receive customer purchase and redemption orders on the Fund's behalf for purposes of Rule 22c-1; (2) Program customers will receive the Fund's NAV next computed after they place their purchase or redemption orders with Schwab or its Sub-designee; and (3) the Fund's board of directors has approved the authorization or will ratify it within a specified time period after the Agreement is revised or becomes effective and will periodically review the authorization. 4/

You represent that an independent public accountant or other qualified independent party will annually review Schwab's internal controls and prepare a written report to Schwab concerning their adequacy. You also represent that Schwab will seek to require each Sub-designee to retain an independent accountant or other independent party to annually review the Sub-designee’s internal controls and prepare a written report to Schwab and to the Sub-designee. You represent that Schwab will make both its internal control reports and the Sub-designee's internal control reports available to a Fund upon request.

You also represent that each Fund's prospectus will identify Schwab and its Sub-designees as parties that may accept purchase and redemption orders on behalf of the Fund. In this regard, you

2/ Pursuant to separate written agreements, Schwab will authorize Sub-designees to accept purchase and redemption orders on its behalf up until the Fund's Pricing Time. The Sub-designee would then transmit the orders to Schwab at an agreed-upon time and Schwab would aggregate them into the orders that it transmits to the Fund, the Fund's transfer agent or Fund Agent.

3/ The Agreements will provide that, under normal circumstances, Schwab will transmit daily orders by 8:00 p.m., Eastern Time, or some other specified time.

4/ Each Agreement between Schwab and a Fund or between Schwab and its Sub-designee will contain procedures for Schwab or the Sub-designee to follow in accepting customer orders and transmitting them to the Fund, the Fund's transfer agent or Fund Agent.
represent that each Agreement will require the following disclosure in a Program Fund's prospectus: (1) that the Fund has authorized one or more brokers to accept on its behalf purchase and redemption orders; (2) if applicable, that the brokers are authorized to designate other intermediaries to accept purchase and redemption orders on the Fund's behalf; (3) that the Fund will be deemed to have received a purchase or redemption order when an authorized broker or, if applicable, a broker's authorized designee, accepts the order; and (4) that customer orders will be priced at the Fund's NAV next computed after they are accepted by an authorized broker or the broker's designee.

Analysis

Rule 22c-1, in relevant part, provides that no fund issuing redeemable securities, no person designated in the fund's prospectus as authorized to sell or redeem the fund's shares, and no principal underwriter of, or dealer in, the fund's shares, may sell or redeem fund shares except at a price based on the current NAV of such shares which is next computed after receipt of a "tender of such security." The primary purpose of the rule is to prevent "backward pricing" (the purchase or sale of fund shares at a price based upon a previously determined NAV). 5/

In an interpretive release published shortly after the adoption of Rule 22c-1, the staff took the position that when a customer transmits an order to a retail dealer, the time of receipt of the order by the retail dealer, rather than the time of receipt by the fund or its underwriter, is controlling for purposes of determining the price to be received by the customer under Rule 22c-1. 6/ This position recognized that a customer would have no opportunity to take advantage of recent changes in the prices of a fund's portfolio securities if the customer receives a price for fund shares that is calculated after the customer placed the order. Moreover, the staff has indicated on several occasions that receipt of an order by a person designated by the fund, whether or not a dealer, would be "receipt of a tender" for purposes of Rule 22c-1. 7/ You maintain that under

5/ Investment Company Act Rel. No. 5519 (Oct. 16, 1968). In adopting Rule 22c-1, the Commission expressed the view that backward pricing could permit a speculator to take advantage of fluctuations in the prices of the fund's portfolio securities that occurred after the fund had last calculated its NAV.


7/ See Letter from Allan S. Mostoff, Director, Division of Investment Management, Securities and Exchange Commission, to Robert L. Augenblick, President, Investment Company
the proposed arrangement, "receipt of a tender" under Rule 22c-1 will occur at the time that Program customers place their orders with Schwab or with a Sub-designee.

Conclusion

We agree that customer orders placed directly with Schwab or its Sub-designee may be deemed to have been received by a Fund for purposes of Rule 22c-1 at the time that Schwab or its Sub-designee accepts them. We therefore would not object if a Program customer who places an order with Schwab or its Sub-designee before a Fund's Pricing Time receives the price calculated as of the Pricing Time, even if the order is transmitted to the Fund after the Pricing Time. You should note that different facts or representations might require a different conclusion.

In ratifying the Agreements and in subsequent periodic reviews, a Fund's board of directors should consider whether Schwab has adopted and implemented internal controls reasonably designed to prevent customer orders received after the Fund's Pricing Time from being aggregated with the orders received before the Fund's Pricing Time. In instances where Schwab has retained a Sub-designee, the board also should, in our view, consider whether Schwab has determined that the Sub-designee has adopted and implemented its own adequate internal controls. A board also may wish to consider whether Schwab has implemented internal controls designed to minimize errors that could result in late transmissions of orders to the Fund, the Fund's transfer agent or Fund Agent.

Jana M. Cayne
Senior Counsel

Institute (Feb. 9, 1973) ("service agents"); letter from Solomon Friedman, Director, Division of Corporate Regulation to David Silver, General Counsel, Investment Company Institute (Mar. 24, 1970) ("designees" including custodian banks and transfer agents).
July 1, 1997

VIA HAND DELIVERY

John V. O'Hanlon, Esq.
Assistant Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Re: Charles Schwab & Co., Inc.

Dear Mr. O'Hanlon:

We are writing to ask that the staff concur with our view that, under Investment Company Act of 1940 ("1940 Act") Rule 22c-1, investors may purchase or redeem mutual fund shares through certain brokerage programs ("Programs")\(^1\) sponsored by Charles Schwab & Co., Inc. ("Schwab") at the fund's net asset value per share ("NAV") next computed after the investor's order is placed with Schwab or an entity designated by Schwab ("Sub-Designee"), even though Schwab may not transmit the order to the fund, the fund's transfer agent or another fund-designated agent until after the NAV has been computed. We believe this practice fully complies with Rule 22c-1's terms and underlying policies, as well as relevant SEC and SEC staff positions.

We understand, however, that there may be some industry confusion concerning the application of Rule 22c-1 to funds participating in the Programs or to similar types of arrangements offered by other brokers. Schwab has asked us to submit this request to help resolve the matter.

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\(^1\) The two Programs are the Schwab Mutual Fund Marketplace and the Schwab Mutual Fund OneSource Programs. Schwab previously has obtained staff no-action and interpretive relief concerning the Programs under 1940 Act Section 22(d). See Charles Schwab & Co., Inc. (Aug. 6, 1992, June 30, 1987, Feb. 2, 1987, and Feb. 8, 1982).
I. BACKGROUND

Schwab is a registered broker-dealer and a member of the National Association of Securities Dealers, Inc. In addition to providing traditional discount brokerage services, Schwab sponsors the Programs, which enable customers to purchase and redeem shares of participating funds ("Funds") through Schwab. Schwab's current procedures for handling Program customer purchase and redemption orders generally are discussed below.

Schwab accepts Program customer orders to purchase and redeem Fund shares each business day that the New York Stock Exchange is open ("Work Day") up until 3:00 p.m. Eastern Time ("Daily Deadline"), an hour before the net asset values (NAVs) for most Program Funds are calculated ("Pricing Time").

Schwab aggregates all Program customer orders it has accepted on each Work Day into a single omnibus purchase order ("Purchase Order") and a single omnibus redemption order ("Redemption Order") (collectively, the "Daily Orders") and transmits the Daily Orders to the Fund, the Fund's transfer agent ("TA") or another Fund-designated agent ("Fund Agent") through accounts it has established with the Fund, TA or Fund Agent in Schwab's own name for the benefit of Program customers. Any customer orders that Schwab receives after the Daily Deadline are not included in the Daily Orders for that Work Day but, instead, are included in the Daily Orders for the next Work Day.

Under normal circumstances, Schwab transmits the Daily Orders to the Fund, TA or Fund Agent before the Fund's Pricing Time. However, due to unforeseen circumstances, such as computer system failures, natural catastrophes or other emergencies or human error, Schwab may not be able to transmit the Daily Orders until later ("After Hours Transmittal").

On these rare occasions, the Fund, TA or Fund Agent usually instructs Schwab to transmit the Daily Orders at a later specified time which the Fund, TA or Fund Agent has determined will be in sufficient time so that (1) the impact of Schwab's order on the Fund's net sales or

2/ For example, certain Funds whose shares are purchased and redeemed through the Programs participate in Fund/SERV, a centralized and automated system for mutual fund purchases and redemptions. Under Fund/SERV, the National Securities Clearing Corporation ("NSCC") collects mutual fund purchase and redemption orders from member broker-dealers and other financial institutions each day for delivery to the Funds or the TAs. NSCC then transmits the orders to the Funds or the TAs in an electronic format.
redemptions can be known and taken into account by the Fund’s portfolio manager in deciding the next day’s portfolio transactions and (2) the transmission delay will not otherwise adversely affect the Fund or its shareholders, e.g. by dilution of other shareholder’s interests in the Fund (“Final Deadline”).

There have been instances where a Fund, TA or Fund Agent has refused to accept an After Hours Transmittal from Schwab. Nonetheless, Program customers whose orders Schwab accepted during a Fund’s Work Day before the Daily Deadline have received a price equal to the Fund’s NAV as of that Work Day’s Pricing Time, and Schwab has had to cover the transaction at a price equal to the Fund’s NAV at the next Work Day’s Pricing Time.

II. PROPOSAL

A. Revised Order Acceptance Procedures

Schwab’s current procedures for accepting Program customer orders to purchase and redeem Fund shares disadvantage Program customers because Program customers must place their orders with Schwab an hour earlier than other investors who place their orders directly with the Fund, TA or Fund Agent. To avoid this disadvantage, Schwab proposes to amend its existing agreements with each Program Fund or the Fund’s service provider (“Agreements”). Under each Agreement, the Fund or the Fund’s service provider will authorize Schwab to accept Program customer purchase and redemption orders for a Fund each Work Day up until the Fund’s Pricing Time. The Agreement will then authorize Schwab to aggregate all Program customer orders it has accepted that Work Day into the Daily Orders and transmit the Daily Orders to the Fund, TA or Fund Agent at a later agreed upon time.

The Agreement will further provide that, under normal circumstances, Schwab will transmit the Daily Orders by 8:00 p.m. Eastern Time, or some other specified time later that evening. On rare occasions, due to unforeseen circumstances discussed above, Schwab will notify the Fund that it is unable to meet the specified time, and the Fund will make a reasonable accommodation to enable Schwab to transmit the Daily Orders by the Final Deadline.

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2/ This is consistent with industry practice. For example, we understand that Fund/SERV member broker-dealers and other financial institutions typically forward mutual fund purchase and redemption orders they have accepted during a Fund’s Work Day to NSCC by 7:00 p.m., Eastern Time, and then NSCC transmits the orders to the Funds or the TAs by 8:00 p.m. Eastern Time.
B. Sub-Designee Proposals

Schwab also proposes to designate one or more Sub-Designees to accept Program customer purchase and redemption orders on behalf of Schwab and, in turn, on behalf of the Funds. To do this, Schwab would enter into a separate written agreement with each Sub-Designee ("Sub-Designee Agreement"). The Sub-Designee would be authorized to accept Fund purchase and redemption orders from its customers each Work Day up until the Fund’s Pricing Time. The Sub-Designee would then transmit the customer orders to Schwab ("Sub-Designee Orders") at an agreed upon time (the "Sub-Designee Daily Deadline") and Schwab, in turn, would aggregate them into the Daily Orders it transmits to the Fund, TA or Fund Agent, as discussed above.

III. ISSUE

Rule 22c-1 prohibits a fund, the fund’s principal underwriter, a dealer in the fund’s shares or any person designated in the fund’s prospectus as authorized to sell or redeem shares, from selling or redeeming fund shares “except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security.” Schwab and the Sub-Designees will be described, either generically or specifically, in the Funds’ prospectuses as entities authorized to accept orders to sell and redeem Fund shares. Therefore, we believe that “receipt of a tender” will occur at the time Program customers place their orders with Schwab or, for those customer orders placed with a Sub-Designee, at the time they are placed with the Sub-Designee. However, we are requesting the staff’s confirmation of our view to resolve any uncertainty.

IV. ANALYSIS

A. Rule Text

By its terms, Rule 22c-1 requires (1) a person described as authorized to sell or redeem a fund’s shares (2) in the fund’s prospectus (3) to sell or redeem the shares at a price equal to the fund’s NAV next computed after receipt of an order. We believe the arrangements described in this letter will fully comply with each element of the rule.
1. Authorization

First, Schwab and the Sub-Designees will be authorized to sell or redeem the Funds' shares. Schwab will have a formal Agreement with each Fund or a Fund's service provider authorizing Schwab or Schwab's Sub-Designees to sell or redeem shares purchased through the Programs with specific provisions governing Schwab's obligations in connection with such sales and redemptions.

Each Agreement will provide or represent: (1) that Schwab and, if applicable, Schwab's Sub-Designees, are authorized to receive Program customer purchase and redemption orders on the Fund's behalf for Rule 22c-1 pricing purposes (the "Authorization"); (2) that, as a result of the Authorization, Program customers will receive the Fund's NAV next computed after they place their purchase or redemption orders with Schwab or, in the case of Sub-Designees, after they place their orders with the Sub-Designees; (3) that the Fund's board of directors has approved the Authorization or will ratify it within a specified time period after the Agreement is revised or becomes effective (the "Ratification"), and will thereafter periodically review the Authorization.

It is, of course, the responsibility of each fund's board of directors to determine the factors it should consider in making the Ratification and subsequent periodic reviews. A board may wish to consider, among other things, the following criteria ("Internal Controls"): (1) that Schwab has adopted and implemented internal controls reasonably designed to prevent customer orders received on a Work Day after the Fund's Pricing Time from being aggregated with the Daily Orders for that Work Day; and (2) that Schwab has established and implemented internal controls designed to minimize emergencies or errors that could result in late transmissions of Daily Orders to the Fund, TA or Fund Agent. In those instances where Schwab has retained a Sub-Designee, the Board also may wish to consider whether Schwab has determined that the Sub-Designee has its own adequate Internal Controls.

To assist the Board in considering the foregoing, Schwab will follow the procedures described below or such other procedures mutually acceptable to Schwab and a Fund. Schwab's independent public accountant or another qualified independent party will annually review Schwab's Internal Controls and prepare a written report concerning their adequacy ("Internal Controls Report"). The Internal Controls Report will identify any noted deficiencies and any corrective actions taken to address the deficiencies. Schwab will make the Internal Controls Report available to the Fund upon request. Schwab also will seek to require each Sub-Designee to retain an independent accountant or other independent party to annually review the Sub-Designee's Internal Controls and prepare an Internal Control Report ("Sub-Designee Internal Controls Report").
Control Report”). Schwab will make each Sub-Designee’s Internal Control Report available to
the Fund upon request.

2. Prospectus Disclosure

Each Fund’s prospectus will identify Schwab and its Sub-Designees (either specifically or
generically) as parties that may accept purchase and redemption orders on behalf of the Fund.
In this regard, each Agreement will require the following prospectus disclosures: (1) that the
Fund has authorized one or more brokers to accept on its behalf purchase and redemption
orders that are in “good form”; (2) if applicable, that the brokers are authorized to designate
other intermediaries to accept purchase and redemption orders on the Fund’s behalf; (3) that
the Fund will be deemed to have received a purchase or redemption order when an authorized
broker or, if applicable, a broker’s authorized designee, accepts the order; and (4) that customer
orders will be priced at the Fund’s NAV next computed after they are accepted by an
authorized broker or the broker’s designee.

3. Pricing

Finally, a Fund’s shares will be sold and redeemed at a price equal to the Fund’s NAV next
computed after Schwab or its Sub-Designee accepts an order. Each Agreement between
Schwab and a Program Fund or the Fund’s service provider, and each Sub-Designee Agreement
between Schwab and a Sub-Designee will contain procedures for Schwab or the Sub-Designee
to follow in accepting customer orders and transmitting them to the Fund, TA or Fund Agent.

In most cases, Schwab anticipates that these procedures will require it to aggregate all the
orders accepted each Work Day up until the Fund’s Pricing Time by Schwab or its Sub-
Designees into the Daily Orders. Schwab will then transmit the Daily Orders to the Fund, TA
or Fund Agent between 7:00 and 8:00 p.m., Eastern Time, or later that evening. In any event,
when unforeseen circumstances arise, the procedures will require Schwab to transmit the Daily
Orders by the Final Deadline.

B. SEC and SEC Staff Positions

The pricing methodology discussed in this letter is consistent with SEC and SEC staff positions
under Rule 22c-1. In 1968, the SEC published an interpretive release (the “1968 Release”)
stating the staff’s view that where customer orders are placed with a retail dealer authorized to
sell and redeem the fund’s shares “the time of receipt of the order by the retail dealer is
controling” for Rule 22c-1 pricing purposes. Consequently, customer purchase and redemption orders must receive a price equal to the fund's NAV next computed after the customer order is accepted by the retail dealer and not when the fund's principal underwriter receives the order from the retail dealer. However, the 1968 Release also states that “it is the responsibility of the retail dealer to establish procedures which would assure that upon his receipt of a customer's order it will be transmitted so that it will be received by the underwriter before the time when the price applicable to the customer's order expires.”

The staff revised the 1968 Release in a 1973 letter to the Investment Company Institute (the "1973 Letter"). The 1973 Letter directly addresses situations such as Schwab's where "orders are forwarded by dealers or investors directly to a 'service agent' and there processed on behalf of the dealers, thus by-passing the dealers' back offices." It concludes that the staff "would have no objection to such orders being considered as having been received for purposes of the Rule at the time that they are received by the 'service agent,' provided that such arrangements are fully disclosed in the mutual fund's prospectus."

Finally, in 1985, the SEC clarified the staff's views concerning the application of Rule 22c-1 to situations where a fund or the fund's designee is not able to price customer orders due to unforeseen emergencies (e.g., a snow storm) and unrelated operational problems (e.g., a computer system failure at the fund's transfer agent) ("1985 Release"). The 1985 Release states that under these circumstances, a "fund is expected to make every effort to price investor orders for purchase and redemption on the day the order is actually received, and to establish procedures so as to be reasonably able . . . to ensure that investor orders can be given the price that, but for the emergency, would have been computed on the day of actual receipt." The 1985 Release further states, however, that where "operational problems unrelated to an emergency closing result in transactions being processed on an 'as of' basis, the adviser, transfer agent or another responsible party may be liable to the fund for any resulting dilution."

The pricing methodology discussed in this letter is fully consistent with each of these positions. First, and most important, the Funds' prospectuses will identify Schwab and Schwab's Sub-Designees (either specifically or generically) as parties that may accept Program customer purchase and redemption orders on their behalf. Therefore, consistent with the 1973 Letter,

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customer orders placed directly with Schwab will be deemed to have been received for Rule 22c-1 purposes at the time Schwab accepts them. Similarly, orders placed with a Sub-Designee will be deemed to have been received when the Sub-Designee accepts them.

Second, although Schwab acts as a broker in connection with the Programs and is not a retail dealer described in the 1968 Release, each Agreement will contain procedures to ensure that the Daily Orders for each Work Day are transmitted to the Fund or the TA before the Final Deadline when the price applicable to the Daily Orders expires. Finally, to deal with possible problems resulting from Daily Orders transmitted after the applicable price expires, Schwab has established mechanisms to make sure customers whose orders it has accepted are made whole.

C. Underlying Policies

The order handling procedures discussed in this letter are consistent with the policies underlying Rule 22c-1. The SEC release adopting the rule states that one of its purposes is to eliminate any share value dilution resulting from (1) the sale of shares at a price below their current NAV; or (2) the redemption of shares at a price above their NAV. The earlier situation could arise where a fund's shares are sold for a specified time period at a price based on a previously determined NAV. This situation could permit a potential investor to take advantage of an upswing in the market and the resulting increase in the fund's NAV by purchasing the shares at a price that does not reflect the increase, causing a dilution in the value of previously outstanding shares.

Rule 22c-1's adopting release also states that the rule was intended to address certain practices, aside from dilution, that could disadvantage existing shareholders:

The Commission believes that the practice of selling securities for a certain period of time, at a price based upon a previously established net asset value, encourages speculative trading practices which so compromise registered investment companies as to be unfair to the holders of their outstanding securities. This practice allows speculators to buy large blocks of such securities under circumstances where the net asset value of the securities has increased but where the increase in value is not reflected in the price. The speculators hold

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such securities until the next net asset value is determined and then redeem them at large profits.\[3\]

The procedures discussed in this letter do not raise either of these concerns since Fund shares are not sold and redeemed at a previously determined NAV. On the contrary, all Program customers receive a Fund's NAV next computed after their orders are accepted by Schwab or, where the orders are placed with a Sub-Designee, after the Sub-Designee accepts them.

V. CONCLUSION

We believe the foregoing arrangements are fully consistent with Rule 22c-1's terms and underlying policies, as well as SEC and SEC staff positions, and ask that the staff issue a letter concurring with our view.

Please call me if you have any questions or comments concerning this matter. We would appreciate a prompt response to our request in light of its importance to the mutual fund industry.

Sincerely,

Lawrence P. Stadulis

cc: Nancy A. Petranco
Vice President and Associate General Counsel
Charles Schwab & Co., Inc.

Kathryn B. McGrath
Morgan, Lewis & Bockius LLP

\[3\] Id.