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S7-29-03

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BARCLAYS GLOBAL INVESTORS

March 8, 2004

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OFFICE OF THE SECRETARY

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

Re: **Concept Release: Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs (File No. S7-29-03)**

Dear Mr. Katz:

I am writing on behalf of Barclays Global Investors, N.A. and Barclays Global Fund Advisors (together, "BGI") in response to the recent Concept Release by the Securities and Exchange Commission (the "Commission") and the Commission's request for comment relating to the disclosure of mutual fund transaction costs. This letter supplements our letter of February 27, 2004 and provides detailed responses to certain of the specific questions set forth in the Concept Release.

BGI is one of the world's largest institutional investment managers and is the world's largest provider of structured investment strategies such as indexing, tactical asset allocation, and quantitative active strategies. As of December 31, 2003, BGI and its affiliates managed over $1 trillion dollars in assets globally, including $217 billion in active strategies and over $105 billion in mutual funds and exchange-traded funds. BGI is a subsidiary of Barclays Bank PLC.

General Questions about Quantifying Transaction Costs

1. **Is investor decision-making harmed because investors lack numerical information about mutual fund transaction costs?**

   As discussed in our February 27 letter (the "Prior Letter"), BGI does not believe that investor decision-making is harmed. First, investors currently receive standardized prospectus disclosure of both pre- and post- tax performance information. This allows investors to compare the historical performance of similar funds. In addition, various information providers (such as Morningstar) provide information that makes it relatively easy for investors to compare performance among similar funds. Second, in comparing how two similar mutual funds arrived at their historical results, we believe that while numerical information about transaction costs would be incremental information, it would not add any incremental value to most investors' decision-making process. If one looks at the thousands of mutual funds currently offered it is clear that they arrive at their investment results from significantly different approaches: for example, long-term buy and hold, short-term momentum, relative valuation models, and indexed return. Using numerical information concerning transaction costs to compare the portfolio transaction efficiency of funds using varying investment strategies does not add any significant value. Similarly, transaction costs will be affected by the level of shareholder purchases into and out of a fund. One would expect a fund with higher or more frequent cash inflows or outflows to have higher transaction costs than a fund with lower or less frequent inflows or outflows.

2. **What would be the best way to provide investors with additional numerical information about the amount of transaction costs that mutual funds incur? Would the information most appropriately be located in the prospectus, the SAI, or in another disclosure document?**

   As we have articulated, we do not believe that investors will be helped by providing additional numerical information about transaction costs because we do not believe such information would improve the decision making process of most investors. As discussed in our Prior Letter, we believe that funds should disclose fund policies on the use of soft dollars and directed brokerage and the amount of directed or soft dollar commissions being paid.

Questions about Quantifying Commissions and Spreads

3. **Would a requirement to quantify (express as a percentage) and disclose brokerage commissions, but not other transaction costs provide useful information to fund investors? If funds are required to quantify and disclose their brokerage commissions, should the number be included in fund expense ratios and fee tables?**

   As discussed in our Prior Letter, we don't believe that this information provides a useful measure that the retail investor will be able to use in comparing one mutual fund to another. Any proposal which focused only on actual brokerage commissions paid could be potentially misleading as it would ignore numerous factors – such as market impact and opportunity costs – that may have a more significant impact on performance. There are many other factors that go into evaluating a 'good manager' from a 'lesser manager' and focusing only on commissions paid ignores this to the potential detriment of investors. If funds are required to disclose brokerage commissions, we believe that requiring disclosure in fund expense ratios and fee tables would distort investor decision-making since such disclosure, by ignoring implicit costs, would paint a misleading picture of a fund's total portfolio execution costs.

4. **Does the increased use of riskless principal trades on NASDAQ make it easier to quantify the cost of NASDAQ trades? What proportion of NASDAQ trades are subject to commission-equivalent fees?**

   Although riskless principal trades (typically assuring closing price) might appear to be easier to quantify, the true cost of these trades (excluding commission) reflects the extent to which closing prices might move due to the executing broker's actions. Measuring what might have been in absence of a trade occurring is impossible or, at best, subject to widely varying estimates. Further, there are no reliable estimates on the fraction of NASDAQ trades that should be subject to commission equivalent fees.

5. **Would quantifying commissions mislead investors because it would result in a number that includes some transaction costs and excludes others? Please explain the reasons for your answer.**

   Yes, as discussed in more detail in our Prior Letter and herein, we believe any such disclosure would be either misleading or of little use to investors. First and foremost, retail investors will not be able to improve their investment decisions by a relative comparison of these numbers – there are too many other factors involved. Further, there is very little agreement throughout the industry on the appropriate way to measure transaction costs and whether any particular trade is 'good or bad' varies based upon the objective of the fund. As an example, assume that three funds execute a trade in a particular stock at exactly the same time and exactly the same price. Fund A is an active mutual fund using cash to buy the stock, Fund B is an index mutual fund using cash to buy the stock, and Fund C is an active mutual fund simultaneously buying this stock while selling another. The true cost of this transaction for each fund is very different. Each fund needs to consider the explicit cost of transacting. In addition, Fund A has to consider the value of trading at that moment versus trading at another time or versus any other opportunity. Fund B, in addition to sharing Fund A's concerns, as an index fund needs to consider the extent to which the price obtained on the transaction might differ from the end of day price at which the fund's underlying index would measure it's return. Fund C, in addition to sharing Fund A's concerns, would have to consider the value of this trade in conjunction with the corresponding sale of the other security – the best outcome for the fund might be to have a high explicit transaction cost for the purchase while accepting a corresponding lower explicit transaction cost on the sale.

6. **If the answer to question 5 is yes, would the concern be alleviated if funds were required to quantify commissions and provide investors with disclosure that details the portion of trades that are performed on a commission basis; spread basis; or some other basis (e.g., directly from an issuer)?**

   No – this is again more information that will not lead to better decision making.

7. **What effect, if any, would a requirement to quantify commissions have on the incentives of fund managers with respect to (1) use of principal versus agency transactions; and (2) use of soft dollar transactions?**

   As we articulated in our Prior Letter, we believe the Commission should separate these two issues. A manager's decision to use principal or agency transactions should be driven by the manager's desire and requirement to seek best execution for their client's portfolio. Many of the proposed quantifications of transaction costs discussed in the Concept Release could lead to an incremental bias to favor one type of transaction over another (because of varying disclosure burdens), without improving the drive to maximize the focus on best execution. As previously discussed, we believe that disclosure of soft dollar and directed brokerage transactions is appropriate because it helps investors quantify the portion of their assets being converted into services that the fund manager chooses to purchase. We believe that the use of soft dollars creates inherent conflicts, which potentially distort efforts to seek best execution, and therefore we do not have any soft dollar agreements. We do believe that managers should be required to disclose in a much clearer manner the amount of commissions allocated for soft or directed brokerage purposes.

8. **Could any possible adverse effects identified in questions 5 and 6 be mitigated or eliminated by requiring funds, in addition to reporting their commission costs, to estimate the spread cost of their principal trades (for example, by imputing to principal trades the fund's average commission rate on agency trades)? If yes, should this number be included in fund expense ratios and fee tables?**

   No. There is no agreed standard for estimating the portion of a principal trade's spread which is risk based versus 'normal'. Further, a 'normal' spread is not necessarily indicative of the cost of the trade either. As stated previously, this doesn't create a measure that is readily or appropriately comparable between funds.

9. **Alternatively, can the portion of spread cost that represents payment for executing a trade be measured separately from the portion of the spread that represents the market impact cost associated with that trade? If yes, should this number be included in fund expense ratios and fee tables?**

   No. See question 8.

Questions about Quantifying All Transaction Costs

10. **Would a requirement to quantify all transaction costs provide useful information to fund investors? Would a requirement to quantify all transaction costs, except opportunity costs, be a better alternative? If you advocate that we mandate either of these alternatives, please explain as**

specifically as possible, how the alternative should be implemented. Please discuss the specific algorithms, formulas, definitions, recordkeeping requirements, and internal control requirements that should be used. Commenters are encouraged to address the following specific topics:

- **A. How should funds measure their spread costs?**
- **B. How should funds measure their market impact costs?**
- **C. How should funds measure their opportunity costs?**
- **D. Should spread, market impact and opportunity costs be measured trade-by-trade or for all transactions?**
- **E. Should spread, market impact and opportunity costs be measured absolutely or relative to a benchmark?**
- **F. Should this number be included in fund expense ratios and fee tables?**

We believe the answer to your first question is "no", for two main reasons. First, investors currently receive disclosure of fund return information on both a pre- and post- tax basis. This allows investors to compare similar asset classes based upon historical results. In comparing how two similar mutual funds arrived at their historical results, numerical information about transaction costs would be incremental information, but would be insufficient to add any incremental value to the decision process. If one looks at the thousands of mutual funds currently offered it is clear that they arrive at their investment results from significantly different approaches; long-term buy and hold, short term momentum, relative valuation models, indexed returns. As an example, compare the transaction cost of a small cap growth index mutual fund versus an actively managed small cap growth mutual fund. The index fund likely will have very low transaction costs as a direct result of being an index fund with relatively low turnover. However, the opposite is likely to be true with the active fund. It would likely have higher transaction costs as a result of its active management. Clearly, using numerical information concerning transaction costs between these two funds would not add significant value to an investor's decision as to whether or not to invest in one of the funds. With respect to the other questions set forth above, we note that, as discussed in our Prior letter and elsewhere herein, it would be extremely difficult to develop generally accepted methodology to measure and disclose implicit costs in a useful fashion.

11. Would the trade effect measure provide useful information to investors, and if so, should we require its disclosure? If the Commission mandated trade effect disclosure, should trade effect be measured with respect to same day closing prices or next day closing prices?

We believe that this measure may in fact contain beneficial information. However, we are concerned that it will place too much emphasis on short-term profit and loss from trading, which is antithetical to the long-term nature of most mutual fund investments. Ultimately, we believe disclosure should provide investors with the information necessary to select those funds that will provide them with an appropriate risk-adjusted return for their investment.

12. **More generally, if the Commission were to choose to require disclosure of only one transaction cost measure, which measure should it be?**

    We strongly suggest that the appropriate focus should be on the clear disclosure of soft dollar and directed brokerage policies and arrangements because of the potential conflicts inherent in such arrangements. We believe it is important for investors to understand that a portion of their transaction costs are in fact being used to purchase services which would otherwise be expected to have been paid from the management fee of the fund or by the adviser. Additional quantitative disclosure of other transaction costs measurements, since they already are factored into the performance information that fund investors currently receive, will not provide investors with additional useful information and is not likely to improve an investor's ability to select one fund over another. In addition, as discussed, to the extent such quantitative disclosure is oversimplified or does not facilitate comparison between funds it could be misleading to investors.

Questions about Accounting Issues

13. **Would it be appropriate to include some or all transaction costs in fund expense ratios and fee tables without accounting for these items as an expense in fund financial statements?**

    We do not believe that explicit costs (*e.g.*, brokerage commissions) or implicit costs (*e.g.*, opportunity costs) should be disclosed in expense ratios or fee tables. We believe the Commission should consider ways to quantify the cost of soft dollar transactions so that their impact on performance could be better understood by investors.

14. **Would it be feasible to account for some or all transaction costs as an expense in fund financial statements? If it is not feasible to reliably measure market impact and opportunity costs, should we still require that commission costs be expensed? If yes, should the requirement apply to all commission costs or only those commission and spread costs that do not relate to the execution and clearing of a portfolio transaction (*i.e.*, soft dollars)? If it is not feasible to reliably measure all research costs, should we still expense those costs that can be reliably measured (*i.e.*, payments to third parties for research)?**

    As stated in our Prior Letter and in our response to the previous questions herein, we strongly suggest that the appropriate focus should be on the clear disclosure of soft dollar and directed brokerage policies and arrangements because of the potential conflicts inherent in such arrangements. Further, any proposal which focused only on actual brokerage commission paid could be potentially misleading as it would ignore numerous factors – such as market impact and opportunity costs – that may have a more significant impact on performance. It could also inadvertently induce fund managers to rely more on certain kind of trading avenues (*e.g.*, principal trading) to minimize the reporting of commissions.

15. **Are mutual funds and their managers better able than they were in the past to track the portion of commission costs that purchase research services from brokers? Has the improvement been sufficient to make it feasible for us to require funds to expense these items in their financial statements? Since soft dollars are earned based on complex-wide trading activity, how should research and other non-execution costs be allocated among funds? Can soft dollars be traced to individual portfolio transactions? (This would entail adjusting the basis of the securities purchased in those transactions for the portion of the commission cost that was used to purchase research services.) Alternatively, should an aggregate adjustment (not specified to a particular portfolio transaction) be made to realized and unrealized gain or loss? If funds and their managers are not yet capable of tracing the portion of commission costs that purchase research services from brokers, what factors continue to prevent funds and managers from developing this capability?**

    We would be surprised if it is suggested that the explicit costs of soft dollar and directed brokerage arrangements cannot be tracked. Any such finding would quickly call into question whether the adviser was satisfying its obligations to obtain best execution on behalf of the funds it advises. This is equally true for complex-wide trading activity.

Questions about Improving Disclosure Related to the Level of Transaction

16. **Are there ways to provide a rough estimate of transaction costs, or develop a scheme to categorize these costs (for example, "very high," "high," "average," "low," or "very low") under general guidelines set by the Commission that would mitigate the difficulties involved in coming up with a more precise measure, and yet still provide useful information to investors? Could such an approach produce results that are consistent enough to permit meaningful comparison among funds? If yes, please provide specific suggestions.**

    No, in order to make the distinction between any two categories meaningful (*i.e.*, "average" or "high"), the same level of accuracy and the same industry-wide standardization as is necessary to create a specific measure would be necessary. In the absence of such standardization and accuracy, investors would have no way to compare funds from different complexes. In addition, to the extent this system relied on self-reporting, it might create a bias in favor of underreporting.

17. **In general, do the current disclosure requirements relating to transaction costs described in this section of the release provide investors with adequate**

information? If not, what additional information should funds provide? Would one or more of the alternatives described in this section provide useful information to investors, or would the alternatives lengthen the prospectus while providing no real benefit? If one or more of these alternatives would provide meaningful information, would the information most appropriately be located in the prospectus, the SAI, the report to shareholders, or in another disclosure document?

As discussed herein and in our Prior Letter, we do not believe that investors will be helped by providing additional numerical information about transaction costs.

18. Does existing portfolio turnover disclosure provide useful information about transaction costs? If additional narrative disclosure concerning portfolio turnover and its relationship to transaction cost is needed, what information should be required?

We do not believe that existing portfolio turnover disclosure requirements are particularly useful to investors or that additional narrative disclosure would add significantly useful information. Portfolio turnover can be generated in many different ways and the relative effect of that turnover is a direct function of how it is generated. If a fund is not growing or shrinking significantly because of net inflows or outflows, its portfolio turnover rate can be compared to other similar funds in order to compare the level of trading activity in each fund. However, in the presence of significant differences between net inflows or outflows these numbers are no longer comparable. In addition, a higher level of portfolio turnover may not be indicative of higher portfolio transaction costs. As discussed, implicit costs typically make up a high percentage of portfolio transaction costs. While portfolio turnover rate may be somewhat suggestive of the level of explicit transaction costs, portfolio turnover rate is not at all suggestive of the level of implicit costs. Another example would be exchange-traded funds ("ETFs"). ETFs provide for the "in-kind" exchange of securities into and out of the ETF portfolio whereby the security transaction cost is generally borne outside the ETF by the institutional investor requesting the transaction. For this reason, portfolio turnover in an ETF portfolio isn't necessarily linked to transaction costs, making meaningful comparison between ETFs and traditional funds more difficult.

19. Does the existing requirement to disclose the dollar amount of commissions paid provide investors with meaningful information about transaction costs? How can the existing requirement be improved?

Because this is a strict dollar number and isn't related to the size of the fund or the level of implicit costs, it provides very little value to the investor. Relating this cost to a percentage of net assets or average commissions paid would be a slight improvement. However, as discussed, this approach leaves out much important information (*i.e.*, implicit costs) and does not do much to help investors make a distinction between funds with different investment objectives (*e.g.*, large vs.

small cap stocks), strategies (*e.g.*, active vs. passive), and turnover – as illustrated in our answer to question number 5.

20. Would an average daily net flow measure provide useful information to investors?

We believe that this measure is potentially confusing to investors and might be distorted by large inflows or outflows. There is also the danger that disclosure of flows might induce further flows in the same direction by investors who are overly influenced by this measure.

21. Should the Commission consider policies to encourage funds to charge purchasers and redeemers of fund shares a fee payable to the funds to compensate existing and remaining investors for the costs they bear when their funds accommodate the purchases and redemptions of other investors? If yes, should the Commission consider requiring funds to disclose how they compute these fees, if they require them; and why they do not require these fees, if they do not?

Such policies would be very difficult to implement. As discussed, there is very little agreement throughout the industry on the appropriate way to measure transaction costs. Any charge which focused only on explicit brokerage commissions paid would potentially understate the level of costs borne by other shareholders as it would ignore numerous factors – such as market impact and opportunity costs – that may have a significant impact on the level of transaction costs. In addition, it would be difficult for funds sold through omnibus accounts to monitor such purchases and redemptions.

22. Should the requirement to disclose average commission rate per share be reinstated, in either its original form or in a revised form? If you advocate that it be reinstated in a revised form, please provide specific suggestions.

See question 19. Average commission in percentage or commission dollars per share will not help to improve investors' decision-making process.

23. Is "transaction costs" as described in this release a useful concept, or would it be more useful for investors to see the effect of all costs combined, for example, by showing the following:

- **Gross or "pure" portfolio return;**
- **Net return to shareholders; and**
- **The resulting difference?**

We do not believe that additional disclosure of transaction costs, as described in the Concept Release, is a useful concept for most investors since we believe it places undue emphasis on one component of gross returns and is likely to confuse ordinary investors. We do not believe the other approaches (*i.e.*, gross portfolio return, net return, etc.) would prove to be significantly more useful,

24. If it would be useful for investors to see the effect of all costs combined, could funds calculate and report the gross or "pure" portfolio return, net return to shareholders and the resulting difference on an annual basis?

See question 23.

25. Should the Commission require disclosure of gross returns? If so, what definition would be most useful? Of what benefit would these returns be to investors? How expensive would it be for funds to compute these returns?

See question 23.

26. Would the disclosure of gross returns allow investors to better identify dilution due to market timers?

Gross returns will reflect short run trading profits, and as such, will be at best a very "noisy" and inaccurate measure of market timing dilution.

27. If portfolio returns are to be disclosed, how should the returns be adjusted for fund flows into and out of the portfolio? Should they be computed using internal rate of return methods; time-weighted average methods; or should other methods be used?

We would favor the use of time-weighted returns as the best measure should disclosure occur.

28. If portfolio returns are to be disclosed, should these returns only be disclosed, or should the differences between these returns and the shareholder returns be disclosed?

We don't believe that these returns are meaningful to investors, and therefore disclosure will add little, if any, value.

29. Where should these returns or return differences be disclosed, and how should they be described?

We don't believe that these returns are meaningful to investors, and therefore disclosure will add little, if any, value.

Questions about Board Review of Transaction Costs

30. Are existing requirements for board review of transaction costs adequate? If they are not adequate, how can they be improved?

We believe that it is critically important that fund boards ensure that the fund manager has in place appropriate policies and procedures to effect best execution in a manner consistent with each fund's investment objective. We also believe that funds should adopt policies on the use of soft dollars and directed brokerage commissions, and that such policies and arrangements should be reviewed by fund boards on an annual basis.

31. **Should boards be required to receive reports with mandated information regarding soft dollars and directed brokerage payments? Should investors be provided periodically with a summary of these reports?**

A requirement to have fund boards receive reports on soft dollar and directed brokerage payments would be consistent with our response in 30 above. Our view on the use of soft dollars, directed brokerage and disclosure to investors is stated in our Prior Letter.

32. **One problem in evaluating execution cost measurements is in identifying a standard of comparison. It may be difficult for fund directors to assess the fund's execution performance statistics in a vacuum, without comparison with other funds' statistics. Should the Commission, or other independent body, collect these statistics from similar funds and make available aggregate statistics for comparison purposes?**

We do not think it would be useful for the Commission or other independent body collect these statistics from similar funds and make available aggregate statistics for comparison purposes. As discussed, there is not a generally accepted methodology for measuring implicit transaction costs. Therefore, any comparative statistics will have limited value – probably well below the cost of acquisition. Boards, in consultation with fund advisers, will need to conduct their own assessments.

33. **Should fund advisers be required to provide fund boards with an internal allocation of their uses of brokerage commissions, indicating the amounts and percentage used by the adviser to obtain execution services and soft dollar benefits, specifically detailing the types and amounts of the various kinds of benefits? Should there be separate allocations among types of research, such as research produced by underwriters, or other broker - dealer affiliates?**

Yes, this information should be disclosed to the fund boards as it will help boards assess the performance of, and level of fees paid to, fund advisers.

We appreciate the opportunity to comment on the Concept Release and look forward to continuing to work with the Commission on these important issues.

Sincerely,

Minder Cheng
Global Head of Equity & Currency Trading