

**NATIONAL SECURITIES CLEARING CORPORATION  
55 WATER STREET  
NEW YORK, NEW YORK 10041**

April 10, 2006

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-9303

**Re: File No. S7-06-06, Proposed Amendments  
to Rules Regarding Mutual Fund Redemption Fees**

Dear Ms. Morris:

National Securities Clearing Corporation (“NSCC”) appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (the “Commission”) to amend Rule 22c-2 under the Investment Company Act of 1940 (the “Investment Company Act”).<sup>1</sup> NSCC is a clearing agency registered with the Commission under Section 17A of the Securities Exchange Act of 1934 (the “Exchange Act”).

As is discussed more fully below, our comments are limited to the portion of the proposing release that refers to a registered clearing agency as a potential agent for a fund that could be authorized, on behalf of the fund, either to enter into a shareholder information agreement with a financial intermediary, or to prohibit a financial intermediary from trading in securities issued by the fund (paragraph (a)(2) of the proposed rule). For the reasons stated below, we respectfully urge the Commission to delete the reference to registered clearing agencies in the final rule.

**NSCC’s Role as a Registered Clearing Agency for the Mutual Fund Industry**

As relevant to this letter, NSCC offers centralized information and settlement services for mutual fund and insurance and annuity transactions by linking mutual funds and insurance carriers with broker dealers, banks and other financial intermediaries that distribute mutual funds and insurance products, respectively.<sup>2</sup>

As indicated in the proposing release, NSCC is the only registered clearing agency for funds.<sup>3</sup> NSCC provides an automated system for trade processing and financial

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<sup>1</sup> Investment Company Act Release No. 27255 (February 28, 2006) (the “proposing release”).

<sup>2</sup> NSCC also provides centralized clearance, settlement and information services for a substantial majority of U.S. inter-broker trades in equity securities, corporate and municipal bonds, exchange-traded funds and unit investment trust shares.

<sup>3</sup> The proposing release at Note 34.

settlement of mutual fund orders, Fund/SERV<sup>®</sup>. NSCC's Fund/SERV system receives order information from broker-dealers, banks, 401(k) plan administrators and other NSCC participants that distribute mutual fund shares, and transmits the information to the appropriate fund. The fund may confirm or reject each order and send the corresponding order confirmation or rejection data through Fund/SERV to the appropriate broker-dealer or other NSCC participant.<sup>4</sup> NSCC also offers net settlement to its members in respect of financial amounts owing to and from the funds and the financial intermediaries that distribute the shares of the fund, in connection with purchase orders, redemptions, commissions, dividends and other transactions.

In addition, NSCC offers information services that are widely used by the funds and their distributors. For example, one such service, Networking, facilitates the transmission and reconciliation of customer account information between a fund and its distributors.

While NSCC's role in the mutual fund settlement process is important,<sup>5</sup> its function is limited. Essentially, NSCC is a systems-driven, automated information and financial conduit. Its systems and services provide cost-effective and efficient solutions to the mutual fund marketplace by centralizing and automating the communication of orders and other data between the mutual funds (or the transfer agents or underwriters, on behalf of the funds) and the financial intermediaries which distribute fund shares, centralizing and netting the settlement of financial amounts between the parties, and providing standardized formats for mutual fund data. NSCC is operated as a not-for-profit industry utility which is owned and governed by the broker-dealers, banks, mutual funds and other financial institutions which use its services.<sup>6</sup>

## **Overview**

On March 11, 2005, the Commission adopted Rule 22c-2 to help curtail trading abuses associated with short-term trading and market timing transactions in fund shares.<sup>7</sup> In the 2005 adopting release, the Commission asked for comments regarding implementation of the rule. Many of the resultant comments from industry participants were directed at the difficulties in implementing the provisions of the rule that directed funds to enter into shareholder

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<sup>4</sup> Use of NSCC's mutual fund services is limited to NSCC members, which are typically broker-dealers, banks, third-party administrators, mutual funds, advisers and distributors of mutual funds. Mutual funds and their principal underwriters may (and typically do) direct receipt of orders from NSCC to the transfer agents for the funds. Qualification for NSCC membership is set forth in NSCC's Rules, which are available on NSCC's website: [www.nsc.com](http://www.nsc.com). As a self-regulatory organization within the meaning of the Exchange Act, NSCC's rules of operation are subject to approval by the Commission (see 15 U.S.C. 78c(a)(26), 78(s)(b)).

<sup>5</sup> In 2005, NSCC processed over 118 million fund transactions at a value of \$1.67 trillion. NSCC processed a daily average of 467,000 fund transactions at a value of \$6.76 billion in 2005. Daily mutual fund transaction volume reached a peak of 1,014,927 transactions processed through Fund/SERV on January 17, 2006.

<sup>6</sup> NSCC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"), which in turn, is owned by its principal users -- major banks, broker-dealers, mutual fund firms and other companies within the financial services industry. DTCC's Board of Directors is made up of directors who also serve as directors of NSCC. NSCC does not pay dividends on its capital stock and rebates excess revenues to its users.

<sup>7</sup> Investment Company Act Release No. 26782 (March 11, 2005) (the "2005 adopting release").

information agreements with the financial intermediaries that distribute their funds. In the proposing release issued this year, the Commission has sought to address these concerns by limiting the types of financial intermediaries with which the fund would be required to enter into such shareholder information agreements, and by addressing the application of the rule in situations where there are chains of intermediaries between the fund and the beneficial owner of its shares. The Commission has also proposed to permit fund service providers — *i.e.*, principal underwriter, transfer agent and clearing agency — to enter into such agreements as agents on behalf of the fund.

### **Comments on the Proposal as it relates to Registered Clearing Agencies**

The Commission included in the proposing release a request for comments on the provision regarding the ability of a fund to enter into a shareholder information agreement through its principal underwriter, transfer agent or registered clearing agency. We respectfully recommend that the reference to registered clearing agencies be deleted, as it is not feasible — given the limited, albeit important, functions it is able to perform based on its current technological capabilities — for a clearing agency to act in such capacity. While the provision is precatory and not mandatory, we fear that retaining the reference in the rule may lead to misunderstandings.

Unlike principal underwriters and transfer agents, a clearing agency does not act as an agent of the fund. A fund will have agreements in place with its principal underwriter and transfer agent regarding their respective obligations to distribute and service fund shares. The agreements generally will authorize and direct the underwriter or transfer agent to act on behalf of the fund under various circumstances. A clearing agency, in contrast, does not act as an agent of the fund in any context; instead, it facilitates daily settlement of mutual fund transactions by acting solely as a conduit for the flow of information and settlement of net financial amounts between the fund (or its underwriter as its agent) and the financial intermediaries which distribute shares of the fund.

Moreover, the terms of shareholder information agreements will vary among the various funds and their financial intermediaries. The Investment Company Institute has developed a suggested form of shareholder information agreement which provides for several alternative provisions. It is further anticipated that the actual agreements that funds and the financial intermediaries ultimately enter into will vary considerably even from this form, and that in some instances, an agreement will be adopted as an addendum to an existing underwriting or transfer agency agreement, in other instances it will incorporate unrelated provisions that address other points, and so forth, according to the circumstances and current documentation that is in place in each distribution arrangement. Under these circumstances, NSCC as the clearing agency could not possibly have the requisite information and capacity to negotiate, enter into, monitor or enforce the agreement.

### **General Comments**

NSCC supports the efforts of the Commission to protect fund investors and curtail abusive short-term trading or market timing activities. NSCC is prepared to assist the Commission and the mutual fund industry in implementing solutions to this problem, in the

manner in which NSCC can be most instrumental.<sup>8</sup> However, NSCC is not in a position to act as a fund's agent in either entering into shareholder information agreements on a fund's behalf or prohibiting future purchases of fund shares by financial intermediaries. Accordingly, we fear that identifying "registered clearing agencies" generically in the proposing release as potential fund agents for these purposes will create false expectations within the fund industry that NSCC is able to provide these services. We therefore urge the Commission to delete the words "registered clearing agency" from the parenthetical in paragraph (a)(2) of the amended rule.

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NSCC appreciates the opportunity to comment on the proposing release. Please contact Ann E. Bergin, Managing Director of NSCC at 212-855-5655, or Carol A. Jameson, Senior Counsel and Vice President of NSCC at 212-855-3213, with any questions that the Commission staff may have regarding our comments.

Sincerely yours,

NATIONAL SECURITIES CLEARING CORPORATION

By: /s/ Carol A. Jameson

Carol A. Jameson

Vice President and Senior Counsel

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<sup>8</sup> NSCC is also developing enhancements to its Networking service which will standardize and automate the request and transmission of shareholder information required under Rule 22c-2. The project was undertaken with the Investment Company Institute's Standardized Data Reporting Working Group, which worked with NSCC to define the functionality and system requirements. This functionality is expected to be in production in August of this year.

NSCC has similarly participated in the Joint NASD/Industry Breakpoint Task Force, established in response to the findings that investors were sometimes receiving incorrect breakpoint discounts on Class A mutual fund shares. NSCC assisted in establishing standard definitions for the communication of the relevant data, and made enhancements to its Profile service to provide a centralized breakpoint schedule and rules database.