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San Antonio, Texas 78288

May 10, 2004

VIA EMAIL TRANSMISSION

United States Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549
Attn: Jonathan G. Katz
Secretary

Re: Mandatory Redemption Fees for Redeemable Fund Securities
(File No. S7-11-04)

Dear Mr. Katz:

USAA Investment Management Company (IMCO) is pleased to provide comments on the Securities and Exchange Commission's (Commission) proposed rulemaking to require mutual funds to impose a 2% redemption fee on shares redeemed within five business days of purchase. Currently, mutual funds may impose redemption fees in certain circumstances but are not required to charge such fees.

Our comments to the proposed rulemaking are summarized as follows:

- We do not believe mandating redemption fees with certain set parameters is either appropriate or necessary. Implementing tools such as fair value pricing can achieve the desired result without placing the Commission in the position of mandating and setting fees.
- Should the Commission believe rulemaking that requires funds to impose redemption fees is necessary, then a fund's board should retain the discretion to establish the circumstances when a fund may waive a redemption fee in a financial emergency.
- Given that shareholders of the USAA family of mutual funds are predominately part of the U.S. military community, it is imperative to us that funds be permitted to waive a redemption fee in the event of military deployment.

We discuss these comments in greater detail below.

Background and Analysis

IMCO serves as the investment adviser and distributor of the funds in the USAA family of funds, including thirty-eight (38) retail funds and five (5) funds used as investment options for variable insurance products issued by an affiliated life insurance company (hereafter, the USAA Funds). United Services Automobile Association (USAA) is a member-owned association that seeks to facilitate the financial security of its members

and their families by providing a full range of highly competitive financial products and services, including insurance, banking and investment products. USAA Funds are marketed to its members, the American military community, and include present and former commissioned and noncommissioned officers, enlisted personnel, and their families.

The Commission has asked for comment whether the rule should be permissive rather than mandatory. We note that currently fund boards have the power to impose a redemption fee of 2% and thus question whether a new rule that would merely permit such fees is necessary. It is certainly unprecedented for the Commission to propose a rule requiring funds to impose a particular fee on all mutual fund shareholders. Given the problems associated with market timing and other detrimental short-term trading activity in mutual fund shares, we understand the reasons that prompted the Commission's proposed mandatory rule. Because of the unique needs of our member base, the USAA Funds have avoided imposing redemption fees in the past largely to ensure that military members, particularly those ordered to deploy, were not negatively impacted by such fees for financial emergencies engendered by orders over which they have no control. We believe that fund boards could reasonably determine that redemption fees are not necessary for particular funds based on the distribution arrangements for its funds and other policies and practices to deter and detect short-term trading activity in fund shares, including utilizing fair value pricing services to reduce arbitrage opportunities for short-term trading in fund shares. Thus, we question whether a rule mandating the imposition of such fees is truly necessary.

If the Commission determines that mandating redemption fees is necessary, IMCO generally supports the rule as drafted but believes that any exception to the imposition of such fees should be determined by the board of directors of the relevant fund. Our primary concern is to ensure that fund companies retain the *discretion* to waive such fees in the event of a financial emergency. Because a large segment of our members are active duty and reserve military officers and personnel, we would oppose any mandatory fee that would not give fund companies any discretion to waive the imposition of such a fee in a financial emergency, including military deployments or extensions of military deployments. Military personnel receive deployment orders to go abroad and/or extension of deployment orders sometimes with limited warning. In such circumstances, IMCO believes that such military members should not be financially penalized for redemptions that may be necessary to support their families during the course of a military deployment. IMCO believes that any adopted exception to the imposition of such redemption fees should be disclosed in the prospectus and/or SAI and exercised uniformly.

We know that some commenters support a provision to eliminate the discretion of fund companies to waive fees in financial emergencies under any circumstances because of concerns that exceptions could be susceptible to abuse and because of the difficulty for intermediaries in administering different exceptions by fund companies. Although we agree that any exception is susceptible to abuse by some determined shareholders, we would not support any mandatory rule imposing fees on *all* shareholders based on the

anticipated actions of a minority of shareholders. Thus, we believe that each fund's board of directors should retain the discretion to determine, based on all relevant factors, whether exceptions to a short-term redemption fee are warranted and can be administered in a reasonable fashion. In our opinion, such relevant factors could include the characteristics of the fund's shareholder base, its prior history with short-term trading activity, and other measures in place to combat market timing, such as fair value pricing services and other monitoring policies and procedures. For that reason, we do not support the provision of the proposed rule that would require each fund to waive such fees in financial emergencies for redemptions up to \$10,000, or a mandatory *de minimus* rule. We agree that such mandatory rules could be susceptible to abuse and may not be necessary depending on the time period chosen by the board of directors.

Finally, we also note that some registered investment companies may be operating under old corporate charters that could require shareholder approval to implement redemption fees. If the Commission adopts a final rule requiring fund companies to impose a mandatory redemption fee, we would interpret such a rule as preempting state law or corporate charters requiring such fees to be approved by shareholders. In the event that the Commission adopts a final rule mandating the imposition of such fees, it would be useful if the Commission stated its view regarding the effect of the rule on conflicting or inconsistent state law or corporate charters.¹

We appreciate the opportunity to provide comments on this rule proposal. If you have any questions regarding our comments, or would like additional information, please contact me at (210) 498-8696 or Eileen Smiley at (210) 498-4103.

Sincerely,

Mark S. Howard
Senior Vice President, Secretary & Counsel
USAA Investment Management Company

¹ For example, one of the investment companies of the USAA Funds contains a charter provision that, based on prior state law, requires shareholder approval of redemption fees in excess of 1%. If the Commission adopts a final rule mandating a minimum 2% redemption fee for a minimum time period, we believe that the USAA Funds organized under that investment company should be able to implement the rule without obtaining shareholder approval of a redemption fee mandated by federal law.