Fidelity Investments

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February 10, 2004

S7-26-03

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Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549-0609

Re: **Proposed Rule: Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings (File No. S7-26-03)**

Dear Mr. Katz:

Fidelity Investments[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to require open-end management investment companies to disclose to shareholders the risks of frequent trading activity in mutual fund shares; the circumstances for use of fair value pricing and its impact on shareholders; and policies and procedures with respect to the disclosure of their portfolio securities. [2]

The Commission proposes to amend its disclosure requirements under Form N-1A[3] to provide shareholders with specific disclosure related to market timing, fair value, and selective disclosure of portfolio holdings. Fidelity Management & Research Company ("FMR") strongly supports the SEC's disclosure initiatives aimed at curbing abuses relating to short-term trading, improving industry adherence to fair value pricing and preventing the misuse of portfolio holdings information by certain investors.[4]

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[1] Fidelity Investments, as investment adviser to over 290 mutual funds, is the largest complex of mutual funds in the United States and is also a diversified financial services company, including several registered investment advisers, registered broker-dealers, registered transfer agents, and a retirement plan services administrator.

[2] SEC Release Nos. 33-8343, IC-26287 (Dec. 11, 2003); Fed. Reg. 70402 (December 17, 2003) ("Proposing Release").

[3] The proposal also includes related changes to Forms N-3, N-4, and N-6 to require similar prospectus disclosure for insurance company separate accounts issuing variable annuity and variable life contracts. FMR's comments herein relate to all investment products registered under the 1940 Act.

[4] FMR also fully supports comments filed by the Investment Company Institute (the "ICI") on this proposal by its letter of February 5, 2004. FMR has endeavored not to repeat comments in the ICI comment letter and intends to limit its comments to additional topics not covered by the ICI.

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FMR supports the Commission's objectives and the proposals designed to address them, subject to recommendations we offer below, which are guided by the following beliefs.

- Each fund's board and its adviser should adopt clear policies that address market timing, fair valuation and selective disclosure.
- Disclosure of these policies is important so that investors know the conditions under which they are buying and selling mutual fund shares.
- Disclosure of policies designed to protect funds from market timing should not be so detailed as to invite circumvention of those very policies by market timers.
- Omnibus accounts pose industry-wide problems dealing with market timing (particular redemption fees and exchange limits) and we support the SEC's rulemaking designed to address the problem.

SUMMARY OF CONTENTS

The Commission's proposed rule addresses some of the most critical concerns regarding mutual fund trading--to protect long-term investors from those engaged in short-term trading and unauthorized use of portfolio information. These concerns must be balanced against the need for the vast majority of other fund shareholders to be able to conduct normal trading activity, and to use exchange privileges within a group of funds, without undue limitations or expense.

FMR submits that the Commission's proposed new disclosures would be best made in the fund's Statement of Additional Information ("SAI"). FMR believes that while it is important to all shareholders that the proposed disclosure be made, the disclosure itself will rarely be relevant to retail fund shareholders day-to-day. In many cases, the operational details of specific procedures could be provided in the SAI without sacrificing the intent or impact of the rule.[5] We believe that prospectus disclosure should summarize the information called for in the Commissions proposals. We believe that for most investors the prospectus should be reserved for statements regarding Board-adopted policies[6] in these areas so that shareholders understand that the fund has focused on these critical issues. We do not believe that the detail inherent in the Commission's proposals is well suited to a mutual fund prospectus. FMR urges the Commission not to abandon the use of simplified prospectuses and plain English. Under the current proposals, funds could be required to make voluminous, highly technical and complex disclosures, with

[5] To the extent that operational details for tracking of mutual fund trades are standardized by means of a centralized registered clearing agency for mutual fund transactions, FMR requests that the SEC consider eliminating industry-level disclosure and retaining a disclosure requirement only for trading policies specific to the fund or its transfer agent(s).

[6] Or lack thereof, in accordance with proposed rule requirements for those fund Boards that chose not to adopt stated policies and procedures for market timing, fair value, or selective portfolio holdings disclosure.

good cause. SAI disclosure has the effect of compelling transparency and brings to bear 1933 Act liability that will have the effect of curbing abuses. It must be recognized that these abuses relate to a small number of investors while prospectuses serve as a manual for investors who are not market timers or late traders and the disclosures contemplated by the rule proposal will be unrelated to their normal day-to-day transactions with the fund.[7]

I. FREQUENT PURCHASE AND REDEMPTION OF FUND SHARES

The Commission's proposed rule change to Item 7(e) of Form N-1A would require disclosure of whether a fund discourages (or accommodates) frequent purchases and redemptions of its shares. The proposal also would require specific discussion of any policies or procedures for deterring frequent purchases and redemptions of the fund's shares. We remain concerned that any specific description of trading limits or exclusions would encourage trading at the margin of those limits, and may preclude the Board from changing a threshold or exclusion without first giving notice to the very shareholders the fund is trying to deter by requiring a publicly-filed amendment of or supplement to the fund's registration statement. We request that the SEC reconsider the specificity requirement.

In FMR's experience the very first thing that market timers seek to find out is how to evade FMR's detection methodologies. Market timers want to know exactly how to conform their conduct to maximize their opportunity to market time. FMR believes that long-term investors are best served if funds are explicit about exchange limits and general policies as to whether the fund permits or prohibits market timing and that stop short of giving a road map to those who seek to evade fund's market timing policies. Looked at differently, if the Commission were regulating credit cards it would not ask issuers to disclose their policies for detecting credit card fraud. Fund shareholders and credit card holders both need to be protected from fraud, and in both cases they need to know that they are protected to a degree, but not to such a detail that the protection is eroded.

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[7] Operational details such as procedures for redemptions-in-kind and other transfers of assets have been disclosed in the SAI and supplemented by separate detailed operational requirements for shareholders engaged in specific transactions. It would make sense to apply consistent disclosure standards for similar types of detailed transaction instructions or limitations relating to market timing. In addition, as noted in the adopting release, many of the proposed changes will need to be incorporated with other existing disclosure such as exchange privileges. We believe that the SEC's concerns can be addressed by integration of this new disclosure into existing sections of the prospectus and/or SAI and should not require, at this point, a significant redesign of these documents. We also note that prospectuses sent to shareholders are a fund expense. Longer prospectuses will have an added cost to be paid by the shareholders who are not market timers. We urge the SEC to consider whether the incremental benefit of *prospectus* disclosure is worth its incremental cost relative to SAI disclosure, which costs far less, simply because it is sent only upon request.

One of the major problems is that an excessive trader is not discovered until he or she is already a shareholder of the fund. A fund or its Board may need additional means to disable this type of trader, once identified. The proposal anticipates that the Board may want to impose specific restrictions on excessive traders under proposed Item 7(e)(4)(iii)(A)-(F), particularly (F) which requires the fund to state "any right of the Fund to reject, limit, delay, or impose other conditions on exchanges or purchases or to terminate or otherwise limit accounts based on a history of frequent purchases and redemptions of Fund shares, including the circumstances under which such right will be exercised."[8]

We recommend that the proposal be clarified to allow a fund to include the right to reject any trade for any reason simply because it is not possible to describe all manner of potentially abusive conduct in advance. Fund companies sometimes reject prospective investments based on timing behavior in another fund within the complex, or intuition that the investor might be a market timer. While it is fair to suggest that timers have the right to know that they are not welcome, it should remain within the discretion of funds to refuse any purchase order at any time if the fund – through its adviser – thinks it may be advisable to do so. If the exercise of this discretion produces unpredictable results for would be market timers, this very unpredictability should not be viewed by the Commission as a disclosure shortcoming or deficiency. Instead, the Commission should recognize that uncertainty is an element in the fund's defense against timers.

Omnibus accounts present a key challenge. The omnibus account holder has few incentives to endure the expense of monitoring sub-accounts for compliance with registration statement polices. Therefore, FMR strongly supports the development of uniform requirements in this area for all funds on behalf of all shareholders, and specifically, urges that the SEC adopt rules requiring either the monitoring and reporting of omnibus underlying account positions and activity to mutual funds or that omnibus account holders enforce policies in the fund's registration statement.

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[8] The SEC might consider adding substantive authority in the area of Rule 11a-3 to provide additional flexibility for funds (i) to impose additional administrative fees on certain types of abusive transactions; (ii) to refuse exchange privileges to specific types or categories of shareholders; (iii) to delay exchanges for certain traders for up to seven days, consistent with the extended redemption period allowed under Sec. 22 of the 1940 Act; or (iv) to impose redemption fees on exchanges in excess of those applied to a redemption. The SEC might also consider allowing differential redemption fees within a fund by transaction type or criteria other than failure to meet the holding period requirement, such as allowing a separate redemption fee for excessive trading not triggered by a holding period, and to allow, under limited circumstances, forced redemptions from a fund. We also anticipate that the SEC would address related Section 18 concerns at the same time, in favor of allowing the fund to describe group(s) of shareholders who may be targeted with specific sanctions for engaging in activities adverse to the fund.

II. DISCLOSURES RELATING TO FAIR VALUE PRICING

The Commission's proposed rule change to Item 7(a)(1) of Form N-1A would require disclosure by a fund (other than a money market fund) of a brief explanation of the circumstances under which it will use fair value pricing and the effects of fair value pricing.

FMR supports the disclosure of Board policies with respect to fair valuation of certain assets held by the fund in the prospectus of the fund. However, FMR recommends that to the extent the SEC requires specificity with respect to fair value procedures, any detailed requirements be disclosed in the SAI. Again, FMR expresses its concern that disclosure of any specific formula, thresholds, or general methodology could encourage gaming of the system. The limitation of any fair value adjustments to specific formulas that could be changed only by required registration statement amendments or supplements, subject to disclosure filing timelines, will almost certainly prove unworkable in volatile markets or business emergencies that require real-time judgment calls. Unlike market timing, where the attention is focused on specific shareholders that may or may not be active during certain periods and may be able to be segregated from impacting the portfolio of the fund, fair value criteria applies to all securities held by the fund, directly affects the fund's NAV for each pricing period, and therefore applies to each and every purchase and redemption transaction from the fund. [9]

In this case, the need for flexibility and skillful judgment calls on a real-time basis requires that the Board and its Fair Value Committee be given the utmost flexibility in determining factors to be using in pricing decisions. For example, factors have been developed to address different market trading requirements and trading limits, different types of securities, different pricing conventions in different markets, derivatives markets, currency markets, and other factors that affect fair value, and one or more may need to be changed at a moment's notice to address new market developments, problems or business emergencies. The disclosure might state in general terms the factors considered for different fund types, and the delegation of specific authority to the Fair Value Committee to make decisions for daily pricing purposes, but not require further detail on pricing decisions.

FMR recognizes also that if fund companies describe precisely the exact methodology that they will use in response to changes that arise after a market close, for example, and if a fund follows that process predictably and uniformly, then it is only a matter of time before professional market timers devise ways to use that information to their advantage and to the disadvantage of long-term shareholders. We believe that one

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[9] Fair value determined for purposes of NAV pricing under these procedures will also be disclosed, and footnoted, in the financial statements for the funds under Form S-X and Audit Guide rules.

of the most effective ways of protecting funds from market timers would be to preserve a degree of unpredictability in the outcome of the fair value process, consistent, of course with producing an NAV that is fair and a process that is consonant with current staff guidance. FMR urges the Commission to assume that arbitrageurs have such a powerful incentive to turn information into profit that any information the Commission puts into their hands will be used to the disadvantage of long-term shareholders.

When it comes to fair value pricing, the Commission should permit funds to disclose that they reserve the right to use measures and procedures to determine fair value in addition to those referred to in the registration statement.

III. DISCLOSURE OF PORTFOLIO HOLDINGS

The Commission's proposed rule change to add Item 4 (d) of Form N-1A would require a fund to state that a description of the fund's policies and procedures with respect to the disclosure of the fund's portfolio securities is available (i) in the fund's SAI and (ii) on the fund's website, if applicable. Proposed Item 12 of N-1A would require a mutual fund to describe in its SAI the fund's policies and procedures with respect to disclosure of the fund's portfolio securities to any person.

FMR strongly supports the full disclosure of all policies relating to the disclosure of portfolio holdings. Unlike market timing policy disclosure and fair value process disclosure, selective holdings disclosure warrants even more specificity than the Commission's proposals. FMR believes that each fund and its Board must consider the costs and benefits of potential disclosure to shareholders and third parties, and strike an appropriate balance between disclosure and confidentiality of portfolio holding and trading information. The factors considered by the Board and the specific types of information provided to different shareholders should be fully disclosed to all shareholders in the fund. We believe that the SAI would provide the appropriate location for this disclosure because we believe it is vital that the disclosure be precise and detailed.[10]

FMR believes that disclosure alone is insufficient and we urge the Commission to provide guidance concerning the duties of the fund's adviser and its board regarding (i) the decision to make selective disclosure to any recipient and (ii) the appropriate lag time before holdings are made publicly available. Holdings disclosure presents a potential conflict of interest between the adviser's desire to stimulate sales and the shareholders' need for confidentiality to preclude front-running of portfolio positions such that any

[10] We assume that the website disclosure requirement under Item 4(d)(ii) relates to circumstances in which a fund chooses to provide full or partial holdings disclosure to all shareholders via a website; in this case, we recommend that the fund be able to provide a link to the appropriate section of the SAI (provided the SAI is itself posted on the website and the SAI discusses website disclosure policies) without requiring additional disclosure.

voluntary holdings disclosure should be viewed as presumptively against shareholders' interests.[11] In any event, the Commission should provide guidance to boards as to the sensitivity of holdings information and the need for the board to examine carefully whether the holdings disclosure practices of the fund adequately protect the fund from potential front running We suggest that the Commission, in its final rule, require advisers to obtain approval of fund boards as to their policies of lagging disclosure of holdings, and that funds be required to disclose those polices to fund shareholders. We believe that typically a 45 day time lag should prove sufficient to protect most equity fund shareholders, although this is an area where a high degree of caution in warranted.

The Commission has sought comment on whether Regulation FD should be extended to investment companies. Regulation FD has as its premise that if an operating company chooses to disclose material information to someone, then simultaneous disclosure to the marketplace is in order. FMR believes that Regulation FD's medicine will not cure what ails mutual funds.[12] The mutual fund problem is not a problem associated with unequal access to information for retail stock market investors. There is no mutual fund secondary market in need of a level playing field. Instead there is proprietary information that is highly valuable and that must be safeguarded for long-term shareholders. FMR believes that mutual fund boards and their advisers should have a more nuanced task than a mere duty to disclose uniformly. The board and the adviser must balance the need to guard against front-running with legitimate uses of non-public holdings information that is a necessary aspect of the fund's operations. Instead of looking to Regulation FD (which may encourage reflexive overdisclosure), the Commission should describe for boards when selective disclosure under confidentiality agreements for valid corporate purposes should be considered by the board in the discharge of its duties in lieu of public disclosure. FMR believes that boards will do an appropriate job of weighing the benefits and burdens of holdings disclosure, if given guidance from the Commission and if the conflict of interest is called to their attention. To that end, we suggest that the final rule call for disclosure of the board's findings as to whether or not the frequency and nature of the fund's disclosure policies adequately protects the fund from the risks of front running.

We would also urge that the Commission give guidance concerning disclosure of holdings selectively to the media. Various for-profit entities regularly receive fund

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[11] FMR believes that fund sales also redound to the benefit of fund shareholders as a general matter, but that does not eliminate the potential for a conflict of interest when it comes to the disclosure of portfolio holdings.

[12] It is reasonable to assume – given the conduct of operating companies – that extending Regulation FD to mutual funds would tend to encourage regular and frequent holdings disclosure to the detriment of long-term shareholders. If this approach were sound, the Commission would have already authorized the launch of actively managed exchange traded funds. But the Commission has not authorized them because of the conflict of interest inherent in the need to maintain the secrecy of fund holdings in an actively managed fund to protect current shareholders and the incentive of fund managers to use that information to stimulate sales, among other concerns.

holdings from fund companies who they write about, evaluate, or otherwise publicize - Morningstar is a leading example. FMR believes that it is essential that the adopting release provide guidance on the appropriate steps when selectively disclosing information to the media. [13] We read the proposing release to require that each media outlet would have to be named in the prospectus. This seems excessive. At the same time, practices in the industry vary widely, and we request that the Commission provide guidance as to whether or not fund boards should be expected to require confidentiality agreements should the media or other fund tracking services receive fund holdings selectively.

FMR also requests that the Commission clarify that portfolio holding disclosure requirements will not include the provision of performance-related information that is derived from portfolio holdings. For example, FMR is aware that certain independent data service providers compute specific analytical performance numbers based on monthly or quarterly portfolio holdings of certain funds. These data providers will use the portfolio holdings to complete their analytical tasks. Advisers typically arrange to have this kind of analytical information made available to fiduciaries. FMR believes that reporting aggregate analytical data on a selective basis does not raise the concerns that are presented by disclosure of actual securities holdings, and does not believe that the proposed disclosure rules will require disclosure of these arrangements. If a fund is required to disclose these practices, FMR requests that the SEC provide a list of the types of arrangements requiring disclosure, and that the SEC permit disclosure of general fund level policies in this regard, rather than a list of anticipated recipients.

FMR requests that the SEC confirm that posting of information to a website in any readable data format[14] would be considered public disclosure.[15]

We appreciate the opportunity to comment on this important initiative and congratulate the Commission for its proposal. As noted above, we urge further rule making to prohibit early release of portfolio holdings. If we may be of further assistance to the Commission, please contact either the undersigned at 617-563-1742, or Stuart Fross at 617-392-2698.

Sincerely yours,

Eric D. Roiter

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[13] If Regulation FD is used by analogy to help guide this question, then the Funds would be obliged to make public any holdings information prior to delivery to the media, or to bind the recipient to confidentiality prior to public release by the issuer.

[14] For example, .pdf, .html or .xml.

[15] Filing Form NQ, when adopted, would also constitute public disclosure.

Cc: The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid
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