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February 3, 2004

Jonathan G. Katz
Secretary
Securities Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: **Proposed Amendments to Rules Governing Pricing of Mutual Fund Shares, File No. S7-27-03**

Dear Mr. Katz:

ICMA Retirement Corporation ("ICMA-RC") writes to express our concern regarding the "Proposed Amendments to Rules Governing Pricing of Mutual Fund Shares," File No. S7-27-03 ("Proposal") published in the Federal Register on December 17, 2003. The Proposal would amend Investment Company Act rule 22c-1 to impose a strict 4 p.m. deadline on mutual fund trades, requiring that all mutual fund purchase and redemption orders be received by a fund, its designated transfer agent or a registered clearing agency (e.g., NSCC Fund/SERV) no later than 4 p.m. in order to receive same-day pricing. As a result, fund intermediaries, such as pension plan administrators, would no longer be allowed to treat orders received from investors by the intermediary before 4 p.m. but not transmitted to the fund, its designated transfer agent or Fund/SERV until later, as having been placed by that day's 4 p.m. cut-off time.

ICMA-RC is a third party administrator and provider of investment options for public sector employee benefit plans nationwide. Our affiliated entities include ICMA RC Services, LLC, a registered broker-dealer subsidiary, and Vantagepoint Transfer Agents, LLC, a registered transfer agent subsidiary, as well as a registered investment adviser subsidiary, Vantagepoint Investment Advisers, LLC. ICMA-RC represents more than 6,700 governmental employers and more than 630,000 public sector employees for whom we administer retirement plans established in accordance with Internal Revenue Code ("Code") Sections 401(a), 401(k), 408, and 457(b) and provide the investment vehicles available as options under the plans. As a not-for-profit corporation dedicated solely to providing recordkeeping and investment services to public sector employees, ICMA-RC's primary focus is the retirement security of public sector employees.



ICMA RETIREMENT CORPORATION
The Public Sector Expert

ICMA-RC shares the Commission's concern regarding late trading and its negative impact on long-term investors and the mutual fund industry in general. While ICMA-RC commends efforts to curb such abuses, we believe that the Proposal will have the consequence of effectively relegating retirement plan investors to a disadvantaged shareholder class. Further, the Proposal would result in a significant increase in the costs of delivering investment-related services to retirement plan investors and a corresponding increase in the costs borne by such investors. In section II below, we detail the technological and procedural changes that ICMA-RC would need to implement to meet the Proposal's requirements and the associated costs of so doing. The Proposal also would, in effect, limit the range of investment options available to plan investors generally, and in particular, to participants in small retirement plans. These consequences will undermine the ultimate goal of these investors of saving for retirement.

Finally, while the Proposal almost certainly will impose costs on plan sponsors, administrators and participants, it is not clear that the "hard" 4 p.m. cut-off will achieve the Commission's aim of preventing short-term traders from exploiting the trading system to profit from investment-related information at the expense of long-term investors. Accordingly, ICMA-RC strongly supports an alternative approach, such as those set forth in the Proposal and in pending legislative proposals, such as H.R. 2420 and S.1971, which would permit plan administrators and other fund intermediaries to continue to submit orders to a fund, its designated transfer agent or clearing agency after 4 p.m. if certain protections and procedures are adopted. Below we discuss why a hard 4 p.m. cut-off time will adversely impact retirement plan investors and the retirement services industry, and why an approach that preserves the ability of a fund intermediary to submit orders received by the intermediary by 4 p.m. to a fund, its transfer agent or clearing agency after the 4 p.m. trade deadline would be a viable and preferable alternative.

Discussion

I. The Proposal Creates a Disadvantaged Shareholder Class

The Commission has proposed a hard 4 p.m. trade cut-off as a means to address late-trading abuses, which unfairly advantage favored or short-term investors at the expense of long-term investors. However, the Proposal's hard 4 p.m. cut-off will, in effect, virtually eliminate same-day pricing for retirement plan investors, and thus, create a disadvantaged shareholder class for the long-term investors the Commission seeks to protect.

Retirement plan investments typically are placed through fund intermediaries, such as a third party administrator or recordkeeper, which also often provide mutual funds as investment options under the plan. While in some instances, the plan



administrator's own mutual funds are the only investment options available under the plan ("bundled arrangements"), in most instances, including ICMA-RC's arrangements with its plan clients, the plan administrator makes available a combination of its own proprietary funds and those of outside mutual funds ("unbundled arrangements").

The Proposal would put the millions of retirement plan investors covered by unbundled arrangements at a disadvantage to those investors who trade directly with a fund or its primary transfer agent. This is because, as discussed in greater detail in section II below, the technological and procedural changes necessary to meet the hard 4 p.m. close will make it virtually impossible for plan administrators to provide same-day pricing for outside mutual fund investments. Because plan transactions often involve both the administrator's proprietary funds and outside funds, this could mean that essentially all retirement plan investment transactions would be ineligible for same-day pricing.

Creating a disadvantaged class of shareholders is at odds with the principles that the Investment Company Act of 1940 ("40 Act") was intended to preserve and protect. In enacting the '40 Act, Congress made clear that the national public interest and the interests of investors are adversely affected when equal treatment is not accorded to mutual fund shareholders and certain special classes of shareholders are advantaged over others.¹ By effectively preventing those shareholders who invest in a fund through their employee benefit plans from receiving the same-day pricing readily available to direct investors in the fund, the Proposal's hard 4 p.m. cut-off would create the type of inequity that the '40 Act is designed to prevent.

The Commission suggests that long-term investors, such as plan participants, "are not sensitive to the time at which their purchase or redemption orders are priced," because their aim is to save for events that are years in the future.² We respectfully disagree.

First, it is incorrect to assume, merely because retirement plan investors are supposed to be long-term investors, that they are indifferent to the effect of short-term price fluctuations. Such a view assumes that the trades being made by these investors primarily are motivated by a desire to capture short-swing profits. In reality, a trade placed by a retirement plan investor is just as likely, if not more so, to occur pursuant to that investor's execution of his or her long-term investment strategy. Maintaining a viable long-term investment strategy should not be confused with allowing a portfolio to stagnate or grow out of balance, particularly in view of the volatility and interdependency of modern markets.

¹ See Section 1(b)(2) of the '40 Act, "Findings and Declaration of Policy."

² Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Act Release No. 26288, 68 Fed. Reg. 70388, 70390 (December 17, 2003) ("Proposing Release").



A prudent retirement plan investor, just as any long-term investor, periodically will attempt to re-balance his or her plan portfolio to maintain a mix of assets that is appropriate for his or her current age, risk tolerance, overall financial situation and prevailing market conditions. The converse, i.e., failing to make periodic adjustments, can erode an investor's long-term strategy by default as the investor's portfolio grows out of balance through failure to timely react to such matters as the strength or weakness of a particular sector, currency fluctuations and sudden changes in an investor's personal circumstances such as illness, disability, divorce or inheritance. Indeed, investment education programs for retirement plan participants almost universally stress the need to periodically rebalance, some even to the point of recommending quarterly rebalancing. The proposal, however, does not distinguish — as, indeed it is impossible to do so — between retirement plan investors who engage in short-term opportunistic trading and those who enter into trades designed to effectuate, and consistent with, the pursuit of long-term investment goals. Instead, the proposal would lump both types of investors into a single category and simply ensure that neither will be able to obtain that day's price.

Moreover, denying plan investors same-day pricing could have a devastating effect on retirement savings in a falling market, locking plan participants into declining investments for an additional day or more while short-term investors who trade directly with a fund remain free to protect their assets against the effects of the down-turn. In fact, giving such short-term investors an additional day or more advantage in terms of trading ability in a falling market could exacerbate the impact on plan participants as direct traders could further drive down share prices before participants were able to effect trades. This adverse effect can be particularly damaging to those who are closest to retirement, as older employees have the least amount of time in which to recoup the damage to their retirement savings that can be inflicted by sudden market reversals. Thus, the proposal has the potential to most adversely affect the most vulnerable of plan participants — arguably, the class to which the highest level of protection should be afforded, as can be seen from the cash balance plan controversy and the recent court cases involving qualified plans that invest in employer securities. Further, this result is fundamentally inconsistent with the principles underlying the Sarbanes-Oxley Act and other post-Enron legislation, which seek to prevent interruptions in plan participants' ability control investment of their retirement assets.³

Even in a rising market, there is no reason to restrict a plan participant's ability to seek and obtain the most beneficial price in connection with his or her investment of retirement assets. While it is possible that participants may receive a better price as a

³ The Sarbanes-Oxley Act of 2002 added new ERISA section 101(i), which requires plan administrators of ERISA covered plans to provide plan participants and beneficiaries with at least 30 days notice before a "black-out" period, during which participants' ability to direct the investment of the plan assets or request other plan transactions is restricted.



result of the delay in trade processing necessitated by the Proposal, participants should be able to exercise the maximum control possible over investment of their plan assets and not be forced to wait and hope that the delayed pricing works in their favor. This is consistent with both the Sarbanes-Oxley Act and the principles underlying section 404(c) of ERISA.⁴

The disadvantages created by the Proposal's hard 4 p.m. cut-off are not justified by any corresponding benefit to retirement plan investors. The Commission explains that long-term investors are harmed by late trading.⁵ As the Commission notes, those involved in late trading tend to be short-term investors or market-timers. A great many were hedge funds engaged in price arbitrage trading. As long-term investors, retirement plan investors could be expected to benefit from rules that protect them against late trading. However, the proposed rules will have a significant, adverse impact upon the legitimate trading activities of retirement plan investors, even though there is no evidence that retirement plan investors are the source of late-trading abuses.

Short-term investors and market-timers, who the Commission identifies as more likely to seek out late trading opportunities, will not be subject to similar impact if they continue to transact directly with mutual funds or mutual fund transfer agents.⁶ Therefore, the proposed remedy may have a disproportionately negative impact on those very investors it seeks to protect, while short-term traders and hedge funds may not be impacted.

II. The Proposal will Significantly Increase Costs to Plan Administrators and Participants

The Commission, in its cost-benefit analysis, appropriately recognizes that fund intermediaries, including plan administrators, will incur costs as a result of the Proposal's hard 4 p.m. close, but states that it has no reasonable basis for determining the cost of technological upgrades necessary to meet this deadline or the number of customers an intermediary might lose or costs associated with lost customer orders. ICMA-RC anticipates that multiple systems and procedural changes would be needed to support the new trade processing structure dictated by the Proposal's firm 4 p.m. deadline. We estimate that the cost of technological changes for ICMA-RC, alone, will be in the \$10-15 million range when considering both developmental costs and opportunity costs

⁴ We note that, although the plans for which ICMA-RC acts as third party administrator and investment provider are not governed by ERISA, ICMA-RC generally administers client plans in a manner consistent with ERISA section 404(c) and believes that its principles provide an appropriate standard with respect to participant investment direction.

⁵ Proposing Release, 68 Fed. Reg. at 70392 ("dilution harms the fund's long-term shareholders as much as late traders gain in profits").

⁶ Indeed, as the Commission notes, fund managers themselves have permitted late trades by favored investors. See Proposing Release, 68 Fed. Reg. at 70389.



associated with deferring or abandoning other development projects beneficial to plan participants. These costs will need to be built into administrative fees that ICMA-RC charges to plans and participants in the future.

ICMA-RC makes available to plans and plan participants a variety of investment options, including both our proprietary mutual funds, The Vantagepoint Funds, as well as a range of nationally recognized outside mutual funds offered through our VantageTrust Mutual Fund Series, Mutual Fund Alliance and Model Portfolios. ICMA-RC processes participant investment orders for these options via the SunGard OmniPlus system. In order to meet the Proposal's hard 4 p.m. cut-off a "pended trade system" would need to be developed, which would require significant changes to ICMA-RC's existing "front-end" and "back-end" systems. This pended trade system would need to treat trades in the Vantagepoint Funds differently from those involving outside mutual funds, and would need to account for trades involving a combination of these options.

A. Current Trade Processing System

In the current trade processing environment, ICMA-RC's front-end system receives plan investment instructions from plan sponsors and participants from a variety of sources, including the internet, voice response unit, Investor Services call center, and paper allocation and transfer forms, which act as user interfaces to the OmniPlus system. These transaction instructions are tested on the front end to ensure compliance with applicable laws and plan rules and requirements.

At the time the transaction is written into the OmniPlus transaction file, it receives an electronic date and time stamp that is set on the host operating system and exists as data on the transaction record. The transaction is then held for later processing at the price established when the market closes that day. In all instances, if investment instructions are received by ICMA-RC after 4 p.m. EST, those instructions are held for processing on the next business day at that day's share price. Transactions on the OmniPlus system are reconciled daily with trade confirmations, trust records and fund reports to ensure accuracy and appropriateness of trade processing.

On the back-end, OmniPlus processes the investment instructions necessary to implement the transactions requested. Because of the administrative complexity of effecting hundreds or thousands of trades each day in both Vantagepoint Funds and outside mutual funds, the back-end system requires several hours to complete processing, and the back-end portion of the process typically is completed in the middle of the night. As the Commission notes, ICMA-RC, like other plan administrators that offer daily-valued investments, nets orders received throughout a business day and transmits a single omnibus purchase and redemption file to effect mutual fund transactions, in lieu of placing each individual order at the time received.



These highly efficient recordkeeping and order processing processes have allowed ICMA-RC to provide services cost-effectively to small-size plans and to participants with small account balances. In many cases, these plans and participants would not have sufficient assets to obtain this level of service from outside mutual funds or to have the opportunity to invest in lower cost institutional investment funds.

B. Pended-Trade System

In order to meet the Proposal's 4 p.m. cutoff, a pended-trade system would need to be developed to separately track and process transactions in The Vantagepoint Funds and outside mutual funds. This would require either "pending" or delaying all trades in outside mutual funds or attempting to segregate and process those outside mutual fund trades meeting a new earlier deadline while pending the remainder. Transactions involving both Vantagepoint Funds and outside funds, such as transfers between funds or multiple purchase/redemption orders ("combination trades") would need to be effected piecemeal to reflect the different pricing and timing accorded to each portion of the trade.

Under the pended trade system, the deadline for submitting orders for any transactions in non-Vantagepoint funds would need to be set at 12 p.m. EST (9 a.m. PST) at the latest, whereas investment instructions in Vantagepoint funds could continue to be accepted up to 4 p.m. EST. The current trade-processing technology would need to be upgraded to differentiate between the two. This would have a particularly onerous impact on West Coast plan investors who would have to submit trades first thing in the morning to have the possibility of same-day pricing for outside funds.

On the front end, systems would need to be modified to communicate whether each trade, or portion of a trade, would be effected on the same day or pended until the next business day. In addition, front-end systems would need to be upgraded to be able to build transactions in pieces for processing on different days for combination trades.

Back-end systems would require modification to be able to account for and reconcile all pended activity and also to create future dated transactions for some pended trades. Outside fund trades that meet the earlier deadline and can be assigned a dollar or a share value before the noon cutoff will need to be created from new processes between noon and 4 p.m. The system would need to be updated to capture trades in outside mutual fund shares and send them through Fund/SERV or directly to a fund in both dollars and shares to account for a lack of NAV share price for the pended trades. This is a departure from ICMA-RC's current practice of effecting trades using dollars only.

Under the pended trade system, combination trades would also need to be examined individually and have special processing rules applied to these transactions. It is not clear whether software currently exists through the OmniPLUS or some other platform that could accomplish the pended trade system as described, or whether custom software



would need to be developed. But it is clear that whatever means is used to create such a system will entail significant development and opportunity costs.

As noted above, we estimate the cost for technology upgrades to run as high as \$10 – 15 million. This includes the cost of modifying existing systems, processes, and procedures necessary to facilitate the hard 4 p.m. close. Additional ongoing costs would be associated with developing and producing transaction confirmations for combination trades, as separate confirmations likely would be needed for both the same-day and the next-day pending portion of the transaction. Further, ICMA-RC's required disclosure documents and other communications materials would need to be revised to describe the new procedures under which various trades are processed. Additional man-hours and possibly additional personnel would be needed to meet these new requirements.

While ICMA-RC is a not-for-profit company with an exclusive public-sector focus, we must remain solvent in order to deliver quality, cost-effective services to public sector plans and participants. In this regard, it would be necessary to pass along much of the increased cost associated with meeting the Proposal's hard 4 p.m. cut-off to retirement plan investors. This would have the effect of eroding retirement savings with no corresponding benefit to those investors. Presumably, this effect would only be more pronounced in the for-profit market.

Further, retirement plan investors likely would be angered and confused by the dual or treble processing systems required for transactions involving Vantagepoint Funds, outside mutual fund and combination trades. Although ICMA-RC is committed to delivering the highest level service and investments to our client plans and participants, such a convoluted new system would have a negative impact on plan investors' perception of the quality of service provided. Moreover, as discussed further below, participants might feel, or be, forced into transferring assets to companies offering a narrower or less beneficial range of investment options and plan services as a result of the costs and burdens associated with the Proposal's hard 4 p.m. cut-off.

III. The Proposal would Limit the Range of Available Investments and Services Available to Retirement Plan Investors

The Proposal's hard 4 p.m. cut-off also would have the effect of disfavoring unbundled retirement plan services arrangements and, thus, potentially concentrating retirement plan investments with a narrower range of mutual fund options and providers. This result is inconsistent with both the '40 Act principle of encouraging competition and with concept underlying ERISA section 404(c) that a broad range of investment options is necessary in order for participants to exercise meaningful control over their investment decisions.

As the Commission notes, third-party intermediaries, such as retirement plan administrators, may find it too expensive to upgrade their computer systems to meet the



demands of the Proposal's hard 4 p.m. cut-off. As a result, those administrators likely would be forced to discontinue offering outside mutual funds to plans and participants. This, in turn, would limit the range of investment options available to participants, as this may mean that most administrators are only able to make available their own proprietary funds. The outcome of these changes will be that plan sponsors' opportunities to obtain for plan participants the best selection of well-performing investment products and effective low-cost plan administration will become more limited. This will be a step backward for the defined contribution industry.

Even if such plan administrators do implement the technological and procedural changes necessary to meet the 4 p.m. cut-off, the costs and burdens associated with a pended-trade system likely would cause plan sponsors to seek bundled arrangements rather than submit participants to delays in outside fund transactions under unbundled arrangements. This would mean that retirement plan assets would be concentrated with a narrow group of large administrators whose funds and services often are more costly to plans and participants. This is particularly true of small plans, which do not enjoy the same bargaining power as larger plans. In addition, these large providers may be less familiar with the administration of governmental plans, which have not historically comprised a significant part of their client base.

As noted, ICMA-RC's serves governmental retirement plans and participants exclusively, and is able to provide high quality services and investments through its unbundled arrangements with these clients. We are also able to provide more personal and cost-effective services to small plans than would be expected from a larger fund company. This is true of many unbundled arrangements, through which smaller fund companies are able to combine their often-lower-cost funds and services with the outside funds of larger companies for a benefit to plan participants and all companies whose funds are made available. The Proposal's effect of reducing, or eliminating, these beneficial types of unbundled arrangements will mean less investment choice for plans and participants, at likely higher costs.

IV. ICMA-RC Supports the Alternative Approach Outlined in the Proposal

As noted above, the Proposal's hard 4 p.m. trade cut-off would impose significant costs and burdens on plan sponsors, plan administrators and plan participants, but it is not clear that it would accomplish the goal of preventing "late traders" from exploiting events that occur after 4 p.m. and profiting at the expense of long-term investors. First, as noted, plan participants and other investors whose trades are executed through fund intermediaries bear the brunt of the Proposal's restrictions. As there has been no indication of pervasive late trading abuses among plan participants, it would seem that the Proposal's restrictions are aimed at the wrong source.

Second, the hard 4 p.m. cut-off actually creates new opportunities for abuse. This is because it creates a situation where large blocks of pended trades exist in a plan



administrator's trade processing system for a day or more after the order is placed by the investor. An unscrupulous trader with access to this type of information could just as easily exploit this information to his or her benefit as other types of investment-related information.

The Commission seeks comment on an alternative approach that would permit plan administrators and other fund intermediaries to submit mutual fund orders to a designated transfer agent or clearing agency after 4 p.m. if the intermediary has adopted certain procedures, including: (1) electronic or physical time-stamping in a manner that cannot be altered or discarded once entered into the trading system; (2) annual certification that the intermediary has policies/procedures in place to prevent late trading and that no late trades have occurred during the period; and (3) annual audit of the intermediary's controls by an independent public accountant. ICMA strongly supports such an approach and believes that it is largely consistent with our current practices and those of most in the retirement plan services industry. As such, any costs associated with complying with this approach would be minimal.

ICMA-RC currently has policies and procedures in place that prohibit trades received after 4 p.m. from being effected on the same day and at the same-day price. Our policies, procedures and controls are designed to prevent late trades and we believe that these systems are effective in ensuring that no late trades have been submitted to any funds. Our policies, procedures and controls are already subject to annual internal review and external review by independent public accountants, and late trading prevention is included as a specific item in our Board-approved audit plan for 2004. We believe that including late trading prevention as a specific item for external, independent public accountant audit, in concert with an intermediary's annual certification that its policies and procedures to prevent late trading have been complied with and that no late trades were permitted would provide strong incentives for an intermediary to prevent its controls from being circumvented.

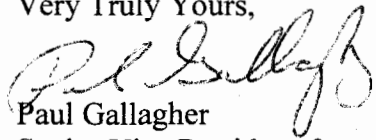
Further, we understand that certain technology firms have developed cryptographically verifiable technology that could be used prevent trade-stamping from being manipulated. For example, we understand that the AbsoluteProof service made available by Surety is a program designed to provide irrefutable evidence that electronic files, such as time-stamps, have been created when claimed and have not been altered in any way. We are aware of at least one other company, Identrus, that has developed similar technology. Thus, the technology appears to exist to allay the Commission's concerns regarding trade-stamp tampering. While ICMA-RC has not fully researched the costs, we are confident that technology such as the AbsoluteProof system or that of other companies could be implemented at a cost substantially less than the technological changes necessary to meet the Proposal's 4 p.m. cut-off.

As a local fund intermediary, ICMA-RC would be pleased to invite Commission staff to review and observe our policies and procedures in practice at our Headquarters office.



We look forward to working with the Commission to devise a proposal that will effectively address late-trading abuses while minimizing any negative impact on retirement plan investors.

Very Truly Yours,



Paul Gallagher
Senior Vice President &
General Counsel

