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November 12, 2003

Paul F. Roye
Director
Division of Investment Management
Securities and Exchange Commission
450 Fifth Sheet, NW
Washington, DC 20549

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OFFICE OF THE SECRETARY

Re: Late Trading and Market Timing Issues

Dear Mr. Roye:

The American Bankers Association[1] would like to take this opportunity to express its views regarding the late trading and market timing issues that are under current consideration within the Division of Investment Management. Our members **are** very concerned about these **issues.** **As** investors *in* mutual funds, either *for* our **own** portfolio or for that *of* our fiduciary **and** brokerage clients, as well as transfer agents and investment advisers to mutual funds, we applaud the Commission's goal to protect mutual fund investors and to restore investor confidence in mutual funds. **As** outlined in recent testimony to the Congress, the Commission is attacking the current market scandals by both bringing swift enforcement actions when wrongdoing is uncovered and promulgating regulations designed to prevent or minimize the possibility of these abuses occurring in the future.

We **are** concerned, however, that the regulatory solutions suggested to date to combat late **trading** and market timing ignore the operational complexities **and** other problems associated **with.** these **proposed** changes, particularly as they impact the retirement savings of millions of 401(k) plan participants. We believe there are alternative solutions that can satisfy the need to curb late trading, while, at the same time. minimize problems associated with some of these suggested solutions. We would also **like** to offer comments on one aspect of suggested proposals addressing market timing issues.

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[1] The American Bankers Association brings together all elements of the American banking community **to** best represent the interests of **this rapidly** changing industry. Its membership - which includes community, regional and money center banks and holding companies, **as** well as savings institutions, trust companies and **savings** banks - makes ABA the **largess banking made** association **in** the United States. The views in this letter are also endorsed by ABASA. ABASA is a separately chattered trade association and non-profit affiliate of the ABA whose mission is to represent before the Congress. the federal government and the *courts* the interests of banking organizations engaged in underwriting **and** dealing securities, proprietary mutual funds and derivatives.

Late Trading

To address illegal late trading, the staff is examining the feasibility of requiring that a fund (or certain designated agents)—rather than an intermediary such as a broker-dealer or other third party—receive a purchase or redemption order prior to the time the fund prices its shares, typically 4:00 p.m. east coast time, for an investor to receive that day's price. It is believed that this "hard" 4 p.m. cut-off would effectively eliminate the potential for late trading through intermediaries that sell fund shares. While this proposal may cure illegal late trading, we believe it does far more than address the problem at hand. We see no reason to fix a problem caused by a few, yet discriminate against the vast majority of mutual fund investors who use intermediaries, including the millions currently saving for retirement through their company's 401(k) or individual retirement accounts. Over $2.11 trillion in assets are currently invested in defined contribution plans, the vast majority of which are in 401(k) plans.[2] We believe there are better, less problematic methods to address late trading.

A 4 p.m. "hard close" to the mutual fund would put investors who invest through an intermediary, such as a bank trustee,[3] a custodian, a recordkeeper, or a broker-dealer, at a disadvantage. It would have the result of setting up two investor classes -- those who invest directly with the mutual fund or its designated agent and those who invest through an intermediary. Investors who invest directly with the mutual fund will get the benefit of today's NAV, while investors who invest through intermediaries will get the nexr-day's NAV, at best. We strongly encourage the Commission to avoid creating a system that discriminates against investors based solely upon their choice of distribution channel.

The discriminatory impact of the proposed 4 p.m. hard close is most clearly illustrated when an individual investor invests in the same mutual fund through three different distribution channels: a retail brokerage account, a 401(k) plan trusteed by a bank, and an account held directly by the mutual fund. Today, if that investor makes an investment decision at 3 p.m. on day 1 that he or she wants to redeem the mutual fund shares held in all three accounts and communicates that decision simultaneously to all three financial service providers: the investor's trade orders for all three accounts will be effected at *today's* NAV. Under the proposed 4 p.m. hard close, the investor's trade order will be effected at two, and possibly three, different NAV prices despite the fact that the decision to redeem was communicated at the exact same time. Specifically, the account held at the mutual fund will definitely receive today's NAV. The account held at the brokerage account may or may not receive today's NAV depending on the amount of processing required. As we discuss more fully below, the degree of processing required for plan participant orders guarantees that the mutual fund shares held through the 401(k) plan will be priced at the next

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[2] FACTS from EBRI, September 2002 analyzing year-end 2001 Retirement Plan Assets

[3] The term "bank" as used in this letter, includes federal and state-chartered savings associations and trust companies.

day's NAV, or possible the NAV for additional days later. Different NAV prices for simultaneous orders will initially lead to investor confusion and, most likely, create a strong investor bias towards dealing directly with the mutual fund for all types of investment accounts.

Encouraging investors to deal directly with mutual funds denies investor choice, and could have **undesirable** implications. Many plans today offer fifteen or more investment options that are cross-mutual fund industry and 'cross: provider. **If** a 4 p.m. hard close is in **place,** investors may sacrifice choice to be able to receive daily valuation and trading. If an investor is invested entirely in one fund, there is far greater potential for loss if that one fund, or fund family, encounters difficulties. History has shown time and again that a **lack** of diversification hurts investors.

Processing 401(k) plan participant orders is **an** operationally complex and rime-consuming **task,** no matter which type of financial **intermediary** is servicing the plan. There **'are** multiple processes and **systems** involved for correlating and transferring data between receipt of the participant's order and delivery of that order to the **find** company. One member institution has informed us that processing trade orders for most of their participant plans involves five steps and four systems between the **participant** trade request **and** fund company receipt. **Specifically,** once the participant communicates a trade request by' the **4** p.m. eastern lime market close, it is moved to tho primary participant recordkeeping system, where it is given **a** value and reconciled with **that** participant's account. The participant's transaction is then combined with others from that same plan, each one being previously reconciled **and** valued. The **next** step requires the specific plan's trade orders *to* he combined with other transactions from other plan accounts held by that recordkeeper, which are **again valued,** netted and reconciled. The penultimate step requires the recordkeepers net trade order to be turned over to the intermediary where it is valued and combined with trades of other recordkeepers for a total *net* buy or sell on each fund. These processing steps are taken after the **4** p.m. close to give plan participants the same consideration for trade orders **as** a direct investor **and** to allow both sides (sale **and** purchase) of an investment option **or** rebalance **of** portfolio to occur as of the same **trade** date. **At** least one bank **has** estimated that it may take 6-10 hours to complete all of this processing.

If a **4** p.m. "hard close" were put in place, then participants **in a** 401(k) plan would have their trade orders effected at the next **day's NAV,** since the order would have to be placed before 10 a.m. eastern time in order to have **any** chance to get today's NAV. For **plan** participants located on the West Coast, the chance *of* receiving that day's NAV is even slimmer. A 4 p.m. **hard** close **favors** the mutual fund 'distribution channel over that **provided by** banks, broker-dealers and other intermediaries because it allows the mutual fund complex to perform the processing tasks **after** 4 p.m. while all other providers must perform the requisite processing **before 4** p.m.

The transaction discussed above involves a simple redeem or purchase order. Even more complexity is involved when a participant's order involves a transfer from one fund to another, i.e. a simultaneous redemption and purchase. Today, if a participant places an order to sell 1000 shares of Fund X and use the proceeds to purchase shares in Fund Y, a bank trustee can process both legs of the transaction, because, some time after the 4 p.m. market close, they have electronically been provided with NAVs for both Funds. With a 4 p.m. "hard close" to the mutual fund, the bank trustee would have to place the order to redeem 1000 shares of Fund X before 4 p.m. Without an NAV for Fund X, the bank trustee could not place the purchase order for Fund Y before 4 p.m. Instead, the plan participant will purchase Fund Y shares at the next day's NAV. Here, again, a 4 p.m. hard close favors the mutual fund distribution channel over that provided by banks, broker-dealers, and others. Under the proposed 4 p.m. hard close, the participant's redemption and purchase orders will both be effectuated at today's NAV if both Fund X and Fund Y are members of the same fund family.

We do not believe it is appropriate for the Commission to adopt a solution to prevent illegal late trading that treats consumers differently based on their choice of one distribution channel over another. The consumers should not be sacrificing choice to be able to receive daily valuation.

An alternative proposal we would like to suggest is that the intermediary be required to prove that all trade requests were recorded before 4 p.m. This would allow all investors to be treated equally. The operational capability to achieve this is either currently in place, or can be put in place to include an electronic time stamp on all trade requests. Such an electronic time stamp could be incorporated into a system in such a way to ensure that it cannot be manipulated. Audit procedures could be developed to assure compliance. This would provide the assurance that the trade request came from the participant before the closing of the market. It would also allow for the equal treatment of all investors, 401(k) plan participants, and others who choose to invest through intermediaries.

<u>Market Timing</u>

There have been several proposals suggested for combating market timing, including stronger policies addressing market timing, better disclosures of these policies, and reinforcing board oversight. Proposals also require there to be procedures in place to ensure compliance with the disclosed policies regarding market timing. In addition, there has been discussion of fair value pricing to minimize market timing opportunities.

We would like to express concern about the 2% redemption component of proposed suggestions for addressing market timing. While this may be one means to discourage market-timers, we are concerned that it will create a huge burden for recordkeepers, and would require wholesale redesign of recordkeeping systems. In particular, it would be most difficult to apply it in omnibus accounts, which are how most retirement plans are handled. It would be very difficult to track the individuals engaging in market timing and then allocate the 2%

redemption charge back to the specific plan within, those omnibus accounts. We urge the Commission to carefully. consider all the potential consequences of possible solutions Through a proposed rulemaking.

Conclusion

We would encourage the Commission to move deliberately, recognizing the complex operational changes that these proposals would necessitate, and the negative impact on 401(k) plan participants and other investors who choose to use intermediaries. We would also encourage the Commission to allow for a suitable notice and comment period for any regulatory solutions proposed to address late trading and market timing. We believe the operational complexities and other difficult issues associated with these issues do not lend themselves to the Commission issuing rules in an interim final form. We look forward to working with the Commission and its staff in the future on these and other mutual fund issues. If you have any questions, or we can provide any further assistance, please contact Sally Miller at 202-663-5325 or Lisa Bleier at 202-663-5479.

Sincerely,

Edward L. Yingling

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RE: Late Trading and Market Timing Issues Letter

Comments: Please see attached. The original letter is being delivered by messenger.