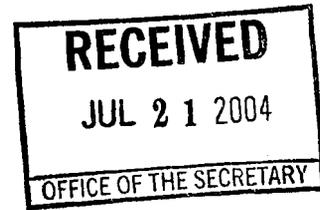


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S7-27-03

July 15, 2004

William H. Donaldson  
U.S. Securities and Exchange Commission  
450 5<sup>th</sup> Street  
Mail Stop 0607  
Washington, D.C. 20549

Dear Chairman Donaldson:

As you may know, the SPARK Institute<sup>1</sup> and others in the retirement services industry are strongly opposed to the imposition of the "hard" 4:00 p.m. cut-off for delivery of orders to mutual funds. Such a rule would harm American workers participating in 401(k) and other similar retirement plans by, among other things, placing plan participants at a disadvantage relative to "retail" mutual fund investors, requiring substantial and expensive changes to most plan recordkeeping and trade processing systems, reducing industry competition, and increasing the plans administration costs paid by participants.

Because of the concerns about the proposed "hard" 4 p.m. close, the SPARK Institute has been actively working on an alternative called the "SPARK Solution." This alternative is being developed with the cooperation of the American Institute of Certified Public Accountants and is endorsed by the American Bankers Association.

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<sup>1</sup> The SPARK Institute is an educational trade council associated with the Society of Professional Administrators and Recordkeepers ("SPARK"). SPARK brings together more than 250 banks, insurance companies, mutual fund managers, third party administrators and benefit consultants providing services to 401(k) and other participant-directed defined contribution retirement plans. SPARK member companies provide services to approximately 97% of the roughly 45 million defined contribution plan participants in the country.

A current draft description of the SPARK Solution is enclosed. This document describes conditions to be satisfied by "intermediaries" authorized to submit orders for purchases and redemptions of mutual fund shares to the funds after 4 p.m. on a business day. These conditions include: approximately

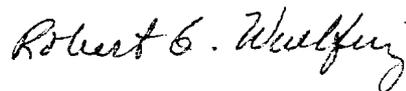
- specific criteria for internal controls, policies and procedures, including a combination of edit checks and controls built into an intermediary's order processing systems to ensure that orders that are not properly time-stamped before 4 p.m., and any orders cancelled or changed after 4:00 p.m., are identified and resolved;
- an independent accountant examination of the intermediary's compliance with criteria for internal controls, policies and procedures and the effectiveness of those controls, policies and procedures;
- senior executive certification requirements; and
- standards for contracts between funds and intermediaries.

We believe that these requirements would form the basis for ensuring, on an ongoing basis, that no intermediaries engage in illegal late trading.

Over the past few weeks, the SPARK Institute formed a working group consisting of representatives from large financial institutions, including some banks, brokers and third party administrators, all of whom provide services to employee benefit plans. This working group has developed an "exposure draft" identifying in additional detail specific controls for financial intermediaries that would be permitted to process orders for shares of mutual funds after hours. The exposure draft has been delivered to SPARK Institute members for comment and we expect to provide a draft to you shortly.

We hope to have an opportunity to meet with you soon to discuss these issues in more detail. We will contact your office shortly to discuss a convenient time.

Respectfully submitted,



Robert G. Wuelfing

Enclosure

cc: Patrick Von Bargaen



**SPARK Solution**  
**(Discussion Draft July 9, 2004)**

**Introduction**

Current rules under the Investment Company Act of 1940, as amended, allow "intermediaries," including retirement plan recordkeepers, to accept purchase and sale orders on behalf of a mutual fund or its designated transfer agent, and to process and submit to the fund orders received before 4 p.m. on a business day after 4 p.m. The SEC has proposed amendments to Rule 22c-1 that would impose a "hard" 4 p.m. close — specifically, an intermediary could submit an order to purchase or redeem fund shares for the current day's price only if the fund, its designated transfer agent or a registered securities clearing agency (*i.e.*, NSCC) would receive the order by 4 p.m.

The "SPARK Solution" provides an alternative to the "hard" 4 p.m. close, under which mutual funds may accept orders from an intermediary after 4 p.m., if the intermediary meets specific requirements to protect against abusive late trading. The first requirement is that the intermediary places in operation internal controls, policies and procedures that satisfy objective and measurable criteria to ensure that —

- only authorized investors, such as (but not limited to) participant-directed retirement plans, may submit transactions through an intermediary's after hours processing system;
- there are "tamper-proof" processes for time-stamping transaction instructions and systems controls that ensure that no transaction instructions received after 4 p.m. are included in after hours order processing for the current day;
- a combination of edit checks and controls built into the intermediary's transaction processing systems ensure that, on a "real-time basis," exceptions (including orders not properly time-stamped before 4 p.m. and any cancelled or changed orders) are identified and resolved;
- there are layers of management review and oversight of the effectiveness of the required internal controls, policies and procedures, including review of exceptions; and
- there is physical and logical security of processing systems.

The SPARK Solution would require the intermediary to engage an independent accountant to determine its compliance with the criteria and the effectiveness of the intermediary's control over compliance with the criteria in accordance with standards set forth in "Compliance Attestation," in Statement on Standards for Attestation Engagements (SSAE) No. 10, *Compliance Attestation: Revision and Codification* (AICPA, Professional Standards, vol. 1, AT section 601). The SPARK Institute is working with representatives of the AICPA to develop a Statement of Position ("SOP") providing guidance on performing these compliance attestation engagements.

**SPARK Solution**  
**Discussion Draft, July 9, 2004**

In addition to intermediary internal controls, policies and procedures meeting the criteria and an independent accountant compliance attestation, the SPARK Solution would require written certification to no late trading by a senior executive officer of the intermediary (*e.g.*, its chief executive officer, or the executive officer in charge of the business unit responsible for processing mutual fund orders) and provide standards for written contracts between a mutual fund and intermediaries.

**Specific Requirements**

SPARK proposes that Rule 22c-1 include an exception from the "hard" 4 p.m. close that enables an investment company issuing redeemable securities (a "fund") to deem its receipt of a purchase or redemption order from an intermediary to have occurred immediately before 4 p.m., even if the intermediary submits the order "after hours" (*i.e.*, after 4 p.m.), if specific requirements described by (a) through (d) below, are met. For purposes of this exception —

- an "intermediary" may be a bank, broker-dealer or other entity, including a retirement plan recordkeeper, designated by a fund (or an agent of the fund) to be the fund's agent to accept orders for purchases and redemptions of the fund's shares;
- "after hours trade processing" is a procedure in which orders received (as defined by subsection (a)(5), below) by an intermediary before 4 p.m. are processed and submitted to a fund after 4 p.m.; and
- "late trading" occurs where an order that the intermediary did not receive (as defined by subsection (a)(5), below) before 4 p.m. on a business day is submitted to the fund to be invested at that day's price.

(a) **Criteria for Internal Controls, Policies and Procedures** The intermediary adopts and places into operation internal controls, policies and procedures meeting the following criteria.

- (1) **Authorized Plan Account** – All orders submitted for after hours trade processing are for the benefit of an "authorized plan account" authorized by the fund to submit orders through the intermediary's after hours trade processing system. For example, funds may designate participant-directed 401(k) and other tax-qualified retirement plans as authorized to submit orders through after hours trade processing systems.
- (2) **Plan Account Opening Dual Controls** – Each plan account is properly classified as an "authorized plan account," as supported by the intermediary in written documentation. The opening of each authorized plan account is subject to a special two-party control — *e.g.*, initiated by a system operator and approved by his or her supervisor in writing. The system generates a periodic (*e.g.*, monthly) report of the opening of authorized plan accounts, including the name of the authorized plan account, identification of the supporting documentation, and identification of the initiating operator and supervisor. These reports and all supporting account documentation are maintained and available for inspection.

## SPARK Solution

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- (3) Electronic Processing and Time Stamping - All authorized plan account "instructions" to be effected in after hours trade processing are recorded in electronic form and automatically date-time stamped at point of entry into the intermediary's electronic order processing system. Such instructions include investment directions as well as other actions or transactions under a plan that will generate orders,<sup>1</sup> e.g., an instruction to invest payroll contributions, to perform portfolio rebalancing or exchanges between plan investment options, or to make a participant loan or hardship distribution. The electronic date-time stamp and primary trade information in the original instruction record is preserved unaltered and available for inspection.
- (4) Tamper-Proof Time Stamping - Date-time stamps are applied by an electronic system using a tamper-proof time source capable of validation.
- (5) Instructions Must Be Received Before 4:00 P.M. - All orders submitted to the fund in after hours trade processing on any business day are based on instructions date-time stamped as received from authorized plan accounts before 4 p.m. For this purpose, an instruction is "received" by an intermediary before 4 p.m. so long as the intermediary receives, before 4 p.m., a date-time stamped instruction (as described by subsection (a)(3)) that will generate purchase or redemption orders for the fund's shares on that business day, provided that the intermediary also receives by 4 p.m. all information necessary to determine the purchases or redemptions of fund shares to be generated by the transaction, other than the price to be applied to shares of funds involved in the transaction. The cancellation, modification or correction of any date-time stamped instruction before 4 p.m. must be time-stamped. Instructions are irrevocable as of 4 p.m. — no instruction may be cancelled, modified or corrected after 4 p.m. on the business day it is received.
- (6) Trade Aggregation Controls - Where the intermediary aggregates and nets order activity of multiple plan accounts in after hours trade processing, the intermediary's trade processing systems include edit processes that validate whether each instruction and order included in the aggregate or net order is valid for after hours trade processing on the intended trade date (i.e., each instruction included in the order is received from an authorized plan account before 4 p.m.).
- (7) End to End Trade Tracking Controls - Every order submitted to the fund (directly or indirectly through another intermediary or through a registered clearing agency) in after hours trade processing is traceable and auditable from the original instruction (as described in subsection (a)(3)) through receipt by the fund. A unique transaction identification, control or reference number is assigned to each instruction that generates orders and to each order. The history of each order is maintained and available for inspection.
- (8) Record Security - Records of instructions and orders are physically secure and protected from unauthorized changes.

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<sup>1</sup> As defined by proposed rule 22c-1(c)(3), an "order" means a direction to purchase or redeem a specific number of fund shares or an indeterminate number of fund shares of a specific value.

**SPARK Solution**

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- (9) System Security - All systems hardware and application software code is kept in locked and secure data centers.
- (10) Change Controls - Any cancellation, correction or other modification to any order made after 4 p.m. is subject to two party control, *e.g.*, initiated by a system operator and approved by his or her supervisor in writing. All such cancellations, corrections or modifications are identified to the specific plan account and documented with a description of the error corrected and reason for the correction. A daily report of all such authorized cancellations, corrections or other modifications is produced, maintained for a period of time, and available for inspection.
- (11) Reconciliation Controls - On a daily basis, the intermediary's records identifying shares of the fund held by each authorized plan account, and all authorized plan accounts in aggregate, are reconciled to reports of shares held by such plans on the fund's records. Differences are reconciled at the plan account level on a transaction by transaction basis. Any unreconciled differences are researched and corrected, and correction is documented. Reconciliation reports are maintained and available for inspection.
- (12) Red-Flag Reporting - The order processing systems generate immediate "red-flag" exception reports identifying —

- (a) any change made to the electronic date-time stamp or key trade information in the original record made at point of entry of an instruction that generates orders;
- (b) the inclusion in aggregate or net orders of any invalid order (*i.e.*, not received from an authorized plan account by 4 p.m.); and
- (c) any cancellation, correction or modification of any order (or any transaction instruction that generates orders) after 4 p.m., unless authorized under a procedure meeting criteria under subsection (a)(10).

The red-flag reports, together with reports of resolutions of these issues, are maintained and available for inspection.

- (13) Independent Compliance Review - The intermediary identifies a senior "compliance officer," who is independent of systems operators and their supervisors acting under subsections (a)(2) and (a)(10), who will be responsible for timely review of the red-flag reports required under (a)(12), review and approval of the intermediary's internal policies and procedures, and review of documentation, reports and logs produced by the intermediary in connection with the requirements under this subsection (a). A record of these reviews is maintained and available for inspection.
- (14) Senior Executive Reporting - Material issues noted by the intermediary's senior compliance officer upon review of reports as required by subsection (a)(13) are reported immediately to a senior executive officer of the intermediary (*e.g.*, its chief executive officer, or the executive officer in charge of the business unit responsible for processing mutual fund orders). If any of these issues resulted in late-trading, the intermediary immediately notifies the fund and corrects the late trade.

(b) **Independent Compliance Attestation Examination** Each calendar year, the intermediary engages an independent accountant to perform an examination of the intermediary's compliance with the criteria set forth in subsection (a) (the "criteria"); and the effectiveness of the intermediary's internal control over compliance with the criteria, in accordance with attestation standards established by the American Institute of Certified Public Accountants. The examination is performed by the independent accountant upon reasonable advance notice to the intermediary. The independent accountant's report must include —

- (1) a description of the intermediary's internal controls, policies and procedures placed in operation to meet the criteria;
- (2) a description of agreed-on procedures performed in evaluating the intermediary's compliance with the criteria and the effectiveness of the intermediary's internal control over compliance with the criteria, including any testing and other procedures performed; and
- (3) the accountant's opinion as to whether the intermediary complies with the criteria and whether the intermediary's internal control over compliance with the criteria is effective, as demonstrated by material examination of actual transactions in addition to control examinations.

The accountant's opinion must conclude that, for the report period, the intermediary complied in all material respects with the criteria and that the intermediary's internal control over compliance with the criteria is effective.

(c) **Executive Officer Certification** A senior executive officer of the intermediary (*e.g.*, its chief executive officer, or the executive officer in charge of the business unit responsible for processing mutual fund orders) annually certifies to the fund that (1) the intermediary has operational controls, policies and procedures in place meeting the criteria set forth in subsection (a), above; and (2) represents that no late trades were submitted to the fund.

(d) **Contract Standards** Written contracts between the fund and intermediary (or an agent of the fund authorized to enter such contracts on the fund's behalf) require the intermediary to —

- (1) provide to the fund company the accountant attestation report and senior executive officer certification required by subsections (b) and (c) above;
- (2) immediately report to the fund known instance of late-trading;
- (3) make available for inspection by the fund and the fund's agents or representatives (including a regulator of the fund), all books and records of the intermediary pertaining to investments in the fund; and
- (4) require the intermediary to indemnify and hold harmless the fund and the fund's shareholders for any loss, damages, fines or penalties resulting from any late trading in the fund's shares for which the intermediary is responsible.