SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

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RIN 3235-AJ51

Mutual Fund Redemption Fees

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting amendments to a rule under the Investment Company Act. The rule, among other things, requires most open-end investment companies ("funds") to enter into agreements with intermediaries, such as broker-dealers, that hold shares on behalf of other investors in so called "omnibus accounts." These agreements must provide funds access to information about transactions in these accounts to enable the funds to enforce restrictions on market timing and similar abusive transactions. The Commission is amending the rule to clarify the operation of the rule and reduce the number of intermediaries with which funds must negotiate shareholder information agreements. The amendments are designed to reduce the costs to funds (and fund shareholders) while still achieving the goals of the rulemaking.

DATES: *Effective Date*: December 4, 2006.

Compliance Dates: Section III of this Release contains more information on applicable compliance dates.

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SUPPLEMENTARY INFORMATION: The Commission today is adopting amendments to rule 22c-2[1] under the Investment Company Act of 1940[2] (the "Investment Company Act" or the "Act").[3]

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I. BACKGROUND

On March 11, 2005, the Commission adopted rule 22c-2 under the Investment Company

[1] 17 CFR 270.22c-2.

[2] 15 U.S.C. 80a..

[3] Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to "rule 22c-2," "the rule," or any paragraph of the rule will be to 17 CFR 270.22c-2.

Act to help address abuses associated with short-term trading of fund shares.[4] Rule 22c-2 provides that if a fund redeems its shares within seven days,[5] its board must consider whether to impose a fee of up to two percent of the value of shares redeemed shortly after their purchase ("redemption fee").[6] The rule also requires such a fund to enter into agreements with its intermediaries that provide fund management the ability to identify investors whose trading violates fund restrictions on short-term trading ("shareholder information agreements").[7]

After hearing concerns about the operation of the information sharing provisions of the rule from fund management companies, in March of this year we proposed amendments that

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4 *See* Mutual Fund Redemption Fees, Investment Company Act Release No. 26782 (Mar. 11, 2005) [70 FR 13328 (Mar. 18, 2005)] ("Adopting Release").

5 Because the large majority of funds redeem shares within seven days of purchase, the practical effect of rule 22c-2, and these amendments, would be to require most funds to comply with the rule's requirements. Therefore, throughout this Release we may describe funds as being "required to comply" with a provision of the rule, when the actual requirement only applies if a fund redeems its shares within seven days. A fund that does not redeem its shares within seven days would not be required to comply with those provisions of rule 22c-2.

6 Rule 22c-2(a)(1). Under the rule, the board of directors must either (i) approve a fee of up to 2% of the value of shares redeemed, or (ii) determine that the imposition of a fee is not necessary or appropriate. *Id*. A board, on behalf of the fund, may determine that the imposition of a redemption fee is unnecessary or inappropriate because, for example, the fund is not vulnerable to frequent trading or the nature of the fund makes it unlikely that the fund would be harmed by frequent trading. Indeed, a redemption fee is not the only method available to a fund to address frequent trading in its shares. As we have stated in previous releases, funds have adopted different methods to address frequent trading, including: (i) restricting exchange privileges; (ii) limiting the number of trades within a specified period; (iii) delaying the payment of proceeds from redemptions for up to seven days (the maximum delay permitted under section 22(e) of the Act); (iv) satisfying redemption requests in-kind; and (v) identifying market timers and restricting their trading or barring them from the fund. *See* Adopting Release, *supra* note 4, at n.9; Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings, Investment Company Act Release No. 26287 (Dec. 11, 2003) [68 FR 70402 (Dec. 17, 2003)] at text preceding and following n.14.

7 Under the rule, the fund (or its principal underwriter) must enter into a written agreement with each of its financial intermediaries under which the intermediary agrees to (i) provide, at the fund's request, identity and transaction information about shareholders who hold their shares through an account with the intermediary, and (ii) execute instructions from the fund to restrict or prohibit future purchases or exchanges. The fund must keep a copy of each written agreement for six years. Rule 22c-2(a)(2), (3).

would reduce the costs of compliance and clarify the rule's application in certain circumstances.[8] The amendments are described in more detail below. We received 32 comment letters on the proposed amendments.[9] Most commenters supported the proposal. Today we are adopting those amendments substantially as proposed, with some changes that reflect the comments we received.

II. DISCUSSION

A. Shareholder Information Agreements

The amendments to rule 22c-2 we are adopting today (i) limit the types of intermediaries with which funds must enter into shareholder information agreements, (ii) address the rule's application when there are chains of intermediaries, and (iii) clarify the effect of a fund's failure to obtain an agreement with any of its intermediaries.

1. Small Intermediaries

Rule 22c-2 prohibits a fund from redeeming shares within seven days unless, among other things, the fund enters into written agreements with its financial intermediaries (such as broker-dealers or retirement plan administrators) that hold shares on behalf of other investors.[10] Under those agreements, the intermediaries must agree to provide, at the fund's request,

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[8] *See* Mutual Fund Redemption Fees, Investment Company Act Release No. 27255 (Feb. 28, 2006) [71 FR 11351 (Mar. 7, 2006)] ("2006 Proposing Release").

[9] Comment letters on the 2006 Proposing Release are available in File No. S7-06-06, which is accessible at http://www.sec.gov/rules/proposed/s70606.shtml. Comment letters on the 2005 adoption are available in File No. S7-11-04, which is accessible at http://www.sec.gov/rules/proposed/s71104.shtml. References to comment letters are to letters in those files.

[10] Rule 22c-2(a)(2). The rule excepts a fund from the requirement to enter into written agreements if, among other things, the fund "affirmatively permits short-term trading of its securities." *See* rule 22c-2(b)(3). "Financial intermediary" is defined in rule 22c-2(c)(1).

shareholder identity (*i.e.,* taxpayer identification number or "TIN"[11]) and transaction information,[12] and carry out instructions from the fund to restrict or prohibit further purchases or exchanges by a shareholder (as identified by the fund) who has engaged in trading that violates the fund's frequent trading (*e.g.* market timing) policies.[13] We designed this provision to enable funds to obtain the information that they need to monitor short-term trading in omnibus accounts and enforce their market timing policies.

After we adopted the rule in 2005, many fund managers expressed concern that the rule would require them to review a large number of their shareholder accounts in order to determine which shareholders are "financial intermediaries" as defined under the rule.[14] They noted that, because the definition encompassed any entity that holds securities in nominee name for other investors, it would include, for example, a small business retirement plan that holds mutual fund shares on behalf of only a few employees and that may not identify itself as a financial intermediary to the fund. These commenters emphasized that the task of identifying these intermediaries, as well as negotiating agreements with them, would be costly and burdensome.

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[11] Some commenters noted that in the case of foreign shareholders, TINs may not always be available, and suggested that the rule permit alternate identifiers in those circumstances. *See* Comment Letter of the Investment Company Institute ("ICI") (Apr. 10, 2006). In order to accommodate the use of alternative identifiers in those circumstances, we have revised the rule to allow for the use of Individual Taxpayer Identification Numbers ("ITINs") or other government issued identifiers to identify foreign shareholders if a TIN is unavailable. *See* rule 22c-2(c)(5)(i).

[12] One comment letter submitted after the adoption of rule 22c-2 expressed concern that the rule's contract provision, requiring that agreements with intermediaries mandate the disclosure of shareholder information at the fund's request, conflicts with Commission rules governing proxy solicitations. *See* Comment Letter of the American Bankers Assoc. (June 6, 2005). The Commission's proxy solicitation rules are set forth in Regulation 14A under the Securities Exchange Act of 1934, 17 CFR 240.14a-1 to14b-2. The proxy rules govern the disclosure of information in the context of proxy solicitations, and do not prohibit banks, broker-dealers and other intermediaries from complying with agreements entered under rule 22c-2. *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at n.17.

[13] *See* rule 22c-2(c)(5) (defining "shareholder information agreement," which is discussed further in Section II.B below).

[14] *See, e.g.*, Comment Letter of OppenheimerFunds, Inc. (May 9, 2005).

To address these concerns, earlier this year we proposed to narrow the scope of the rule by excluding from the definition of "financial intermediary" those intermediaries that the fund treats as individual investors for purpose of the fund's frequent trading policies. Our proposal was premised on the understanding that when a fund places restrictions on transactions at the intermediary level (*i.e.*, when the fund treats the intermediary itself as an individual investor), the fund is unlikely to need data about frequent trading by individual shareholders who hold shares through that intermediary, because abusive short-term trading by the individual shareholders holding through the omnibus account would ordinarily trigger application of those policies to the intermediary's trades.[15] Therefore, transparency regarding underlying shareholder transactions executed through these accounts seemed unnecessary to achieve the goals of the rule. We believed that this new approach would substantially eliminate the need for funds to devote resources to identifying intermediaries, because the funds will have already identified the relevant intermediaries in the course of administering their policies on short-term trading. Commenters agreed with our analysis and urged that we adopt the amendments.[16]

Today we are amending the definition of "financial intermediary" in rule 22c-2 to exclude from that definition any entity that the fund treats as an "individual investor" for

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15 A fund typically exempts from its frequent trading policies the transactions of an intermediary that holds fund shares, on behalf of its customers, in an omnibus account with the fund. *See, e.g.,* Mandatory Redemption Fees For Redeemable Fund Securities, Investment Company Act Release No. 26375A, at text accompanying n 39 (Mar. 5, 2004) [69 FR 11762 (Mar. 11, 2004)] ("2004 Proposing Release"). The fund exempts the intermediary because the daily changes in the intermediary's position, on behalf of its various customers' purchases and redemptions, result in a single purchase or redemption each day in the intermediary's omnibus account. If the intermediary were not exempt, its daily net trades would likely subject it to redemption fees or trading limitations. *See* The Coalition of Mutual Fund Investors, An Evaluation of the Redemption Fee and Market Timing Policies of the Largest Mutual Fund Groups (May 5, 2005) (*available at* http://www.investorscoalition.com/CMFIMarketTimingStudy05.pdf.).

16 *See, e.g.,* Comment Letter of the Investment Company Institute (Apr. 10, 2006); Comment Letter of Charles Schwab & Co., Inc. (Apr. 10, 2006).

purposes of the fund's policies intended to eliminate or reduce dilution of the value of fund shares, *i.e.*, frequent trading and redemption fee policies.[17] As a result, if a fund, for example, applies a redemption fee or exchange limits to transactions by a retirement *plan* (an intermediary) rather than to the purchases and redemptions of the *employees* in the plan, then the plan would not be considered a "financial intermediary" under the rule, and the fund would not be required to enter into an agreement with that plan.[18]

The Commission is making one change from our proposal in response to commenters who pointed out that, in some cases, purchase and redemption orders are aggregated and submitted by agents of intermediaries on behalf of the intermediaries.[19] These commenters stated that under the rule as proposed, it was unclear whether an order submitted by an agent of an intermediary would be covered by the rule. In order to clarify the rule in response to those comments, we have revised it to provide that funds must enter into agreements with "each financial intermediary that submits orders, itself *or through its agent,* to purchase or redeem shares directly to the fund …" (changes in italics).[20] This revision clarifies that funds must enter

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[17] Rule 22c-2(c)(1)(iv). If a fund has not established frequent trading policies and thus has not determined which persons it does not treat as individual investors, this exclusion from the definition of "financial intermediary" would not apply, and the fund would need to identify those shareholder accounts that are "financial intermediaries." *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at n.23.

[18] We have not, as recommended by some commenters, revised the rule to specify the circumstances under which a fund may treat an intermediary as an individual investor rather than an intermediary for purposes of its frequent trading policies. *See, e.g.,* Comment Letter of Charles Schwab & Co., Inc. (Apr. 10, 2006). We continue to believe that funds are in the best position to determine the treatment of an account as an individual investor under their frequent trading policies. Moreover, we believe a fund will have little incentive to "inappropriately" treat any intermediary as an individual shareholder, because the intermediary is free to terminate its relationship with the fund.

[19] *See, e.g.,* Comment Letter of Matrix Settlement & Clearing Services, L.L.C. (Apr. 10, 2006).

[20] Rule 22c-2(a)(2). We are also revising paragraph (a)(2)(i) of the rule to require that the fund enter into an agreement with each such "intermediary (or its agent)." Rule 22c-2(a)(2)(i).

into agreements with financial intermediaries or their agents even if the intermediaries submit orders through entities that do not qualify as financial intermediaries.

2. Intermediary Chains

In some cases, an intermediary such as a broker-dealer may hold shares of a mutual fund not only on behalf of individual investors, but also on behalf of other financial intermediaries, such as pension plans or other broker-dealers ("indirect intermediaries") through one or more layers of intermediaries or "chains." After we adopted rule 22c-2 in 2005, fund managers expressed uncertainty as to how the rule applied to these arrangements, and expressed concern how, as a practical matter, a fund could obtain shareholder information through multiple layers of intermediaries.[21] In response to these concerns, we proposed and are now adopting amendments to clarify the operation of the rule as it applies to "chains of intermediaries."

The revised rule requires that a fund (or, on the fund's behalf, its principal underwriter or transfer agent[22]) enter into a shareholder information agreement[23] only with those financial

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[21] *See, e.g.*, Comment Letter of T. Rowe Price Associates, Inc. (May 24, 2005).

[22] When rule 22c-2 was adopted in 2005, it required a fund, or a principal underwriter acting on behalf of the fund, to enter into shareholder information agreements with intermediaries. In addition to the amendments described above, as proposed, we are also revising the rule to include a fund's *transfer agent* as an entity that may enter into a shareholder information agreement on the fund's behalf. As we noted when we proposed this change, the fund's transfer agent often has preexisting agreements with a fund's financial intermediaries, and thus permitting transfer agents to enter into information agreements may avoid potentially duplicative agreements or inefficiencies in the process. *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at text accompanying n.38. If a transfer agent enters into an agreement on behalf of the fund, the agreement must require the financial intermediary to provide the requested information to the *fund* upon the fund's request. *See id.* at n.37.

We are not adopting the proposed revision that would have permitted a *registered clearing agency* to enter into shareholder information agreements on behalf of a fund. We received comment from the only registered clearing agency that receives orders for transactions in fund shares, noting that it does not have the capability to serve in this function (because it does not act as an agent for funds) and requesting that we revise the final rule to reflect this fact. *See* Comment Letter of the National Securities Clearing Corporation (Apr. 10, 2006). We agree with the commenter's concern that including this reference to clearing agencies might cause confusion.

[23] Rule 22c-2(c)(5). The agreement, which must be in writing, may be part of another

intermediaries[24] that submit purchase or redemption orders directly to the fund, its principal underwriter or transfer agent, or a registered clearing agency ("first-tier intermediaries").[25] The rule does not require first-tier intermediaries to enter into shareholder information agreements with any indirect intermediaries.

Under the proposed rule amendments, a shareholder information agreement would obligate a first-tier intermediary to, upon request of the fund, use its best efforts to identify any accountholders who are themselves intermediaries, and obtain and forward (or have forwarded) the underlying shareholder identity and transaction information from those indirect intermediaries farther down the chain.[26] Some commenters expressed concern that shareholder information agreements might require first-tier intermediaries (and indirect intermediaries) to canvass all of their shareholder accounts to determine which accountholders are themselves intermediaries if a fund made a blanket request to identify all indirect intermediaries.[27]

In light of these concerns, we have revised the rule text to clarify that a fund, after receiving initial transaction information from a first-tier intermediary, must make a *specific*

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contract or agreement, such as a distribution agreement.

[24] We understand that retirement plan administrators and other persons that maintain the plan's participant records typically submit fund shares transactions to the fund or its transfer agent, principal underwriter, or a registered clearing agency. The rule as we adopted it last year specifically includes these administrators and recordkeepers within the definition of a "financial intermediary." *See* rule 22c-2(c)(1)(iii).

[25] Rule 22c-2(a)(2). We also considered, as an alternative to this requirement, that shareholder information agreements not require the collection of any shareholder information from indirect intermediaries. We did not take that approach because we are concerned that providing such an exception might encourage abusive short-term traders to conduct their activities through an indirect intermediary in order to avoid detection by the fund.

[26] *See* proposed rule 22c-2(c)(5)(iii) (discussed in 2006 Proposing Release, *supra* note Error: Reference source not found, at Section II.B).

[27] *See* Comment Letter of the Securities Industry Assoc. (Apr 10, 2006); Comment Letter of Charles Schwab & Co., Inc. (Apr. 10, 2006).

further request to the first-tier intermediary for information on certain shareholders.[28] As adopted, the amended rule defines "shareholder information agreement" as an agreement under which a financial intermediary agrees to "[u]se best efforts to determine, promptly upon request of the fund, whether any *specific person about whom it has received the identification and transaction information … [required by the rule]*, is itself a financial intermediary …." (changes in italics).[29] Under the revised rule, a shareholder information agreement need not obligate a first-tier intermediary to perform a complete review of its books and records to identify all indirect intermediaries. Instead, pursuant to a shareholder information agreement, a first-tier intermediary must use its best efforts to identify whether or not certain specific accounts identified by the fund are indirect intermediaries.[30] If an indirect intermediary that holds an account with a first-tier intermediary does not provide underlying shareholder information, the agreement must obligate the first-tier intermediary to prohibit, upon the fund's request, that indirect intermediary from purchasing additional shares of the fund through the first-tier intermediary.[31]

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[28] *See* rule 22c-2(c)(5)(iii). For example, after receiving identity and transaction information from a first-tier intermediary, the fund could then request information from the first-tier intermediary concerning those frequent trading shareholders whose transactions were particularly active, in order to determine whether those shareholders are themselves intermediaries. Under the shareholder information agreement, the first-tier intermediary would then be required to use its best efforts to determine, on behalf of the fund, whether any of those shareholders are intermediaries (*i.e.*, second-tier intermediaries). After the first-tier intermediary informs the fund which of the shareholders are second-tier intermediaries, the fund could then request that the first-tier intermediary obtain underlying shareholder transaction information from any or all of those second-tier intermediaries.

[29] *See* rule 22c-2(c)(5)(iii).

[30] Rule 22c-2(a)(2). A first-tier intermediary also may choose to indicate to the fund, when the intermediary initially discloses transaction information requested by the fund, which shareholders it knows to be indirect intermediaries. This practice may reduce a fund's need to request further information about indirect intermediaries.

[31] Rule 22c-2(c)(5)(iii)(B). Under the rule, therefore, if, upon specific request of the fund, an indirect intermediary (such as a third-tier intermediary) does not provide information whether one or more of its shareholders is an intermediary, then upon further request by the fund, the first-

3. Effect of Lacking an Agreement

After we adopted the rule, some commenters expressed concern that the rule, which made it unlawful for a fund to redeem a security within seven days without entering into a shareholder information agreement, could be interpreted to prevent a fund from redeeming *any* of its shares if it failed to enter into an agreement with any intermediary. Therefore we proposed, and are today adopting, an amendment to the rule that clarifies and further limits the consequences of failing to enter into an information agreement.

Under rule 22c-2, as amended, if a fund does not have an agreement with a particular intermediary, the fund thereafter must prohibit that intermediary from purchasing securities issued by the fund.[32] The prohibition applies only to the intermediary with which the fund does *not* have an agreement; purchases from other intermediaries will not be affected.[33] One

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tier intermediary would be required to restrict or prohibit that indirect intermediary from purchasing additional shares of the fund on behalf of other investors.

[32] Rule 22c-2(a)(2)(ii). One commenter suggested that we clarify that in these circumstances a "purchase" would not include the automatic reinvestment of dividends. *See* Comment Letter of the Investment Company Institute (Apr. 10, 2006). We agree that the reinvestment of dividends does not present the types of frequent trading risks that the rule is designed to help funds prevent. We therefore have revised the rule text to clarify that, for purposes of this provision, a "purchase" does not include the automatic reinvestment of dividends. *See* rule 22c-2(a)(2)(ii).

[33] A number of commenters expressed concerns about possible conflicts with the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 ("ERISA"), and Department of Labor rules under ERISA, in complying with rule 22c-2. They stated that those laws: (i) require certain "blackout" disclosures before a plan sponsor may carry out a fund's request to prohibit future purchases; and (ii) provide a safe harbor under section 404(c) of ERISA from liability as a fiduciary only if the plan provides participants an adequate number of investment alternatives and the ability to trade among them with appropriate frequency, in light of the market volatility of those alternatives. *See, e.g.,* Comment Letter of the American Bankers Assoc. (Apr. 14, 2006) (citing ERISA section 101(i), ERISA section 404(c), 29 CFR 2520, and 29 CFR 2550.404c-1); Comment Letter of the American Benefits Council (Apr. 10, 2006). Our staff has conferred with representatives of the Department of Labor, who have advised us that these concerns have been addressed in guidance on the duties of employee benefit plan fiduciaries in light of alleged abuses involving mutual funds. *See* Statement of Ann L. Combs, Assistant Secretary, Department of Labor, *Fiduciary Responsibilities Related to Mutual Funds,* (Feb. 17, 2004) (available at http://www.dol.gov/ebsa/newsroom/sp021704.html) (reasonable redemption fees and reasonable plan or investment fund limits on the number of times a participant can move in and out of a

commenter argued that the rule should not prohibit purchases that are fully disclosed to the fund.[34] We agree that the fund does not need further information under an agreement to scrutinize those purchases. Therefore, we have revised the final rule to provide that, if there is no shareholder information agreement with a particular intermediary, the fund must prohibit the intermediary from purchasing the fund's securities only "in nominee name on behalf of other persons."[35] We have also, for the same reason, revised this provision so that it does not apply to the intermediary's purchases of fund securities on behalf of the intermediary itself.[36]

Some commenters suggested alternative approaches that we have decided not to adopt. One recommended that the rule preclude intermediaries that lack an agreement with funds from redeeming shares within seven days of purchase, rather than prohibiting further purchases of fund shares.[37] This approach is not acceptable to us because it would deny investors access to their funds for seven days after purchasing shares through such an intermediary, thereby

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particular investment within a particular period "represent approaches to limiting market timing that do not, in and of themselves, run afoul of the 'volatility' and other requirements set forth in the Department's regulation under section 404(c), provided that any such restrictions are allowed under the terms of the plan and clearly disclosed to the plan's participants and beneficiaries.").

[34] *See* Comment Letter of the American Bankers Assoc. at 6 (Apr. 14, 2006).

[35] A similar revision has been made to the same type of provision concerning chains of intermediaries. *See* rule 22c-2(c)(5)(iii)(B).

[36] Rule 22c-2(a)(2)(ii), (c)(5)(iii)(B). One commenter requested that the Commission provide further guidance to financial intermediaries that attempt to carry out instructions from a fund, under rule 22c-2(c)(5)(ii), to "restrict or prohibit further purchases or exchanges" by a particular investor whom the fund has identified as violating its frequent trading policies. *See* Comment Letter of the Committee of Annuity Insurers (submitted by Sutherland Asbill & Brennan LLP) (Apr. 10, 2006). The commenter noted that an "exchange" (or transfer) request is actually two simultaneous orders: an order to redeem shares of one fund and an order to purchase, with the proceeds of the redemption, shares of another fund. This commenter questioned whether the rule was meant to include both the redemption and purchase order. As noted, the rule permits a fund to restrict or prohibit "exchanges." We agree with the commenter that an "exchange" request includes both a redemption order and purchase order, and if a fund instructs an intermediary to restrict an "exchange" (or a purchase), the intermediary may notify the investor that it will not effect the redemption portion of a request to exchange into the fund, as well as the purchase portion of the request.

[37] *See* Comment Letter of the American Benefits Council (Apr. 10, 2006).

penalizing investors for the inability or unwillingness of a fund and intermediary to enter into a shareholder information agreement. Another commenter argued that the rule should instead preclude a fund from making further payments under selling or dealer agreements to intermediaries that lack shareholder information agreements.[38] However, all funds do not necessarily have selling or dealer agreements with all of their "financial intermediaries" as defined in the rule, and restricting the rule's scope to those intermediaries that have such agreements would likely seriously restrict a fund's ability to gather information and enforce its policies. After careful consideration of the suggested alternatives, we believe that barring future purchases by intermediaries best serves the purposes of the rule.

B. Operation of the Rule

When we adopted rule 22c-2, we explained that the shareholder information agreement requirement is designed to give fund managers (and their chief compliance officers) a compliance tool to monitor trading activity in order to detect frequent trading and to assure consistent enforcement of fund policies.[39] But we also explained that the rule gives managers flexibility to request information periodically such as when circumstances suggested that abusive trading activity is occurring.[40]

We recognize that in some cases, frequent use of this tool might be costly for funds and intermediaries. Commenters expressed concerns about these costs, and several commenters urged us to impose limits on the frequency of information requests made by funds pursuant to the

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[38] *See* Comment Letter of Federated Investors, Inc. (submitted by ReedSmith LLP) (Apr. 6, 2006).

[39] Adopting Release, *supra* note Error: Reference source not found, at text accompanying n.49.

[40] *Id.* at text following n.42.

information agreements.[41] We are not imposing limits because, as we noted in the Adopting Release, we expect funds that are susceptible to market timing to use the tool regularly.[42] Not all funds, however, are susceptible to market timing.

A fund, in determining the frequency with which it should seek transaction information from its intermediaries, could consider: (i) unusual trading patterns, such as abnormally large inflows or outflows, that may indicate the existence of frequent trading abuses; (ii) the risks that frequent trading poses to the fund and its shareholders in light of the nature of the fund and its portfolio; (iii) the risks to the fund and its shareholders of frequent trading in light of the amount of assets held by, or the volume of sales and redemptions through, the financial intermediary; and (iv) the confidence the fund (and its chief compliance officer[43]) has in the implementation by an intermediary of trading restrictions designed to enforce fund frequent trading policies or similar restrictions designed to protect the fund from abusive trading practices. In some cases, fund managers may seek transaction information only occasionally to determine whether the intermediary is, in fact, enforcing trading restrictions or imposing redemption fees on behalf of the fund.[44]

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[41] *See, e.g.*, Comment Letter of Massachusetts Mutual Life Insurance Company (Apr. 10, 2006); Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

[42] Adopting Release, *supra* note Error: Reference source not found, at text accompanying n.50.

[43] *See, e.g.,* Compliance Programs of Investment Companies and Investment Advisors, Investment Company Act Release No. 26299, at n.69 and accompanying text (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] ("[U]nder rule 38a-1, a fund must have procedures reasonably designed to ensure compliance with its disclosed policies regarding market timing. These procedures should provide for monitoring of shareholder trades or flows of money in and out of the funds in order to detect market timing activity, and for consistent enforcement of the fund's policies regarding market timing.").

[44] Some commenters expressed concern about the ability of financial intermediaries to provide information to funds, in light of applicable privacy laws. *See, e.g.*, Comment Letter of the American General Life Insurance Company, *et al* (submitted by O'Melveny & Myers LLP), (May 9, 2005); 15 U.S.C. 6801-09, 6821-27 (privacy provisions of Gramm-Leach-Bliley Act); Regulation S-P, 17 CFR Part 248 (Commission rules implementing privacy provisions for funds, broker-dealers, and registered investment advisers). Under those laws, financial institutions such

Some intermediaries have responded to market timing concerns by enforcing their own frequent trading policies, which may be different from policies established by fund boards. We believe that a fund in appropriate circumstances could reasonably conclude that an intermediary's frequent trading policies sufficiently protect fund shareholders, and could therefore defer to the intermediary's policies, rather than seek to apply the fund's policies on frequent trading to shareholders who invest through that intermediary. In those circumstances, the fund should describe in its prospectus that certain intermediaries through which a shareholder may own fund shares may impose frequent trading restrictions that differ from those of the fund, generally describe the types of intermediaries (*e.g.*, broker-dealers, insurance company separate accounts, and retirement plan administrators), and direct shareholders to any disclosures

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as funds, broker-dealers, and banks must provide a notice describing the institution's privacy policies and an opportunity for consumers to opt out of the sharing of information with nonaffiliated third parties. These privacy laws also contain important exceptions to the notice and opt-out requirements. Under the Commission's privacy rules, for example, these requirements do not apply to the disclosure of information that is "necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes," which includes a disclosure that is "[r]equired, or is a usual, appropriate, or acceptable method … [t]o carry out the transaction or the product or service business of which the transaction is a part …" 17 CFR 248.14(a), (b)(2). *See also* 17 CFR 248.15(a)(7)(i) (notice and opt-out requirements not applicable to disclosure of information to comply with law). Financial privacy rules that are substantially identical to these rules apply to financial intermediaries other than broker-dealers, and contain comparable exceptions. *See, e.g.*, 12 CFR Part 40 (rules applicable to national banks, adopted by the Comptroller of the Currency). We believe that the disclosure of information under shareholder information agreements, and the fund's request and receipt of information under those agreements, are covered by these exceptions. We also note that financial institutions often state in their privacy policy notices that the institution makes "disclosures to other nonaffiliated third parties as permitted by law." *See* 17 CFR 248.6(b). Therefore we believe it will not be necessary for intermediaries such as broker-dealers and banks to provide new privacy notices or opt-out opportunities to their customers, in order to comply with rule 22c-2. Commenters on the 2006 Proposing Release generally agreed that complying with rule 22c-2 should not require broker dealers and banks to provide new privacy notices to their customers. *See* Comment Letter of the Investment Company Institute (Apr. 10, 2006); Comment Letter of the American Bankers Assoc. (Apr. 14, 2006).

A fund that receives shareholder information for a purpose permitted by the privacy rules under the exceptions to consumer notice and opt out requirements may not disclose that information for other purposes, such as marketing, unless permitted under the intermediary's privacy policy. *See* Adopting Release, *supra* note Error: Reference source not found, at n.47.

provided by the intermediaries with which they have an account to determine what restrictions apply to the shareholder. We note that a fund is required to disclose whether each restriction imposed by the fund to prevent or minimize frequent trading applies to trades that occur through omnibus accounts at intermediaries, and to describe with specificity the circumstances, if any, under which each such restriction will not be imposed.[45]

C. Redemption Fees

Rule 22c-2 requires fund directors to consider whether to adopt a redemption fee, but the rule neither requires funds to adopt such a fee nor specifies the terms under which such a fee should be assessed.[46] A number of commenters raised concerns about redemption fees, and encouraged us to become involved in establishing the terms and conditions under which funds charge them.[47] A number of commenters, for example, urged us to require that fund redemption fee policies waive fees that might be imposed as a result of transactions not initiated by investors.[48]

We appreciate the commenters' suggestions that standardizing the terms and conditions of redemption fee policies might reduce the costs that intermediaries and others (including funds themselves) will bear in implementing fund redemption fees. However, we have decided not to

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[45] *See* Item 6(e) of Form N-1A [17 CFR 239.15A and 274.11A]; Item 8(e) of Form N-3 [17 CFR 239.17a and 274.11b]; Item 7(e) of Form N-4 [17 CFR 239.17b and 274.11c], Item 6(f) of Form N-6 [17 CFR 239.17c and 274.11d]. These disclosure items would not require a fund to describe the frequent trading policies of each intermediary to whose policies the fund defers.

[46] The rule does, however, require that any redemption fee charged not exceed two percent and apply to redemptions no less than seven days after purchase. *See* rule 22c-2(a)(1)(i).

[47] *See, e.g.*, Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006); Comment Letter of the American Council of Life Insurers (Apr. 10, 2006); Comment Letter of the Committee of Annuity Insurers (submitted by Sutherland Asbill & Brennan) (Apr. 10, 2006).

[48] *See, e.g.*, Comment Letter of the American Society of Pension Professionals & Actuaries (Apr. 10, 2006); Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006). Non-investor initiated transactions may include automatic asset rebalancing, automatic distributions, and prearranged periodic contributions.

propose to standardize the terms or conditions to preserve the flexibility of each fund to fashion policies that are best suited to protect the investors in each fund. We have done this after receiving extensive comment on the matter and after observing a lack of consensus among industry participants on the appropriate terms of a uniform redemption fee.[49] Although we may reconsider our decision at a later time, until then, the terms of redemption fee policies are a matter for fund boards to determine.[50]

III. COMPLIANCE DATES

When the Commission adopted rule 22c-2 in March 2005, we established a compliance date of October 16, 2006. In the 2006 Proposing Release, we requested comment on whether we should extend that compliance date. Nearly every commenter requested an extension, pointing out the need for significant time to revise agreements with intermediaries and change systems to accommodate the transmission and receipt of trading information. Commenters requested a variety of compliance date extensions, ranging from 6 months to 18 months.

Today we are extending the compliance date for the shareholder information agreement provisions of rule 22c-2. We are extending by 6 months, until April 16, 2007, the date by which

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[49] *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at text following n.12.

[50] Several commenters noted that a number of state insurance and contract law issues might arise in connection with a redemption fee charged to investors who invest in funds through insurance company separate accounts. *See, e.g.,* Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006); Comment Letter of the American Council of Life Insurers (Apr. 10, 2006). As we stated in the 2006 Proposing Release, we believe that because redemption fees and frequent trading policies are imposed by the fund, and not the insurance company, enforcing those limits or fees with respect to these investors should not cause insurance companies to breach their contracts. *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at n.12. Moreover, nothing in this rule would preclude a fund that is concerned about the legality under existing contracts of imposing these limits or fees on certain insurance contractholders, from choosing not to impose them with regard to investors whose policies would not permit imposition of such limits or fees.

funds must enter into shareholder information agreements with their intermediaries.[51] We also are extending by 12 months, until October 16, 2007, the date by which funds must be able to request and promptly receive shareholder identity and transaction information pursuant to shareholder information agreements. This latter extension is designed to allow additional time for funds, intermediaries, and others to revise their systems to accommodate the request, provision, and use of information from intermediaries *after* the negotiation of shareholder information agreements.

We did not propose, nor did we receive comment on, an extension of the compliance date for section 22c-2(a)(1), which requires a fund's board to consider the adoption of a redemption fee policy. The compliance date for that provision, October 16, 2006, remains in effect.

IV. COST-BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. As discussed above, the amendments we are adopting today will (i) limit the types of intermediaries with which funds must enter into shareholder information agreements, (ii) address the rule's application when there are chains of intermediaries, and (iii) clarify the effect of a fund's failure to obtain an agreement with any of its intermediaries. These amendments are designed to respond to concerns that commenters identified during the course of implementing rule 22c-2, and in response to our request for comment on these proposed amendments. We believe that the amendments will result in substantial cost savings to funds, financial intermediaries, and investors, and provide clarification of the rule's requirements.

A. Benefits

We anticipate that funds, financial intermediaries, and investors will benefit from these

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[51] *See* rule 22c-2(a)(2).

amendments to rule 22c-2. As discussed more fully in the Adopting Release we issued in 2005, rule 22c-2 is designed to allow a fund to deter, and to provide the fund and its shareholders reimbursement for the costs of, short-term trading in fund shares.[52]

The amendments to rule 22c-2 that we are adopting today will likely result in additional benefits to funds, financial intermediaries, and investors. As discussed in the previous sections of this Release, some commenters on the Adopting Release argued that the rule's definition of "financial intermediary" was too broad because it would have required funds to identify and enter into agreements with a number of intermediaries that may not pose a significant short-term trading risk to funds, and may have imposed unnecessary costs to market participants.[53] For example, one large fund complex indicated that, under the rule as adopted, identifying their "financial intermediaries" could cost that fund complex $8.5 million or more.[54] These amendments will modify the definition of financial intermediary to exclude entities that a fund treats as an individual investor for purposes of the fund's policies on market timing or frequent trading. We believe that these amendments will reduce the burden on funds of identifying those entities that might have qualified as financial intermediaries under the rule as adopted, because a fund should already know which entities it treats as intermediaries for purposes of its policies on market timing or frequent trading.[55] As further discussed in the Paperwork Reduction Act

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[52] *See* Adopting Release, *supra* note Error: Reference source not found, at Section IV.A.

[53] *See* Comment Letter of the Investment Company Institute at 3 (May 9, 2005). The ICI stated in its 2005 comment letter that, under the rule as adopted in 2005, three large fund complexes alone would have to evaluate 6.5 million accounts that are "not in the name of a natural person and thus could be held as an intermediary for purposes of the rule" and might have to enter into agreements with a significant portion of those accounts that are held in nominee name. *Id*. The ICI noted that many of these accounts are likely associated with small retirement plans, small businesses, trusts, bank nominees and other entities that are unlike typical financial intermediaries such as broker-dealers. It added that funds typically do not have agreements with such small entities, other than agreements incidental to the opening of an account.

[54] *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at n.48.

[55] Under the revised rule, if the fund does *not* exempt an intermediary from its frequent

Section below, for purposes of the Paperwork Reduction Act we have estimated that identifying the intermediaries with which a fund complex must enter into agreements may take the average fund complex a total of 250 hours of a service representative's time, at a cost of $40 per hour,[56] for a total burden to all funds of 225,000 hours, at a total cost of $9 million. These amendments will likely provide a significant benefit because they should reduce the costs associated with the intermediary identification process.

By enabling funds to forego the cost of entering into agreements with omnibus accountholders that they treat as individual investors, we anticipate that the large majority of small omnibus accountholders will now fall outside the shareholder information agreement provisions of the rule. This will likely result in significant cost and time savings to funds and financial intermediaries through reduction of the expenses associated with these agreements. The reduction of these costs also may benefit fund investors and fund advisers, to the extent that these costs may have been passed on to them. We estimate that this will significantly reduce the burden on many entities that would otherwise have qualified as intermediaries under the rule as adopted, because the excluded entities would no longer need to enter into shareholder information agreements, or develop and maintain systems to provide the relevant information to funds. Commenters on the 2006 Proposing Release generally agreed that the rule amendments are likely to reduce costs to market participants.[57]

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trading policies, *i.e.* if the fund treats the intermediary as an individual investor for purposes of those policies, then the entity would not be a "financial intermediary" (with respect to that fund), and the fund would not have to enter into an shareholder information agreement with it. These intermediaries might include small retirement plans that do not identify themselves as intermediaries or omnibus accounts to the fund and request an exemption from the fund's frequent trading policies. These intermediaries will likely either have very few underlying investors, and/or restrict their transactions so that transactions by investors do not trigger application of a redemption fee or violate the fund's frequent trading policies.

[56] *See infra* note Error: Reference source not found.

[57] *See, e.g.,* Comment Letter of the Investment Company Institute (Apr. 10, 2006) ("[The

Commenters on the 2005 adoption were also concerned that the rule as adopted might have required funds to enter into agreements with intermediaries that hold fund shares in the name of other intermediaries (a "chain of intermediaries"), potentially resulting in a fund having to enter into agreements with intermediaries with which it may not have a direct relationship (*i.e.*, indirect intermediaries).[58] These amendments further clarify and define the operation of the rule with respect to intermediaries that invest through other intermediaries. These amendments to rule 22c-2 define the term "shareholder information agreement," and provide that funds need only enter into shareholder information agreements with intermediaries that directly submit orders to the fund, its principal underwriter, transfer agent, or to a registered clearing agency. Accordingly, funds will not need to enter into agreements with indirect intermediaries and may incur lower systems development costs related to the collection of underlying shareholder information, thereby reducing the costs of compliance.

Under the amendments adopted today, a first-tier intermediary, in its agreement with the fund, must agree to, upon further request by the fund: (i) provide the fund with the underlying shareholder identification and transaction information of any other intermediary that trades through the first-tier intermediary (*i.e.*, indirect intermediary); or (ii) prohibit the indirect intermediary from purchasing, on behalf of others, securities issued by the fund. This approach is designed to preserve the investor protection goals of the rule by ensuring that funds have the ability to identify short-term traders that may attempt to evade the reach of the rule by trading through chains of financial intermediaries.

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proposed approach] should reduce the costs and burdens associated with the rules implementation while still providing funds access to underlying shareholder information.")

[58] *See* Comment Letter of T. Rowe Price Associates, Inc. at 2 (May 24, 2005); Comment Letter of OppenheimerFunds, Inc. at 3 (May 9, 2005).

By defining minimum standards for what must be included in these shareholder information agreements, we intended to balance the need for funds to acquire shareholder information from indirect intermediaries who trade in fund shares, with practical concerns regarding the difficulty that funds might face in identifying these intermediaries and entering into agreements with them. Because an intermediary that trades directly with a fund already has a relationship with its second-tier intermediaries (and is likely to have a closer relationship than the fund to any intermediary that is farther down the "chain"), a first-tier intermediary appears to be in the best position to arrange for the provision of information to a fund regarding the transactions of shareholders trading through its indirect intermediaries. By providing a definition of the term "shareholder information agreement," the amended rule clarifies the balance of duties and obligations between funds and financial intermediaries. Because first-tier intermediaries may already have access to the shareholder transaction and identification information of their indirect intermediaries, they will likely be able to provide this information to funds at a minimal cost, especially compared to the significant costs that funds would incur if they were required to collect the same information from indirect intermediaries themselves. Although first-tier intermediaries may incur some costs in collecting and gathering this information from indirect intermediaries, there is a benefit in having the entity that has the easiest access to the relevant information have the responsibility for arranging for its delivery to funds.

In general, commenters on the 2006 Proposing Release agreed that first tier intermediaries are in a better position than funds to collect data from indirect intermediaries,[59] although one commenter disagreed and stated that intermediaries are not in a better position than

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funds to collect information from indirect intermediaries.[60] We continue to believe that the amended rule's approach of having the agreements require first-tier intermediaries to identify and collect information from indirect intermediaries appears to be the most cost effective method of handling the chain of intermediaries issue while still effectuating the purposes of the rule. Funds and intermediaries are also likely to engage in negotiations that will distribute the costs of information sharing between the entities, resulting in incentives for funds to narrowly target their information requests.

As discussed in the previous sections, these amendments clarify the result if a fund lacks an agreement with a particular intermediary. In such a situation, the fund may continue to redeem securities within seven calendar days, but it must prohibit that financial intermediary from purchasing fund shares in nominee name, on behalf of any other person. Some commenters had stated that the rule, as adopted in 2005, could be interpreted to require a different approach to these situations.[61] The amendments will provide the benefit of certainty regarding the duties of funds and financial intermediaries under the rule without imposing additional costs.

B. Costs

Many commenters expressed concerns about the costs of rule 22c-2 as adopted in 2005. As discussed above, we anticipate that the amendments adopted today will allow funds, financial intermediaries, and investors to incur significantly reduced costs. Although these amendments will reduce many of the costs of the rule, they should nonetheless maintain the investor protections afforded by the rule.

One of the primary results of these amendments will be to reduce the number of financial intermediaries with which funds must enter into shareholder information agreements. This

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[60] *See* Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

[61] *See* Comment Letter of the Investment Company Institute at 4 (May 9, 2005).

should reduce costs to all participants by allowing funds to enter into shareholder information agreements only with those intermediaries that hold omnibus accounts that are most likely to trade fund shares frequently. The rule's investor protections will be maintained because funds will continue to monitor the short-term trading activity of the rest of the fund's omnibus accounts as if they were individual investors in the fund, according to the fund's policies on short-term trading.

The amendments will reduce the number of entities that will be considered financial intermediaries under the rule. Commenters in 2005 raised concerns about the costs of identifying which accountholders are financial intermediaries.[62] The costs related to this review will be greatly reduced under the rule as we have revised it, because we expect that a fund will generally already have identified those accountholders that it does not treat as an individual investor for purposes of its restrictions on short-term trading. As discussed above in the benefits section, for purposes of the Paperwork Reduction Act, we have estimated that completion of this identification process will cost all funds a total of approximately $9 million.

We also received a few comments on the 2005 adoption regarding the number of accounts maintained by funds that qualify as financial intermediaries.[63] Commenters indicated

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[62] As discussed above, the ICI noted that, between just three large fund complexes, 6.5 million accounts may need to be reviewed, and estimated that the total number of accounts which would be evaluated by all funds could be in the "tens of millions." Comment Letter of the Investment Company Institute at 3 (May 9, 2005). OppenheimerFunds noted that, although it has more than 7.5 million shareholder accounts in its records, 137,000 or fewer of those accounts may qualify as financial intermediaries under the rule as adopted last spring. *See* Comment Letter of OppenheimerFunds, Inc. at 8 (May 9, 2005). Neither commenter estimated the costs of performing this review.

[63] OppenheimerFunds estimated that it has 137,000 omnibus accounts that might qualify as financial intermediaries, USAA Investment Management Company stated that it has "thousands" of these accounts, and T. Rowe Price estimated 1.3 million accounts that are not registered as natural persons. *See* Comment Letter of OppenheimerFunds, Inc. at 8 (May 9, 2005); Comment Letter of USAA Investment Management Company at 2 (May 9, 2005); Comment Letter of T. Rowe Price Associates, Inc. at 2 (May 24, 2005).

that revising the rule to address concerns about the definition of financial intermediaries would significantly reduce the costs of entering into or modifying these agreements, as well as the costs of developing, maintaining and monitoring the systems that will collect the shareholder information related to these agreements for funds.[64] Omnibus accountholders that previously would have qualified as financial intermediaries are also likely to realize substantial savings under the amended rule. When an omnibus accountholder is treated as an individual investor (or does not trade directly with the fund), such an omnibus account will no longer be treated as a financial intermediary and will not incur the costs of entering into or modifying agreements with that fund. There will also no longer be the start-up and ongoing costs of developing and maintaining shareholder information-sharing systems for those accountholders.

In 2005, we received a few comments regarding the costs of modifying or entering into shareholder information agreements. One of the few commenters that gave specific numbers indicated that it would take approximately four hours to modify and/or enter into, follow-up on, and maintain an agreement on its systems for each account identified as a financial intermediary.[65] The same commenter indicated that it may have as many as 137,000 accounts that might qualify as financial intermediaries under the rule as adopted. We anticipate that the large majority of the omnibus accountholders that would have qualified as financial intermediaries under the rule as initially adopted, will now be treated as individual investors by funds, and therefore no new agreements will be required. As discussed in the 2006 Proposing Release, we anticipate that in most cases complying with the amended rule will require a very limited number of new agreements between funds and intermediaries (in many cases virtually no

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[64] *See* Comment Letter of USAA Investment Management Company at 2 (May 9, 2005); Comment Letter of the ICI at 3 (May 9, 2005).

[65] *See* Comment Letter of OppenheimerFunds, Inc. at 8 (May 9, 2005).

new agreements would be required).[66] We understand that the number of existing agreements that funds have with their intermediaries can vary greatly, from less than 10 agreements for a small direct-sold fund, to 3000 or more agreements for a very large fund complex sold through various channels.[67] Although funds will still need to modify the existing agreements that they have with their intermediaries (*i.e.*, distribution agreements), we believe that these amendments will greatly reduce or eliminate the need for most funds to identify and negotiate new agreements. Funds are also likely to incur lower costs when modifying existing agreements than when entering into new agreements, and the actual hours required to modify an existing agreement thus may be less than the four hour figure suggested by the commenter.[68] Accordingly, based on the cost data provided by this commenter, we estimate that the cost reduction that may result from the amendments for a fund complex in a similar position as the commenter could be approximately 536,000 hours.[69]

For purposes of the Paperwork Reduction Act as discussed below, we have estimated that it will cost all funds and financial intermediaries a total of approximately $53,550,000 to enter

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[66] *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at text following n.55.

[67] *See id.*

[68] *See* Comment Letter of OppenheimerFunds, Inc. (May 9, 2005). Section VI below contains a discussion, in the context of the Paperwork Reduction Act, of some of the estimated costs of the shareholder information agreement and information-sharing system development and operations aspects of the rule.

[69] *See* Comment Letter of OppenheimerFunds, Inc. (May 9, 2005). This estimate is based on the following calculations: 137,000 potential accounts times 4 hours per account equals 548,000 potential hours. However, the amendments might eliminate the burden of reviewing and modifying those 137,000 potential accounts, and could limit the burden to a far reduced number, perhaps 3000 agreements for a very large fund. (3000 agreements to be modified times 4 hours equals 12,000 hours.) Instead of potentially incurring 548,000 hours complying with the agreement portion of the rule, a similar fund might incur 12,000 hours in modifying its existing agreements, for a savings of 536,000 hours (548,000 potential hours minus 12,000 hours equals 536,000 hours saved).

into and/or modify the agreements required under the amended rule.[70] This represents a significant cost reduction from the estimates provided to us in response to the rule's adoption.[71]

There will also be some costs related to the amendments we are adopting to the rule regarding chains of intermediaries. By clearly defining the duties that a fund's agreement must impose on intermediaries in the "chain of intermediaries" context, the proposed rule amendments may result in first-tier intermediaries incurring some costs that might otherwise have been borne by funds. These may include costs related to negotiating agreements (if necessary) with indirect intermediaries, processing requests from funds to investigate accounts, costs related to collecting and providing the underlying shareholder information to funds from the indirect intermediaries and restricting further trading by indirect intermediaries if the fund requests it. We believe that first-tier intermediaries are in a better position than funds to fulfill these obligations. Unlike funds, first-tier intermediaries have a direct relationship with second-tier intermediaries (and may be in a better position than funds to collect information from other indirect intermediaries), and

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70 *See infra* Section VII.

71 However, this revised estimate is a significant increase over the amount we estimated in the Adopting Release ($3,353,279) for funds and intermediaries to enter into shareholder information agreements. *See* Adopting Release, *supra* note Error: Reference source not found, at n.108. In response to our request for comment on any aspect of the rule's implementation, we received new information and updated estimates that noted that the cost of entering into agreements for funds and intermediaries would be significantly higher than the estimate included in the Adopting Release. After reviewing the comments we received in response to the Adopting Release, as well as other information received from fund representatives prior to the 2006 Proposing Release, we estimated in the 2006 Proposing Release that on average, a fund complex might incur $250,000 or more in expenses related to entering into or modifying the agreements required under the rule as adopted. *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at n.59. With approximately 900 fund complexes currently operating, we therefore estimate that the agreement portion of the rule as adopted could potentially cost all funds a total of approximately $225,000,000. Despite the increase in estimated costs for entering into agreements that we have included here over the cost estimates included in the Adopting Release, we anticipate that the amendments will reduce the costs of the agreement portion of the rule as adopted by approximately $171,450,000 ($225,000,000 (updated cost estimate) minus $53,550,000 (cost estimate after proposed amendments) equals $171,450,000 (total potential cost reduction)).

will thus be able to identify, communicate with, and collect information from these indirect intermediaries at a lower cost than if funds were to conduct such activities. First-tier intermediaries are also in a better position than funds to identify and gather shareholder information from more distant indirect intermediaries because of their relationships with second-tier intermediaries.

As further discussed in connection with the Paperwork Reduction Act, we have estimated that the costs of entering into arrangements between first-tier and more indirect intermediaries will be approximately $63 million.[72] We anticipate that intermediaries will generally use the same systems that they use to provide the required underlying shareholder identity and transaction information directly to funds to process the information that first-tier intermediaries will forward (or have forwarded) to funds from indirect intermediaries, thus resulting in significant cost efficiencies.

Funds and intermediaries may also incur some costs related to drafting or revising terms for the agreements required by rule 22c-2. We have been informed that industry representatives are working together to develop a uniform set of model terms, and anticipate that such model terms may significantly reduce the costs related to developing individualized agreement terms for each fund and intermediary.[73] As further discussed in the Paperwork Reduction Act Section of this release, for purposes of the Paperwork Reduction Act, we estimate that a typical fund complex will incur a total of 5 hours of legal time at $300 per hour in drafting these agreement terms, for a total of 4500 hours for all 900 fund complexes at a total cost of $1,350,000.

We understand that several service providers are developing systems to accommodate the transmission and receipt of transaction information between funds and intermediaries pursuant to

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[72] *See infra* note Error: Reference source not found and accompanying text.

[73] *See* Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

contracts negotiated to comply with rule 22c-2. At least one of these organizations is revising the infrastructure that it already has in place, in order to facilitate the communication of fund trades and other "back office" information between funds and financial intermediaries, including the information required under the rule. We understand that, with the exception of some smaller to mid-sized funds and intermediaries, the large majority of funds and intermediaries currently use the organization's existing infrastructure to process fund trades.[74] In addition, some funds, intermediaries, or third party vendors may develop their own competing or complementary information-sharing systems.[75]

Commenters on the 2006 Proposing Release suggested that in complying with the amended rule, funds and intermediaries may choose to incur certain additional costs in analyzing data received under shareholder information agreements, including costs for additional staffing, third-party vendors, and data repositories.[76] Generally, any such potential costs would be a consequence of the initial rule adoption, and are not a result of these rule amendments. These potential costs are also likely to vary significantly among entities depending on their size, the services they use, and the frequency with which they request and analyze information, among other factors.

One commenter on the 2006 Proposing Release noted that, as a large fund complex, it had received estimates of up to $730,000 a year for a third party to provide information transmittal systems, certain data analysis, and data repository services for the information

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74 *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at text following n.61.

75 *See id.* at n.40.

76 *See, e.g.*, Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006); Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

requested under shareholder information agreements.[77] Such third-party vendor systems costs will vary significantly depending on the size of the fund complex, the frequency that information is requested, the length of time the information is stored, any analysis performed, a fund's preexisting internal resources, and many other factors. In the Paperwork Reduction Act section below, we have estimated the costs we believe an average fund will incur in building these systems internally, or in using a third party vendor to provide these services. The same commenter also suggested that intermediaries might incur third party vendor costs to store and process data, and make it available to funds, with such costs possibly ranging up to $170,000 in start up costs, and $360,000 a year in annual costs.[78] We have incorporated the estimates provided by commenters on the 2006 Proposing Release into the cost calculations we made for purposes of the Paperwork Reduction Act, and as a result have increased the cost estimates made in this release over the estimates provided in the 2006 Proposing Release.[79]

One commenter also suggested that funds and intermediaries might choose to hire additional staff to process information received under the rule, although it noted that if the current volume of transactions continues, a fund in its position probably would not need to hire additional staff.[80] Other commenters did not estimate the potential costs related to hiring

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[77] *See* Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006). The commenter has informed our staff that the latest estimates it has received have been revised downwards to $620,000 a year for these services.

[78] *Id*.

[79] *See infra* Section VI.

[80] *See* Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006). During further discussions with the commenter, it noted that the cost of hiring one additional analyst to monitor information received under rule 22c-2 and these amendments could be approximately $35,000-40,000 a year, exclusive of overhead. Although we believe that most funds will not need to hire additional staff to comply with rule 22c-2, we estimate that the cost of hiring one additional senior compliance examiner could be $347,000 a year, inclusive of overhead and other expenses (based on compensation estimates for a Senior Compliance Examiner, from the *Securities Industry Assoc., Report on Management & Professional Earnings in the Securities Industry* (2005), multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

additional staff, the number of additional staff that might be hired, or the likelihood that more staff would be needed. In some circumstances, funds or intermediaries might choose to hire additional staff to process information received under the rule, but funds and intermediaries are likely to have sufficient staff in place to monitor frequent trading abuses that violate fund policies, and therefore are unlikely to need more staff under the amended rule.[81] The rule, by requiring funds to set up formalized information-sharing networks with their intermediaries, might also result in more efficient monitoring of frequent trading by funds and possible opportunities to reduce staff.

In response to comments received on the 2006 Proposing Release, we have revised certain of our cost estimates upwards over those discussed in the 2006 Proposing Release. As further described in Section VI below, for purposes of the Paperwork Reduction Act, we have estimated that all funds will incur a total of approximately $47,500,000[82] in one-time capital costs to develop or upgrade their software and other technological systems to collect, store, and receive the required identity and transaction information from intermediaries, and a total of $22,655,000 each year thereafter in operation costs related to the transmission and receipt of the information.[83] We have also estimated that financial intermediaries may incur $280,000,000[84] in one-time capital costs to develop or upgrade their software and other technological systems to collect, store, and transmit the required identity and transaction information to funds and from

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[81] *See, e.g.,* Compliance Programs of Investment Companies and Investment Advisers, *supra* note Error: Reference source not found at n.75 and surrounding text.

[82] This estimate, as well as many other estimates in this section may differ from the estimates made in the 2006 Proposing Release. These differences reflect new information provided to us by commenters, and are further discussed in Section VI.

[83] *See infra* Section VI.

[84] We estimate a total of approximately $327,500,000 in one time start-up costs ($280,000,000 + $47,500,000 = $327,500,000) for purposes of the Paperwork Reduction Act.

other intermediaries, and a total of $192,500,000[85] each year thereafter in operation costs related to the transmission and receipt of the information. These estimates were made for purposes of the Paperwork Reduction Act, and do not include certain costs, discussed above, that funds and intermediaries may incur which are not related to collections of information required by the rule. For example, the Paperwork Reduction Act estimates do not include all potential staffing costs, outside vendor analysis of information to discern trading patterns, or data repository costs that funds and intermediaries may incur in analyzing the information that they may collect under the agreements required by the rule. Although these are costs that funds and intermediaries may choose to incur, they are not required by the rule, and may vary significantly between every fund and intermediary depending on the frequency of data requests, their policies on frequent trading, their ability to analyze information, and many other factors.

For the reasons discussed above, we anticipate that these amendments will not create additional costs beyond the rule as adopted. In fact, we anticipate that the amendments will significantly reduce costs to most market participants.[86]

V. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. As discussed in the Cost-Benefit Analysis above, these amendments to rule 22c-2 are designed to reduce the burdens of the rule as adopted in 2005, while maintaining its investor protections. Funds will no longer be required to incur the expense of modifying or

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[85] We estimate a total of approximately $215,155,000 in ongoing annual costs ($192,500,000 + $22,655,000 = $215,155,000) for purposes of the Paperwork Reduction Act.

[86] *See infra* note Error: Reference source not found.

entering into agreements with omnibus accounts that they already effectively monitor by treating as individual investors, and would not need to enter into agreements with intermediaries that do not trade directly with the fund. These amendments will promote efficiency in the capital markets by enabling funds to focus their short-term trading deterrence efforts on those omnibus accounts that could be used to disguise this type of trading. These amendments will also promote efficiency by reducing the number of omnibus accountholders that would otherwise incur the expenses of entering into agreements, and of establishing and maintaining systems for collecting and sharing shareholder information.

We do not anticipate that these amendments will harm competition. They apply to all market participants and, as discussed in the Cost-Benefit Analysis above, serve to reduce cost burdens for large funds as well as small funds.[87] Some commenters expressed concern that the rule as adopted may disproportionately burden small intermediaries, and thus hinder competition.[88] We anticipate that under these amendments, most omnibus accounts that are treated by the fund as individual investors will be small intermediaries. By excluding these small intermediaries from the rule’s requirements, the amendments should serve to alleviate potential anti-competitive effects on small intermediaries.

These amendments are designed to reduce the costs of imposing redemption fees for both funds and intermediaries. Even after these amendments, the competitive pressure of marketing funds, especially smaller funds, coupled with the costs of imposing redemption fees in omnibus accounts, may deter some funds from imposing redemption fees. Intermediaries may use their market power to prevent funds from applying the fees, or provide incentives for fund groups to waive fees. However, by reducing the costs of imposing redemption fees, we believe that these

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87 *See supra* Section IV.

88 *See, e.g.,* Comment Letter of the Investment Company Institute (May 9, 2005).

amendments will likely reduce such anti-competitive effects.

We anticipate that these amendments may indirectly foster capital formation by reducing the costs of the rule for funds and intermediaries. If these cost savings are passed on to investors, they may increase investment in funds, thereby promoting capital formation. These amendments also may foster capital formation by improving the beneficial effect of the rule on investor confidence, because the rule is designed to permit funds to deter, and recoup the costs of, abusive short-term trading. To the extent that the amended rule enhances investor confidence in funds, investors are more likely to make assets available through intermediaries for investment in the capital markets.

VI. PAPERWORK REDUCTION ACT

As discussed in the Adopting Release,[89] the rule includes "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[90] The Commission submitted the collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11, and OMB approved these collections of information under control number 3235-0620 (expiring 06/30/2009). The title for the collection of information requirements associated with the rule is "Rule 22c-2 under the Investment Company Act of 1940, Redemption fees for redeemable securities." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

In response to the 2006 Proposing Release, we received a number of comments on the estimates made in the Paperwork Reduction Act section, and which provided additional cost

[89] *See* Adopting Release, *supra* note Error: Reference source not found, at Section V.

[90] 44 U.S.C. 3501-3520.

estimates and other information.[91] In light of those comments, we have revised upwards several of the per-fund estimates made in this section. However, because these amendments reduce the number of shareholder information agreements required, we estimate that the amendments should, in general, reduce the aggregate burden associated with the collections of information required by the rule, and will not create new collections of information. We have revised our previous burden estimates under the Paperwork Reduction Act to reflect (i) new cost and time burden information that we have received from market participants, and (ii) the revised number of entities that will be affected by the amended rule.

This revised Paperwork Reduction Act section contains a number of new cost and hour estimates that are significantly altered from the estimates made in the Adopting Release. Some of these estimates are based on different methods, and different sources, from those in the Adopting Release. Therefore there is not a strict comparability between the estimates made here and those made in the Adopting Release. These cost estimates, hourly rate estimates, and the methodology used to make these proposed estimates are based on comments we received in response to the Adopting Release and the 2006 Proposing Release, as well as information received from funds, intermediaries, and other market participants.[92]

Rule 22c-2 includes two distinct "collections of information" for purposes of the Paperwork Reduction Act. The first is related to shareholder information agreements, including the costs and time related to identifying the relevant intermediaries, drafting the agreements,

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[91] *See, e.g.*, Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006); Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

[92] *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at Sections VI and VIII. In general, the cost estimates provided in this section are derived from rounded and weighted averages of the cost estimates provided during conversations with industry representatives that took place prior to the 2006 Proposing Release, combined with the additional information submitted by commenters on that release.

negotiating new agreements or modifying existing ones, and maintaining the agreements in an easily accessible place. The second is related to the costs and time related to developing, maintaining, and operating the systems to collect, transmit, and receive the information required under the shareholder information agreements.[93]

Both collections of information are mandatory for funds that choose to redeem shares within seven days of purchase. These funds will use the information collected to ensure that shareholders comply with the fund's policies on abusive short-term trading of fund shares. There is a six year recordkeeping retention requirement for the shareholder information agreements required under the rule. Any responses that are provided in the context of the Commission's examination and oversight program are generally kept confidential.[94]

A. Shareholder Information Agreements

The Commission staff anticipates that most shareholder information agreements will be entered into at the fund complex level, and estimates that there are approximately 900 fund complexes. The Commission staff understands that the number of intermediaries that hold fund shares can vary for each fund complex, from less than 10 for some fund complexes to more than 3000 for others. Based on conversations with fund and financial intermediary representatives that took place prior to the 2006 Proposing Release, our staff estimates that, on average, under the revised definition of financial intermediary, each fund complex has 300 financial intermediaries. We understand that most funds already know and previously identified the majority of their intermediaries that they do not treat as individual investors. Therefore, funds should expend a limited amount of time and costs related to the identification of such

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[93] This second collection of information does not include potential costs or time that funds or intermediaries might incur in analyzing or using the provided information.

[94] For a discussion of restrictions on the disclosure of information under applicable privacy laws, *see supra* note Error: Reference source not found.

intermediaries. Our staff estimates that identifying the intermediaries with which a fund complex must enter into agreements may take the average fund complex 250 hours of a service representative's time at a cost of $40 per hour[95], for a total of 225,000 hours at a cost of $9,000,000.[96] Our staff estimates that for a fund complex to prepare the model agreement, or provisions modifying a preexisting agreement, between the fund and the intermediaries, it will require a total of 5 hours of legal time at $300 per hour, for a total of 4500 hours[97] at a total cost of $1,350,000**.**

The Commission staff estimates that for a fund complex to enter into or modify a shareholder information agreement with each existing intermediary, it will require a total one-time expenditure of approximately 2.5 hours of fund time and 1.5 hours of intermediary time for each agreement, for a total of 4 hours expended per agreement.[98] Therefore, for an average fund complex to enter into shareholder agreements, the fund complex and its intermediaries may expend approximately 1200 hours at a cost of $48,000,[99] and all fund complexes and intermediaries may incur a total one-time burden of 1,080,000 hours at a cost of $43,200,000.[100]

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[95] The title and hourly cost of the person performing the intermediary identification and entering into agreements may vary depending on the fund or financial intermediary. This $40 per hour cost is an average estimate for the hourly cost of employing the person doing the relevant work, derived from conversations with industry representatives that took place prior to the 2006 Proposing Release.

[96] This estimate is based on the following calculations: 250 hours times 900 fund complexes equals 225,000 hours, and 225,000 hours times $40 equals $9,000,000.

[97] This estimate is based on the following calculation: 5 hours times 900 fund complexes equals 4500 hours of legal time.

[98] The 4 hour figure represents time incurred by both the fund and the financial intermediary for each agreement. The Commission staff estimates that this 4 hour figure is comprised of approximately 2.5 hours of a fund service representative's time at $40 per hour and 1.5 hours of an intermediary representative's time at $40 per hour.

[99] This estimate is based on the following calculations: 4 hours times 300 intermediaries equals 1200 hours; and 1200 hours times $40 dollars per hour equals $48,000.

[100] This estimate is based on the following calculations: 1200 hours times 900 fund complexes equals 1,080,000 hours; and 1,080,000 hours times $40 per hour equals $43,200,000.

The Commission staff understands that there are efforts under way (including an industry task force devoted to the project) to produce standardized shareholder information-sharing model agreements and terms.[101] These efforts may reduce the costs associated with the agreement provision of the rule for both funds and intermediaries.[102] Finally, the Commission staff does not anticipate that funds or intermediaries will incur any new costs in maintaining these agreements in an easily accessible place, because such maintenance is already done as a matter of course.

The staff therefore estimates that, for purposes of the Paperwork Reduction Act, the shareholder information agreement provision of the rule as revised will require a total of 1,309,500 hours at a total cost of $53,550,000.[103]

B. Information-sharing

Some funds and intermediaries will incur the system development costs discussed in this section, but many will not because they already process all of their trades on a fully disclosed basis, use a third party administrator to handle their back office work,[104] or already have systems in place that allow intermediaries to transmit the shareholder identity and transaction information to funds. Other funds and intermediaries may have special circumstances that may increase the costs they face in developing and operating systems to comply with the rule. The estimates below represent the Commission staff's understanding of the average costs that might be encountered by a typical fund complex or intermediary in complying with the information-

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[101] *See* 2006 Proposing Release, *supra* note Error: Reference source not found, at text accompanying n.45.

[102] *See, e.g.*, Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

[103] This estimate is based on the following calculations: 4500 hours of legal drafting time plus 1,080,000 hours of agreement negotiating time plus 225,000 hours of intermediary identification time equals 1,309,500 total hours; and $43,200,000 plus $1,350,000 plus $9,000,000 equals $53,550,000.

[104] Third party administrators maintain accounts for many other intermediaries, and therefore incur the costs to develop a single system.

sharing aspect of the rule as amended.

1. Funds

The Commission staff understands that various organizations have developed, or are in the process of developing, enhancements to their systems that will allow funds and intermediaries to share the information required by the rule without developing or maintaining systems of their own.[105] Our staff anticipates that most funds and intermediaries will use these systems, and will generally make minor changes to their back office systems to comply with the rule requirements and to match their systems to those of the service providers. Our staff estimates that most funds could adapt their in-house systems to utilize these service providers' systems at a one-time cost of approximately $10,000 or less.[106] Although the costs that systems providers will charge may vary, one large provider has indicated that it plans to charge a monthly fee of $200 and fees of 25 cents for every 100 account transactions requested through the service.[107]

As an example of the cost of using these services, if a fund complex requests information for 100,000 transactions each week,[108] then it would incur costs of $250 each week, or $13,000 a

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[105] These service providers systems include the National Securities Clearing Corporation's Fund/SERV system, as well as other systems being developed by a number of other providers such as SunGard, BISYS, AccessData, and Charles Schwab. *See, e.g.*, Comment Letter of AccessData Corp. (Apr. 10, 2006).

[106] We expect that, in many cases, upgrades to fund transfer agents' as well as fund complex's systems will take place, and the transfer agents' costs will be charged back to the fund complex.

[107] *See* National Securities Clearing Corporation, Networking Service to Support SEC Rule 22c-2, Important Notice A #6228, P&S #5798 (Apr. 12, 2006) (*available at* http://www.nscc.com/impnot/notices/notice2006/a6228.pdf).

[108] The number of transactions and weekly request used here is an example, and is not intended to be a guideline as to how often a fund should request information under the rule. The frequency of information requests could vary significantly based on a wide variety of factors, as discussed in Section II.C above.

year, plus the monthly fee of $200, equaling $2,400 a year, for a total cost of $15,400 a year.[109] Our staff estimates that approximately 475 fund complexes would use these systems (including substantially all of the largest, and most of the medium-sized, fund complexes). If all of these complexes use these service providers' systems at the rate described above, they would incur a one-time system development cost of $4,750,000[110] and an annual system use cost of approximately $7,315,000.[111] Those 475 fund complexes may also incur system development costs related to the processing of information under the rule on trades that they receive through other channels than these service providers' systems, which we estimate to cost an average approximately $50,000 per fund complex, and $20,000 annually[112], for a total of $23,750,000[113] in

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[109] This estimate is based on the following calculations: 100,000 transaction requests times one quarter of a cent (the charge is 25 cents per 100 transactions requested, or one quarter of a cent per transaction) equals $250; $250 times 52 weeks equals $13,000; $200 monthly charges times 12 months equals $2,400; and $13,000 plus $2,400 equals $15,400. The costs of utilizing these services may vary widely, based on the frequency funds make information sharing requests, and the number of accounts requested.

[110] This estimate is based on the following calculation: 475 fund complexes times $10,000 (one-time system update costs) equals $4,750,000.

[111] This estimate is based on the following calculation: 475 fund complexes times $15,400 (annual costs) equals $7,315,000.

[112] In response to the 2006 Proposing Release, many commenters discussed the difficulty of estimating the costs of creating and operating information-sharing systems. As a result, very few monetary cost estimates were submitted by commenters. One fund commenter did provide some monetary estimates, and noted that although it agreed that many of the cost estimates made in the 2006 Proposing Release were reasonable, it believed that the Commission may have underestimated some of the costs it will likely encounter when designing and operating information sharing systems. *See* Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006). The commenter noted that additional staffing, data repository, and intermediary vendor costs related to information sharing systems may result in costs significantly higher than those estimated in the Paperwork Reduction Act section of the 2006 Proposing Release. We agree that these may be significant costs, but note that the estimates made in this section are limited to the scope of the Paperwork Reduction Act, and therefore do not include all of the costs encountered by funds and intermediaries in implementing the rule that are not related to a "collection of information" as defined under that Act. 44 U.S.C. 3501-3520. Other costs and benefits of the rule, including the costs mentioned by that and other commenters, are discussed in Section IV of this Release.

[113] This estimate is based on the following calculation: 475 fund complexes times $50,000 system development cost per fund complex equals $23,750,000.

system development costs and $9,500,000 annually[114]. Our staff estimates that the total system development cost for these 475 fund complexes that are likely to use these existing systems is $28,500,000 with annual operation costs of $16,815,000.[115]

There are approximately 900 fund complexes currently operating, of which approximately 475 may use these existing systems, leaving approximately 425 fund complexes possibly needing to develop specific systems to meet their own particular needs. Our staff understands that approximately 75 percent of those fund complexes (or 319 complexes) are small to medium-sized direct-sold funds that have a very limited number of intermediaries. Our staff anticipates that those 319 fund complexes would incur minimal system development costs to comply with the information-sharing provisions of the rule, due to the limited number of intermediaries with which they interact. Our staff estimates that system development costs for handling information under the rule for those 319 fund complexes will be approximately $25,000 each, with annual operation costs of approximately $10,000, for a total system development cost of $7,975,000[116] and an annual operations cost of $3,190,000.[117]

The remaining approximately 106 fund complexes may face additional complexities or special circumstances in developing their systems. Our staff estimates that the start-up costs for those fund complexes will be approximately $100,000 per fund complex and the annual costs for handling the information will be approximately $25,000, for a total start-up cost of $10,600,000

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[114] This estimate is based on the following calculation: 475 fund complexes times $20,000 annual costs per fund complex equals $9,500,000.

[115] This estimate is based on the following calculations: $23,750,000 plus $4,750,000 (one-time system development costs) equals $28,500,000 total start-up costs for fund complexes utilizing existing systems; and $7,315,000 plus $9,500,000 equals $16,815,000 in annual costs.

[116] This estimate is based on the following calculation: 319 funds times $25,000 equals $7,975,000.

[117] This estimate is based on the following calculation: 319 funds times $10,000 equals $3,190,000.

and an annual cost of $2,650,000 for these fund complexes.[118]

For purposes of the Paperwork Reduction Act, our staff therefore estimates that the information-sharing provisions of the rule as amended will cost all fund complexes a total of approximately $100,625,000 in one-time capital costs to enter into agreements and develop or upgrade their software and other technological systems that allows them to collect, store, and receive the required identity and transaction information from intermediaries, and a total of $22,655,000 each year thereafter in operation costs related to the transmission and receipt of the information.[119]

2. Intermediaries

The Commission staff estimates that there are approximately 7000 intermediaries that may provide information pursuant to the information-sharing provisions of rule 22c-2.[120] Of those 7000 intermediaries, our staff anticipates that approximately 350 of these intermediaries are likely to primarily use the existing systems that are in place or under development. The staff understands that these approximately 350 intermediaries include several major "clearing

[118] This estimate is based on the following calculations: 106 funds times $100,000 equals $10,600,00; and 106 funds times $25,000 equals $2,650,000.

[119] This estimate is based on the following calculations: $28,500,000 (funds that use service providers start-up costs) plus $7,975,000 (direct-traded funds' start-up costs) plus $10,600,000 (other funds' start-up costs) equals $47,075,000 system development costs; $47,075,000 (system development costs) plus $53,550,000 (agreement costs) equals $100,625,000 total fund start-up costs; and $16,815,000 (funds that use service providers annual costs) plus $3,190,000 (direct-traded funds' annual costs) plus $2,650,000 (other funds' annual costs) equals $22,655,000 annual funds' costs.

[120] This number is a rounded estimate, based on the number of intermediaries that may be affected by the rule. The number consists of the following: 2203 broker-dealers classified as specialists in fund shares, 196 insurance companies sponsoring registered separate accounts organized as unit investment trusts, approximately 2400 banks that sell funds or variable annuities (the number of banks is likely over inclusive because it may include a number of banks that do not sell registered variable annuities or funds, or banks that do their business through a registered broker-dealer on the same premises), and approximately 2000 retirement plans, third-party administrators, and other intermediaries (this number may be either over or under inclusive, because under the rule as we are amending it, the actual number of intermediaries that funds have is dependent on the precise application of varying fund policies on short-term trading).

brokers" and third-party administrators that aggregate trades and handle the back-end work for thousands of other smaller broker-dealers and intermediaries, thereby providing access to these service providers' information-sharing systems to a significant majority of all intermediaries in the marketplace. Our staff estimates that these approximately 350 intermediaries will provide access to systems that will allow for the transmission of information required by the rule and other processing for the transactions of approximately 80 percent of the 7000 intermediaries (5600 intermediaries) affected by the rule, leaving 1400 intermediaries that do not in some way utilize these systems, that may need to develop their own systems.[121]

Our staff understands that in general, the providers who have developed or are developing these information sharing systems charge the fund, and not the intermediary, for providing these systems to transmit shareholder identity and transaction information, or else include access to such systems as a complementary part of their other processing systems, and do not charge additional fees to intermediaries for its utilization. These intermediaries may be required to develop systems to ensure that they are able to transmit the records to these service providers in a standardized format.[122] Our staff estimates that it will cost each of these 350 intermediaries approximately $200,000 to update its systems to record and transmit shareholder identity and transaction records to these service providers, and an additional $100,000 each year to operate their own systems for communicating with the service providers, for a total start-up

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121 This number is based on the following calculation: 7000 total intermediaries times 20% (the percentage of intermediaries that do not use these service providers systems or use the services of those 350 intermediaries that use those service provider systems) equals 1400 intermediaries that do not use service providers' systems.

122 Our staff anticipates that in most cases, first-tier intermediaries will use the same or slightly modified systems that have been developed to identify and transmit shareholder identity and transaction information to funds when collecting and transmitting this information from indirect intermediaries. Therefore, we have also included the costs of developing and operating systems to collect information from indirect intermediaries and providing the information to funds in these estimates.

cost of $70,000,000, and an annual cost of $35,000,000.[123] We understand that these approximately 350 intermediaries may also have to upgrade their systems to handle rule 22c-2 information on trades that do not go through the service providers' systems. Our staff estimates that it will cost each of those 350 intermediaries[124] an additional $400,000[125] to update their systems, and $250,000[126] annually to process this information through non-service provider networks, for a total cost of $140,000,000 in system development costs and $87,500,000 in annual costs to process data through non-service provider networks.[127] We have increased these estimates over those made in the 2006 Proposing Release in light of the new cost information provided to us by the commenters in 2006. Our staff therefore estimates that these approximately 350 intermediaries will incur a total of approximately $210,000,000 in start-up

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123 This estimate is based on the following calculations: 350 broker-dealer times $200,000 (start-up costs) equals $70,000,000; and 350 broker-dealer times $100,000 (start-up costs and annual costs) equals $35,000,000.

124 The estimate includes higher costs for these 350 intermediaries in developing systems to handle non-service provider information than for remaining intermediaries to handle the same data due to our staff's understanding that, in general, these 350 intermediaries that utilize the service provider's networks represent the largest intermediaries in the marketplace, and will face the highest costs in complying with the rule.

125 Many of the costs that intermediaries incur in developing and operating systems to handle this information may be recouped from fund complexes through a variety of methods. However, it is unclear what recoupment might take place, and therefore the cost estimates for funds and intermediaries are made here prior to any potential recoupment.

126 In response to the 2006 Proposing Release, a few commenters provided additional cost estimates regarding the costs intermediaries may face in designing and operating information sharing systems under the amended rule. One commenter estimated that some intermediary system start-up costs may range from approximately $125,000 to $2,300,000, and that ongoing annual costs may range from $150,000 to approximately $1,000,000. *See* Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006). Another commenter estimated that for some insurance company intermediaries, the cost to comply with all aspects of the redemption fee rule could exceed $2,000,000 per company. *See* Comment Letter of the National Association for Variable Annuities (Apr. 7, 2006). We have incorporated this additional information into our calculations for our revised estimates.

127 This estimate is based on the following calculations: 350 broker-dealers times $400,000 (start-up costs) equals $140,000,000; and 350 broker-dealers times $250,000 (annual costs) equals $87,500,000.

costs and $122,500,000 in annual costs associated with the information-sharing provisions of the rule.[128]

The fund complexes and intermediaries that do not use these service providers' systems to process their trades will have to either develop their own systems to share information under the rule or engage some other third-party administrator to process the information. Our staff estimates that approximately 1400 intermediaries will not utilize these service provider systems to process this information, and estimates that each of these intermediaries will incur $50,000 in system development costs and $50,000 in annual costs in complying with the rule, for a total of $70,000,000 in development costs and $70,000,000 in annual costs for those intermediaries.[129]

Although the amended rule does not require first-tier intermediaries to enter into agreements with their indirect intermediaries to share the indirect intermediaries' underlying shareholder data to funds upon a fund's request, we anticipate that in many cases, intermediaries will nonetheless enter into such agreements, or at least enter into informal arrangements and design methods by which to collect the shareholder information. Our staff estimates that each of the 7000 intermediaries potentially affected by the rule will spend approximately 150 hours of service representatives' time at $40 per hour, and 10 hours of legal counsel time at $300 per hour, for a total of 1,050,000 hours of service representatives' time at a cost of $42,000,000, and 70,000 hours of in-house legal time at a cost of $21,000,000 to design and enter into these

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[128] This estimate is based on the following calculations: $70,000,000 (intermediary start-up costs for processing information through service providers) plus $140,000,000 (intermediary start-up costs for handling information through other channels) equals $210,000,000; and $35,000,000 (intermediary annual costs for processing information through service providers) plus $87,500,000 (intermediary annual costs for handling information through other channels) equals $122,500,000.

[129] This estimate is based on the following calculations: 1400 intermediaries times $50,000 (development costs) equals $70,000,000; and 1400 intermediaries times $50,000 (annual costs) equals $70,000,000.

arrangements with other intermediaries.[130] The Commission staff therefore estimates that intermediaries will expend a total of approximately 1,120,000 hours at a cost of $63,000,000 to enter into arrangements to ensure the proper transmittal of information to funds through chains of intermediaries.[131]

Our staff estimates that the information-sharing provisions of the rule will cost all intermediaries a total of approximately $343,000,000 in one-time capital costs to enter into agreements and develop or upgrade their software and other technological systems to collect, store, and transmit the required identity and transaction information to funds and from other intermediaries, and a total of $192,500,000 each year thereafter in operation costs related to the transmission and receipt of the information.[132]

C. Total Costs and Hours Incurred

For purposes of the Paperwork Reduction Act, our staff estimates that the amended rule will have a total collection of information cost in the first year to both funds and intermediaries of $443,625,000 in one-time start-up costs, and annual operation costs of $215,155,000.[133] Our staff estimates that the weighted average annual cost of the rule to funds and intermediaries for

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[130] This estimate is based on the following calculations: 7000 intermediaries times 150 service representative hours at $40 per hour equals 1,050,000 hours at a cost of $42,000,000; and 7000 intermediaries times 10 hours of in-house legal time at $300 per hour equals 70,000 hours at a cost of $21,000,000.

[131] This estimate is based on the following calculations: 1,050,000 service representative hours at $42,000,000 plus 70,000 in-house counsel hours at $21,000,000 equals 1,120,000 hours at $63,000,000.

[132] This estimate is based on the following calculations: $210,000,000 (intermediaries that use service providers start-up costs) plus $70,000,000 (other intermediaries' start-up costs) plus $63,000,000 (intermediary agreement costs) equals $343,000,000 in intermediary start-up costs; and $122,500,000 (annual costs of intermediaries that use service providers) plus $70,000,000 (other intermediaries' annual costs) equals $192,500,000 in annual costs.

[133] This estimate is based on the following calculations: $100,625,000 (fund start-up costs) plus $343,000,000 (intermediary start-up costs) equals $443,625,000 in total start-up costs; and $22,655,000 (fund annual costs) plus $192,500,000 (intermediary annual costs) equals $215,155,000 in total annual costs.

each of the first three years would be $363,030,000.[134] The total hours expended by both funds and intermediaries in complying with the amended rule will be a one-time expenditure of 2,429,500 hours at a total internal cost of $116,550,000.[135] We anticipate that there will be a total of approximately 7900[136] respondents, with approximately 14,310,000 total responses in the first year, and 14,040,000 annual responses each year thereafter.[137]

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with 5 U.S.C. 604. It relates to amendments to rule 22c-2 under the Investment Company Act, which we are adopting in this Release. The

[134] This estimate is based on the following calculations: $443,625,000 in total start-up costs plus $645,465,000 (3 years at $215,155,000 in total annual costs) equals $1,089,090,000 in total costs over a three-year period. $1,089,090,000 divided by three years, equals a weighted average cost of $363,030,000 per year.

[135] This estimate is based on the following calculations: 1,309,500 hours at a cost of $53,550,000 in agreement time plus 1,120,000 hours at a cost of $63,000,000 in chain of intermediary arrangement time equals 2,429,500 hours at a cost of $116,550,000.

For purposes of the Paperwork Reduction Act, Section VI of the Adopting Release, *supra* note Error: Reference source not found, included an estimate of the total start-up costs to funds and financial intermediaries in complying with the collection of information aspect of the rule of approximately $1,111,500,000. We now estimate that funds and intermediaries will incur the reduced amount of $443,625,000 in start-up costs, for a potential cost reduction of approximately $667,875,000 resulting from the amendments. In the Adopting Release we also estimated that the ongoing annual costs will be $390,556,800. We now estimate that after these amendments funds and intermediaries will incur the reduced amount of $215,155,000 in total annual costs, for a potential ongoing annual cost reduction of approximately $175,401,800 resulting from the amendments.

[136] This estimate is based on the following calculation: 7000 intermediaries plus 900 fund complexes equals 7900 respondents.

[137] This estimate is based on the following calculation: 900 fund complexes with an average of 300 intermediaries each, equals 270,000 one time responses for the shareholder information portion of the collection (900 funds times 300 intermediaries equals 270,000). Assuming that each fund requests information from each of its intermediaries once each week (we have revised our initial monthly assumption to a weekly assumption, although we expect that the frequency of requests will vary significantly between funds depending on their circumstances), the total number of annual responses would be 14,040,000 (270,000 fund intermediaries times 52 weeks equals 14,040,000 annual responses). Therefore, in the first year, there would be 14,310,000 total responses (14,040,000 weekly responses plus the 270,000 initial responses required for the agreements) and 14,040,000 annual responses thereafter.

Initial Regulatory Flexibility Analysis ("IRFA") which was prepared in accordance with 5 U.S.C. 603 was published in the 2006 Proposing Release.

A. Need For and Objectives of Rule

Rule 22c-2 allows funds to recover some, if not all, of the direct and indirect (*e.g.*, market impact and opportunity) costs incurred when shareholders engage in short-term trading of the fund's shares, and to deter this short-term trading. As discussed more fully in Sections I and II of this Release, the amendments to rule 22c-2 are necessary to clarify the operation of the rule, to enable funds and intermediaries to reduce costs associated with entering into agreements under the rule, and to enable funds to focus their short-term trading deterrence efforts on the entities most likely to violate fund policies. These amendments also set forth the limitations on transactions between a fund and an intermediary with whom the fund does not have an agreement.

B. Significant Issues Raised By Public Comment

We requested comment on the IRFA. We specifically requested comment on the number of small entities that would be affected by the rule amendments, and the likely effect of the amendments on small entities, the nature of any impact, and any empirical data supporting the extent of the impact. We received a number of comments discussing the impact that the rule amendments will have on small entities in the mutual fund marketplace. Generally, these comments supported the rule amendments, and agreed that the amendments would reduce the costs of compliance with the rule for small entities, and would reduce the number of small entities that would be

required to comply with the rule.[138] They indicated that the rule amendments would reduce costs for all mutual fund marketplace participants and would alleviate many of the concerns they had expressed with the rule as it was originally adopted.

Although most commenters supported the rule amendments, some commenters also suggested other changes that may reduce the costs of compliance. A few commenters noted that as proposed, the amended rule might have posed some difficulties to funds (including small funds) in contracting with certain entities that do not qualify as financial intermediaries under the rule, but who nevertheless submit trades directly to funds on behalf of financial intermediaries.[139] In light of this concern, we have clarified the amended rule to require that if a financial intermediary submits orders directly, *itself or through its agent*, the fund must enter into a shareholder information agreement with that financial intermediary. This clarification should eliminate any confusion and attendant costs to small entities in determining whether and with which entities funds must enter into shareholder information agreements.

Some commenters noted that in some cases (such as foreign shareholders) Taxpayer Identification Numbers ("TINs") may not always be available, and suggested that the rule allow for the use of alternate forms of identification in those cases.[140] To reduce the costs of compliance, alleviate any confusion, and provide flexibility to funds and intermediaries, we have

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[138] *See, e.g.*, Comment Letter of the Investment Company Institute (Apr. 10, 2006); Comment Letter of Charles Schwab & Co., Inc. (Apr. 10, 2006).

[139] *See, e.g.*, Comment Letter of T. Rowe Price Associates, Inc. (Apr. 10, 2006); Comment Letter of Matrix Settlement & Clearing Services, L.L.C. (Apr. 10, 2006); and Comment Letter of the Investment Company Institute (Apr. 10, 2006).

[140] *See* Comment Letter of the Investment Company Institute (Apr. 10, 2006); Supplemental Comment Letter of the SPARK Institute, Inc. (May 1, 2006).

revised the rule to allow for the use of Individual Taxpayer Identification Numbers or other government issued identifiers when a TIN is not available.

We also received many comments requesting an extension of the compliance date. Commenters noted that with the uncertainty accompanying the exact requirements of the rule, the significant technical challenges associated with compliance, and the current unsettled state of contracting and information sharing standards in the marketplace it would be very beneficial to provide an extended compliance date. We agree, and are extending the compliance date for all entities.[141]

C. Small Entities Subject to the Rule

A small business or small organization (collectively, "small entity") for purposes of the Regulatory Flexibility Act is a fund that, together with other funds in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[142] Of approximately 3,925 funds (2,700 registered open-end investment companies and 825 registered unit investment trusts), approximately 163 are small entities.[143] A broker-dealer is considered a small entity if its total capital is less than $500,000, and it is not affiliated with a broker-dealer that has $500,000 or more in total capital.[144] Of approximately 7,000 registered broker-dealers, approximately 880 are small entities.

As discussed above, rule 22c-2 provides funds and their boards with the ability to impose a redemption fee designed to reimburse the fund for the direct and indirect costs incurred as a result of short-term trading strategies, such as market timing. These amendments are designed to

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141 *See supra* Section III.

142 17 CFR 270.0-10.

143 Some or all of these entities may contain multiple series or portfolios. If a registered investment company is a small entity, the portfolios or series it contains are also small entities.

144 17 CFR 240.0-10.

maintain these investor protections while reducing costs to market participants and clarifying the operation of the rule. While we expect that the rule and these amendments will require some funds and intermediaries to develop or upgrade software or other technological systems to enforce certain market timing policies, or make trading information available in omnibus accounts, the amendments we are adopting today are specifically designed to reduce the costs incurred by small entities. In particular, we anticipate that the changes we are making to the definition of financial intermediary will significantly reduce the number of small intermediaries that funds must enter into agreements with, and reduce the burden of complying with the rule for small funds and small intermediaries.

D. Reporting, Recordkeeping, and Other Compliance Requirements

These amendments do not introduce any new mandatory reporting requirements. Rule 22c-2 already contains a mandatory recordkeeping requirement for funds that redeem shares within seven days of purchase. The fund must retain a copy of the written agreement between the fund and financial intermediary under which the intermediary agrees to provide the required shareholder information in omnibus accounts.[145] The amendments reduce the number of small entities that would otherwise be subject to this recordkeeping requirement.

E. Commission Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. Alternatives in this category would include: (i) establishing different compliance or reporting standards that take into account the resources available to small entities;

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145 Rule 22c-2(a)(3).

(ii) clarifying, consolidating, or simplifying the compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

The Commission does not presently believe that these amendments would require the establishment of special compliance requirements or timetables for small entities. These amendments are specifically designed to reduce any unnecessary burdens on all funds (including small funds) and on small intermediaries. To establish special compliance requirements or timetables for small entities may in fact disadvantage small entities by encouraging larger market participants to focus primarily on the needs of larger entities when establishing the information-sharing systems envisioned by the rule and these proposed amendments, and possibly ignoring the needs of smaller entities.

With respect to further clarifying, consolidating, or simplifying the compliance requirements of the rule, using performance rather than design standards, and exempting small entities from coverage of these amendments or any part of the rule, we believe additional such changes would be impracticable. These amendments in effect except a large number of smaller entities from the scope of the rule, by revising the definition of financial intermediary. We have designed these amendments to reduce the cost and compliance burden on small entities to the greatest extent practicable while still maintaining the investor protections of the rule as adopted.

Small entities are as vulnerable to the problems uncovered in recent enforcement actions and settlements as large entities. Therefore, shareholders of small entities are equally in need of protection from short-term traders. We believe that the rule and these amendments will enable funds to more effectively discourage short-term trading of all fund shares, including those held in omnibus accounts. Further excepting small entities from coverage of the rule or any part of the

rule could compromise the effectiveness of the rule. We anticipate that the amendments will alleviate much of the burden imposed by the rule on small entities, and result in a more cost effective system for discouraging short-term trading for all entities. Alternatives that we considered but are not adopting included, among others, (i) fully exempting all small entities from complying with the information-sharing aspect of the rule, (ii) not requiring that the information-sharing agreement obligate first-tier intermediaries to assist in providing information from indirect intermediaries to funds, and (iii) extending the compliance date for small entities.

VIII. STATUTORY AUTHORITY

The Commission is amending rule 22c-2 pursuant to the authority set forth in sections 6(c), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-22(c) and 80a-37(a)].

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF AMENDED RULE

For reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 270--RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

* * * * *

2. Section 270.22c-2 is revised to read as follows:

§ 270.22c-2 Redemption fees for redeemable securities.

(a) *Redemption fee*. It is unlawful for any fund issuing redeemable securities, its principal underwriter, or any dealer in such securities, to redeem a redeemable security issued by the fund within seven calendar days after the security was purchased, unless it complies with the following requirements:

(1) *Board determination.* The fund's board of directors, including a majority of directors who are not interested persons of the fund, must either:

(i) Approve a redemption fee, in an amount (but no more than two percent of the value of shares redeemed) and on shares redeemed within a time period (but no less than seven calendar days), that in its judgment is necessary or appropriate to recoup for the fund the costs it may incur as a result of those redemptions or to otherwise eliminate or reduce so far as practicable any dilution of the value of the outstanding securities issued by the fund, the proceeds of which fee will be retained by the fund; or

(ii) Determine that imposition of a redemption fee is either not necessary or not appropriate.

(2) *Shareholder information.* With respect to each financial intermediary that submits orders, itself or through its agent, to purchase or redeem shares directly to the fund, its principal underwriter or transfer agent, or to a registered clearing agency, the fund (or on the fund's behalf, the principal underwriter or transfer agent) must either:

(i) Enter into a shareholder information agreement with the financial intermediary (or its agent); or

(ii) Prohibit the financial intermediary from purchasing in nominee name on behalf of other persons, securities issued by the fund. For purposes of this paragraph, "purchasing" does

not include the automatic reinvestment of dividends.

(3) *Recordkeeping.* The fund must maintain a copy of the written agreement under paragraph (a)(2)(i) of this section that is in effect, or at any time within the past six years was in effect, in an easily accessible place.

(b) *Excepted funds.* The requirements of paragraph (a) of this section do not apply to the following funds, unless they elect to impose a redemption fee pursuant to paragraph (a)(1) of this section:

(1) Money market funds;

(2) Any fund that issues securities that are listed on a national securities exchange; and

(3) Any fund that affirmatively permits short-term trading of its securities, if its prospectus clearly and prominently discloses that the fund permits short-term trading of its securities and that such trading may result in additional costs for the fund.

(c) *Definitions*. For the purposes of this section:

(1) *Financial intermediary* means:

(i) Any broker, dealer, bank, or other person that holds securities issued by the fund, in nominee name;

(ii) A unit investment trust or fund that invests in the fund in reliance on section 12(d)(1)(E) of the Act (15 U.S.C. 80a-12(d)(1)(E)); and

(iii) In the case of a participant-directed employee benefit plan that owns the securities issued by the fund, a retirement plan's administrator under section 3(16)(A) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(16)(A)) or any person that maintains the plan's participant records.

(iv) *Financial intermediary* does not include any person that the fund treats as an

individual investor with respect to the fund's policies established for the purpose of eliminating or reducing any dilution of the value of the outstanding securities issued by the fund.

(2) *Fund* means an open-end management investment company that is registered or required to register under section 8 of the Act (15 U.S.C. 80a-8), and includes a separate series of such an investment company.

(3) *Money market fund* means an open-end management investment company that is registered under the Act and is regulated as a money market fund under § 270.2a-7.

(4) *Shareholder* includes a beneficial owner of securities held in nominee name, a participant in a participant-directed employee benefit plan, and a holder of interests in a fund or unit investment trust that has invested in the fund in reliance on section 12(d)(1)(E) of the Act. A shareholder does not include a fund investing pursuant to section 12(d)(1)(G) of the Act (15 U.S.C. 80a-12(d)(1)(G)), a trust established pursuant to section 529 of the Internal Revenue Code (26 U.S.C. 529), or a holder of an interest in such a trust.

(5) *Shareholder information agreement* means a written agreement under which a financial intermediary agrees to:

(i) Provide, promptly upon request by a fund, the Taxpayer Identification Number (or in the case of non U.S. shareholders, if the Taxpayer Identification Number is unavailable, the International Taxpayer Identification Number or other government issued identifier) of all shareholders who have purchased, redeemed, transferred, or exchanged fund shares held through an account with the financial intermediary, and the amount and dates of such shareholder purchases, redemptions, transfers, and exchanges;

(ii) Execute any instructions from the fund to restrict or prohibit further purchases or exchanges of fund shares by a shareholder who has been identified by the fund as having

engaged in transactions of fund shares (directly or indirectly through the intermediary's account) that violate policies established by the fund for the purpose of eliminating or reducing any dilution of the value of the outstanding securities issued by the fund; and

(iii) Use best efforts to determine, promptly upon request of the fund, whether any specific person about whom it has received the identification and transaction information set forth in paragraph (c)(5)(i) of this section, is itself a financial intermediary ("indirect intermediary") and, upon further request by the fund:

(A) Provide (or arrange to have provided) the identification and transaction information set forth in paragraph (c)(5)(i) of this section regarding shareholders who hold an account with an indirect intermediary; or

(B) Restrict or prohibit the indirect intermediary from purchasing, in nominee name on behalf of other persons, securities issued by the fund.

By the Commission.

Nancy M. Morris
Secretary

Dated: September 27, 2006.