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GENERAL COUNSEL

February 5, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

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

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to express its views on the Securities and Exchange Commission's recent proposal to enhance disclosure by mutual funds in the areas of market timing, fair value pricing, and selective disclosure of portfolio holdings.[2] The Institute strongly believes that enhanced disclosure in these areas is an important part of the necessary regulatory response to abusive trading practices involving mutual funds. In particular, such disclosure: (1) should allow mutual fund shareholders to gain a better understanding of how the fund will protect their interests; (2) would facilitate the fund's compliance with its stated policies in these areas; and (3) could deter harmful market timing.

The Institute supports the Commission's proposal. We have several specific comments, which are intended to assist the Commission in refining the proposal so that it focuses more effectively on the information that is important to investors and does not inadvertently make it easier for market timers to trade in a manner that would be harmful to a fund and the majority of its shareholders.

In summary, the Institute's comments are as follows.

- The Institute seeks clarification that a fund's disclosure regarding its market timing policies and procedures is not required to detail the precise ways in which the fund seeks to deter market timers.

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,672 open-end investment companies ("mutual funds"), 605 closed-end investment companies, 108 exchange-traded funds, and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.149 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

[2] SEC Release Nos. 33-8343, IC-26287 (Dec. 11, 2003); 68 Fed. Reg. 70402 (Dec. 17, 2003) ("Proposing Release").

- The Institute recommends modifying the proposal to delete the requirement that funds describe their policies and procedures for *detecting* market timing activity.

- The Institute recommends modifying the proposal to permit funds to reserve, as part of their market timing policies, limited discretion to impose greater restrictions on market timers than those in the fund's stated policies, provided there is appropriate disclosure and board oversight.

- The Institute recommends modifying the proposal to exclude exchange-traded funds from the proposed disclosure requirements relating to market timing.

- The Institute seeks clarification that a fund's required explanation of the circumstances in which it will use fair value pricing should be a general discussion of the types of situations in which the fund may be likely to use such pricing.

- The Institute recommends modifying the proposal to require that a fund's prospectus include a brief description of the objectives (rather than the effects) of using fair value pricing.

- The Institute seeks clarification as to the application of the proposed disclosure requirements relating to disclosure of portfolio holdings to a fund's agreements with affiliated or third-party service providers.

- The Institute seeks clarification that a fund may identify by category both the persons who receive information about its portfolio securities and the persons who may authorize disclosure of its portfolio securities.

- The Institute would not support the application of Regulation Fair Disclosure ("Regulation FD") to a fund's disclosure of information about its portfolio securities.

- The Institute recommends modifying the proposed compliance date to correlate with the compliance date for new Rule 38a-1 under the Investment Company Act of 1940.

Each of these comments is discussed more fully below.

I. Disclosure Concerning Frequent Purchases and Redemptions of Mutual Fund Shares

A. Deterrence Policies and Procedures

Under the proposal, a mutual fund would be required to describe, with specificity, any policies and procedures for deterring frequent purchases and redemptions of fund shares. As part of this discussion, a fund would have to describe specifically any restrictions that it imposes to prevent or minimize such purchases and redemptions (including, if applicable, the

various possible restrictions identified in the Proposing Release), as well as the circumstances in which any such restriction will not be imposed.

The Institute strongly supports requiring disclosures in fund offering documents of market timing policies and procedures, as well as requiring funds to have procedures to ensure compliance with those representations.[3] Such disclosures should serve to give mutual fund investors a better understanding as to how the fund seeks to protect itself against abusive market timing activity; they also would alert market timers that the fund may restrict their ability to purchase, redeem, or exchange fund shares, thus potentially deterring market timing.

We are concerned, however, that the proposal may call for a level of specificity in disclosure about a fund's methods for deterring market timing that could prove counterproductive, in that the disclosure could unwittingly – and, in the view of many of our members, would inevitably – become a "roadmap" for potential market timers. The Institute accordingly requests that the Commission clarify that such disclosure is not required to detail the precise ways in which the fund seeks to deter market timers. For example, if a fund seeks to curtail market timing activity by denying trades above a certain threshold – such as any trade of $50,000 or more – disclosure of the exact dollar threshold would alert the timer to split its purchase or redemption into two or more transactions that would each come in under the $50,000 threshold. To avoid this outcome, we believe that a fund should be able to disclose that it denies trades above a certain dollar threshold, but it should not be required to identify the precise dollar amount. We believe that this level of specificity would be consistent with the Commission's stated purpose for the proposed disclosure requirements, which is to "enable investors to better assess a mutual fund's risks, policies, and procedures in this area, and to determine if a fund's policies and procedures are in line with their expectations."[4]

B. Detection Policies and Procedures

Under the proposal, a fund would be required to describe any policies and procedures for detecting frequent purchases and redemptions of its shares, including any arrangements for detecting such purchases and redemptions through intermediaries. We agree that if a fund has adopted policies and procedures to *deter* market timing activity, it is critical that the fund also have in place policies and procedures to *detect* such activity.[5] Funds may seek to detect timing activity in a variety of ways, such as screening every trade above a certain dollar threshold, monitoring exchange activity across the fund complex, and requiring certain actions on the part of financial intermediaries who sell the fund's shares.

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[3] *See* Statement of Matthew P. Fink, President, Investment Company Institute, *Mutual Funds: Trading Practices and Abuses That Harm Investors*, Before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U.S. Senate, 108th Cong., 1st Sess. (Nov. 3, 2003), at 7-8.

[4] *See* Proposing Release at 70404.

[5] We note that a fund's detection policies and procedures would have to be approved by the fund's board and monitored on an ongoing basis by both the board and the fund's chief compliance officer. *See Compliance Programs of Investment Companies and Investment Advisers*, SEC Release Nos. IA-2204, IC-26299 (Dec. 17, 2003); 68 Fed. Reg. 74714 (Dec. 24, 2003) ("Compliance Release").

It is quite another thing, however, for a fund to have to describe its detection policies and procedures in its prospectus. In the Institute's view, such disclosure would be of marginal utility to most investors, who would be in a position to judge whether the fund's approach to market timing is in line with their expectations based on the fund's disclosure regarding its policies and procedures to deter market timing. At the same time, disclosure concerning the fund's detection efforts could in fact prove harmful, by giving clues to market timers about how to time the fund without being caught. The Institute accordingly recommends modifying the proposal to delete the requirement that funds describe their policies and procedures for *detecting* market timing activity.

C. Additional Restrictions on Market Timers

Under the proposal, a fund must disclose *any* restrictions imposed by the fund to prevent or minimize frequent purchases and redemptions. We are concerned that no set of policies and procedures designed to deter market timing is foolproof and that professional traders inevitably will continue to look for ways to time funds despite the existence of robust procedures. For this reason, the Institute believes that the discretion to impose restrictions that go beyond a fund's stated policies – if that discretion is properly limited, expressly permitted by the fund's policies, and specifically disclosed in the prospectus – would provide funds with an important tool to curb harmful market timing activity. (Funds, of course, would also have the option of refusing a request from a market timer to purchase or exchange fund shares).[6]

The Institute recognizes that, by exercising such discretion, a mutual fund could be seen as treating a particular investor differently from other fund shareholders and that such treatment may raise questions of fairness. For these reasons, the Institute recommends that funds be permitted to expressly reserve such discretion in their prospectuses with respect to their market timing policies and procedures, only if the fund or its adviser reports to the board at least quarterly all instances in which it has imposed a restriction on market timing activity greater than that specified in the fund's policies and procedures. This quarterly reporting requirement would enable the board to monitor the application of all discretionary limitations on short-term trading and to determine whether the adviser acted reasonably in imposing them.[7]

D. Application to Exchange Traded Funds ("ETFs")

The Proposing Release requests comment as to whether ETFs should be expressly excluded from the proposed disclosure requirements relating to market timing. The Institute believes that such an exclusion would be appropriate. Unlike traditional mutual funds, ETF shares may be purchased or redeemed at net asset value ("NAV") only in large aggregations

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[6] *See, e.g.*, Paul Roye, "Navigating the Mutual Fund Industry Through Challenging Times," Speech Before the ICI General Membership Meeting (May 18, 2001) ("No one questions the right of funds to turn away additional investments by shareholders who have been identified as market timers."). A copy of the speech is available on the SEC's website at http://www.sec.gov/news/speech/spch491.htm.

[7] The Institute notes that the Commission has strongly urged fund boards to impose a quarterly reporting requirement with respect to all instances involving the waiver of a fund's stated policies regarding market timing. *See* Compliance Release at 74720.

and through in-kind transfers of securities. Intra-day trading of ETF shares, on the other hand, occurs in the secondary market at market prices. Any dilution from market timing, therefore, would be external to the fund and would not affect the calculation of its NAV. Policies and procedures to prevent and detect market timing are simply not applicable to this type of investment vehicle.

II. Disclosure Relating to Mutual Funds' Use of Fair Value Pricing

At present, a mutual fund must include in its prospectus a description of the fund's procedures for pricing its shares.[8] The fund does not have to describe its use of fair value pricing unless it has a policy contemplating the use of such pricing under "special circumstances."[9] Under the proposal, every mutual fund would be required to include in its prospectus a brief explanation, specific to the fund, of the circumstances under which the fund will use fair value pricing and the effects of using fair value pricing.

A. Explanation of the Fund's Use of Fair Value Pricing

As noted above, the proposal would require that a fund's prospectus contain a brief explanation of the circumstances under which the fund will use fair value pricing. The Proposing Release states that this explanation should be specific to the fund. The Institute does not believe that the Commission intended this statement to suggest that a fund must identify *every* circumstance that might require it to fair value securities in its portfolio. Such a result would be unreasonable, because it is simply not possible for funds to anticipate each and every scenario that potentially could require the use of fair value pricing. In addition, as with market timing, the Institute notes that too much specificity could be counterproductive, in that it might help arbitrageurs to identify circumstances in which they could take unfair advantage of a fund's pricing policies. Requiring a fund to disclose the specific "triggers" (*e.g.*, a percentage change in the S&P 500 index) that prompt it to consider using fair value pricing, for example, could encourage arbitrage activity at times when the market is just shy of those benchmarks. Therefore, we recommend that the Commission clarify that the required explanation should discuss generally the types of situations in which the fund may be likely to use fair value pricing.

B. Disclosure Regarding the Effects of Using Fair Value Pricing

The proposal calls for a mutual fund to explain briefly in its prospectus the *effects* of using fair value pricing. As an example of the requested disclosure, the Proposing Release notes that the Commission would expect a fund investing in overseas markets to state that fair value pricing minimizes the possibilities for time-zone arbitrage.[10] From this example, it appears that the proposed disclosure is meant to provide investors with information about the *objectives* of fair value pricing, rather than to make any sort of guarantee as to the results a fund

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[8] Item 7(a)(1) of Form N-1A.

[9] Instruction to Item 7(a)(1) of Form N-1A.

[10] *See* Proposing Release at 70408.

may achieve by fair valuing one or more portfolio securities. To better reflect what appears to be the Commission's intent, the Institute recommends that the proposal be modified to require that funds explain briefly the objectives (rather than effects) of using fair value pricing.

C. Application of the Proposed Disclosure Requirement to Money Market Funds

Under the proposal, money market funds would be expressly excluded from the proposed disclosure requirement. The Proposing Release explains that the proposed exclusion is based on the fact that money market funds are subject to their own detailed pricing requirements, which are set forth in Rule 2a-7 under the Investment Company Act. The Institute fully supports the Commission's decision to exclude money market funds from the disclosure requirements relating to fair value pricing. If the pricing requirements of Rule 2a-7 are followed, a money market fund is not required to fair value its portfolio securities under any circumstances. Accordingly, the proposed disclosures would have little meaning for an investor in a money market fund, whose decision to invest likely was based in large measure on the fund's objective of maintaining a stable NAV pursuant to Rule 2a-7's pricing requirements.

D. Application of the Proposed Disclosure Requirement to Funds of Funds

The Institute notes that the Proposing Release does not discuss how the proposed disclosure requirement would apply to a registered fund of funds that invests its assets in one or more registered mutual funds. Each of the underlying mutual funds, which also would be subject to the proposed disclosure requirement, presumably would have in its prospectus a brief explanation relating to its use of fair value pricing in particular circumstances. The Institute requests that the Commission clarify that a registered fund of funds may comply with this disclosure requirement by stating in its prospectus that: (1) it is entitled to rely on the NAV calculated by each underlying registered mutual fund; and (2) information about the use of fair value pricing by each underlying fund is available in that fund's prospectus.

III. Disclosure of Mutual Fund Portfolio Holdings

A. Location of Disclosure

Under the proposal, a mutual fund would be required to make certain specific disclosures in its statement of additional information ("SAI") regarding the policies and procedures that apply with respect to disclosure of the fund's portfolio securities to any person.[11] The fund's SAI also would have to contain certain information about any ongoing arrangements to make such information available to any person. The Institute concurs that the SAI would be the appropriate location for the proposed disclosures. While information about a fund's portfolio holdings disclosure policies should be available to investors, we believe that it is not part of the key information that investors need to make an informed investment decision.

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[11] In its prospectus, the fund would be required to state that a description of its policies and procedures with respect to disclosure of its portfolio securities is available in the SAI and, if applicable, on the fund's website.

B. Disclosures to Third-Party Service Providers and Affiliated Persons

Under the proposal, a mutual fund would be required to describe how its policies and procedures with respect to disclosure of portfolio securities apply to different categories of persons. Among the categories identified in the proposal are third-party service providers and affiliated persons of the fund.

A mutual fund typically relies on various service providers, including its investment adviser and other affiliated and/or unaffiliated entities, to perform all services relating to the fund's operations. Some services, such as custody, fund audits, proxy voting, and pricing of portfolio securities, require that the service provider have access to information about the fund's current portfolio holdings. In addition, if the fund wants to sell certain securities in its portfolio, the fund will have to identify those securities to the broker handling the sale. The Institute agrees that SAI disclosure informing investors of the fact that the fund shares information about its portfolio holdings with certain service providers is consistent with the Commission's goals of providing greater transparency of fund practices with respect to portfolio holdings disclosure and reinforcing funds' and advisers' obligations to prevent the misuse of material, nonpublic information.[12] At the same time, however, we believe that detailed information about the sharing of portfolio holdings information with service providers, where such information is necessary to enable the provider to perform services for the fund, would not be particularly useful to investors. The Institute accordingly requests that the Commission clarify that it is appropriate for funds to discuss briefly, in general terms, how their policies and procedures apply to disclosures of portfolio holdings information to the fund's service providers.

C. Disclosures Relating to Ongoing Arrangements

Under the proposal, a mutual fund would be required to describe in its SAI any ongoing arrangements to make available information about its portfolio securities to any person.[13] Its description of an ongoing arrangement would have to include, among other things, the identity of the person receiving the information.

1. Service Providers

As discussed in Section III.B above, a fund may provide an affiliated or third-party service provider with access to information about its current portfolio holdings so that the provider may perform services relating to the fund's operations. The Institute requests that the Commission clarify that a fund's agreements with affiliated or third-party service providers

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[12] *See* Proposing Release at 70405.

[13] This provision would appear to cover arrangements in which the fund provides *publicly available* information about its portfolio holdings to any person. For example, if a fund has a policy of making its portfolio holdings available upon request to any person on a quarterly basis with a 30-day lag, retail or institutional shareholders might request that the fund automatically send them this information each time it becomes publicly available. We do not believe that detailed disclosure of such arrangements would provide meaningful information to investors. The Institute accordingly recommends that the Commission clarify that any arrangement in which a fund provides publicly available portfolio holdings information to any person is not an "ongoing arrangement" for purposes of proposed Item 12(f)(2) to Form N-1A.

involving the service provider's receipt of information about the fund's portfolio securities would not have to be described in the fund's SAI as "ongoing arrangements."

2. Identifying Recipients

The Proposing Release does not specify whether a fund would be required to identify each recipient of portfolio holdings information by name or whether it could do so by category. The Institute believes that while investors would benefit from knowing generally about both the nature of the fund's ongoing arrangements and the protections in place to prevent misuse of information about the fund's portfolio holdings, investors do not need to know the name of each and every recipient of such information. Identifying each recipient by name, moreover, could prove to be more burdensome than it may at first appear.

For example, many mutual funds enter into agreements with financial planners pursuant to which the planners receive access to information about the fund's current holdings. The planners use that information to provide asset allocation services for their clients who own the fund's shares. In our view, fund investors do not need to know the name of each financial planner with whom the fund has such an agreement but, rather, should be provided with information sufficient to alert them to the parameters of the fund's ongoing arrangements with financial planners generally. As a further example, a mutual fund may have a policy that permits it to provide information about its portfolio holdings to an institutional investor that is considering whether to invest in the fund. We believe that investors should know that the fund might share such information with certain types of prospective investors and how the fund prevents misuse of the information. Confidentiality and other concerns dictate, however, that the fund should not be required to identify by name each such prospective investor.

The Institute therefore recommends that the Commission clarify that a fund may identify by category (rather than by name) the persons who receive information about its portfolio holdings pursuant to ongoing arrangements.

D. Identifying Persons Who May Authorize Disclosure

Under the proposal, a fund would be required to identify the persons who may authorize disclosure of the fund's portfolio securities. This disclosure would have to be included both as part of the fund's description of its policies and procedures with respect to the disclosure of its portfolio securities and as part of its description of any ongoing arrangements to make available information about its portfolio securities to any person. As with recipients of fund portfolio holdings information, the Proposing Release does not specify whether the fund would be required to identify each such person by name or whether it could do so by category (*e.g.*, executive officers of the fund, the fund's adviser or other service provider, independent directors). The Institute recommends that the Commission clarify that a fund may identify by category the persons who may authorize disclosure of its portfolio securities. Categorical identification should provide investors with more relevant information than the name(s) of select individuals. We note that this approach is consistent with the Commission's recent

decision to permit mutual funds and other issuers to identify the source of a director nominee by category, rather than by name, in proxy statements relating to the election of directors.[14]

E. Application of Regulation FD to Mutual Funds

The Proposing Release requests comment on whether the Commission should apply Regulation FD to mutual funds with respect to their disclosure of portfolio holdings or other information. Under Regulation FD, whenever an issuer or any person acting on its behalf discloses material nonpublic information to certain enumerated persons (in general, securities market professionals or holders of the issuer's securities who may trade on the basis of the information), the issuer must publicly disclose that information simultaneously, in the case of an intentional disclosure, or promptly, in the case of a non-intentional disclosure.[15] As explained below, the Institute believes that applying Regulation FD to a mutual fund's disclosure of portfolio holdings information could harm the fund's long-term shareholders.

When mutual funds make their portfolio holdings information available to the public – whether twice yearly as currently required, quarterly as proposed by the Commission,[16] or more frequently at their discretion – there is always a lag between the date of the information and the date it is disclosed. There is sound reason for this practice. As recent events have shown, persons who were wrongfully given access to a fund's current portfolio holdings information were able to trade ahead of the fund or otherwise benefit at the expense of other investors in the fund. Indeed, in its release proposing that mutual funds be required to report their portfolio holdings on a quarterly basis, the Commission stated that a 60-day filing delay would limit the ability of professional traders to engage in predatory trading practices, such as trading ahead of funds.[17]

If Regulation FD were extended to mutual funds, however, any selective disclosure of a fund's portfolio holdings information – even if accidental – could only be "cured" by the fund having to make that same information about its holdings widely available to the public. The effect of this public dissemination would no doubt lead to third parties being able to exploit the information to their advantage, thus harming fund shareholders, who paid for the costs associated with development of the fund's portfolio.[18]

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[14] *See Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors*, SEC Release Nos. 33-8340, 34-48825, IC-26262 (Nov. 24, 2003); 68 Fed. Reg. 66992, 66996 (Nov. 28, 2003).

[15] 17 C.F.R. § 243.100.

[16] *See* Item 22(c) of Form N-1A; *Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies*, SEC Release Nos. 33-8164, 34-47023, IC-25870 (Dec. 18, 2002); 68 Fed. Reg. 160 ("Portfolio Holdings Release").

[17] *See* Portfolio Holdings Release at 167.

[18] A 2001 research report by Professor Russ Wermers (Department of Finance, Robert H. Smith School of Business, University of Maryland at College Park) on the consequences of more frequent portfolio holdings disclosure by mutual funds may be instructive on the issue of the potential harmful effects to fund shareholders of extending Regulation FD to a fund's disclosure of portfolio holdings information. *See* Russ Wermers, "The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance," *Perspective*, Vol. 7, No. 1, June 2001, Investment

In the Institute's view, the better approach is to require mutual funds to have a system designed to prevent selective disclosure, in the first instance, of portfolio holdings information that is not in the best interests of fund shareholders. We believe that this Commission proposal, taken together with the Commission's recent adoption of Rule 38a-1 under the Investment Company Act, would do just that. Mutual funds will be required to have compliance policies and procedures that address disclosure to third parties of material information about the fund's portfolio and that preclude disclosure of holdings information not generally available to the public unless the fund has legitimate business purposes for doing so and the recipients of the information are subject to a duty of confidentiality.[19] Those policies and procedures will have to be approved by a mutual fund's board of directors, administered by the fund's Chief Compliance Officer ("CCO"), and reviewed at least annually in a report by the CCO to the board. If adopted by the Commission, this proposal would require funds to make certain specific disclosures about such policies and procedures in their registration statements.

Finally, we note that Regulation FD generally was designed with public companies in mind. The central premise of the regulation – if disclose to one, then disclose to all – is intended to ensure that all investors have access to market-sensitive information about a public company so that the marketplace can set an appropriate value for the company's securities. When the Commission proposed Regulation FD four years ago, it expressly recognized that this framework does not fit mutual funds, which "already are required to update their prospectuses to disclose material changes subsequent to the effective date of the registration statement or any post-effective amendment, and are not permitted to sell, redeem, or repurchase their securities except at a price based on their securities' net asset value."[20] The Commission correctly determined that "Regulation FD would offer little additional protection to investors in these types of investment companies."[21] We believe that this fundamental distinction between public companies and mutual funds remains unchanged and, accordingly, no change in the Commission's original conclusion about the scope of Regulation FD is warranted.

IV. Compliance Date

Under the proposal, mutual funds would have to comply with the disclosure requirements discussed above in all new registration statements and post-effective amendments to effective registration statements filed on or after the effective date of the disclosure requirements. The Proposing Release requests comment on this proposed compliance date.

The Institute notes that, by October 5 of this year, mutual funds will be required to adopt compliance policies and procedures satisfying the requirements of new Rule 38a-1 and to

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Company Institute. A copy of Professor Wermers' report is available on the ICI's website at http://www.ici.org/pdf/per07-03.pdf.

[19] *See* Compliance Release at 74719 & n.55.

[20] *See Selective Disclosure and Insider Trading*, SEC Release Nos. 33-7787, 34-42259, IC-24209 (Dec. 20, 1999); 64 Fed. Reg. 72590, 72597 (Dec. 28, 1999).

[21] *Id.*

have their boards approve such policies and procedures. This includes policies and procedures in the three areas covered by the proposed disclosure requirements – market timing, pricing of portfolio securities and fund shares, and disclosure of material information about fund portfolio holdings. Given the recent revelations of abusive trading practices by some in the fund industry, as well as the adoption of Rule 38a-1, it is certain that all mutual funds will be closely reviewing and possibly refining their policies and procedures in these areas over the next several months.[22]

While the Institute fully recognizes the importance of providing investors with complete and accurate disclosure in the areas outlined in the proposal, we believe that it would be ill-advised to require mutual funds to comply with the new disclosure requirements *before* they and their boards have made any needed refinements to their policies and procedures. First, in light of the current scandal, investors are likely to pay more attention to a fund's disclosures regarding market timing in particular. Disclosures based on the fund's current policies and procedures may give investors the mistaken impression that their fund has not taken steps to shore up its protections in this critical area. Second, and perhaps more importantly, the primary focus in the short term for fund advisers, board members, fund counsel, and independent counsel alike should be on strengthening those protections by scrutinizing the fund's existing policies and procedures and making refinements where needed. Requiring disclosure changes in these areas before that effort is finalized could inappropriately divert their efforts. Finally, we ask the Commission to be mindful of the cost to small mutual funds of requiring successive disclosure changes, particularly in light of the increasing compliance costs that these funds now face.

Accordingly, the Institute requests that the Commission modify the proposed compliance date to require that mutual funds comply with the disclosure requirements in all new registration statements and post-effective amendments to effective registration statements filed on or after December 5, 2004, which is two months following the compliance date for new Rule 38a-1. This would give funds sufficient time between obtaining board approval for their policies and procedures, as required by Rule 38a-1, and filing with the Commission registration statements that contain disclosures based on those policies and procedures.[23]

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[22] Indeed, the Commission recognized as much in its release adopting rule 38a-1: "We expect all funds will begin reviewing their compliance policies and procedures currently, not only in light of the adoption of these rules, but also in light of the recent revelations of unlawful practices involving fund market timing, late trading, and improper disclosures and use of nonpublic portfolio information." *See* Compliance Release at 74720.

[23] The Institute recommends that the Commission clarify that funds will be permitted to file post-effective amendments with the new disclosure under Rule 485(b) under the Securities Act of 1933, if otherwise eligible to do so under the rule. Allowing funds to do so would be appropriate given that the disclosure would cover specific items prescribed by the Commission in Form N-1A.

We appreciate the Commission's consideration of our comments. If you have any questions or need additional information, please contact me at (202) 326-5815, Amy B.R. Lancellotta at (202) 326-5824, or Rachel H. Graham at (202) 326-5819.

Sincerely,

Craig S. Tyle
General Counsel

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

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Division of Investment Management