



February 6, 2004

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

VIA ELECTRONIC MAIL

Subject: Proposed Rule: Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings/File No. S7-26-03

Dear Mr. Katz:

The Coalition of Mutual Fund Investors ("CMFI" or "Coalition") is pleased to submit the following comments regarding proposed rules to address market timing and the selective disclosure of portfolio holdings, as issued by the Securities and Exchange Commission ("SEC" or "Commission") on December 11, 2003.

CMFI is an Internet-based shareholder advocacy organization representing the interests of individual mutual fund investors. The Coalition is based in Washington, D.C., with a Web site that can be accessed at [www.investorscoalition.com](http://www.investorscoalition.com).

A. Market Timing and Forward Pricing

CMFI strongly supports the Commission's proposal to require mutual funds to develop and disclose more comprehensive policies and procedures to address market timing activities. As the Commission noted in its explanation of this issue, many mutual fund prospectuses contain language stating that it is a fund's general policy to discourage market timing. However, only a few funds describe with specificity the type and frequency of market timing trading that is to be discouraged as well as the specific steps that are to be taken to address or prevent problematic market timing trades.

The Commission proposes to strengthen the current regulatory rules in this area by requiring that specific information about market timing policies and procedures be disclosed in a fund's Prospectus and Statement of Additional Information ("SAI").

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The specific disclosures recommended by the Commission address most, if not all, of the important issues in this area. A fund would need to: (1) provide an explanation of the risks of market timing to long-term shareholders; (2) provide a detailed description of a fund's market timing policies and procedures; (3) provide a specific explanation to investors if a fund board has chosen not to adopt market timing protections; and (4) disclose any arrangements that permit frequent purchases and redemptions of fund shares (i.e., market timing transactions).

The Coalition has two concerns with the Commission's proposals. First, market timing policies and procedures—including the imposition of redemption fees, trading restrictions, and minimum holding periods—are all going to be impossible for a mutual fund to apply uniformly across all shareholder classes under the current sales and distribution system used by many funds and their intermediaries. As many as 30% of the shareholders of a mutual fund are not known to the individual fund because of the use of omnibus accounts by fund intermediaries. In these cases, the mutual fund has to rely on its intermediaries to apply and enforce fund policies and procedures.

The Investment Company Act requires that investment companies be operated in the “interest of *all classes* of such companies' security holders.” 15 U.S.C. § 80a-1(b)(2) (emphasis added). It also is the fund board's fiduciary duty to treat all shareholders evenly and fairly. Unfortunately, the sales and distribution system employed by many funds and their intermediaries has created two different classes of shareholders—one “direct” class and one “omnibus” class.

The Coalition believes that a mutual fund cannot effectively monitor the activities of omnibus shareholders or properly enforce its existing policies and procedures with respect to these shareholders. The current practice of using contractual relationships with fund intermediaries to enforce a fund's rules is bound to fail as a solution because it is not in the economic interest of the intermediary to enforce mutual fund rules on its customers. As the Commission imposes new market timing requirements on funds, this structural problem is only going to worsen.

To address this bifurcated structure of shareholder classes, CMFI has proposed to the Commission that financial intermediaries be required to disclose shareholder identity and transaction information to mutual funds, so that each fund can monitor shareholder activity and be in a position to ensure the uniform application of its policies and procedures. See Letter to SEC Chairman William Donaldson, Coalition of Mutual Fund Investors, December 12, 2003 ([www.investorscoalition.com/regulatory.htm](http://www.investorscoalition.com/regulatory.htm))

This proposal is not an attempt to provide mutual funds with access to the customers of fund intermediaries. To avoid that result, protections will need to be

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developed to ensure that this information is used for compliance activities only and not for any marketing or customer relationship purpose.

A second issue for the Commission to consider is its proposed requirement that a fund disclose any arrangements it may have regarding frequent purchases and redemptions of fund shares. This proposal appears to be sanctioning special treatment for some shareholders as long as the “arrangements” are properly disclosed.

CMFI strongly disagrees with this approach. The Commission should require that all investors be provided with the same rules for purchases and redemptions. The Investment Company Act specifically prohibits investment companies from issuing securities containing “inequitable or discriminatory provisions, or [that] fail to protect the preferences and privileges of the holders of their outstanding securities.” 15 U.S.C. § 80a-1(b)(3).

There cannot and should not be any special market timing arrangements for favored investors. The Commission should clarify this point. Once policies and procedures for market timing are established and disclosed, these rules must be applied uniformly across all shareholder classes. A fund should not be able to sanction special treatment for some investors through Prospectus or SAI disclosure. Instead, a fund’s policies and procedures should be applied in the same manner to all shareholders.

On the issue of the placement of these disclosures, the Coalition supports the Commission’s recommendations. To the extent a fund’s market timing policies and procedures are placed in a fund’s SAI, CMFI recommends that the Commission require that every mutual fund with a Website provide investor access to the SAI on such Website. This step should help to provide additional investor awareness about these market timing policies and procedures, as well as the other information contained in the SAI.

Regarding the issue of fair value pricing, the Coalition supports the Commission’s efforts to reemphasize the obligation of mutual funds to “fair value” their securities under appropriate circumstances. If mutual fund shares are mispriced because of unreliable market quotes, then arbitrage opportunities exist which can harm the interests of long-term shareholders. This arbitrage opportunity can be reduced or eliminated through better use of fair value pricing methods.

#### B. Selective Disclosure of Portfolio Holdings

The Coalition is concerned about published reports of mutual fund managers selectively disclosing non-public portfolio information as a reward to large investors. In

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a recent Commission survey of the 88 largest mutual fund complexes, more than 30% of the respondents reported that portfolio information may have been disclosed under circumstances that provided certain shareholders with the ability to make advantageous trades for their own special benefit.

As the Commission notes in its explanation, this is a misuse of material, nonpublic information that needs a strong regulatory response. In summary, the Commission proposes to require mutual funds to disclose the following information:

- (1) any policies and procedures by a fund regarding disclosure of the fund's portfolio securities to any person;
- (2) any ongoing arrangements to make available information about the fund's portfolio securities to any person; and
- (3) a statement that a description of the fund's portfolio disclosure policies and procedures is available in the fund's Statement of Additional Information and, if applicable, on the fund's Website.

The Commission's proposal implies that it will be acceptable to have selective disclosure of this portfolio information through either specific "arrangements" or through policies and procedures that permit such selectivity. For the same reasons as described above, the Commission should not permit mutual funds to sanction special treatment of certain investors through mere disclosure of such conduct in the fund's Prospectus or its SAI. Instead, a fund should have portfolio disclosure rules that provide all investors with equal access to this material, nonpublic information at the same time and in the same manner.

Regulation FD, which currently applies to close-end funds, should be extended to mutual funds to ensure that the disclosure of material, nonpublic information is not provided in a selective manner. To maintain investor trust, mutual funds should not be permitted to enter into discriminatory disclosure arrangements with favored investors; instead, material, nonpublic information should be disclosed publicly to all investors at the same time and in the same manner. Application of Regulation FD to mutual funds will accomplish this purpose. Any other result will not provide a level playing field for the release of portfolio information.

To the extent a fund's portfolio disclosure policies and procedures are placed in a fund's SAI, CMFI restates its recommendation that the Commission require that every mutual fund with a Website provide investor access to the SAI on such Website.

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Thank you for providing CMFI with the opportunity to present its views on these regulatory proposals. If you or any member of the Commission staff have any questions or need additional information from CMFI, please contact me at 202-783-5300.

Sincerely,

Niels Holch  
Executive Director  
Coalition of Mutual Fund Investors