



October 16, 2006

Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

VIA ELECTRONIC MAIL

Subject: Proposed Distribution Plan for Massachusetts Financial Services Company, John W. Ballen and Kevin R. Parke (Administrative Proceeding File Number 3-11393)

Dear Ms. Morris:

The Coalition of Mutual Fund Investors (“CMFI” or “Coalition”) is pleased to submit the following comments to the U.S. Securities and Exchange Commission (“Commission”), regarding the proposed plan of distribution (“Distribution Plan”) in the Massachusetts Financial Services Company (“MFS”) administrative proceeding noted above.

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

The proposed MFS Distribution Plan is one of several Distribution Plans to be adopted and implemented as a result of earlier Commission enforcement actions to address market timing schemes and other trading abuses. As one of the initial Distribution Plans, this Plan may establish precedent for other administrative proceedings, at least where similar facts exist.

1. The Analysis of Market Timing Losses is Incomplete Without Data from Omnibus Accounts.

In a manner similar to the approach taken in the Pilgrim Baxter Distribution Plan<sup>1</sup>

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<sup>1</sup> Proposed Plan of Distribution, In the Matter of Pilgrim Baxter & Associates, Ltd., Administrative Proceeding File No. 3-11524, available at <http://www.sec.gov/litigation/admin/2006/34-54073-pdp.pdf>.

and the Columbia Funds Distribution Plan,<sup>2</sup> the Independent Distribution Consultant (“IDC”) for this Plan appears to be using the same methodology to estimate the net gains received from market timing activities in the 11 MFS Funds which were the subject of this proceeding (i.e., the “profits” method). Additionally, the Proposed Loss Model developed by the IDC intends to estimate the dilution and related harm to shareholders on a *daily* basis. This is the proper time period to evaluate market timing gains, as mutual fund shares are priced once a day, usually on or after the close of the major U.S. exchanges at 4 P.M. Eastern Time. The IDC also was directed to evaluate the proportionate share of advisory fees paid by MFS Funds that suffered losses during the period of such market timing.

The IDC’s analysis and evaluation of market timing losses is significantly flawed, however, in that there is no attempt to obtain account data beyond “record” holders for these 11 Funds, thereby ignoring short-term trading activity by investors transacting through omnibus accounts managed by third-party financial intermediaries. These omnibus accounts represent thousands of beneficial owners of the 11 Funds who have chosen a different distribution channel than a direct purchase. Many of the short-term trading abuses uncovered several years ago by the Commission and state regulators occurred in omnibus accounts, so it is disappointing that market timing losses are not being evaluated at the investor level for these accounts after they were used as a haven for market timing activities.

As the Commission is well aware, many investors choose to transact in mutual funds through third-party financial institutions, such as brokers, retirement plan providers, financial advisers, and other intermediaries. Unlike direct purchase shareholders, these investors do not deal directly with a fund; instead, shareholder statements and recordkeeping are handled by each intermediary, as well as all other aspects of the customer relationship.

During each trading day, financial intermediaries aggregate all purchase, redemption, and exchange requests from their customers and send one consolidated order to each mutual fund. A mutual fund handles this consolidated order as a single transaction, recording the third-party intermediary on its books as one shareholder or omnibus account. Each omnibus account order may represent the transactions of thousands of customers of a particular third-party financial institution; however, the intermediary is the “record” owner of the fund shares and no information is generally disclosed to the compliance personnel at a mutual fund about the individual trading

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<sup>2</sup> Proposed Plan of Distribution, In the Matter of Columbia Management Advisers, Inc. and Columbia Funds Distributor, Inc., Administrative Proceeding File No. 3-11814, available at <http://www.sec.gov/litigation/admin/2006/34-54175-pdp.pdf>.

activities of these beneficial investors, nor are the actual identities of the investors known to anyone but the financial intermediary.

To overcome the lack of transparency within omnibus accounts, several other Distribution Plans propose to engage in an “omnibus outreach” program, where financial intermediaries using this accounting method are contacted to provide identity and account information at the investor level. The receipt of this information would ensure a more accurate analysis and evaluation of market timing losses for the 11 MFS Funds which are the subject of this administrative proceeding. This information also would be helpful to the IDC in distributing the payments to each shareholder for his or her prorated portion of the losses which were incurred.

While the disclosure of identity and account information at the investor level would not change the total amount of money to be distributed from the Fair Fund in this administrative proceeding, the IDC would have been able to develop a more precise estimate of market timing profits by evaluating *all* account data at the investor level for the time period involved, instead of relying only on direct purchaser account records and aggregate trading data from omnibus accounts. A better estimate of market timing gains would have resulted in a more accurate allocation formula to compensate investors harmed by these activities.

2. The Procedures for Identifying Investors and Distributing Fair Fund Monies in Omnibus Accounts Should Be Substantially Modified.

The problems presented by omnibus accounts become even more troublesome in the proposed distribution process advocated by the IDC. As mentioned earlier, the IDC does not intend to request identity and account information at the investor level from third-party financial intermediaries using omnibus accounting. Instead, the IDC seeks to rely exclusively on the holders of omnibus accounts to handle distributions directly for their beneficial owners. This is a very different approach than other Distribution Plans released earlier this year, in which the IDC engaged in an “omnibus outreach” process to obtain this information and only in a relatively rare set of circumstances was the third-party intermediary to handle the distribution process directly.

With hundreds of intermediaries and omnibus account holders involved in the distribution of MFS Funds, it is a virtual certainty that individual investors in these Funds will receive differing treatment depending on which intermediary or distribution channel they selected to transact in these Fund shares.

Under the Distribution Plan, an investor who purchased and redeemed shares directly with the Funds (referred to as a “record owner other than an omnibus account or

a network level account”) will be identified through Fund and transfer agent records. The identity and transactions of these investors are available from these records. On the other hand, and as mentioned earlier, investors in most omnibus accounts are unknown to the Funds, as are their transactions. To address this issue, the IDC proposes three options. The first option is to have the omnibus account holder receive one check or wire transfer with its share of the overall distribution, as estimated by the IDC. The intermediary holder then will calculate the amounts owned to its beneficial shareholders using the methodology developed by the IDC. Finally, the intermediary will make the distributions directly to its beneficial shareholders in the Funds.

The second option proposed by the IDC has a third-party consultant, intended to be the Fund Administrator or one of its affiliates, calculate and make the distributions to the beneficial shareholders of the omnibus account holder. The third option is to have the intermediary handle the distribution with “calculation assistance” from the Fund Administrator or one of its affiliates.

This overall approach is dramatically different than other Distribution Plans in which the IDC generally retained the responsibility of calculating and making the distributions, using identity and account information for beneficial owners provided by the omnibus account holders.

The methodology advocated by the IDC is likely to result in widely disparate treatment of distributions at the individual investor level. The estimated distribution amount for each omnibus account is not an accurate number because no attempt has been made to evaluate market timing by the beneficial owners of these Funds. This also may cause distributions to be made to individuals who engaged in short-term trading activities in violation of MFS prospectus disclosures, a result that should not be permitted to occur.

In distributing these Fair Funds, there are several scenarios which may occur that are harmful to the interests of individual investors. The most unfair scenario is the one in which an omnibus account holder can refuse to accept a distribution on behalf of its beneficial investors. Other than the result that the distribution is returned and becomes part of the residual proceeds, there is no sanction for a lack of cooperation by an intermediary.

Another harmful scenario involves the ability of an omnibus account to create an alternative distribution process if there are “operational limitations” in an intermediary’s recordkeeping system or the costs of making the distribution are “impractical” or “disproportionate to the Omnibus Account’s Distributable Share.” In this scenario, an intermediary may be able to avoid making distributions based on daily share totals, the standard being used for other shareholder distributions. This is another example of non-

uniformity in the distribution process. The cost issue should be a secondary consideration to the proper payment of distribution amounts to all investors in all omnibus accounts.

These potential outcomes penalize investors who are customers of intermediaries with recordkeeping systems that may be less efficient than other third-party institutions, something that is totally outside the control of each investor. The Distribution Plan should not be permitting these inefficiencies to result in disparate treatment at the individual investor level.

A further harmful scenario involves the \$10,000 distribution threshold and the \$1,000 *de minimis* threshold for any particular omnibus account. Since an omnibus account can range in size from a very small group of retirement plan investors to a brokerage account with tens of thousands of sub-accounts, CMFI believes that it is possible that investors within a small omnibus account may be left without a distribution because of a potential distribution of less than \$1,000. It may be fair and reasonable to make a distribution of \$950 to an omnibus account consisting of five beneficial owners, but not feasible to make the same distribution to an omnibus account with two hundred investors. The Commission and the Independent Distribution Consultant should consider deleting these threshold amounts, in favor of a simpler formula which only looks at a *de minimis* threshold at the individual investor level.

3. The Commission Should Use Rule 22c-2 to Facilitate Intermediary Information-Sharing with the Independent Distribution Consultant.

It is CMFI's view that investors in the MFS Funds who chose to use third-party intermediaries are not adequately protected by the procedures outlined in the Distribution Plan involving omnibus accounts. Through no fault of the Independent Consultant, the current distribution procedures rely heavily on the cooperation of financial intermediaries. Further, if a financial intermediary is unwilling to provide information or handle the distributions in a manner consistent with the IDC's methodology, then the individual investors within these accounts may not receive any distribution or may receive non-uniform treatment compared to other beneficial owners of the Funds.

As an alternative to the IDC's proposal, the Commission should use its authority to require all financial intermediaries to disclose the necessary identity and transaction information at the investor level to the Independent Distribution Consultant, to facilitate a more uniform process of identifying and compensating individual investors within omnibus accounts.

Specifically, CMFI recommends that the Distribution Plan for this proceeding require that the Funds request this information for all omnibus accounts, pursuant to section 270.22c-2 of the Investment Company Act regulations.

In order to provide omnibus account transparency for mutual funds using redemption fees to deter short-term trading abuses, the Commission adopted new Rule 22c-2 in March of 2005, requiring that funds enter into written information-sharing agreements with all financial intermediaries to provide, upon request, the same type of identity and transaction information needed under the Distribution Plan.<sup>3</sup>

In order to ensure that mutual funds and financial intermediaries comply with this rule, the Commission placed responsibility for implementing this rule on the funds, prohibiting any one fund's ability to redeem shares unless compliance has been achieved.<sup>4</sup> The Commission also made the intermediary information-sharing rule a separate requirement from the decision by a fund to impose (or not impose) a redemption fee. The only funds which are exempted are: (1) money market funds; (2) funds issuing securities listed on a national securities exchange; and (3) funds that permit short-term trading through proper prospectus disclosure.<sup>5</sup> None of these exceptions would apply to the Funds selected for distributions in this administrative proceeding.

In the spring of this year, the Commission issued a proposed rule to modify Rule 22c-2 by exempting small intermediaries from the shareholder information agreement provision and proposing certain clarifying amendments.<sup>6</sup> These proposed changes have now been generally adopted by the Commission in a new final rule; however, the requirement of an intermediary information-sharing agreement has been left intact for most intermediaries.<sup>7</sup> Rule 22c-2 should be used by the Commission as a resource to improve the process of receiving investor level information from intermediaries so that eligible investors can receive their distribution payments from the Fair Funds. The compliance date for this Rule is currently April 16, 2007.<sup>8</sup>

#### 4. Conclusion.

The MFS Distribution Plan is likely to result in disparate and non-uniform treatment of beneficial shareholders who transacted in MFS Funds through intermediaries

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<sup>3</sup> 70 Fed. Reg. 13328 (March 18, 2005).

<sup>4</sup> 17 C.F.R. § 270.22c-2(a).

<sup>5</sup> 17 C.F.R. § 270.22c-2(b).

<sup>6</sup> 71 Fed. Reg. 11351 (March 7, 2006).

<sup>7</sup> 71 Fed. Reg. 58257 (October 3, 2006)

<sup>8</sup> Id. at 58262.

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using omnibus accounting. To ensure uniform and fair treatment of all shareholders, in a manner completely independent of their choice of distribution channel, the Commission should use its authority to require intermediaries to provide identity and transaction information at the investor level so that all MFS investors can be treated in the same manner.

Many of the short-term trading abuses uncovered by federal and state regulators occurred because of a lack of full transparency in omnibus accounts. It is ironic that now, several years later, the use of omnibus accounting is serving as a significant obstacle to a uniform and fair distribution of restitution payments. The answer to both the regulatory problems caused by omnibus accounts and the practical problems of distributing Fair Funds is to have full transparency and uniform treatment at the individual investor level. An intermediary's choice of recordkeeping strategies cannot be allowed to prohibit or limit the effectiveness of the ultimate objective—the equitable calculation and distribution of restitution payments to shareholders who were damaged by these abuses.

Individual investors deserve a system in which there is no difference in how mutual fund rules and regulations are applied as a consequence of the distribution channel used for fund transactions. Individual shareholders expect equal treatment, and it is very important that investor trust in mutual funds not be eroded further because of omnibus accounts and the economic needs of financial intermediaries.

CMFI is happy to provide further information or clarification regarding the recommendations in this comment letter if it would be helpful to the Commission's deliberations regarding this matter.

Sincerely,

A handwritten signature in black ink that reads "Niels Holch". The signature is written in a cursive, flowing style.

Niels Holch  
Executive Director  
Coalition of Mutual Fund Investors

cc: The Honorable Christopher Cox  
The Honorable Paul S. Atkins  
The Honorable Kathleen L. Casey

The Honorable Roel C. Campos  
The Honorable Annette L. Nazareth  
Linda C. Thomsen, Division of Enforcement  
Andrew Donahue, Division of Investment Management  
Robert Plaze, Division of Investment Management