

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-26288; File No. S7-27-03]

RIN 3235-AJ01

Amendments to Rules Governing Pricing of Mutual Fund Shares

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule amendments.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing amendments to the rule under the Investment Company Act that requires forward pricing of redeemable securities issued by registered investment companies ("funds"). The amendments would provide that an order to purchase or redeem fund shares would receive the current day's price only if the fund, its designated transfer agent, or a registered securities clearing agency receives the order by the time that the fund establishes for calculating its net asset value. The amendments are designed to prevent unlawful late trading in fund shares.

DATES: Comments must be received on or before February 6, 2004.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only. Comments in paper format should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549-0609. Comments in electronic format should be submitted to the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-27-03; if E-mail is used, this file number should be included on the subject line. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street NW., Washington, DC 20549. Electronically submitted comment letters will be posted on the Commission's Internet Web site (<http://www.sec.gov>).¹

FOR FURTHER INFORMATION CONTACT: Adam B. Glazer, Attorney, or Penelope W. Saltzman, Senior Counsel, Office of Regulatory Policy, (202) 942-0690, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0506.

¹ We do not edit personal, identifying information, such as names or E-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

SUPPLEMENTARY INFORMATION: The Commission today is proposing for public comment amendments to rule 22c-1 [17 CFR 270.22c-1] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the "Investment Company Act" or the "Act").

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I. Background

Rule 22c-1 under the Investment Company Act, the "forward pricing" rule, requires funds, their principal underwriters, and dealers to sell and redeem fund shares at a price based on the current net asset value ("NAV") next computed after receipt of an order to buy or redeem.² The rule also requires that funds calculate their NAV at least once a day.³ Today, most funds calculate NAV when the major U.S. stock exchanges close at 4 p.m. Eastern Time.⁴

Under rule 22c-1, an investor who submits an order before the 4 p.m. pricing time must receive that day's price, and an investor who submits an order after the pricing time must receive the next day's price. "Late trading" refers to the illegal practice of permitting a purchase or redemption order received after the 4 p.m. pricing time to receive the share price calculated as of 4 p.m. that day.⁵ A late trader can exploit events occurring after 4 p.m., such as earnings

² 17 CFR 270.22c-1(a). The rule also applies to any other person designated in the fund's prospectus as authorized to receive purchase orders or tenders of securities for redemption. *Id.*

³ See 17 CFR 270.22c-1(b)(1). The rule provides exceptions from the daily pricing requirement for: (i) days on which changes in the value of the fund's portfolio securities will not materially affect the current NAV of the fund's redeemable securities; (ii) days during which the fund does not receive an order for purchase or redemption of fund shares; and (iii) customary national business holidays and local and regional business holidays listed in the fund's prospectus. *Id.*

⁴ Thus, a fund's NAV generally reflects the closing prices of the securities it holds. For securities that are not listed on exchanges or for which there are otherwise no readily available market values, a fund's board of directors must establish a fair value for the securities. See 15 U.S.C. 80a-2(a)(41)(B)(ii).

⁵ In this Release, we will assume for convenience that all funds choose to price their securities daily as of 4 p.m. Some funds, however, price their securities more than once per day, and many funds price their securities earlier than 4 p.m.

announcements, by buying on good news (and thus obtaining fund shares too cheaply) or selling on bad news (and thus selling at a higher price than the shares are worth). In either case, the late trader profits at the expense of long-term investors in the fund.

Investors do not submit orders directly to funds, but to any one of several different types of intermediaries. All order information for a particular fund is ultimately submitted to the transfer agent ("primary transfer agent") that acts as the master recordkeeper for the fund, keeping track of shares sold and redeemed and cash flowing into and out of the fund.⁶ Those investors who deal directly with the fund by telephone or computer typically submit their order information to the fund's primary transfer agent.⁷ Many, however, invest in mutual fund shares through other intermediaries such as broker-dealers, banks, and retirement plans⁸ that form a network of intermediaries that process and record the transactions.⁹

Instead of submitting hundreds or even thousands of individual purchase and redemption orders each day, intermediaries typically net orders received from investors against each other and submit a single file containing net or omnibus purchase or redemption

⁶ A "transfer agent" is any person who engages on behalf of a securities issuer, or on behalf of itself as an issuer of securities, in (a) countersigning the issuer's securities when issued; (b) monitoring issuance of the securities to prevent unauthorized issuance; (c) registering the transfer of the securities; (d) exchanging or converting the securities; or (e) transferring record ownership of the securities by book entry (*i.e.*, record entry of ownership without issuing a physical certificate). See 15 U.S.C. 78c(a)(25). Transfer agents are registered with and regulated by the Commission. See 15 U.S.C. 78q-1(c).

⁷ Such intermediaries that are not registered as broker-dealers need to consider whether the securities activities that they are undertaking are brokerage activities that require them to register as broker-dealers. Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act") defines a broker as a person engaged in the business of effecting transactions in securities for the account of others. It includes several exceptions for certain bank activities. See 15 U.S.C. 78c(a)(4). It includes several exceptions for certain bank activities. See 15 U.S.C. 78c(a)(4). Section 15 of the Exchange Act essentially makes it unlawful for a broker or dealer "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills)" unless the broker or dealer is registered with the Commission. See 15 U.S.C. 78o(a)(1).

⁸ A large portion of these investors invest through tax-advantaged retirement plans, such as 401(k) accounts. About one-third of all mutual fund shares are held through retirement accounts. See Investment Company Institute, *Mutual Funds and the U.S. Retirement Market in 2002*, Fundamentals, June 2003, AT 1, 2.

⁹ See *supra* note 7.