

March 14, 2006

Memorandum to Our Mutual Fund Clients and Friends

**Proposed Amendments to Rule 22c-2**

**Introduction**

The Securities and Exchange Commission (“SEC”) recently proposed amendments to Rule 22c-2 (the “Rule”) under the Investment Company Act of 1940 (the “1940 Act”). The Rule, which was adopted in March 2005, permits a registered open-end investment company (a “fund”) to impose a redemption fee to be retained by the fund and requires a fund to enter into written agreements with its financial intermediaries that hold shares on behalf of other investors (as termed by the SEC, “shareholder information agreements”). Under these agreements, the intermediaries must agree to provide the fund, upon its request, with certain shareholder identity and transaction information and carry out certain instructions from the fund.

The proposed amendments to the Rule are designed to limit the types of intermediaries with which funds must enter into shareholder information agreements, address the Rule’s application when there are multiple layers of intermediaries, and clarify the effect of a fund’s failure to obtain an agreement with any of its intermediaries.

**Compliance and Comment Dates**

- *Original Effective Date: **May 23, 2005***
- *Compliance Date: **October 16, 2006***
- *Additional Comments: **April 10, 2006***

**Current Rule 22c-2**

The Rule prohibits a fund from redeeming its shares within seven calendar days after the shares were purchased, unless:

- (i) the fund’s board of directors (including a majority of independent directors) either approves a redemption fee that in its judgment is necessary or appropriate or determines that imposition of a redemption fee is not necessary or appropriate;
- (ii) the fund or its principal underwriter enters into a written agreement with each financial intermediary of the fund, in which the intermediary agrees to:

- (a) provide, promptly upon request by the fund, certain shareholder identity and trading information about shareholders who purchased or redeemed shares held through an account with the intermediary; and
- (b) execute any instructions from the fund to restrict further purchases or exchanges of shares by a shareholder who has been identified as having engaged in transactions that violate the fund's market timing policies; and
- (iii) the fund maintains copies of the written agreements with its financial intermediaries.

The Rule excepts certain funds, such as money market funds and funds that issue securities that are listed on a national securities exchange, from its requirements unless they impose a redemption fee. The Rule also excepts any fund that permits short-term trading of its securities, provided the fund's prospectus discloses that the fund permits short-term trading and that such trading may result in additional costs for the fund.

### **Exclusion of Certain Intermediaries**

The proposed amendments, if adopted, would exclude from the definition of financial intermediaries under the Rule any intermediary that the fund treats as an individual investor for purposes of the fund's restrictions on frequent purchases and redemptions and redemption fee program. 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 a shareholder information agreement with that plan.

### **Chain of Intermediaries**

The proposed amendments permit transfer agents and registered clearing agencies to enter into shareholder information agreements with financial intermediaries on behalf of funds. The SEC noted that it is often the transfer agent that may have preexisting agreements with a fund's financial intermediaries and including transfer agents among the entities that may enter into shareholder information agreements on behalf of funds would avoid potentially duplicative agreements or inefficiencies in the process.

The proposed amendments also specify how the written agreement requirement of the Rule would apply in situations of "chain of intermediaries" where, for example, a brokerage firm holds its shares of a fund not only on behalf of individual investors, but also on behalf of other intermediaries, such as pension plans or other broker-dealers. The proposed amendments, if adopted, would require a fund to enter into a written shareholder information agreement only with those financial intermediaries that submit orders to purchase or redeem shares directly to the fund, its principal underwriter or transfer agent, or a registered clearing agency ("first-tier

intermediaries”). If the first-tier intermediary maintains a shareholder account for another financial intermediary, the shareholder information agreement must obligate the first-tier intermediary to use its best efforts to identify, upon request by the fund, those account holders who are themselves intermediaries, and obtain and forward (or have forwarded) the underlying shareholder identity and transaction information from the second- or third-tier intermediaries.

### **Effect of Lacking an Agreement**

The proposed amendments also address the effect under the Rule of a fund’s failure (or inability) to obtain agreements with all of its intermediaries. As the SEC noted, the rule could be interpreted to mean that the absence of agreements with all intermediaries would preclude a fund from redeeming its shares. To clarify this issue, a fund would be required to, under the proposed amendments, prohibit an intermediary with which it did not have an agreement from purchasing, on behalf of itself or other persons, securities issued by the fund. According to the SEC, this change would focus the remedy for the absence of an agreement on the particular intermediary rather than on the fund or its shareholders.

### **Additional Comment**

The SEC requested additional comment on various aspects of the proposed amendments, including whether any additional entities should be excluded or included as financial intermediaries under the Rule and whether the Rule should require that the agreement between the fund and each first-tier intermediary include a provision requiring first-tier intermediaries to enter into explicit agreements with all of their indirect intermediaries. The SEC also requested additional comment on whether, as an alternative to restricting any further purchases by a financial intermediary that does not have an agreement with a fund, precluding such an intermediary from redeeming purchased shares would effectively encourage intermediaries to enter into agreements with funds.

### **Compliance Date**

Most fund groups will need substantial lead time to implement shareholder information agreements with all of their intermediaries as well as to change their systems to accommodate the receipt of shareholder information. Funds will not be able to move forward with this process until the proposed amendments are adopted. The SEC stated that the original compliance date of October 16, 2006 will remain in effect but that it would consider whether to extend the compliance date depending on when it adopts the proposed amendments.

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If you have any questions or need more information, please contact Kathleen Clarke or Paul Miller at (202)737-8833.