



**Investment Company Institute  
Standardized Data Reporting Working Group**

**Rule 22c-2 Sample Mutual Fund  
Agreement Package for Intermediaries**

**March 13, 2006**

## **Overview**

### **Rule 22c-2 Sample Mutual Fund Agreement Package for Intermediaries**

The Investment Company Institute's Standardized Data Reporting Working Group has created a mutual fund agreement package to assist the Institute's members in communicating key information about the new redemption fee rule to financial intermediaries, including its requirement to have agreements in place by October 16, 2006. This package may be used to educate intermediaries of the new requirements and assist them in understanding their obligations under the rule. Towards this end, funds should feel free to revise the enclosed sample documents as necessary to address their particular circumstances. At a minimum, the enclosed documents should serve as a useful resource in deciding the subjects to be addressed when communicating with their intermediaries about Rule 22c-2.

Accordingly, enclosed for your consideration and use are the following:

- Cover Letter – Agreement Execution Version - A sample cover letter that could accompany the agreement when it is sent to an intermediary. This letter requests that the contract be executed no later than October 16, 2006 and references relevant documents from this package that may be sent with the cover letter and agreement.
- Cover Letter – Negative Consent Version – A sample cover letter notifying the intermediary of the fund's intent to revise the terms of their existing agreement via negative consent on or after October 16, 2006. This letter also references the relevant documents from this package that may be sent with the cover letter and agreement.
- Agreement Package List & Documents – This document lists the various documents that the intermediary is receiving from the fund and explains what is needed from the intermediary. The documents included on this list (and in the package) are:
  - ABC Funds Rule 22c-2 Agreement, which would be one of the following -
    - Model Agreement
    - Model Agreement with Modifications (highlight changes)
    - Proprietary Agreement

***Please see Important Notice to Funds Utilizing the Model Contractual Clauses, which immediately precedes the Rule 22c-2 agreement in this packet.***

- Executive Summaries of -
  - Rule 22c-2
  - Privacy Issues
  - DTCC Standardized Data Reporting Service

- ABC Funds Excessive Trading Policies
- ABC Funds Expectations of Intermediary
- Agreement Instruction –
  - Sign and Return
  - Negative Consent Applies

We hope you find this information helpful as you implement the new rule. If you have any questions regarding the enclosed sample agreement package or the requirements of the new rule, please contact Kathy Joaquin at 202-326-5930 or at [kjoaquin@ici.org](mailto:kjoaquin@ici.org) or Tami Salmon at 202-326-5825 or at [tamara@ici.org](mailto:tamara@ici.org).

## Cover Letter – Agreement Execution Version

Date

Ms. Jane Doe

Title

Company

Address

City, State, Zip

Dear Jane,

Enclosed please find information that has been prepared for you by the ABC Funds as part of our implementation of the SEC's new redemption fee rule, Rule 22c-2 under the Investment Company Act of 1940. As you may know, this rule, in part, requires us as a fund company to enter into an agreement with each of our financial intermediaries that provides us access to shareholder identification and transaction information upon request. The terms of the agreement are set forth in the SEC's rule. Based upon a review of our records, your company appears to be a financial intermediary covered by the rule.

Accordingly, enclosed is the ABC Funds Agreement that, in accordance with the SEC's rule, must be executed by an appropriate signatory of your firm and returned to the undersigned **no later than October 16, 2006**. To facilitate this agreement process, ABC Funds has decided to utilize the "Model Contractual Clauses of Rule 22c-2" that were jointly developed by the Investment Company Institute and the Securities Industry Association.

**Please note that, pursuant to the SEC's rule, your failure to have an agreement executed with ABC Funds by the rule's compliance date may result in our inability to continue to accept trades you place on behalf of your clients.**

In addition to the required agreement, I have also enclosed a summary of the SEC's rule, privacy considerations, information regarding DTCC's Standardized Data Reporting Service, which we expect to use whenever we request trading data from your firm, our funds' excessive trading policies and expectations of intermediaries with whom we do business.

I hope you find this information useful. Should you have any questions about the enclosed Agreement, the SEC's new rule, or other issues relating to our implementation of the rule, please feel free to contact me at xxx-xxx-xxxx.

Sincerely,

John Smith

Title

3/13/2006

## Cover Letter – Negative Consent Version

Date

Ms. Jane Doe

Title

Company

Address

City, State, Zip

Dear Jane,

Enclosed please find information that has been prepared for you by the ABC Funds as part of our implementation of the SEC's new redemption fee rule, Rule 22c-2 under the Investment Company Act of 1940. As you may know, this rule, in part, requires us as a fund company to enter into an agreement with each of our financial intermediaries that provides us access to shareholder identification and transaction information upon request. The terms of the agreement are set forth in the SEC's rule. Based upon a review of our records, your company appears to be a financial intermediary covered by the rule.

Our records also indicate that our existing agreement with you contains "negative consent" language, which we may use to alter the terms of such agreement. Pursuant to this negative consent language, **we are hereby notifying you of our intent to revise the terms of our existing agreement** to include the provisions set forth in the attached ABC Funds Agreement. Any transaction you submit to us on or after **October 16, 2006** will be deemed to evidence your consent to this revision to our existing agreement. To facilitate this agreement process, the revisions to our existing agreement are consistent with the "Model Contractual Clauses of Rule 22c-2" that were jointly developed by the Investment Company Institute and the Securities Industry Association.

**Please note that, pursuant to the SEC's rule, your failure either to accept these revisions to our existing agreement or reach other accommodations with ABC Funds by the rule's compliance date may result in our inability to continue to accept trades you place on behalf of your clients.**

In addition to the required agreement, I have also enclosed a summary of the SEC's rule, privacy considerations, information regarding DTCC's Standardized Data Reporting Service, which we expect to use whenever we request trading data from your firm, our funds' excessive trading policies and expectations of intermediaries with whom we do business.

I hope you find this information useful. Should you have any questions about the enclosed Agreement, the SEC's new rule, or other issues relating to our implementation of the rule, please feel free to contact me at xxx-xxx-xxxx.

Sincerely,  
John Smith  
Title

3/13/2006

## ABC Funds

### Redemption Fee Rule (22c-2) Agreement Packet

#### Included in this Packet:

- ✓ **ABC Funds Rule 22c-2 Agreement**
  - Model Agreement
  - Model Agreement with Modifications (highlight changes)
  - Proprietary Agreement
- ✓ **Executive Summary – Rule 22c-2**
- ✓ **Executive Summary – Privacy Issues**
- ✓ **Executive Summary – DTCC Standardized Data Reporting Service**
- ✓ **Executive Summary – ABC Funds Excessive Trading Policies**
- ✓ **Executive Summary – ABC Funds Expectations of Intermediary**

#### What is needed from your firm:

- ✓ **Execute Attached Agreement by no later than October 6, 2006**
  - Sign and return
  - Negative consent applies

## IMPORTANT NOTICE TO FUNDS UTILIZING THE MODEL CONTRACTUAL CLAUSES

*As discussed in the enclosed Executive Summary of Rule 22c-2, the SEC has recently proposed revisions to the Rule. If adopted, these revisions may impact Paragraph x.1.2 of the Model Contractual Clauses ("Model Agreement") that were jointly agreed to by the ICI and the SIA in December 2005. In particular, to conform the Model Agreements to the SEC's proposed revisions, in the Institute's view, Paragraph x.1.2 of the Model Agreement may need to be revised as follows:*

**x.1.2 Form and Timing of Response.** Intermediary agrees to transmit the requested information that is on its books and records to the Fund or its designee promptly, but in any event not later than \_\_\_\_ business days, after receipt of a request. If the requested information is not on the Intermediary's books and records, Intermediary agrees ~~to use reasonable efforts to:~~ (i) provide or arrange to provide to the fund promptly obtain and transmit the requested information from shareholders who hold an account with an indirect intermediary; or (ii) obtain assurances from the ~~account holder that the requested information will be provided directly to the Fund promptly; or (iii) if directed by the Fund, block further purchases of Fund Shares from such indirect intermediary account holder.~~ In such instance, Intermediary agrees to inform the Fund whether it plans to perform (i) or (ii) or (iii). Responses required by this paragraph must be communicated in writing and in a format mutually agreed upon by the parties. To the extent practicable, the format for any transaction information provided to the Fund should be consistent with the NSCC Standardized Data Reporting Format. For purposes of this provision, an "indirect intermediary" has the same meaning as in SEC Rule 22c-2 under the Investment Company Act.

## ABC Funds Rule 22c-2 Agreement

*For purposes of complying with the SEC's redemption fee rule, ABC Funds has elected to use the model agreement jointly developed by the Investment Company Institute and the Securities Industry Association. Accordingly, the only revisions we have made to this agreement, as indicated below, are to insert the time periods applicable to the agreement's provisions.*

- **Model Agreement (no changes)**
  - x.1.1. **Period Covered by Request.** Requests must set forth a specific period, not to exceed 90 days from the date of the request, for which transaction information is sought. The Fund may request transaction information older than 90 days from the date of the request as it deems necessary to investigate compliance with policies established by the Fund for the purpose of eliminating or reducing any dilution of the value of the outstanding shares issued by the Fund.
  - x.1.2. **Form and Timing of Response.** Intermediary agrees to transmit the requested information that is on its books and records to the Fund or its designee promptly, but in any event not later than 5 business days, after receipt of a request.



## ABC Funds Rule 22c-2 Agreement

*For purposes of complying with the SEC's redemption fee rule, ABC Funds has elected to use the model agreement jointly developed by the Investment Company Institute and the Securities Industry Association as a starting point, though we have made various modifications to the model agreement. To assist you in reviewing these modifications, additions to the agreement are indicated by underscoring; deletions are indicated by ~~overstriking~~.*

### □ **Model Agreement with Modifications**

- x.1.2 **Form and Timing of Response.** Intermediary agrees to transmit the requested information that is on its books and records to the Fund or its designee promptly, but in any event not later than 5 business days, after receipt of a request. If the requested information is not on the Intermediary's books and records, Intermediary agrees to use reasonable efforts to: **(i) promptly obtain and transmit the requested information;** ~~(ii) obtain assurances from the accountholder that the requested information will be provided directly to the Fund promptly;~~ or ~~(iii) if directed by the Fund, block further purchases of Fund Shares from such accountholder. In such instance, Intermediary agrees to inform the Fund whether it plans to perform (i), (ii) or (iii).~~ Responses required by this paragraph must be communicated in writing and in a format mutually agreed upon by the parties. To the extent practicable, the format for any transaction information provided to the Fund should be consistent with the DTCC Standardized Data Reporting Format.

## ABC Funds Rule 22c-2 Agreement

*For purposes of complying with the SEC's redemption fee rule, in lieu of using a version of the model agreement jointly developed by the Investment Company Institute and the Securities Industry Association, ABC Funds has decided to develop its own proprietary agreement, which is enclosed.*

- Proprietary Agreement**

## **Rule 22c-2 Agreement**

AGREEMENT entered into as of \_\_\_\_\_, by and between ABC Funds “Fund Agent” and XYZ Firm “Intermediary”.

As used in this Agreement, the following terms shall have the following meanings, unless a different meaning is clearly required by the contexts:

Client-shareholders shall mean those clients of the Intermediary who maintain an interest in an account with the Funds who receive administrative services from the Intermediary.

Intermediary shall mean (i) any broker, dealer, bank, or other entity that holds securities of record issued by the Fund in nominee name; and (ii) in the case of a participant-directed employee benefit plan that owns securities issued by the Fund (1) a retirement plan administrator under ERISA or (2) any entity that maintains the plan’s participant records.

Fund Agent is either (i) an investment adviser to or administrator for the Funds, or (ii) the principal underwriter or distributor for the Funds, (iii) the transfer agent for the Funds.

WHEREAS, the Intermediary...

WHEREAS, the Intermediary and either the Funds or Fund Agent...

WHEREAS, the Fund Agent and the Intermediary...

WHEREAS, this Agreement shall inure to the benefit of and shall be binding upon the undersigned and each such entity shall be either a Fund Agent or Intermediary for purposes of this Agreement (the Fund Agent and the Intermediary shall be collectively referred to herein as the “Parties” and individually as a “Party”);

NOW, THEREFORE, in consideration of the mutual covenants herein contained, which consideration is full and complete, the Fund Agent and the Intermediary hereby agree as follows:

**(x) Shareholder Information**

x.1. **Agreement to Provide Information.** Intermediary agrees to provide the Fund, upon written request, the taxpayer identification number (“TIN”), if known, of any or all Shareholder(s) of the account and the amount, date, name or other identifier of any investment professional(s) associated with the Shareholder(s) or account (if known), and transaction type (purchase, redemption, transfer, or exchange) of every purchase, redemption, transfer, or exchange of Shares held through an account maintained by the Intermediary during the period covered by the request.

x.1.1 **Period Covered by Request.** Requests must set forth a specific period, not to exceed 180 days from the date of the request, for which transaction information is sought. The Fund may request transaction information older than 180 days from the date of the request as it deems necessary to investigate compliance with policies established by the Fund for the purpose of eliminating or reducing any dilution of the value of the outstanding shares issued by the Fund.

*Those funds that decide to obtain daily feeds of transaction information on an ongoing basis may want to use the following language in lieu of the above:*

**Period Covered by Request.** Unless otherwise directed by the Fund, Intermediary agrees to provide the information specified in x.1 for each trading day.

x.1.2 **Form and Timing of Response.** Intermediary agrees to transmit the requested information that is on its books and records to the Fund or its designee promptly, but in any event not later than 10 business days, after receipt of a request. If the requested information is not on the Intermediary’s books and records, Intermediary agrees to use reasonable efforts to: (i) promptly obtain and transmit the requested information; (ii) obtain assurances from the account holder that the requested information will be provided directly to the Fund promptly; or (iii) if directed by the Fund, block further purchases of Fund Shares from such account holder. In such instance, Intermediary agrees to inform the Fund whether it plans to perform (i), (ii) or (iii). Responses required by this paragraph must be communicated in writing and in a format mutually agreed upon by the parties. To the extent practicable, the format for any transaction information provided to the Fund should be consistent with the NSCC Standardized Data Reporting Format.

x.1.3 **Limitations on Use of Information.** The Fund agrees not to use the information received for marketing or any other similar purpose without the prior written consent of the Intermediary.

x.2 **Agreement to Restrict Trading.** Intermediary agrees to execute written instructions from the Fund to restrict or prohibit further purchases or exchanges of Shares by a Shareholder that has been identified by the Fund as having engaged in transactions of the Fund's Shares (directly or indirectly through the Intermediary's account) that violate policies established by the Fund for the purpose of eliminating or reducing any dilution of the value of the outstanding Shares issued by the Fund.

x.2.1 **Form of Instructions.** Instructions must include the TIN, if known, and the specific restriction(s) to be executed. If the TIN is not known, the instructions must include an equivalent identifying number of the Shareholder(s) or account(s) or other agreed upon information to which the instruction relates.

x.2.2 **Timing of Response.** Intermediary agrees to execute instructions as soon as reasonably practicable, but not later than five business days after receipt of the instructions by the Intermediary.

x.2.3 **Confirmation by Intermediary.** Intermediary must provide written confirmation to the Fund that instructions have been executed. Intermediary agrees to provide confirmation as soon as reasonably practicable, but not later than ten business days after the instructions have been executed.

x.3 **Definitions.** For purposes of this paragraph:

x.3.1 The term "Fund" includes the fund's principal underwriter and transfer agent. The term does not include any "excepted funds" as defined in SEC Rule 22c-2(b) under the Investment Company Act of 1940.<sup>1</sup>

x.3.2 The term "Shares" means the interests of Shareholders corresponding to the redeemable securities of record issued by the Fund under the Investment Company Act of 1940 that are held by the Intermediary.

x.3.3 The term "Shareholder" means the beneficial owner of Shares, whether the Shares are held directly or by the Intermediary in nominee name.

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<sup>1</sup> As defined in SEC Rule 22c-2(b), term "excepted fund" means any: (1) money market fund; (2) fund that issues securities that are listed on a national exchange; and (3) fund that affirmatively permits short-term trading of its securities, if its prospectus clearly and prominently discloses that the fund permits short-term trading of its securities and that such trading may result in additional costs for the fund.

*Alternative for use with retirement plan recordkeepers:*

x.3.3 The term “Shareholder” means the Plan participant notwithstanding that the Plan may be deemed to be the beneficial owner of Shares.

*Alternative for use with insurance companies:*

x.3.3 The term “Shareholder” means the holder of interests in a variable annuity or variable life insurance contract issued by the Intermediary.

x.3.4 The term “written” includes electronic writings and facsimile transmissions.

IN WITNESS WHEREOF, the undersigned has caused this Agreement to be executed as of the date first above written.

ABC FUNDS

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By: John Doe  
Title: Senior Vice President

XYZ FIRM

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By:  
Title:

## Executive Summary – Rule 22c-2

In March 2005, the U.S. Securities and Exchange Commission adopted Rule 22c-2 under the Investment Company Act of 1940. This rule is more commonly referred to as the “redemption fee rule.” The who, what, when, where, why, and how of the rule’s requirements are briefly summarized below.

### WHO – TO WHOM DOES THE RULE APPLY?

#### Funds

The rule applies to all funds except money market funds, exchange-traded funds, and funds that both affirmatively permit market timing of fund shares and disclose this fact in their prospectus.

#### Financial Intermediaries

As discussed below under WHAT, the rule impacts every “financial intermediary” of the fund. Generally speaking, the rule defines a financial intermediary as: (1) any broker, dealer, bank, or other entity that holds securities of record issued by the fund in nominee name; and (2) in the case of a participant-directed employee benefit plan that owns securities issued by the fund (i) a retirement plan administrator under ERISA or (ii) any entity that maintains the plan’s participant records.

### WHAT – WHAT DOES THE RULE REQUIRE?

The rule requires all funds that are subject to it to take the following two actions:

- Each fund’s board of directors must either (1) approve a redemption fee for the fund or (2) determine that imposition of a redemption fee is either not necessary or not appropriate for the fund; and
- Each fund or its principal underwriter, transfer agent, or registered clearing agency on behalf of the fund – ***regardless of whether the fund imposes a redemption fee*** – must enter into a written agreement with each of its financial intermediaries under which the financial intermediary agrees to:
  - (1) Provide, upon request of the fund, the taxpayer identification number and transaction information (purchases, redemptions, transfers, and exchanges) about fund shareholders who hold their shares through the financial intermediary; and
  - (2) Carryout any instructions from the fund to restrict or prohibit any further purchases or exchanges of fund shares by a shareholder who the fund

identifies as having violated the fund's market timing or excessive trading policies.

The required agreements must be maintained by a fund for six years. Obviously, once a financial intermediary executes the agreement with the fund it must be in a position to comply with all provisions in the agreement including those relating to responding to a fund's request for trading data and implementing any instructions from the fund to restrict or prohibit a shareholder's trades.

#### **WHEN – WHEN MUST A FUND COMPLY WITH EACH OF THE ABOVE REQUIREMENTS?**

Though the rule's effective date was in May 2005, funds currently have until **October 16, 2005** to comply with its requirements. **The SEC has sought comment on whether to extend this compliance date.** Accordingly, unless the compliance date is revised by the SEC, by October 16<sup>th</sup> the fund's board must have made its determination about whether to impose a redemption fee and funds or their principal underwriters **must have executed the required agreements with each of their financial intermediaries.**

#### **WHERE – WHERE CAN I FIND A COPY OF THIS RULE?**

A complete copy of: (1) the rule, along with the SEC's release that adopted it and discusses its provisions in detail; and (2) revisions to the rule proposed by the SEC on February 28, 2006, are available free of charge on the SEC's website at: <http://www.sec.gov/rules/final/ic-26782.pdf> and <http://www.sec.gov/rules/proposed/ic-27255.pdf>, respectively.

#### **WHY – WHY SHOULD FINANCIAL INTERMEDIARIES – INCLUDING THIRD-PARTY ADMINISTRATORS, RECORDKEEPERS, AND BANK TRUST DEPARTMENTS – CARE ABOUT THIS RULE?**

Financial intermediaries should care about this rule for two reasons. First, they are going to be asked by funds to sign the agreements that funds are required to have executed with each of their intermediaries by the rule's compliance date. Second, under the rule, **failure to have these agreements in place may result in the fund's inability to accept future purchases from the financial intermediary after the rule's compliance date.**

#### **HOW – HOW WILL A FUND REQUEST MY CUSTOMERS' TRADING DATA FROM ME AND HOW WILL I TRANSMIT THE REQUESTED DATA BACK TO THE FUND?**

Funds are expected to utilize the DTCC Standardized Data Reporting Service as the vehicle through which trading data will be requested and provided under the redemption fee rule. This approach enables funds to utilize standardized formats for requesting data; and intermediaries to respond to such requests in a uniform format through a secure facility. It also



enables both funds and their intermediaries to leverage existing technology through which trade data currently passes. These standardized formats, which are discussed in more detail in this package under “Executive Summary – DTCC Standardized Data Reporting Service,” will be used by funds who expect to request data on a regular basis as well by those that expect to request data on an infrequent or *ad hoc* basis.

**HOW – HOW CAN I, AS A FINANCIAL INTERMEDIARY, SHARE NONPUBLIC FINANCIAL INFORMATION ABOUT MY CUSTOMERS, INCLUDING THEIR SOCIAL SECURITY NUMBERS, WITH THE FUND COMPANY WITHOUT VIOLATING FEDERAL OR STATE LAW?**

Provisions under both federal and state laws govern when financial intermediaries may share nonpublic personal financial information about their customers with other entities or persons. These provisions are discussed in more detail in the enclosed document – “Executive Summary – Privacy Issues.” Importantly, according to the legal analysis of this issue prepared by the ICI’s outside counsel, none of these laws would appear to restrict the ability of a financial intermediary to share information about their shareholders – including the shareholders’ taxpayer identification numbers – with a fund or its principal underwriter under the SEC’s redemption fee rule. With respect to federal privacy laws, the SEC, too, believes that such laws would not impede the transfer of information from financial intermediaries to funds as required by Rule 22c-2. For a discussion of this issue in the Commission’s recent release, *see Mutual Fund Redemption Fees*, SEC Release No. IC-27255 (Feb. 28. 2006) at n.16.

## Executive Summary – Privacy Issues

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ALSTON&BIRD LLP

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TO: Investment Company Institute

FROM: Alston & Bird LLP

DATE: March 13, 2006

RE: Privacy Implications of SEC Rule 22c-2

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We have been asked to assess whether SEC Rule 22c-2 (the “Rule”) is consistent with existing federal and state consumer privacy requirements.

The Rule makes it unlawful for a mutual fund (“fund”) that issues redeemable securities,<sup>2</sup> to redeem them unless it has entered into agreements with each of its financial intermediaries to enable it to obtain taxpayer identification numbers and transaction information for each shareholder who buys or sells shares in the fund.<sup>3</sup>

Applicable federal and state privacy laws permit a financial institution to disclose otherwise confidential customer information if the disclosure is necessary to carry out transactions on behalf of the customer, to protect against fraud or other wrongdoing, to carry out risk management, or to comply with applicable legal requirements.<sup>4</sup>

Under the Rule, the financial intermediary cannot redeem fund shares unless it has agreed to disclose the specified customer information to the fund. The agreement to provide these disclosures is required to carry out transactions on behalf of customers, for the anti-fraud and risk management purposes of the fund with which it has the contractual relationship, and for the fund to meet SEC legal requirements. Accordingly, we conclude that provision of the customer

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<sup>2</sup> The Rule excepts from this requirement certain funds as follows: money market funds, any fund that issues securities that are listed on a national securities exchange, and any fund that affirmatively permits short-term trading of its securities, if its prospectus clearly and prominently discloses that the fund permits short-term trading of its securities and that such trading may result in additional costs for the fund, unless the fund elects to impose a redemption fee (also defined in the Rule), in which case the exception does not apply.

<sup>3</sup> The Rule defines financial intermediary to include any broker, dealer, bank, or other entity that holds fund securities in nominee name, a unit investment trust or fund that invests in the fund in reliance on section 12(d)(1)(E) of the Investment Company Act of 1940, and the administrator or record keeper of a participant-directed employee benefit plan. 17 C.F.R. § 270.22c-2(c)(1).

<sup>4</sup> For federal law see 15 U.S.C. § 6802(e)(3)(B), (C), (5), (8); 17 C.F.R. § 248.15(a)(2)(ii), (iii), (4), (7)(i); for state laws see citations *infra*.

information to the fund will not cause the financial intermediary making the disclosure to violate federal or state privacy law.

## **RULE 22C-2**

Shares in a fund are not always held in the name of the individual shareholder. Instead, they may be held in an omnibus account that is held in nominee name by a broker-dealer, bank, plan administrator, or other financial intermediary that aggregates individual accounts. The use of omnibus accounts may impair the ability of a fund to determine whether an individual may be market-timing purchases and sales of fund shares held through such account. The Rule attempts to enable a fund to detect and redress the trading of its shares that is inconsistent with the fund's policies established for the purchase of eliminating or reducing any dilution of the value of the outstanding securities issues by the fund (*e.g.*, market timing). It does so by prohibiting a fund from redeeming its shares within seven days of the share purchase unless it has in place a written agreement with each of the financial intermediaries that hold an account with the fund. The contract must include two elements. The financial intermediary must agree to:

1) Provide, promptly upon request by the fund, the Taxpayer Identification Number of all shareholders that purchased, redeemed, transferred, or exchanged shares held through an account with the financial intermediary, and the amount and dates of such shareholder purchases, redemptions, transfers and exchanges;<sup>5</sup> and

2) Execute any instructions from the fund to restrict or prohibit further purchases or exchanges of fund shares by a shareholder who has been identified by the fund as having engaged in transactions of fund shares (directly or indirectly through the intermediary's account) that violate policies established by the fund for the purpose of eliminating or reducing any dilution of the value of the outstanding securities issued by the fund.<sup>6</sup>

## **PRIVACY REQUIREMENTS**

The Rule directly applies only to the fund. However, its consequence is that the financial intermediary, not directly covered by the Rule, must provide nonpublic personal information about its customers, including Social Security numbers, to a non-affiliated financial institution – the fund.<sup>7</sup> Disclosures of customer information to non-affiliates, except for certain specified purposes, are generally prohibited under the privacy provisions of Title V of the Gramm-Leach-Bliley Act (“GLB”) as well as by various state privacy laws. In the guidance accompanying the original adoption of the Rule, the SEC stated that a fund receiving shareholder information may not use it for its own marketing purposes.<sup>8</sup> The SEC did not directly address in the Release the question of whether the disclosure by the financial intermediary is permissible under GLB.

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<sup>5</sup> See 17 C.F.R. § 270.22c-2(a)(2)(i). The other condition is that the fund's board of directors has determined whether to impose a redemption fee on shares redeemed within a certain time period. See 17 C.F.R. § 270.22c-2(a)(1).

<sup>6</sup> See 17 C.F.R. § 270.22c-2(a)(2)(ii)

<sup>7</sup> For the purpose of this memorandum, we assume that the Social Security numbers and other information involved constitute protected information under the applicable definitions in federal and state law.

<sup>8</sup> See 70 Fed. Reg. 13328, 13332 n.47 (Mar. 18, 2005) (the “Release”).

Below, we address both federal and state privacy laws as they apply to the financial intermediary.

### ***Federal Requirements***

Although Section 502 of GLB permits the sharing of any information among affiliates, it generally requires a financial institution to allow a customer to opt out of the disclosure of protected information to non-affiliates.<sup>9</sup> The SEC’s Regulation S-P implements this requirement as to SEC-regulated financial intermediaries, including brokers, dealers, investment advisers, and investment companies.<sup>10</sup> Banks and other insured depository institutions that may act as financial intermediaries are subject to essentially identical rules imposed by their federal bank regulators.<sup>11</sup> Insurance companies are regulated at the state level, and nearly every state has enacted legislation that applies the section 502 requirements to them. Other financial intermediaries that are financial institutions for purposes of GLB are subject to the same requirements under rules promulgated by the Federal Trade Commission.<sup>12</sup>

Section 502 specifies a number of exceptions to the general prohibition on disclosure of customer information to non-affiliates. Relevantly, these exceptions permit disclosures of nonpublic personal information:

- “as necessary to effect, administer, or enforce a transaction requested or authorized by the consumer, or in connection with ... servicing or processing a financial product or service requested or authorized by the consumer.”
- “to protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability.”
- “for required institutional risk control ....”
- “to the extent specifically permitted or required under other provisions of law and in accordance with the Right to Financial Privacy Act.”
- “to comply with Federal, State, or local laws, rules, and other applicable legal requirements.”<sup>13</sup>

The purposes of the written agreement that the Rule requires of the fund, and of the disclosures that the agreement requires of the financial intermediary, fall under each of these exceptions. The Rule requires each fund subject to it to enter into a written agreement with each of its financial intermediaries. Such agreement must require the intermediary to disclose to the fund, upon request, customer information. For the fund, entering into such an agreement is

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<sup>9</sup> See 15 U.S.C. § 6802.

<sup>10</sup> See 17 C.F.R. § 248.10(a)(1).

<sup>11</sup> See 12 C.F.R. § 40.10(a)(1) (national banks); 12 C.F.R. § 216.10(a)(1) (state member banks); 12 C.F.R. § 332.10(a)(1) (state nonmember banks); 12 C.F.R. § 573.10(a)(1) (savings associations).

<sup>12</sup> See 16 C.F.R. § 313.10(a)(1).

<sup>13</sup> 15 U.S.C. § 6802(e)(3)(B), (C), (5), (8); see also 17 C.F.R. § 248.15(a)(2)(ii), (iii), (4), (7)(i).

necessary “to comply with Federal ... rules.” Similarly, a financial intermediary that wants to redeem shares from the fund (*i.e.*, provide a service to its customer) must agree to enter into a written agreement with the fund that meets the SEC requirements. Thus, for the intermediary, entering into the agreement is “necessary to effect [or] administer ... a transaction requested or authorized by the consumer.”<sup>14</sup> Because a redemption within seven days can, as a practical matter, occur only if a fund and an intermediary have entered into the agreement, the financial intermediary’s obligation under the agreement also is an “other applicable legal requirement,” with which the financial intermediary must comply. Also, because the purpose of the disclosure by the financial intermediary is to enable the fund, in part, to protect against fraud, market manipulation and insider trading and to engage in risk control of trading in its securities, there are multiple grounds for determining that the disclosures by the financial intermediary to the fund are permissible under GLB.

The SEC has recently proposed amendments to the Rule that, if finalized in their current form, would clarify the responsibilities of mutual funds and financial intermediaries that effect transactions in fund shares through other financial intermediaries.<sup>15</sup> Specifically, the amendments would provide that if a financial intermediary fails to execute with the fund the written agreement required by the Rule, the fund must restrict or prohibit such financial institution from purchasing shares of the fund. The amendments also would require that, in the written agreement between the fund and a financial institution that is a “first-tier” intermediary, the first-tier intermediary make two commitments. First, it must agree that it will use its “best efforts” to determine whether any other person that holds fund shares through the first-tier intermediary is itself a financial intermediary (such an intermediary would be an indirect intermediary). Second, it must agree that, if an indirect intermediary declines to provide identification and transaction information about its individual customers, the first-tier intermediary, at the request of the fund, will restrict or prohibit the indirect intermediary from purchasing, on behalf of itself or others, securities issued by the fund.

Assuming that an indirect financial intermediary is itself a “financial institution” for purposes of the GLB, we believe two conclusions follow. First, if the first-tier and indirect intermediaries enter into a written agreement between themselves to ensure that the fund is provided customer information upon request, the same analysis above relating to the provision of information by a first-tier intermediary to a mutual fund, pursuant to an agreement, would apply. Second, in the absence of an agreement between the first-tier intermediary and its indirect intermediaries, the indirect intermediaries must comply with an information request from the first-tier intermediary or lose its purchasing privileges in the fund through the first-tier intermediary. Compliance is, in other words, a condition of continuing to do business with the first-tier intermediary in fund shares and thus is “in connection with ... servicing or processing a

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<sup>14</sup> The SEC previously has advised that the disclosure by an investment adviser to a broker of customer information in order to execute a transaction comes within the “necessary to effect” exception. *See* SEC Staff Responses to Questions about Regulation S-P, Q. 13 (updated Jan. 23, 2003) ([www.sec.gov/divisions/investment/guidance/regs2qa.htm](http://www.sec.gov/divisions/investment/guidance/regs2qa.htm)). Similarly here, unless an agreement for disclosure is in place, redemption within seven calendar days cannot lawfully be effected.

<sup>15</sup> *See* SEC Release No. IC-27255 (Feb. 28, 2006) (“SEC February Release”). Intermediaries that effect transactions directly with mutual funds are referred to herein as “first-tier intermediaries;” those that conduct transactions in fund shares through other intermediaries are referred to herein as “indirect intermediaries.”

financial product or service requested or authorized by the consumer” who has made trades in the fund’s shares.

Additionally, the purpose of the disclosure by the indirect intermediary is (as was the case above) to enable the fund to protect against fraud, market manipulation and insider trading and to engage in risk control of trading in its securities. Thus, disclosures by indirect intermediaries under the circumstances set forth in the proposed rule are protected by a number of the GLB exceptions. The SEC’s February 2006 Release, which did address privacy concerns about the Rule, noted the SEC’s belief “that the disclosure of information under shareholder information agreements, and the fund’s request and receipt of information under those agreements, are covered by [GLB] exceptions.”<sup>16</sup>

If the indirect financial intermediary is not a “financial institution,” as such term is defined in the GLB, the GLB’s provisions would not apply to restrict or prohibit the financial intermediary’s sharing nonpublic customer information with the fund either directly or through a first-tier financial intermediary.

GLB also requires each financial institution to provide a privacy statement annually to its customers, which includes a statement of entities to which the institution may disclose protected information, even if the disclosure itself is permissible.<sup>17</sup> Under the federal GLB regulations, an institution that makes disclosures under the exceptions identified above may meet this obligation by stating that it “make[s] disclosures to other nonaffiliated third parties as permitted by law.”<sup>18</sup> Each financial intermediary must ensure that its privacy statement includes this or other language sufficient to meet this requirement.

### ***State Requirements***

Two categories of state laws are implicated by the Rule: those based on Section 502 of GLB and those that address Social Security numbers specifically.

#### **State GLB-Related Laws**

Nearly every state has in place a statute that applies the substance of the Section 502 requirements to that state’s licensed insurers. These statutes contain the same exceptions as Section 502, including the exception for disclosures required by federal laws or rules. Two states, California and Vermont, have enacted laws that impose more onerous requirements – an opt-in rather an opt-out – on disclosures of consumer information to non-affiliates by financial institutions. Both state laws include an exception for disclosures required by federal law,<sup>19</sup> and accordingly do not prevent the disclosures intended by the Rule.

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<sup>16</sup> See SEC February Release at n.16.

<sup>17</sup> See 15 U.S.C. § 6803.

<sup>18</sup> See, e.g., 17 C.F.R. § 248.6(b).

<sup>19</sup> See Cal. Fin. Code § 4056; Vt. Stat. Ann. Tit. 8, § 10204(11).

## State Social Security Laws

Thirteen states have legislation restricting the use Social Security numbers by private companies.<sup>20</sup> Each of these laws contains an exception for disclosures that are required or permitted by federal law.<sup>21</sup> Most of these states (other than Arkansas, Minnesota, and North Carolina) also exempt disclosures from any restriction where the release is for internal verification or administrative purposes.<sup>22</sup> Accordingly, the disclosures required by the Rule are lawful.<sup>23</sup>

## CONCLUSION

For the foregoing reasons, we believe that the disclosures of Social Security numbers and other information about individual shareholders mandated by the Rule are consistent with applicable federal and state law.

Dwight Smith  
Romulus Johnson

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<sup>20</sup> Some states also have statutes that regulate the use of Social Security numbers by state agencies, but these are not relevant here.

<sup>21</sup> See Ariz. Rev. Stat. § 44-1373(B) (2005); Ark. Code Ann. § 4-86-107(c) (2005); Cal. Civ. Code § 1798.85(b); Conn. Gen. Stat. Ann. § 42-470(d) (2002); 815 Ill. Comp. Stat. 505/2QQ(b) (2004); Md. Code, Com. Law § 14-3402(b) (2005); Mich. Comp. Laws Ann. § 445.83(g) (2004); Minn. Stat. Ann. § 325E.59, subdiv. 2 (2005) (effective July 1, 2007); Vernon's Ann. Mo. Stat. § 407.1355 (2004); N.M. Stat. Ann. § 57-12B-3 (2003); N.C. Gen.Stat. Ann. § 75-62(b) (2005) (effective Oct. 1, 2006); Vernon's Tex. Code Ann. Bus. & C. § 35.38(e); Va. Code Ann. § 59.1-443.2 (2005).

<sup>22</sup> Exceptions in North Carolina also include disclosures to prevent fraud. See N.C. Gen.Stat. Ann. § 75-62(b) (2005) (effective Oct. 1, 2006).

<sup>23</sup> Although a New York consumer protection law has been construed to prohibit the disclosure of Social Security numbers between two private entities, this interpretation does not apply to disclosures required by statute or regulation. See *Meyerson v. Prime Realty Services, LLC*, 7 Misc.3d 911, 796 N.Y.S.2d 848 (Sup. Ct. 2005).

## Executive Summary – DTCC Standardized Data Reporting Service

The redemption fee rule requires funds to enter into written agreements with their intermediaries, under which the intermediaries must, upon request, provide funds with certain shareholder identity and trading information for those positions representing the omnibus account assets. This requirement will enable funds to ensure that their market-timing policies are being followed, monitor the frequency of trading, and determine whether redemption fees are being properly assessed, if applicable.

Funds are expected to utilize the *DTCC Standardized Data Reporting Service* as the vehicle through which trading data will be requested and provided under the redemption fee rule. This approach enables funds to utilize standardized formats for requesting data, and intermediaries to respond to such requests in a uniform format through a secure facility. It also enables both funds and their intermediaries to leverage existing technology through which transaction and account data currently passes. These standardized formats, which are discussed in more detail below, will be used by funds that expect to request data on a regular basis as well by those that expect to request data on an infrequent or *ad hoc* basis.

Today, many intermediaries do not send omnibus level transaction information or underlying shareholder trading data to funds for market timing monitoring. For those intermediaries that do, the data is sent to funds through a variety of methods including hard-copy reports, electronically through non-standardized or non-centralized methods, such as proprietary system links, and in certain instances via non-secure methods.

In order to reduce the variety of methods, formats and associated processing costs for requesting and receiving shareholder transaction data as required under the new redemption fee rule, the Investment Company Institute's Bank and Trust Advisory Committee, Broker/Dealer Advisory Committee and the Depository Trust & Clearing Corporation (DTCC) formed a Standardized Data Reporting (SDR) Working Group last year, consisting of funds, transfer agent service providers, banks/trusts, TPAs/recordkeepers and other service providers to create a standard, automated facility for funds to request and receive shareholder trading information from intermediaries through DTCC.

The DTCC solution is designed to provide the funds with a robust mechanism (through the NSCC's Networking service) to request data from intermediaries as their compliance and monitoring programs warrant. The mechanism allows data to pass in standardized file formats for varying functionality, such as *summary* requests for super omnibus accounts (for plan/omnibus account level data) or *detail* requests for retail or plan omnibus accounts (for shareholder or individual participant level data). SDR requests may be for a specific date or a period of time, or on a regular or periodic basis.

The SDR functionality was designed to provide funds the ability to filter requests for retirement plan accounts to efficiently and cost-effectively obtain data for market timing monitoring as required under SEC rule 22c-2. Funds may request *Category 1* data for retirement



plan accounts that will only include those transaction types that are commonly considered to be “directed” by the shareholder, financial advisor or investment fiduciary, where there may be sufficient control to perform market timing activities. Or funds may request all data for retirement plan accounts that will include both participant directed *Category 1* data and non-participant directed *Category 2* data, such as systematic or automated investment transactions (e.g., payroll contributions, earnings, etc.).

The DTCC Standardized Data Reporting Service— processing flows and record layouts are outlined in **[Important Notice Release A#, P&S #]** and may be accessed via the DTCC website at <http://funds.dtcc.com/media/impntc/index8891.html>. The Important Notice also references the SDR Users Guide, which is available to DTCC Participants through their website at <http://funds.dtcc.com>. Participants must access the Participant Services password protected section of the DTCC site to access this document on the Networking Manual web page. The User Guide offers best practices for utilizing the SDR functionality and examples for a sampling of relevant processing scenarios. The SDR file formats, best practices, and examples may also be applied as an industry standard to other processing mechanisms used outside of the DTCC.

Funds and financial intermediaries that program for the DTCC SDR Reporting enhancements may begin testing in the summer of 2006. The SDR enhancements will be implemented by DTCC prior to the rule’s October 16, 2006 compliance date. Questions regarding the DTCC SDR Reporting Service may be directed to DTCC Mutual Fund Services at 212-855-8877 or to your DTCC Relationship Manager.

## **Executive Summary – ABC Funds Excessive Trading Policies**

The fund and ABC Distributors reserve the right to reject any purchase order for any reason. The fund is not designed to serve as a vehicle for frequent trading in response to short-term fluctuations in the securities markets. Accordingly, purchases, including those that are part of exchange activity, that the fund or ABC Distributors has determined could involve actual or potential harm to the fund may be rejected. Frequent trading of fund shares may lead to increased costs to the fund and less efficient management of the fund's portfolio, resulting in dilution of the value of the shares held by long-term shareholders.

The fund's Board of Directors has adopted policies and procedures with respect to frequent purchases and redemptions of fund shares. Under the fund's "purchase blocking policy," any ABC Funds shareholder redeeming shares (including redemptions that are part of an exchange transaction) having a value of \$5000 or more from a fund in the ABC Funds Group (other than an ABC Funds money market fund) will be precluded from investing in that fund (including investments that are part of an exchange transaction) for 30 calendar days after the redemption transaction.

Under the fund's purchase blocking policy, certain purchases will not be prevented and certain redemptions will not trigger a purchase block. These include: systematic redemptions and purchases where the entity maintaining the shareholder account is able to identify the transaction as a systematic redemption or purchase; purchases and redemptions of shares having a value of less than \$5000; retirement plan contributions, loans and distributions (including hardship withdrawals) identified as such on the retirement plan recordkeeper's system; and purchase transactions involving transfers of assets, rollovers, Roth IRA conversions and IRA re-characterizations, where the entity maintaining the shareholder account is able to identify the transaction as one of these types of transactions.

In addition to implementing purchase blocks, ABC Funds will monitor for other types of activity that could potentially be harmful to the ABC Funds – for example, short-term trading activity in multiple funds. When identified, ABC Funds will request that the shareholder discontinue the activity. If the activity continues, ABC Funds will freeze the shareholder account to prevent all activity other than redemptions of fund shares.

Please consult a current prospectus for more information about ABC Funds excessive trading policies.

## **Executive Summary – ABC Funds Expectations of Intermediary**

The fund and ABC Distributors reserve the right to request data, as defined by the Rule, for any agreed upon time period and for any reason.

### **Data Requests**

For intermediaries that hold plan level omnibus accounts with ABC Funds:

- Request Category 1 data (as defined in the DTCC SDR Executive Summary attached) for all plans for the period of 90 days no less than on a quarterly basis.
- Request all data - Category 1 and Category 2 (as defined in the DTCC SDR Executive Summary attached) for individual plans that meet certain criteria for the period of 180 days.
- Request all data - Category 1 and Category 2 for individual plans for the period of 90 days no less than on an annual basis.

For intermediaries that hold super omnibus accounts with ABC Funds:

- Request plan level summary data (as defined in the DTCC SDR Executive Summary attached) for all plans on a daily basis.
- Request Category 1 data (as defined in the DTCC SDR Executive Summary attached) for all plans for the period of 90 days no less than on a quarterly basis.
- Request all data - Category 1 and Category 2 (as defined in the DTCC SDR Executive Summary attached) for individual plans that meet certain criteria for the period of 180 days.
- Request all data - Category 1 and Category 2 for individual plans for the period of 90 days no less than on an annual basis.

### **Trading Restrictions**

- ABC Funds will work in conjunction with the intermediary to implement measures to restrict and/or prohibit trading of ABC Funds from those individuals found to be engaged in frequent or excessive trading.

## **Request Acknowledgement and Fulfillment**

It is the expectation of ABC Funds that the intermediary will comply with our requests in accordance with the following:

Acknowledgement of the request -

- The intermediary will acknowledge receipt of a data request within 3 business days.

Fulfillment of a request for data -

- The intermediary will respond to “normal” (as defined above) requests for data within 10 business days of their acknowledged receipt.

Trading Restrictions -

- The intermediary will confirm receipt and placement of any trading restrictions imposed by ABC Funds within 10 business days of its receipt.