ASPPA Comments to SEC and DOL on Possible Late-Day Trading Restrictions

November 6, 2003

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Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549

Dear Mr. Roye:

We appreciate the opportunity to meet with you and your colleagues at the SEC respecting proposals you are considering to address illegal late-day trading activities. We recognize the serious nature of the allegations made and are understanding of the importance of taking steps to prevent such conduct in the future. However, we have some concerns about the potential impact the rule we understand you are considering could have on retirement plan administration, and consequently the retirement security of plan participants. As discussed below, we believe any apprehensions that the SEC may have about the potential for future illegal late-day trading conduct can be effectively and quickly addressed with very minor modifications to existing computer systems used by virtually the entire retirement plan marketplace. We believe this approach will in fact provide more assurance to the SEC then what is currently being considered, and without potentially affecting the investment rights of millions of 401(k) plan participants.

Meeting with you today are senior representatives from all sectors of the retirement plan marketplace, including third-party recordkeepers and intermediaries, as well as representatives from the technology company that maintains the most prevalent retirement plan administration system. ASPPA is a national organization of over 5,000 retirement plan professionals who assist employers in establishing and maintaining retirement plans for their workers. The firms that ASPPA members work for administer virtually all the retirement plans in the United States.

Background on Retirement Plan Recordkeepers and Intermediaries

According to the Investment Company Institute, mutual funds represent almost half of all 401(k) plan investments. 36 million American households own mutual funds through an employer-sponsored retirement plan. The majority of these plans are administered by third-party recordkeepers responsible for collecting investment decisions (i.e., trades) made by 401(k) plan participants who partner with intermediaries—banks, insurance companies, and trust companies—who are responsible for processing the trades.

Third-party recordkeepers and intermediaries play a critical role in delivering secure retirement benefits for America's workers. First, they are specialists in complying with the myriad of rules governing retirement plans contained in the Employee Retirement Income Security Act (ERISA). Second, they are in a position to offer 401(k) plan participants a more objective, diversified selection of investments, including funds from different mutual fund companies and including other, non-mutual fund investment strategies appropriate for many retirement plan participants. By contrast, plans administered directly by a mutual fund company may offer participants only their own family of funds. Even where a mutual fund company offers participants investments of other mutual fund companies, there implicitly is a strong incentive for the mutual fund company to emphasize their own proprietary funds. As recent media reports suggest, an investigation of a single mutual fund company can impact the value of such company's funds. Accordingly, the retirement security of 401(k) participants with only a single family of funds to choose from are inherently subject to greater risk as compared to participants who can select investments from several fund families.

Impact on 401(k) Plan Participants

We understand the SEC is considering a blanket rule that would require all trades be received by the mutual fund company by 4:00 p.m. est. in order to get the closing price for the same day. Such a rule would have a dramatic impact on the administration of retirement plans since one-third of mutual fund assets are held through retirement accounts. The rule, if adopted would prevent a substantial majority of 401(k) participants from being able to trade on the same day and get that day's closing price. By treating these 401(k) plan participants as second-class investors, the possible rule could seriously threaten their retirement security, public confidence in 401(k) plans, and national savings rates.

It is important to note that none of the alleged late-day trading involved participants in 401(k) plans, and no evidence exists that such illegal activity is occurring with respect to the administration of retirement plans. Retirement plan recordkeepers and intermediaries employ sophisticated computer systems and procedures to ensure that trades are received timely by 4 p.m. est. Once received, it can take the retirement plan recordkeeper and/or intermediary between 4-6 hours on average to audit, reconcile, and batch the trades involving mutual funds for submission directly to the mutual fund company. Consequently, if the SEC adopts a rule requiring the trade be received by the mutual fund company by 4 p.m. est., the retirement plan recordkeeper will likely be forced to close trading by 401(k) plan participants sometime between 10:00 a.m. to noon. In the case of west coast 401(k) participants, this could mean their right to trade 401(k) plan investments closes at 7 a.m. As a practical matter, the rule would force a substantial majority of American 401 (k) plan participants into next-day trading status.

Imagine during the demise of Enron, a 401(k) participant invested in a mutual fund with a substantial position in Enron stock. The morning news breaks a story alleging potential illegal activities by Enron that will clearly affect Enron's stock value as well as the value of the mutual fund. Before the 401(k) participant has an opportunity to read the newspaper, particularly if he or she is on the west coast, the 401(k) participant will likely be foreclosed from trading out of the mutual fund that day. Instead, the participant will be forced to trade the mutual fund effective as of the next day's closing price. With situations like the Enron collapse, a lot can certainly happen during that extra 24-hour waiting period. 401(k) plan participants should not be unnecessarily put at a disadvantage relative to other mutual fund investors.

Proposal to Prevent Late-Day Trading Without Impacting 401(k) Plan Participants

The rule currently being considered by the SEC to prevent illegal late-day trading activities is by no means foolproof. Imposing a deadline that a trade must be received by 4 p.m. est. by the mutual fund company would not prevent a mutual fund company from conspiring with traders to manipulate the deadline. In fact, some cases of late-day trading currently being investigated by the SEC directly involved a regulated investment company with its own mutual funds.

Technology, coupled with an independent audit process, is the most efficient and secure way to prevent late-day trading, and it can be used in a manner that will not negatively affect the investment rights of 401(k) participants. As noted earlier, retirement plan administration is conducted using sophisticated software systems. These systems can easily be modified in only a few months to ensure that there is no possibility of manipulation by either the third-party recordkeeper or the intermediary. Each of these systems date and time stamp (using an atomic clock) every trade, which would allow independent parties, including the SEC, to easily verify the timeliness of any trades. It would further be proposed that these systems would be subject to an independent SAS 70 or similar audit as required by the SEC to make certain that the program is performing as intended and that there is no possibility of manipulation. Given that there is a fairly limited number of such computer systems presently used in virtually the entire retirement plan marketplace, it would also be very feasible for the SEC to conduct its own audits of these systems. Additionally, under the proposal third-party recordkeepers and intermediaries would be permitted to rely on the SAS 70 or similar audits conducted on the computer system.

Under this proposal, an exception to the 4 p.m. est. receipt by the mutual fund trading deadline would be provided for trades collected by third-party recordkeepers and intermediaries that utilize these audited systems. In these instances, the trade would be considered timely received if date and time stamped by the system before 4 p.m. est. Under this exception, the concerns of the SEC respecting late-day trading will arguably be even further protected than the underlying rule since the exception would require use of audited computer systems that will foreclose any possible manipulation of the deadline.

It is certainly important to prevent illegal conduct like late-day trading. However, it is critical that any proposed solution not punish 36 million innocent American families who own mutual funds through their 401(k) plan. This can quickly be accomplished using technology that already exists, and in a way that does not dramatically change the administration of retirement plans.

We again appreciate the opportunity to meet with you on these important matters and discuss our concerns. We would be more than happy to further discuss any issues raised or other questions that may arise as you continue formulating rules to combat illegal late-day trading.

Sincerely,

Brian H. Graff

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