Policy Regarding Fund Transfers Within the 401(k), 457 & IRA Savings Plans

Dear Valued Member:

The Utah State Retirement Board has revised the 2% fee on frequent transfers (within 30 days of a previous transfer) to apply to the amount transferred rather than to the entire account balance.

Trading Policy

Participants are allowed to submit one transfer request (whether electronically, by fax, mail or hand delivered) for their current account balances every 7 days. This shall apply separately to each plan in which they participate - the 401(k), 457, Roth IRA and Traditional IRA each constituting separate plans. In addition, individuals who transfer any or all of their current account between core investment options more often than once every 30 days will be charged a 2% administrative fee on amounts transferred. Each transfer, after being processed, will start a new 30-day period. The fees generated by this policy will be used to reduce the administrative expenses for all plan participants.

Elections for the investment allocation of future deferrals and the elections of future deferral amounts will be allowed as often as daily.

EXAMPLE

If Mary submits a request to transfer any or all of her current account balances between the Plan's core investment options, and it is received by URS on Monday before the trading cutoff of 2:00 p.m. and processed that same evening, the next date she could submit a new transfer request would be on the following Monday. If Mary then chooses to transfer again before 30 days has elapsed, her account will be charged a fee equal to 2% of the amount transferred. This second transfer will start a new 7-day trading restriction and a new 30-day short-term trading period.

THE GOAL OF THIS POLICY

URS' money managers have asked the Retirement Board to develop a trading policy to prevent individuals from trading frequently between investment options in an attempt to "time" the daily fluctuations of the stock market. However, the Board also wanted to maintain a policy that would allow participants the flexibility to periodically rebalance their portfolio and react to changing market conditions. This policy will protect long-term investors from costs or reduced returns created by those who trade frequently. In addition, it will allow those who are willing to pay this additional expense the flexibility to transfer their funds if they feel it will be in their best interest to do so.

The following is a discussion of the issues which led to this decision

The mutual fund industry has undergone scrutiny regarding the manner and timing in which participants are able to trade between funds. As a result, our fund managers have contacted Utah Retirement Systems (URS) and have requested that the Retirement Board establish policies which would protect the plans from possible frequent trading or “market timing” activities.

MARKET TIMING AND STALE PRICING

An important tenet of the stock market is that an investor should not be able to buy into a stock at an old price using new information gained after the close of the applicable stock market. An unforeseen anomaly that developed with international mutual funds managed in the United States gave investors the ability to buy Asian and European investments many hours after the close of their respective exchanges, but with the knowledge of new market information and trends developing within the U.S. marketplace. This practice resulted in a disadvantage to certain investors who could not take advantage of this opportunity. The industry has termed this effect as “stale pricing.”

COSTS CREATED BY FREQUENT TRADING

When money managers receive money and invest it in the stock or bond market, trading fees and commissions are generated. Similar fees and commissions are created when the investments are sold in order to redeem fund shares. As participants increase their purchases and redemptions between investment options, the additional costs are passed on equally to all participants, even those not involved in the trading activity.

REDUCED RETURNS FOR LONG-TERM INVESTORS

In addition to increased transaction costs, the rate of return long-term investors realize from the investment option may be affected. Recently, *The Wall Street Journal* reported that the market timing activity of a few individuals could reduce the potential returns of long-term investors by as much as 2%. This could be the result of two factors: 1) increased cash holdings to cover possible redemptions, and 2) short-term investors sharing equally in gains, even though their money is not yet invested.

If the fund managers are experiencing frequent and large cash flows in and out of the investment funds, they will necessarily increase the portion of cash being held in order to accommodate these cash flow needs. Cash and other short-term investment vehicles generally receive a small long-term rate of return relative to other types of investments. For example, a savings account at the local bank may have paid 1% in 2004, whereas large cap stocks experienced returns of over 10%. By holding a large portion of the fund in cash, the total returns of the fund will have been diluted.

Each day when the books are closed on a mutual fund, the assets (including earnings gained that day) are divided equally among the shareholders based on the number of shares they own. When participants buy into a fund today, they are treated equally with the other shareholders tomorrow. However, because it may take several days for the money to be invested in a stock or bond, their money is not actually invested in the assets producing these earnings. This effect is compounded if they quickly sell out of the new fund and return to the previous fund over the course of one or two days. The result is that their money was in essence “floating” between the funds and never invested in any vehicle which would add to the overall returns of the portfolio.

WHAT OUR FUND MANAGERS SAY

The Retirement Board received and considered information from each of our money managers prior to making the new trading policies. The money managers indicated that market timing appears to be an industry-wide problem particularly affecting plans whose participants are permitted daily, unrestricted trading privileges and that such market timing may have a harmful impact on long-term shareholders. The money managers advised that ***many plan sponsors and record keepers have successfully eliminated this problem by implementing participant trading restrictions.*** Some money managers indicated that URS must establish trading restrictions or the fund managers will implement their own restrictions.

SHORT-TERM TRADING FEES

The Board wants to eliminate any possible impact short-term trading may have on the funds. They also feel it is important participants have the ability to periodically rebalance their investments. They determined that a 30-day period would adequately allow long-term investors to rebalance and update their investment structure, while it would protect the funds from frequent or short-term trading activities. Therefore, restricting trades to once every 30 days was considered.

However, a concern was voiced for the individuals who, within a 30-day period, feel that certain economic or political situations may have a significant impact upon their account. Therefore, the Board chose to allow an individual to trade during that period, if they pay a fee that will be used to eliminate the impact on other participants.

CONCLUSION

The trading policies were established at the request of the fund managers and in keeping with current industry standards and practices. Most, and perhaps all, mutual fund companies have implemented such policies for the protection of their plan participants.

The Utah State Retirement Board is concerned with fairness and equity for all plan participants. The Board has established this policy in an effort to maintain fairness, yet allow enough flexibility for participants to make timely adjustments to their accounts.