

April 4, 2005

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Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

**Re: File No. S7-06-04**  
**Release Nos. 33-8544; 34-51274; IC-26778**  
**Point of Sale Disclosure and Confirmation Requirements for**  
**Transactions in Mutual Funds, College Savings Plans, and Certain**  
**Other Securities, and Amendments to the Registration Form for**  
**Mutual Funds**

Dear Mr. Katz:

Citigroup Global Markets Inc. ("CGMI")<sup>1</sup> appreciates the opportunity to comment on proposed new rules 15c2-2 and 15c2-3, amendments to Rule 10b-10 and amendments to Form N-1A. The proposed rules and amendments serve an important purpose of providing investors with enhanced information regarding costs and broker conflicts associated with mutual-fund transactions. As an initial matter, CGMI expresses its support for the views advanced by the Securities Industry Association ("SIA") in both its prior comments to Securities Exchange Act Release No. 49148 (January 9, 2004) ("Proposing Release") and current comments on this subject.<sup>2</sup> In particular, we endorse the "Profile Plus" proposal outlined in the SIA's current comment letter.

Please note that we are confining our comments to what we believe are important, overarching issues raised by the proposal.

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<sup>1</sup> Citigroup Global Markets Inc. is dually registered with the Securities and Exchange Commission (the "Commission") as a broker-dealer and investment advisor. Smith Barney is a division of CGMI. Smith Barney offers its clients a full range of investment products including equities, bonds, mutual funds, insurance and annuities.

<sup>2</sup> See Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 12, 2004 and Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 4, 2005.

In general, we support the Commission's goal to improve the character and meaningfulness of disclosures concerning broker conflicts and compensation practices, including improved disclosure to help investors better understand their investments and attendant costs. We agree that investors should have access to clear, comprehensive disclosure concerning mutual-fund loads, fees and expenses. However, we are concerned that the breadth and detail of the multiple disclosures mandated by the proposal will overwhelm investors thereby negating the purpose and usefulness of this important information. We are also concerned that the practical difficulties associated with conveying so much detail will ultimately result in the unintended consequence of fewer investment choices being presented to investors for their consideration. Finally, we are concerned that the substantial costs to the broker-dealer and fund industries of implementing and maintaining the required disclosures are disproportionately high compared to any reasonably anticipated benefits.

The Staff has done a commendable job in identifying factors that investors may wish to consider when making investment decisions. The challenge, however, is how to best make this information available, recognizing that investors are diverse, with varying objectives, needs, and levels of financial sophistication.

**The Proposed Disclosure Process Seems Too Inflexible, Will Prove To Be Impractical In The Context Of Telephone Point Of Sale, And May Result In Unintended Negative Consequences For Investors**

The proposal would require disclosure in all cases at two separate points in the transaction process: first, at the point of sale, and second, at the completion of a transaction in the confirmation statement. With respect to mutual funds, the proposal would require, for each share class under consideration, point-of-sale disclosure of various factors including the following: sales charges at three separate standardized levels in both dollar and percent figures; distribution fees, management fees, and other expenses, again at three separate standardized purchase levels in both dollar and percentage terms; information concerning other fees such as account-activity fees; two disclosures concerning conflicts; one disclosure about volume discounts; and one disclosure concerning the availability of additional information concerning any special incentives distributors may receive for selling the fund. In addition, broker-dealers would be required to provide investors, at their request, with a written statement setting forth the estimated total sales charges and other fees based on the specific amount of the investor's anticipated purchase. Finally, broker-dealers would be required to provide investors with a purchase transaction confirmation containing much of this same point-of-sale-required information for the fund they ultimately elect to purchase.

Without addressing the individual disclosure components, we note that even the simplest mutual-fund transaction consisting of one fund and one share class would mandate, at a minimum, the disclosure of approximately 25 separate specific cost, expense, and conflict items. Significantly, this does not include information about other equally if not more important factors investors should be given to consider when making mutual-fund purchases, such as the fund's objectives, track record, and associated risks. Moreover, mutual-fund transactions often involve the consideration of multiple share classes and funds. For example, clients interested in mutual-fund investments will typically be presented with a variety of fund recommendations designed to diversify a

portfolio. Depending upon the customer's individual objectives and goals, a registered representative might recommend three or more broad fund categories, e.g., fixed income, equities, or some combination thereof, to meet the investor's needs. From these broad fund categories, the client might be presented with five or more funds. In this example, if more than one share class and fund family is under consideration, as is commonly the case, at least twenty separate point-of-sale disclosures each containing twenty-five separate pieces of information would be required.

A process that requires such multiple, detailed disclosures is unwieldy and ultimately self-defeating. These problems are compounded for firms such as Smith Barney and other national firms and their clients who conduct the vast majority of their business over the telephone rather than through in-person meetings. Although the proposal allows for oral disclosure, the practical limitations and challenges of attempting to convey this much information in a meaningful way during a telephone conversation are overwhelming for the registered representative and the client. How do firms ensure that the required disclosures were in fact made? Must all such disclosures be made for each and every subsequent investment? What happens if the client is not interested in receiving this information? Is the firm then prohibited from recommending mutual-fund transactions to the client? In-person transactions allow for giving of written disclosures directly to the investor. However, this option is not available for over-the-phone sales. Invariably firms would feel compelled to mail written disclosures to clients thereby extending the sales process, foregoing same-day trade executions and increasing costs even in situations where clients have voiced their preference not to receive extensive specific disclosures.

An unintended negative consequence to the investing public is that registered representatives may be less inclined to present investors with alternative choices when recommending fund purchases rather than overwhelm customers with multiple disclosures. Indeed, registered representatives may be less inclined to recommend mutual funds generally for this reason. This result surely is not in the interest of the investing public or the intention of the proposed regulations. At a minimum, the Commission should amend the proposal to permit investors to elect not to receive detailed fund specific disclosures during oral point-of-sale discussions. Such an exemption would be particularly compelling in the case of subsequent purchases of the same fund and fund share class. It is redundant and counterproductive to require the repeated recitation of the same information before permitting an investor to make an additional investment in the same security. In the alternative, firms could be required to record the fact that the investor was offered the additional information but declined to receive it.

### **The Impracticality Of The Disclosure Process Is Compounded In The Case Of Variable Annuities And 529 Plans.**

The application of the disclosure regime to variable annuities and 529 plans is even more problematic due to the particular characteristics of these products. For example, variable annuities commonly offer purchasers a selection of funds built into the product. The investor purchases the annuity contract and then chooses between the available fund offerings. Smith Barney offers variable annuities which contain as many as 50 separate funds from 15 different fund companies. In such cases, we would need to

make available, if applicable, conflict disclosure information with respect to Smith Barney's relationship with the insurance carrier as well as potentially 15 different mutual-fund complexes. The resulting information overload would likely confuse investors and further detract from equally or more important considerations associated with variable-annuity purchases.

Similar issues arise in the 529 plan context. Most 529 plan accounts consist of blended portfolios of multiple funds and fund families, each presumably requiring separate disclosure information. Moreover, 529 plans have varying expense categories making it difficult to categorize the fees or to make accurate comparisons. They also do not uniformly offer various standardized share classes. Some offer ownership interests comparable to a no-load or institutional share class. All of these variations further compound the task of providing meaningful and useful information to investors.

### **A More General And Flexible Disclosure Process With Access To Supplemental Fund-Specific Disclosure Such As The NASD's "Profile Plus" Approach Would Better Serve Investors**

The inherent difficulties and limitations of a disclosure approach that attempts to identify every possible cost and conflict issue that may be of some interest to some investors is evident from the supplemental release itself. The supplemental release poses over 300 separate questions on how best to provide appropriate information to investors. However, the supplemental release does not account for the possible answers to all those questions. That is to say, after more than one year and the consideration of over 200 pages of release materials, hundreds of questions still remain. We submit that this situation results at least in part from an approach that attempts to convey in a strictly prescribed manner too much specific information that by its nature is not easily captured or subject to uniform categorization.

We can appreciate the difficulties the Commission and Staff have encountered in trying to strike the right balance. Indeed, we have confronted many of these same issues over the past two years in our attempts to provide meaningful and useful information to our clients so that they can make informed investment decisions. As a result of our experience, we have adopted an approach (described below) that utilizes more generalized, yet fairly extensive, disclosure of the principal cost and expense aspects of fund and variable-annuity investments.

Our experience also suggests that the "Profile Plus" approach adopted by the NASD Mutual Fund Task Force<sup>3</sup> represents a significant development that should be given careful consideration by the Commission. In brief, the Task Force Report recommends that broker-dealers make available through the use of the Internet a short, understandable point-of-sale document that describes the principal features of a fund, including expenses, fees, and compensation arrangements. Significantly, Profile Plus would provide information on additional important point-of-sale factors such as the fund's investment strategies, risks, and other significant features. Moreover, Profile Plus would provide hyperlinks to the fund prospectus and other sources of information permitting investors to obtain more comprehensive information, if they so chose.

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<sup>3</sup> See NASD, Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 30, 2005).

We believe that Profile Plus provides an effective means to convey the information that investors may desire at the point of sale without the negative impact of the current rule proposal, which requires the delivery principally of expense-related information whether or not it is practical, or desired by the client. For this reason and the additional reasons set forth in the NASD Task Force Report and SIA current comment letter, we endorse the Profile Plus proposal. However, should the Commission determine that this approach does not fully meet the needs of investors, we suggest that a more generalized disclosure approach be utilized that provides disclosure by varying means and at various stages of the sales process. In this respect, some of the specific steps Smith Barney has taken are set forth below.

We have amended our new account booklet to include a section describing the costs associated with the various mutual-fund and variable-annuity share classes. We have included a section outlining the types of fees we receive from fund companies and their affiliates, including information on revenue sharing, mutual-fund sales support and recordkeeping functions. This information is also available to investors on our website, Smith Barney Access. Our website also contains links to educational materials and fund calculators contained on the NASD and SEC Websites.

In addition, we adopted a point-of-sale disclosure process with respect to solicited mutual-fund and variable-annuity transactions. Smith Barney's "Mutual Fund Purchase Financial Consultant Attestation" procedure requires that its registered representatives confirm that certain matters were discussed with clients and specific information was provided before entering a mutual-fund purchase order. For example, Financial Consultants must confirm that they have inquired about, among other things: other mutual-fund positions owned by the client and qualifying family members for "rights-of-accumulation" purposes; the client's anticipated investment horizon and future purchases; and the client's available funds. They must also confirm that they have informed the client of the following:

- the availability of educational materials regarding mutual funds that they can provide or can be found on our website or the sites of the SEC and NASD;
- relevant costs and expenses such as sales loads, contingent deferred sales charges, and annual fees;
- an estimate of the comparative costs and relative benefits and disadvantages of each appropriate share class; and
- the availability of letters of intent for Class A shares.

Finally, we provide investors with a detailed summary entitled "Important Remuneration Note" as part of our purchase trade confirmation. The summary contains information about revenue sharing, including our revenue-sharing fee formula and a listing of all fund companies that made revenue-sharing payments to us during the prior year. The fund companies are ranked by size of prior-year payments. Our confirmation summary contains additional information on other reimbursements or fees we receive from fund companies, including support for training, education meetings and recordkeeping services. A copy of the confirmation summary for mutual-fund

transactions is attached as Exhibit A. We utilize a similar summary for variable-annuity purchase confirmations.

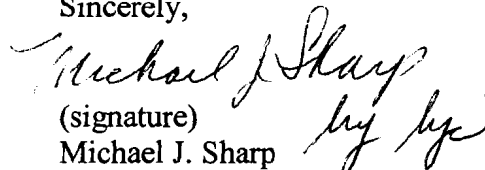
We found that this approach provides our clients with important, basic information, while not overwhelming them with supplemental detail unless they chose to receive it. An added benefit of a more generalized approach is that it permits the necessary flexibility to address variations between products that could make side-by-side comparisons difficult or even misleading. Investors seeking more detailed disclosure can be directed to the individual fund prospectuses and statements of additional information. On-line calculators could also be developed to provide further detailed information on fund expenses and fees for any specific investment amount.

### **Conclusion**

We agree with the Commission that point-of-sale and related disclosure of investment costs and broker conflicts is appropriate and can be an effective tool for ensuring that investors have important information to make informed decisions. However, we believe that the proposed disclosure regime should be revised to more effectively communicate material information to investors while balancing those benefits against the potential for investor confusion, the negative impact to investors of potentially fewer investment choices, and the prohibitive cost of compliance. A framework that would permit greater flexibility in conveying relevant information to investors would achieve the Commission's goals while avoiding the negative consequences associated with mandating the delivery of too much information for most investors. We recognize the difficulties of designing a disclosure process that would achieve these results. The uncertainties remaining in the supplemental release, as evidenced by the large number of questions still outstanding, attest to this fact. For these reasons, we agree with the SIA that the NASD's Profile Plus alternative would best achieve the goal of providing investors with needed information in a usable format at a more reasonable cost. The Profile Plus format will give investors effective disclosure, including ready access to additional, more-detailed disclosure, without inundating them with unnecessary and potentially confusing information.

Please contact me if you need any additional information.

Sincerely,

  
(signature)

Michael J. Sharp  
General Counsel  
Smith Barney

## EXHIBIT A

### **Important Remuneration Note**

The statistical and other information contained in the disclosure below pertains to mutual fund purchases transacted through traditional private client accounts, as well as purchases of non-AssetOne eligible mutual funds within AssetOne accounts. It is not applicable to and does not include information pertaining to mutual fund purchases through a TRAK or Integrated Investment Services account.

Smith Barney, a division of Citigroup Global Markets Inc. ("CGMI"), offers clients a selection of over 1,700 mutual funds from more than 80 fund families. We review and evaluate each fund family whose mutual funds we offer based upon various factors, including but not limited to the number and variety of funds offered; length of track record and historic appeal to our clients and Financial Consultants; short- and long-term performance of the funds offered; size of assets under management; ability to support our Financial Consultants and clients through training, education, and sales literature; and level of interest and demand among our clients and Financial Consultants. Evaluating the fund families in this manner allows us to focus our marketing and sales support resources on the fund families of greatest interest to our clients and their Financial Consultants. Our Financial Consultants are not permitted to execute investments in funds that we have not reviewed and evaluated.

### **Revenue Sharing**

For each fund family we offer, we seek to collect a mutual fund support fee, or what has come to be called a revenue-sharing payment. These revenue-sharing payments are in addition to the sales charges, annual service fees (referred to as "12b-1 fees"), applicable redemption fees and deferred sales charges, and other fees and expenses disclosed in a fund's prospectus fee table. Revenue-sharing payments, however, are paid out of the investment adviser's or other fund affiliate's assets and not from the fund's assets. Moreover, no portion of these payments to CGMI is made by means of brokerage commissions generated by the fund and no portion of these payments is directed or allocated to Financial Consultants.

It is also important to note that our Financial Consultants receive absolutely no additional compensation as a result of these revenue-sharing payments.

In 2004, we are charging fund families a revenue-sharing fee, calculated quarterly, based upon the following percentages of the average aggregate value of our clients' fund holdings during the quarter: (a) up to 0.09% per year (\$9 per \$10,000) on fixed income fund assets, and (b) up to 0.12% per year (\$12 per \$10,000) on equity, balanced and offshore fund assets. These rates are subject to a minimum charge of \$50,000 per year per fund family, or \$25,000 per year for fund families that offer five or fewer funds at Smith Barney. In addition, they will be subject to volume discounting (that is, as the number of assets increases, the basis-point charge for those assets will decrease). For 2003, we received revenue-sharing payments that were generally based upon a previous revenue-

sharing formula that took into account overall fund sales and fund assets held in client accounts during the year. We expect overall levels of revenue-sharing payments to increase in 2004.

Set forth below is a listing of the fund families from which we received revenue-sharing payments in 2003. The listing is divided into two categories: "Fund Families With Branch Access" and "Fund Families Without Branch Access." Fund families are listed within each category based upon the total amount of revenue-sharing payments each fund family made to us for 2003. Mutual funds offered by these two categories of fund families represented approximately 99.2% of our total mutual fund sales in 2003, with Fund Families With Branch Access representing approximately 96.9% of the total.

Representatives of Fund Families With Branch Access are, subject to the discretion of Branch Office Managers, provided access to our branch offices and Financial Consultants for marketing and other promotional efforts because of, among other things, their product offerings and demand among our Financial Consultants and clients. Similar access is not given to Fund Families Without Branch Access. Because Fund Families With Branch Access have access to our branch offices and Financial Consultants, they have enhanced opportunities to promote their funds to our Financial Consultants. This fact could, in turn, lead our Financial Consultants to focus on those funds when recommending mutual fund investments to our clients instead of on funds from those fund families that do not have access to our branch offices and Financial Consultants. Fund families (With or Without Branch Access) that do not remit revenue-sharing payments typically will not be provided such access and will not participate in or receive other corporate promotional support. In 2003 and prior years, those fund families now classified as Fund Families With Branch Access were categorized as Level I, or Strategic Partners, and Level II fund families. Level I Strategic Partners generally were given greater access to our Financial Consultants than Level II fund families.

### **Revenue-Sharing Fund Families**

Fund Families With Branch Access: Smith Barney; American Funds; Franklin; Lord Abbett; Salomon Brothers; PIMCO; Putnam; Pioneer; MFS; Oppenheimer; AIM; Calamos; Federated; Evergreen; AllianceBernstein; Fidelity Advisor; First Eagle; Van Kampen; Eaton Vance; Davis; Nuveen; ING; John Hancock; IDEX; Mainstay; Columbia; Scudder; The Hartford; Delaware; SunAmerica; Dreyfus; Goldman Sachs; JPMorgan; Blackrock; CDC Nvest; Seligman; Strong; Invesco; Nations; Strategic Partners; GE; American Century.

Fund Families Without Branch Access: Sentinel; Phoenix; Calvert; Enterprise Group; Thornburg; American Skandia Advisor Funds; Alger; Munder; Gabelli; Touchstone; Emerald; Van Eck; IVY; Cohen & Steers; Guardian; Prudent Bear; State Street Research; WM Group; Parnassus; GAM; Burnham; North Track; Security (Financial Consultants may not solicit new sales of funds within this fund family); Credit Suisse; Hotchkis and Wiley; Integrity; American Growth Fund (Financial Consultants may not solicit new sales of funds within this fund family); Gartmore; Van Liew.

We will update this listing periodically as necessary. During the first quarter of 2005, you will be able to obtain the most recently updated listing at



[http://www.smithbarney.com/products\\_services/mutual\\_funds/investor\\_information/revenue.html](http://www.smithbarney.com/products_services/mutual_funds/investor_information/revenue.html), by calling a toll-free number that we will provide, or through your Financial Consultant.

### **Reimbursement and Related Fees**

We receive expense reimbursements and fees for recordkeeping and related services, which are more fully described below. These reimbursements and recordkeeping fees may be viewed as a form of revenue sharing but are not included in the data provided above.

We may be reimbursed by funds or their affiliates or other service providers for the expenses we incur for various sales meetings, seminars, and conferences held in the normal course of business. Although fund companies independently decide what they will spend on these activities, we are aware that some fund companies allocate their promotional budgets based upon prior sales and asset levels and that they work with our branch offices or Financial Consultants to plan promotional and educational activities on the basis of such budgets. We do not control fund companies' determinations of how to allocate their promotional budgets or their spending decisions in this regard.

We receive compensation from funds or their affiliated service providers for providing certain recordkeeping and related services to the funds. These charges typically are based upon the number or aggregate value of client positions and the levels of service provided. We trade with certain fund families on an omnibus basis, which means we consolidate our clients' trades into one daily trade in our name with the fund, and therefore we maintain all pertinent individual shareholder information for the fund. Trading in this manner requires that we maintain the transaction history necessary to track and process sales charges, annual service fees, and applicable redemption fees and deferred sales charges for each position, as well as other transaction details required for ongoing position maintenance purposes. We charge those funds administrative service fees of up to \$21 per year per client position. Because omnibus trading offers economies for us and the funds that are greatest when daily trade volumes are high, we have sought to establish omnibus trading arrangements with the fund families that our clients trade the most.

As of the end of 2003, we were trading on an omnibus basis with 22 of the fund families listed above. You can obtain the most recently updated listing of these fund families at [http://www.smithbarney.com/products\\_services/mutual\\_funds/investor\\_information/admin\\_svc\\_fee.html](http://www.smithbarney.com/products_services/mutual_funds/investor_information/admin_svc_fee.html), by calling a toll-free number that we will provide, or through your Financial Consultant.

We trade all other fund families on a networked basis, which means we submit a separate trade for each individual client trade to the fund in our name, and therefore we maintain only certain elements of the fund's shareholder information. We charge these remaining funds a networking fee of up to \$6 per year per client position.

### **Other Compensation**

CGMI and other Citigroup affiliates receive from certain funds compensation in the form of commissions and other fees for providing traditional brokerage services, including

related research and advisory support, and for purchases and sales of securities for fund portfolios. CGMI and other Citigroup affiliates also receive other compensation from certain funds for financial services performed for the benefit of such funds. We prohibit linking the determination of the amount of such brokerage commissions and service fees charged to a fund to the aggregate values of our overall fund share sales, client holdings of the fund, or to offset the revenue-sharing or expense reimbursement and administrative fees described above. Moreover, such commissions or other service fees are not paid to or shared with our mutual fund business unit.

For additional information on a particular fund's payment and compensation practices, please refer to the fund's Prospectus and Statement of Additional Information. For further information regarding the fund fees and expenses borne by you and how Smith Barney and your Financial Consultant are compensated when you purchase and hold mutual fund shares, please refer to "Mutual Fund Share Classes and Smith Barney Compensation", which you can obtain at [http://www.smithbarney.com/products\\_services/mutual\\_funds/investor\\_information/sharclass.html](http://www.smithbarney.com/products_services/mutual_funds/investor_information/sharclass.html) or by calling your Financial Consultant.