INVESTMENT COMPANY INSTITUTE

April 4, 2005

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

Re: Point of Sale and Confirmation Disclosure Requirements; File No. S7-06-04

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on proposed point of sale and confirmation disclosure about the costs and potential conflicts of interest associated with the distribution of mutual fund shares.[2]

The Institute has continued to study point of sale disclosure issues over the past year. Based on discussions with the brokerage industry and additional consideration of these issues, our position and recommendations have evolved. Our continued support for requiring point of sale disclosure rests upon the Commission's ability to address effectively the many difficult challenges involved.[3] We are concerned that, absent workable solutions to these challenges, the new disclosure requirements will have a highly undesirable, albeit unintended, result. They will discourage brokers from selling mutual funds and incentivize them instead to recommend other investment products not subject to the same requirements at the point of sale.

One change to the Commission's proposal that is essential to alleviate this concern is designation of the Internet as the primary medium for point of sale disclosure. The Internet is

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[1] The Investment Company Institute is the national association of the American investment company industry. More information about the Institute is attached to this letter.

[2] We commented on the Commission's original proposal approximately one year ago. *See* Letter from Amy B.R. Lancellotta, Acting General Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated Apr. 12, 2004 ("April 2004 ICI Letter"), commenting in response to SEC Release Nos. 33-8358; 34-49148; IC-26341 (Jan. 29, 2004), 69 Fed. Reg. 6438 (Feb. 10, 2004) (the "Proposing Release").

[3] The 300-plus questions in the Commission's request for supplemental comments illustrate how numerous and difficult the issues are. *See* SEC Release Nos. 33-8544; 34-51274; IC-26778 (Feb. 28, 2005), 70 Fed. Reg. 10521 (Mar. 4, 2005) (the "Supplemental Release").

the best way to provide investors with timely and convenient access to the required information without imposing inappropriate costs and burdens on brokers.

In addition to our recommendation that the Commission embrace the Internet as the primary medium for point of sale disclosure, the Commission must address the following issues.

- The point of sale disclosure requirements should be specifically targeted to accomplish the Commission's goal of informing investors about the costs and potential conflicts of interest arising from the distribution of mutual funds. Other possible improvements to mutual fund disclosure requirements deserve careful study but should not delay adoption of targeted point of sale disclosure. We strongly encourage the Commission to undertake a wholesale reexamination of the mutual fund disclosure framework as a separate initiative.

- Appropriate exceptions from the point of sale requirements are critical. In particular, directly-sold funds should not be subject to the disclosure requirements because they do not involve the conflicts that are the genesis of the requirement. Absent an exception, the requirement will disrupt this business model without providing any countervailing benefits to investors.

These and our other comments are discussed below.

II. RISK OF DISCOURAGING BROKERS FROM SELLING MUTUAL FUNDS

The possibility that the proposed disclosure requirements will decrease brokers' willingness to offer mutual funds for sale is not an idle concern. The public record is replete with comment letters expressing concerns along these lines.[4] The proposed requirements will expose brokers to heightened liability risks. The requirements will complicate the process of selling mutual funds and cause delays in effecting investor transactions. They will layer significant programming and compliance costs for brokers on top of the costs of implementing a host of other relatively new and anticipated regulatory requirements. For these reasons, it is only logical that many brokers will tend to steer customers to alternative investments, such as separately managed accounts or even hedge funds.

We do not believe that the Commission intends this result. Mutual funds play a key role in helping investors meet their investment goals and brokers play a key role in helping

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[4] *See* http://www.sec.gov/rules/proposed/s70604.shtml. Examples include: Letter from William A. Bridy, First Vice President, and William J. Rittling, First Vice President, Merrill Lynch, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated April 12, 2004 (stating that the "sheer size and complexity of the point of sale disclosure requirements may cause some financial advisors to shy away from recommending investments in mutual fund shares when they would have done so otherwise"); Letter Type G, which states in relevant part: "The steep costs of this proposal will undoubtedly discourage broker-dealers from offering mutual finds [sic], and require those that do to charge increased account and service fees to small investors. In the end, the greatest lasting effect of this proposal may well be to reduce the availability and affordability of mutual funds to investors like me." According to the Commission's website, 633 individuals and entities filed Letter Type G.

investors. Institute research indicates that more than 80 percent of fund shareholders who own funds outside of 401(k) plans do so through professional advisers, including brokers.[5] This high use of professional advisers is consistent across shareholder populations, regardless of age, mutual fund asset level or educational background. These fund investors clearly value professional help and advice.

The Commission's proposal seeks to inform investors who purchase fund shares through a broker about the compensation the broker receives for the services provided and related potential conflicts of interest. It is incumbent upon the Commission to consider carefully how best to achieve this goal without imposing undue burdens that will discourage brokers from offering funds for sale. That result would serve no one's interests, least of all the interests of the investing public.

In the interests of investors more generally, the Commission should extend point of sale disclosure requirements to other investments that brokers sell. The Commission also should work with other regulators, as appropriate, to extend similar requirements to other distribution channels through which mutual funds are sold (*e.g.,* banks). In this way, all investors who purchase funds through professional advisers or other intermediaries will have access to similar information, regardless of the distribution channel.

II. ADDITIONAL DISCLOSURE REFORM

Based on comments received on the original proposal, it appears that some investors want to receive information in addition to, or different from, that contained in the original proposal.[6] The Institute supports reexamining the mutual fund disclosure framework and is pleased that Chairman Donaldson already has asked the SEC staff to commence such a review.[7] This review should include a wholesale reexamination of how funds communicate with investors and how investors absorb information and make investment decisions.

Since publication of the Proposing Release, the NASD Mutual Fund Task Force has undertaken a review of brokers' disclosure obligations in connection with fund transactions.[8] The Task Force recommends that investors be provided access to website disclosure that

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[5] Investment Company Institute, *2004 Profile of Mutual Fund Shareholders.*

[6] The SEC and the NASD conducted investor research that they are relying on to support this point. *See* Siegel & Gale, LLC/Gelb Consulting Group, Inc., *Results of In-Depth Investor Interviews Regarding Proposed Mutual Fund Sales Fee and Conflict of Interest Disclosure Forms,* Report to the Securities and Exchange Commission (Nov. 4, 2004) and Supplemental Report to the Securities and Exchange Commission (Nov. 29, 2004); Applied Research & Consulting, LLC, *Mutual Fund Point of Sale Disclosure Investor Research* (Mar. 10, 2005) ("NASD Focus Group Report"). The SEC and the NASD each conducted either focus groups or one-on-one interviews with fewer than 40 investors in each study. Studies involving such small groups cannot serve as a basis for determining broad investor preferences. The Institute expects to comment separately on this aspect of the SEC's and NASD's research efforts.

[7] *See Remarks Before the Mutual Fund and Investment Management Conference,* Chairman William H. Donaldson (Mar. 14, 2005) ("Donaldson Remarks") at 2-3.

[8] *See Report of the Mutual Fund Task Force: Mutual Fund Distribution* (March 2005) ("NASD Mutual Fund Task Force Report").

includes simple and clear information about key characteristics of the fund, including the fund's investment objective, strategies, risks, performance, and fees and expenses, with a hyperlink to the fund's prospectus. While streamlining and layering fund disclosure along these lines deserves careful consideration, it should not delay the Commission's adoption of a targeted point of sale disclosure requirement – with its attendant investor benefits – in the near term.

We also urge the Commission not to expand the disclosure at this time to include additional information about a fund's fees and expenses. In our view, the Commission's current proposal best serves investors by remaining true to its original purpose – providing customers with "targeted information . . . regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares."[9] The proposal includes information about potential broker conflicts that, unlike disclosure of fees and expenses, is not currently required elsewhere. Requiring additional information about the fund's ongoing costs could have the unintended consequence of obscuring the purpose of the disclosure. While we agree that cost information is important, we strongly question the appropriateness of elevating it above all other information that is important to an investment decision.[10] For these reasons, fee and other information that should be included in streamlined fund disclosure should be evaluated as part of a separate and broader Commission initiative.

III. COMMUNICATION OF POINT OF SALE DISCLOSURE

A. Internet Disclosure

Under the Commission's proposal, point of sale disclosure likely will be provided in paper form. This is because oral disclosure will be unduly burdensome and expose brokers to an unacceptably high risk of liability resulting from the "put" investors would have under the proposal. Consequently, investor transactions will be delayed and brokers will incur inordinately high costs. Given this practical reality, the Commission must determine how brokers can provide the information in a way that neither impedes investors' ability to effect fund transactions nor imposes unwarranted costs and burdens on brokers.

In our view, the best way to achieve this objective is to designate the Internet as the primary medium for point of sale disclosure. Consistent with the recommendations of the NASD Task Force and the Securities Industry Association,[11] we recommend permitting brokers to provide the disclosure by referring investors to information on the broker's website or e-mailing investors a link to the website. Brokers should be required to refer to this information at the time of recommending a particular fund to an investor. The rule should allow investors

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[9] Proposing Release at 6438.

[10] Currently, there is no automated way to communicate this information to brokers for purposes of generating the required disclosure. As a result, requiring inclusion of additional information about fund expenses also will be extremely burdensome for brokers and will increase their compliance costs.

[11] *See* NASD Mutual Fund Task Force Report; Letter from George R. Kramer, Vice President and Acting General Counsel, Securities Industry Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated Apr. 12, 2004.

who do not have access to the Internet, or who otherwise want to obtain this information in paper form, to request the disclosure in paper form.

According to data the Commission recently cited, "75% of Americans have access to the Internet in their homes, and . . . those numbers are increasing steadily among all age groups."[12] Not only would the Internet be the most efficient and effective means of communicating the required information, but also it would be consistent with Chairman Donaldson's expressed interest in examining ways to make "better use of technology, including the Internet, in [the Commission's] disclosure regime."[13]

The Internet has several important benefits that will help assure the success of the new disclosure requirements. First, it is well-suited to serving the differing needs and preferences of different investors; those investors who are interested in more detailed information will easily be able to obtain it (*e.g.,* through a hyperlink to the fund's prospectus). Second, accessing the required disclosure on the Internet will not impede an investor's ability to make a trade, as will occur if the broker has to furnish a paper copy of the information to the investor prior to trade execution. Website disclosure also will enable an investor to compare information among funds, as well as among brokers. Finally, Internet disclosure is substantially less expensive than paper disclosure. For example, it reduces printing and mailing costs.

Cost is an important consideration. We appreciate Chairman Donaldson's recent statement that the Commission would "like to minimize the costs" of this disclosure to the broker-dealer and fund industries.[14] Use of the Internet as the primary vehicle for point of sale disclosure will help keep costs down while also providing an effective means to achieve the goals of the Commission's proposal. It also will help ensure that the new requirements do not have the undesirable effect of creating a burdensome disincentive for brokers to sell mutual funds, as compared to other products that are not subject to similar requirements.

B. Timing of Point of Sale Disclosure

The proposal provides that a mutual fund purchase order is only an "indication of interest" until after the required information is disclosed to the customer and, following disclosure, the customer has had an opportunity to determine whether to place an order. We have serious concerns about this provision. As we discussed in our previous comment letter, it allows an investor who experiences buyer's remorse after purchasing a fund to disavow the trade on the basis that he or she did not receive the required disclosure or have a sufficient opportunity to review it. Allowing investors to void a trade on this basis inappropriately exposes brokers to open-ended liability.

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[12] SEC Release Nos. 33-8501; 34-50624; IC-26649 (Nov. 3, 2004), 69 Fed. Reg. 67392 (Nov. 17, 2004) ("Securities Offering Reform Proposal") at n.353.

[13] Donaldson Remarks at 3.

[14] *Id.* at 2. According to the Proposing Release, the Commission estimates that the costs associated with producing and distributing the proposed point of sale disclosure document will exceed $450 million initially, with ongoing costs in excess of $975 million annually. Proposing Release at 6473. These costs likely will be shared by investors.

To address these concerns, we recommend deleting this provision. We further recommend that the rule clarify that when required point of sale information is provided via the Internet, a broker satisfies his or her disclosure obligation by referring the investor to the broker's website (or e-mailing a link) to obtain the information. The Commission has proposed this approach in connection with securities offerings of operating companies, based on the principle that "access equals delivery."[15] We have supported this approach for those offerings and emphasize the compelling reasons to apply the same principle in this context.

When the information is not provided via the Internet, the rule should provide that the obligation is satisfied by streamlined oral disclosure and transmission of the required information by fax, mail or other appropriate means. Streamlined oral disclosure should consist of a summary of all the required information (revised as we recommend in Section V below), rather than a verbatim reading of the form. Upon providing this oral disclosure and transmitting the information in writing, the broker should be able to accept the investor's purchase order.

This approach balances the interests of brokers and investors. In particular, it ensures that investors who are unable, or do not wish, to receive point of sale information via the Internet receive basic point of sale information orally before they purchase fund shares. At the same time, it avoids both undue delays in effecting investors' purchase transactions and open-ended liability for brokers.

C. Monitoring Compliance with the Disclosure Requirements

A significant issue that is not directly addressed in either the Proposing Release or the Supplemental Release is how brokers will monitor compliance with the new point of sale disclosure requirements. NASD Rule 3010 requires brokers to establish and maintain written supervisory policies and procedures and a system for implementing such policies and procedures that is reasonably designed to achieve compliance with the rule's requirements. The Institute recommends that the Commission expressly acknowledge that brokers can monitor ongoing compliance by incorporating policies and procedures regarding point of sale disclosure into their supervisory procedures under Rule 3010. This approach would best enable brokers to tailor their compliance programs to their businesses and relationships with customers. Regulators would be able to review broker policies and procedures, websites and other available information to determine compliance with these requirements in the course of inspections.

The Institute would strongly oppose a requirement that brokers document compliance with the new rule by, for example, obtaining electronic, recorded, telephonic, or written affirmations. Such a requirement would significantly increase the complexity and costs of compliance, thereby adding to concerns that brokers may migrate away from selling mutual funds.

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[15] *See* Securities Offering Reform Proposal.

IV. EXCEPTIONS FROM THE POINT OF SALE REQUIREMENTS

A. Directly-Sold Funds

The Institute strongly urges the Commission to provide an exception from the disclosure requirements for directly-sold funds.[16] For these funds, no broker makes a recommendation to purchase fund shares. There are no sales fees or broker-related conflicts of interest to disclose. Moreover, in the event the Commission requires point of sale disclosure to include information about ongoing fund fees or other additional matters, the information would be redundant. Investors in directly-sold funds already have the opportunity to review a prospectus containing comprehensive fund fee and other information before they purchase fund shares. Requiring directly-sold funds to provide point of sale disclosure will disrupt the processing of investor transactions and add costs with no countervailing benefits for investors.

B. Subsequent Purchases

The Commission also should provide an exception from the disclosure requirements for subsequent purchases of the same fund through the same broker. There is no need for the investor to receive the same information again. If the Commission does not adopt our recommendation to permit disclosure via the Internet, failure to provide such an exception will make it cumbersome for an investor to add to existing holdings. The absence of an exception also would impede the use of, for example, systematic investment plans, asset allocation programs, or money market sweep programs – a result that would not be in the interests of investors.

C. Institutional Orders

The Institute strongly supports an exception from the disclosure requirements for purchases by institutional investors. In our previous comment letter, we recommended such an exception and suggested that it be based on the definition of "institutional investor" in NASD rules. In response to the Commission's request for comment, we would support expanding the definition we previously recommended to include any "qualified investor" as defined in Section 3(a)(54) of the Securities Exchange Act of 1934, and any person acting solely on behalf of any qualified investor. While this approach provides a broader exception than our original recommendation, it still imposes strict parameters that limit the exception's scope to investors that are well-equipped to obtain information relevant to their investment decisions.

We do not believe that it is necessary to condition this exception on the broker providing point of sale disclosure upon an institutional investor's request. If the Commission follows our recommendation regarding Internet disclosure, institutional investors that wish to review a broker's point of sale disclosure will easily be able to do so of their own volition. On the other

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[16] This exception should apply where (1) the fund has no front-end or back-end sales load, (2) asset-based sales charges or service fees do not exceed 25 basis points, and (3) there are no broker-related conflicts of interest that otherwise would require disclosure. The first two criteria are consistent with NASD Conduct Rule 2830(d)(4), concerning which funds may be referred to as "no load" funds.

hand, we are also confident that brokers will provide the disclosure, if requested, even in the absence of a specific requirement.

D. Unsolicited Orders

The Institute recommends that the Commission except from the disclosure requirements unsolicited orders where the broker has not made a recommendation to the investor. The disclosure relating to conflicts of interest would be meaningless to an investor in this situation because those conflicts would have had no impact on the investor's investment decision. In addition, an investor who has made his or her own investment decision very likely would not want to face the possible delays or other inconveniences that will result if the Commission declines to follow our recommendations regarding the method and timing of disclosure.

To define the parameters of this exception, we recommend that it apply to every transaction for which the broker is not required to make a suitability determination.[17] This approach will enable brokers to determine the availability of this exception by relying on their current familiarity in applying NASD Rule 2310 to a particular transaction. Moreover, because the NASD provides interpretive guidance to brokers from time to time regarding the application of Rule 2310,[18] the broker's point of sale disclosure obligation would evolve in tandem with its duty to make a suitability determination.

In the Supplemental Release, the Commission expresses concern that "[a]llowing disclosure to vary depending on whether a recommendation has occurred also may give some broker-dealers the incentive to inappropriately assert that they are not making recommendations when in fact they are."[19] We believe there are other, better ways to address the Commission's concern, such as through SEC and NASD inspections and, when appropriate, enforcement actions. To the extent a broker makes a recommendation, the broker is required by Conduct Rule 2310 to make a suitability determination. Characterizing a solicited order as unsolicited to avoid this requirement violates the NASD's rules. Given that there are other effective ways to guard against inappropriate conduct by brokers, the Commission should avoid additional burdens and expense that provide no concomitant benefits to investors by providing an exception for unsolicited transactions that do not involve a broker recommendation.

V. CONTENTS OF THE POINT OF SALE DOCUMENT

The Supplemental Release includes revised forms of point of sale disclosure tailored to both the type and class of security the investor is considering. We support this approach because it will make the disclosure simpler, shorter and more relevant to the investor. For the

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[17] NASD Conduct Rule 2310 requires a broker to make a suitability determination whenever the broker recommends to a customer the purchase, sale, or exchange of any security.

[18] For instance, when the NASD observed brokers increasingly using the Internet to communicate with their customers, the NASD provided interpretive guidance regarding the intersection of a broker's online activities with its suitability obligations. *See NASD Notice to Members 01-23* (April 2001).

[19] Supplemental Release at n.40.

same reasons, we support permitting brokers to omit any negative disclosure (*e.g.*, Class A shares that have no ongoing distribution fees). We also recommend that the disclosure include a date (*e.g.*, "This information is current as of [date]").

The comments below address the specific disclosures set forth on the revised forms.

A. You Pay When You Buy

The Institute recommends several changes to this section. First, we recommend, at the end of the sentence stating that the amount of the up-front fee is based on the investor's total payment amount, insertion of the phrase "unless you qualify for a volume discount (see above)." This change recognizes that factors in addition to the investor's current investment (*e.g.*, investments of other family members or investments in other funds in the same fund family) may impact the amount of the front-end sales load.[20] It also directs the investor's attention to information about volume discounts.

Second, we recommend that only a $1,000 hypothetical investment amount be shown. According to the Supplemental Release, the Commission has included the hypothetical investment amounts of $50,000 and $100,000 "to provide additional context and also illustrate the effect of breakpoint discounts on upfront sales loads."[21] While we agree with the Commission's objective of alerting investors to the impact of volume discounts on their sales load, we do not believe that this disclosure is the best way to accomplish it. The hypothetical investments of $50,000 and $100,000 add complexity and density to the disclosure, and they are not relevant for typical fund investors.[22] The narrative disclosure about volume discounts at the top of the form, coupled with the enhanced disclosure we recommend above underscores to investors the availability of sales load breakpoints.[23]

Finally, the question "Do you want us to fill in the blanks for you?" is impractical for Internet disclosure. Instead of this question, we recommend that the $1,000 hypothetical investment amount be accompanied by narrative disclosure informing the investor that personalized information is available from the broker upon request.

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[20] We also recommend that the Commission insert the word "sales" before "fee" in the first sentence under the heading "Volume Discount" in the upper right hand corner of the form. This change will clarify that the discounts referred to involve sales fees only, not all fund fees.

[21] Supplemental Release at n.17.

[22] The median U.S. household income for mutual fund shareholders is $68,700. *See* Investment Company Institute, *Mutual Fund Fact Book* (2004 Ed.) at 82. Institute research indicates that the median initial fund investment during 2004 was in the range of $2,000 to $2,500, and the mean initial investment was just over $10,000.

[23] These disclosures complement a series of additional initiatives designed to assure that investors are aware of, and receive the benefits of, sales load discounts for which they qualify. *See Report of the Joint NASD/Industry Task Force on Breakpoints* (July 2003). Most of the Task Force's recommendations have been implemented and others are in progress.

B. You Also Pay Each Year

We support requiring disclosure of the estimated first year distribution or service fees.[24] This information is relevant to an investor in evaluating a fund's distribution costs. We recommend adding narrative disclosure to clarify that investors do not pay these fees directly, but rather, they are paid out of the fund's assets annually to cover the costs of marketing, distribution, administration, and other services provided by the broker.[25] Distribution fees should be disclosed in both percentage and dollar terms based only upon a $1,000 hypothetical investment, for the reasons discussed above. If an investor is interested in the dollar amount of the fee based on his or her actual investment amount, that information should be available upon request.

The Institute recommends that the Commission not require disclosure of account fees, whether charged by the fund or by the broker. These fees are not related to the costs and potential conflicts of interest that arise from the distribution of mutual fund shares. Account fees charged by a broker may vary depending upon the type(s) of account held by the investor (*e.g.*, brokerage or wrap fee account) as well as the assets held in the account. As a result, it is not possible to provide standardized account fee information.

C. Conflicts of Interest

We generally support the changes to this section, subject to the following comments.

First, we urge the Commission to revise the proposed definition of "revenue sharing" to address the issues that we highlighted in our previous letter.[26] In particular, the definition should not be so broad as to encompass all payments to a broker, regardless of the purpose of the payment. Instead, it should only cover payments in connection with the sale or distribution of fund shares. Funds are accustomed to analyzing the purpose(s) for which payments to brokers are made; they must do so, for example, for purposes of determining whether payments out of fund assets must be made under a 12b-1 plan.[27] We agree with the Commission's proposal to exclude from the definition of revenue sharing asset-based fund payments, dealer concessions and other sales fees. Distribution fees and sales fees will be included in other sections of the point of sale disclosure. The conflict of interest disclosure should relate to payments a broker receives *above and beyond* those amounts.

In addition, the definition of revenue sharing, as revised, should not inadvertently sweep in payments (*e.g.*,12b-1 fees) made by other funds in the same fund complex or payments

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[24] To avoid potential investor confusion, we recommend that the caption for this item track the corresponding caption in the mutual fund fee table required by Item 3 of Form N-1A (*i.e.*, "Distribution and/or Service (12b-1) Fee").

[25] For the same reason, the heading for this section should be changed to "Your fund pays each year."

[26] *See* April 2004 ICI Letter at 9-11.

[27] *See, e.g.*, Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, Securities and Exchange Commission, to Craig S. Tyle, Esq., General Counsel, Investment Company Institute, dated Oct. 30, 1998.

that are made to promote sales of funds in a different fund complex (*e.g.,* payments by a subadviser that relate to a different fund complex). It also should not include inter-company payments within a fund complex that relate to the sale of proprietary funds, provided that these payments do not support differential compensation for sales personnel. Such payments do not present potential conflicts of interest.

Consistent with our comments on the definition of revenue sharing, the question "Does the fund or its affiliates pay us extra to promote this fund over other funds?" should be revised to refer only to payments made by affiliates of the fund, and not the fund itself. Payments by the fund to promote sales are already included in the distribution fee disclosure. In addition, consistent with the purpose of the disclosure, the question should focus on the broker's receipt of revenue sharing payments. To place the focus of the disclosure where it belongs, we recommend further revising the question to ask "Do we receive additional payments from the fund's affiliates to promote the fund?"

D. Find Out More

The Institute is pleased that the Commission has followed our recommendation to add narrative information to the point of sale disclosure directing investors to the fund's prospectus for more information about the fund's costs, goals and risks. We recommend adding at the beginning of this section the following sentence: "In addition to the fees disclosed above, the fund pays ongoing fees and expenses every year you hold shares in the fund." This disclosure will specifically tell investors that there are such additional costs, thereby addressing concerns about potential investor confusion on this point.

To further enhance this disclosure, we recommend that brokers be required to provide a hyperlink from this section to the fund's prospectus, or to a site on the fund's website that is no more than one click away from the fund's prospectus. The Commission should require the link on the fund's website to the prospectus to be prominently displayed.

We also recommend changing the heading "Summary of special incentives" to "Additional details on conflicts of interest" so that the terminology is consistent with that used elsewhere in the form. For the same reason, we recommend that the reference to "the special incentives" in the first line of this narrative disclosure be replaced with "additional details on the compensation."

VI. CONTENTS OF THE CONFIRMATION

The Institute supports the revisions to the original proposal that tailor the contents of the confirmation to the type of transaction. We further recommend that the Commission provide brokers the flexibility to design their own confirmations so long as they include the information specified by the Commission.

The Institute is pleased that the Commission has deleted from the confirmation forms the proposed comparison range information disclosure. According to the Supplemental Release, the Commission plans to request further comment about such disclosure at a later date

and in a separate release. For each of the reasons set forth in our previous comment letter, the Institute continues to strongly oppose disclosure of comparison range information.

Our specific comments on the proposed confirmation are set forth below.

A. You Paid When You Bought

As with point of sale disclosure, the Institute recommends revising the narrative disclosure in confirmations regarding the basis for the sales fee paid by the investor. In particular, we recommend replacing the sentence "This fee pay [sic] was based on your total payment amount" with disclosure along the following lines: "The amount of this fee should reflect any applicable volume discounts. For information about the fund's volume discounts, see the fund's prospectus. Please call your broker if you have any questions concerning these discounts or believe you did not receive all discounts for which you are eligible." This disclosure is consistent with other ongoing efforts to assure that investors receive all breakpoint discounts to which they are entitled.

The Institute is pleased that the confirmation disclosure about the effect of rounding on the investor's sales load tracks the disclosure recommended by the Joint NASD/Industry Task Force on Breakpoints. As we indicated in a supplemental comment letter on the Commission's original proposal, the Commission should not require fund prospectuses to include information about the range of possible sales loads that an investor might pay.[28]

B. You Also Pay Each Year

The Institute strongly recommends deleting this portion of the confirmation. The information is redundant of other disclosure provided to the investor, it clutters the confirmation, and it distracts from other relevant information. If the Commission follows our recommendation with respect to the contents of the point of sale disclosure, that disclosure will include information about any distribution or service fees. In addition, fund investors receive a prospectus that includes a fee table containing information about *all* fund fees and expenses no later than with the confirmation. Fund investors also receive dollar amount disclosure of fund fees and expenses in annual shareholder reports. As such, including information about ongoing fund fees and expenses on confirmations is unnecessary.[29] If the Commission goes forward with this approach, investors will bear the substantial costs of developing systems and retooling confirmations to include this redundant information.

In addition, requiring this information on the confirmation will impede a broker's ability to confirm multiple transactions on a single confirmation. This will further increase the costs associated with producing and mailing mutual fund confirmations, without providing any

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[28] Letter from Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated Dec. 9, 2004.

[29] In addition, as noted above, there is currently no mechanism in place for funds to communicate expense information to brokers for this purpose. *See* note 10 above.

corresponding benefit to investors. If the Commission believes it necessary to use the confirmation to again draw an investor's attention to this information, we recommend that the confirmation include narrative disclosure encouraging the investor to consult the fee table in the fund's prospectus.

C. Conflicts of Interest

The Institute strongly recommends deleting this information from the confirmation. An investor will have received this information at the point of sale. We do not believe that providing the same disclosure in the confirmation provides any additional benefit to an investor.

Requiring this information on the confirmation also creates practical problems. There are many instances when an entity other than the selling broker, such as a fund's transfer agent, confirms the trade. In these situations, the entity confirming the trade would not have access to information about whether the selling broker pays its representatives differential compensation. In addition, the requirement to provide additional narrative disclosure regarding the selling broker's "special incentives" would further complicate the production of confirmations. The confirming entity would need to insert the correct phone number and website for each selling broker. This would substantially increase the steps and costs associated with the confirmation process. These costs will be borne by investors.[30]

VII. INTERNET DISCLOSURE OF ADDITIONAL INFORMATION

According to the Supplemental Release, the Commission is considering supplementing both the point of sale disclosure and the confirmation with specified Internet disclosure. We are pleased that the Commission is contemplating using Internet disclosure to make available additional information about the compensation a broker receives for selling a fund and the broker's revenue sharing and differential compensation arrangements. At the same time, however, we are concerned that the Commission's proposal contains an unnecessary level of detail, does not provide appropriate context, and will entail substantial costs. We recommend the changes described below to address these concerns.

First, we recommend that the hypothetical investment amount used to illustrate the compensation that broker-dealers receive for selling a fund's shares be $1,000, for the reasons discussed in Section V.A above.

Second, for disclosure of revenue sharing payments, we recommend that the Commission adopt an approach similar to that proposed by the NASD in 2003.[31] Like the Commission's proposed disclosure, the NASD's proposal was designed to enable investors to evaluate whether a registered representative's particular investment recommendation was inappropriately influenced by revenue sharing arrangements. Unlike the Commission's

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[30] If the Commission does not follow our recommendation to delete this information from the confirmation, it should permit omission of any negative disclosure.

[31] *See* NASD Notice to Members 03-54 (Sept. 2003). The Institute supported the NASD's proposal with certain modifications. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Barbara Z. Sweeney, NASD, dated Oct. 17, 2003.

proposal, the NASD's proposal would not require dollar amount disclosure of revenue sharing payments. Instead, it would require disclosure of the nature of any revenue sharing payments received over the previous 12 months along with the name of each offeror that made such a payment, listed in descending order based upon the amount of compensation received from each offeror.[32]

This approach is similar to that taken by the NASD when it had concerns about potential conflicts of interest of research analysts. The NASD addressed such conflicts by requiring research reports to include relevant disclosure of the *existence* of compensation or other financial interests.[33] The NASD did not require disclosure of specific amounts of compensation. Similarly, a broker's disclosure of the *existence* of revenue sharing arrangements with various fund families should suffice to alert investors to potential conflicts of interest without requiring specific dollar amount disclosure. Indeed, we are not aware of any other instances in which the Commission or the NASD has required financial arrangements that may create conflicts of interest to be disclosed in specific dollar amounts.

The NASD's approach is less burdensome and costly. The Supplemental Release contains no cost-benefit analysis relating to a broker's compliance with a detailed, dollar-based disclosure requirement. The costs of preparing and maintaining this disclosure are likely to significantly increase the $1.3 billion dollars in start-up costs and $2.965 billion in ongoing annual costs that the Commission estimated its original point of sale and confirmation proposals would entail. This significant increase is not offset by commensurate investor benefits and is inconsistent with Chairman Donaldson's interest in minimizing the costs to the brokerage and fund industries of the point of sale disclosure initiative.[34] It also raises the very real possibility of discouraging brokers from selling fund shares.

VIII. Prospectus Disclosure of Revenue Sharing Arrangements

The Institute continues to support the Commission's proposed approach to prospectus disclosure of revenue sharing arrangements. We agree that, if any person within the fund complex makes revenue sharing payments, it is appropriate to require brief prospectus disclosure of that fact. We also support prospectus disclosure that directs investors to their brokers for more specific information.[35] Brief prospectus disclosure will achieve the goal of alerting investors to potential conflicts of interest that might affect a broker's investment

[32] As we recommended in our comment letter to the NASD, all payments in connection with the sale or distribution of funds in a single complex should be aggregated for purposes of the list. Also, the list should identify just the primary sponsor/adviser of those funds, not each separate entity making payments. Furthermore, there should be a *de minimis* threshold beneath which disclosure would not be required. We believe that when revenue sharing payments relating to funds in a single complex amount to one percent or less of the aggregate payments received by the broker-dealer during the period covered, the payments do not need to be disclosed.

[33] *See* NASD Conduct Rule 2711.

[34] *See* note 14 above and accompanying text.

[35] As discussed above and in our April 2004 letter, we recommend against requiring fund confirmations to include disclosure concerning revenue sharing payments. Therefore, the Commission should revise its proposal so that the prospectus disclosure does not refer investors to information about revenue sharing payments in confirmations.

recommendation, while letting them know how to obtain more specific information relevant to their particular broker.

If the Commission determines that funds should be required to provide additional information about revenue sharing arrangements, it should address the appropriate level of detail of that information. It is important that the Commission avoid mandating overly detailed disclosure in the prospectus. To do otherwise would undermine the principles that the Commission established in adopting the current two-part disclosure format for funds.[36] It also would be inconsistent with the Commission's upcoming initiative to improve the fund disclosure regime. Accordingly, any detailed or technical information regarding revenue sharing payments should be included in the Statement of Additional Information (SAI) or posted on the fund's website. The Commission also should restate its incorporation by reference doctrine, reaffirming that information in the SAI is deemed to be included in the prospectus.

IX. SAFE HARBOR

The Supplemental Release seeks comment on whether the Commission should address concerns about exposure to unfair private actions by, for example, requiring additional disclosures or providing a safe harbor. The Institute strongly supports the adoption of a safe harbor to protect brokers from unfair private actions, including those that seek to impose liability for any non-fraudulent disclosures made pursuant to proposed Rules 15c2-2 or 15c2-3. This protection will play a key role in ensuring that brokers remain willing to offer mutual funds for sale.

X. TREATMENT OF UITS AND 529 PLANS UNDER THE PROPOSAL

We support tailored point of sale and confirmation disclosure for investors in unit investment trusts and 529 plans. We are concerned that the Commission's current proposal does not sufficiently take into account the unique features associated with these products and their distribution. Consequently, it could unnecessarily frustrate or impede a broker's ability to sell these products, to the detriment of investors. The Institute strongly recommends that the Commission carve these products out of the new requirements while it continues to explore separate point of sale and confirmation disclosure better suited for investors in each of these products. The Institute's April 2004 letter highlighted specific issues raised by application of the proposal to UITs.[37] Our concerns about application of the proposal to 529 plans are described below.

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[36] *See* SEC Release Nos. 33-7512; 34-39748; IC-23064 (Mar. 13, 1998), 63 Fed. Reg. 13916, 13919 (Mar. 23, 1998) (stating, among other things, that "[f]unds should limit disclosure in prospectuses generally to information that is necessary for an average investor to make an investment decision," and that "[d]etailed or highly technical discussions, as well as information that may be helpful to more sophisticated investors, dilute the effect of necessary prospectus disclosure and should be placed in the SAI.").

[37] April 2004 ICI Letter at 22. The Supplemental Release is completely silent on disclosure requirements and implementation issues relating to UITs. In contrast to other types of securities, the Supplemental Release does not provide samples of point of sale or confirmation disclosures for UITs.

While the Institute appreciates the Commission's efforts thus far to develop tailored point of sale and confirmation disclosure for 529 plans, we are concerned that further changes are necessary to adapt the disclosure requirements to the needs and circumstances of the 529 plan market. Such adaptation is crucial because the manner in which the 529 plan market functions is fundamentally different from the mutual fund market. Most importantly, information relating to mutual fund transactions typically flows between the selling broker and the mutual fund issuer in an automated manner. This includes both the distribution information (*e.g.,* sales load information) provided by the fund to the broker as well as the trade information provided by the broker to the fund company. The same is not true for 529 plan transactions.

The 529 plan market also currently has no automated systems that could be used to populate the point of sale disclosure with information from state issuers of the securities and state program managers. The lack of these systems will complicate a broker's ability to provide accurate and timely information to investors. Further exacerbating this problem is the fact that the information required to be disclosed may differ depending upon whether the investor is purchasing an in-state or out-of-state plan as well as the broker's relationship with the program manager and the state issuer of the securities. While one solution to these concerns might be for the industry to build automated systems that could be used by state issuers, program managers, and brokers to capture this information, we understand that this is not likely to occur. This is because the responsibility for building such systems likely would rest with the brokerage industry and, as evidenced by the lack of automation in this market thus far, the costs of building such systems appear to far exceed their benefit to brokers.

XI. COMPLIANCE DATE

The Institute reiterates its recommendation that the Commission provide a sufficiently long transition period before enforcing compliance with the new rules. The Commission should work with the brokerage industry to develop an appropriate timetable. As we stated previously, the compliance date should take into account both the systems and other changes necessitated by the new requirements and other recent and pending Commission initiatives that impact the systems, policies and procedures that brokers and funds use in connection with the offer and sale of fund shares.

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The Institute appreciates the opportunity to communicate these comments recommending changes that are critical to the success of the new disclosures and brokers' continued willingness to sell fund shares. If you have any questions concerning our views or would like additional information, please contact me at 202-326-5815 or Tamara Salmon at 202-326-5825.

Sincerely,

Elizabeth Krentzman
General Counsel

cc: The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid

Meyer Eisenberg, Acting Director
Susan Nash, Associate Director
Division of Investment Management

Annette L. Nazareth, Director
Catherine McGuire, Chief Counsel
Division of Market Regulation

About the Investment Company Institute

The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,534 open-end investment companies ("mutual funds"), 648 closed-end investment companies, 144 exchange-traded funds and 5 sponsors of unit investment trusts. Its mutual fund members manage assets of about $8.037 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 87.7 million as of mid 2004, representing 51.2 million households.