Fidelity Investments®

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May 17, 2004

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

Re: **Proposed Rule: Confirmation Requirements and Point-of-Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, File No. S7-06-04**

Dear Mr. Katz:

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to comment on the Commission's proposal[2] to adopt new Rules 15c2-2 and 15c2-3 under the Securities Exchange Act of 1934 (the "Exchange Act"), as well as to amend Rule 10b-10 and Form N-1A. These changes will greatly enhance disclosure by broker-dealers to their customers regarding the costs the latter incur in their purchase of shares of mutual funds ("covered securities") and the potential conflicts of interest that may bear upon their brokers' recommendations or advice regarding investments in particular funds.[3]

I. Summary

Fidelity strongly supports the Commission's goal to improve investor access to important information concerning distribution costs in the purchase of mutual funds and potential conflicts of interest faced by broker-dealers. Investors will benefit from this

[1] Fidelity Investments, as investment adviser to over 290 mutual funds, is the largest complex of mutual funds in the United States and is also a diversified financial services company that includes several registered investment advisers, registered broker-dealers, including a retail broker-dealer and a clearing firm, registered transfer agents, and a retirement plan services administrator.

[2] SEC Release Nos. 33-8358; 34-49148; IC-26341 (Jan. 29, 2004) ("Proposing Release").

[3] As proposed, "covered securities" would include: (i) any security issued by an "open-end company," as defined by section 5(a)(1) of the Investment Company Act of 1940, that is not traded on a national securities exchange; (ii) any security issued by a "unit investment trust," as that term is defined by Section 4(2) of the Investment Company Act of 1940 ("UITs"), other than an exchange-traded fund that is traded on a national securities exchange or facility of a national securities association, or a UIT that is the subject of a secondary market transaction; and (iii) any municipal security that is issued pursuant to a qualified state tuition program as defined by Section 529 of the Internal Revenue Code.

information by being able to make better informed investment decisions. Fidelity's interest in this issue is consistent with its recent support of other disclosure initiatives.[4]

We have organized our comments based upon the various channels and business lines through which we distribute mutual funds. [5] Our main points can be summarized as follows:

- The final rules should exempt covered securities from point of sale disclosure where none of the fees or sales loads described in the Proposing Release is charged and none of the potential conflicts of interest is implicated. We refer to this as the Directly Sold Covered Securities exemption.
    - We also propose that individual line items be omitted from point of sale disclosure and confirmations if the appropriate response would be "none" or "zero".
- Point-of-sale disclosure requirements should be streamlined for transactions through mail, automated telephone and Web or any other medium that does not entail direct interactions with a broker-dealer's sales representatives.
- The final rules should exempt from point-of-sale disclosure transactions by institutional investors.
- Point of sale and confirmation disclosure requirements should be modified for clearing firms and principal distributors.
- We urge that the persons covered by the proposed rules and amendments be expanded to include banks operating as broker-dealers.

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[4] See, e.g., Letter from Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Feb. 10, 2004) (supporting Commission proposals relating to disclosure of policies relating to portfolio holdings disclosure and use of fair value pricing); Letter from Eric D. Roiter and David Jones, Senior Vice President, Product Strategy & Communications, Fidelity Management & Research Company, to Jonathan G. Katz (March 2, 2004) (responding to Commission concept release on improving mutual fund transaction cost disclosure).

[5] Variable insurance and 529 college savings plan do not fit neatly into the proposed rules. We ask that the Commission consider the unique aspects of variable insurance and 529 college savings plan programs closely in adopting final rules.

- The final rules or the adopting release should make clear that mutual funds, themselves, will not be liable under the Securities Act of 1933 for the failure of a broker-dealer or other covered person to discharge its disclosure obligations.

II. The Direct Market

Fidelity is one of a number of fund complexes that offer no-load, no 12b-1 fee funds[6] that are offered to customers directly or through an affiliated broker-dealer.[7] Many of our purchase orders arrive by mail, touchtone telephone, or over the Web, without any interaction at the point-of-sale. In the scope of Fidelity's direct market business:

- The distribution costs of the Fidelity Funds are paid by the fund adviser out of its own resources.

- The Fidelity Funds do not use brokerage to compensate for distribution.

- Fidelity employees engaged in the sales process do not receive sales-based compensation or any differential compensation.

In addition to distribution of proprietary funds on the basis described above, Fidelity also operates a fund supermarket. In this context, Fidelity is a recipient of various forms of payment from the fund complexes on some funds, but not on others. We call the funds that do pay fees to Fidelity: "no-transaction fee funds" (or NTFs), because Fidelity is paid for servicing costs by the fund complex rather than by our brokerage customer. We also have transaction fee funds, where our customer pays us a transaction fee (or a sales load) and where we do not receive payment from the fund complex.

Fidelity also operates affiliated funds of funds and a discretionary mutual fund wrap program through a registered investment advisory affiliate of its direct market broker-dealer.

[6] Fidelity pays for distribution from its own resources, including retained earnings from its diversified business activities, including fund management. The Fidelity Funds pay no 12b-1 fees, but they have adopted, with approval by the Board of Trustees of the Fidelity Funds, so-called "defensive" or "no-fee" Rule 12b-1 plans, which authorize Fidelity to use some or all of its management fees for distribution. The purpose of a no-fee plan is to clarify that Fidelity may use its own resources to finance distribution while complying with Section 12(b) of the 1940 Act.

[7] Fidelity also distributes "Fidelity Advisor Funds" through brokers and other financial intermediaries Certain classes of Fidelity Advisor Funds have loads and 12b-1 fees. These funds are discussed below in Sections V and VI of this letter.

In light of the varied conditions prevalent in the direct market within Fidelity's experience, we make the following suggestions regarding the scope of the Proposing Release:

A. Point-of-sale Exemption for Directly Sold Covered Securities. Fidelity urges that the final rules provide for a Directly Sold Covered Securities exemption, available when (i) the shareholder pays no sales load or deferred sales charge, (ii) the fund pays no asset-based sales charge, (iii) covered persons receive no sales load or contingent deferred sales charge, revenue sharing or directed brokerage, (iv) there are no differential compensation arrangements and (iv) none of the enumerated "potential conflicts of interest" required to be disclosed on new Schedule 15D is present.[8]

We believe that point-of-sale disclosure for Directly Sold Covered Securities would be of little, if any, import to the customer and unduly burdensome in the distribution of direct marketed funds. Our experience is that investors who transact via telephone or the Web value speed of service and responsiveness. Minimizing time on the phone or on the Web is critical to customer satisfaction, and the delay and cost occasioned by mandatory point-of-sale disclosure far outweighs whatever minimal information could be conveyed to the customer.[9] Indeed, a Directly Sold Covered Security presents none of the items called for by Schedule 15D.

In the case of Fidelity's no-load funds, Fidelity incurs distribution costs, but these costs are paid for out of Fidelity's own resources. The point of sale disclosure requirements therefore should not be triggered so long as neither Fidelity's affiliated distributor nor affiliated brokers, nor any of their sales representatives, receive any of the types of compensation or are implicated in any of the potential conflicts of interest that the proposed rules address.[10]

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[8] See Letter from Amy B.R. Lancellotta, Acting General Counsel, Investment Company Institute, to Jonathan G. Katz (April 12, 2004) at 17.

[9] If the final rules do not include a Directly Sold Covered Securities Exemption, consider the empty formality of this likely telephone conversation: "I am now obliged to tell you that your mutual fund transaction does not involve the imposition of any directed brokerage. Directed brokerage is when a fund company allocates mutual fund portfolio securities transactions to a selling broker because the broker sold fund shares. Your fund did not do that. Similarly, neither your fund nor the fund's adviser engaged in any revenue sharing payments. These are payments prevalent in some parts of the mutual fund industry to compensate intermediaries for inclusion of funds on their approved lists. That is not true in respect of your fund. Further, I am obliged to tell you that you will not pay a Rule 12b-1 fee or other asset-based sales charge."

[10] The new definition would be added to Rule 15c2-2 because all definitions are currently found there. However, the definition would apply only to 15c2-3.

Further, we urge the Commission to amend the definition of Asset-Based Sales Charges to explicitly exclude advisory fees so as to make absolutely clear that fund advisory fees are exempt from point-of-sale or confirmation disclosure. This is entirely consistent with the Commission's proposal at footnote 91 of the Proposing Release,[11] but the definition of Asset-Based Sales Charges as proposed is overbroad and potentially contradictory.

B. Point of Sale Disclosure -- Fidelity's Funds Supermarket. In maintaining its funds supermarket, Fidelity acts as a broker-dealer in facilitating trades by its customers of third party mutual funds. With respect to trades for which Fidelity receives a transaction fee from its customer and no compensation from the third party fund or its adviser, the proposed point of sale disclosure rules appear not to apply. We request that the Commission clarify in the final rules whether this is, in fact, the case and whether such transaction fees can simply be disclosed in the 15c2-2 confirmation as a commission paid by the customer.

With respect to those third-party funds for which Fidelity enters into revenue sharing agreements, or receives loads or asset-based sales charges, it is clear that point-of-sale disclosure should be provided.

C. Short Form Confirmation. Fidelity supports the use of a short form confirmation for transactions exempted from point-of-sale disclosure under our proposed Directly Sold Covered Securities Exemption. This follows from the fact that there is nothing to disclose regarding loads, fund paid asset-based sales and service fees, revenue sharing or differential compensation. When a sales load is not paid, the disclosures in Sections C, D and E of Schedule 15C simply have no relevance to fund investors.

We also urge the Commission to clarify in the final rules that if the confirmation disclosure would be "none" or "not applicable," the relevant line item need not be included. This will help reduce disclosure costs for Directly Sold Covered Securities, which will redound to the benefit of investors in directly sold no-load funds.

Of course, if one of the items is in fact present, it should be disclosed at both point-of-sale and in the confirmation. For example, Fidelity would propose that for third-party funds in its funds supermarket (assuming that Fidelity's sole compensation from the fund complex is revenue sharing based on a percentage of assets sold), Fidelity's brokerage confirmations would disclose revenue sharing in the short form confirmation, but would not recite all the other kinds of potential compensation in which Fidelity does not participate.

D. Streamlining Point of Sale Disclosure For Unilateral Trading Activity

[11] See Proposing Release, at p. 106.

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Retail customers can choose to interact with Fidelity in many ways, including in-person meetings or through direct telephone conversations with sales representatives. Alternatively, they can do so by acting unilaterally, either through the mail[12] or automated communications systems, namely, automated telephone [13] systems or our websites. When a customer acts unilaterally (and our proposed Directly Sold Covered Securities Exemption does not apply), we do not propose a complete exemption from point of sale disclosure. We do, however, urge the Commission to streamline the way in which point of sale disclosure can be made to take into account the medium through which a customer has chosen to transact. This can be accomplished in the following manner:

Mail orders. We recommend that the final rule should afford covered persons the alternative of including in mail-in purchase applications a statement informing customers of the covered person's toll-free number and website (if any) for point-of-sale disclosure information. We respectfully suggest that the periodic delivery of point-of-sale disclosure after the sale is a regulatory oxymoron and will essentially repeat disclosure that will, in any event, be provided in confirmations.

- Providing the toll-free number (or toll-free number and website) on the application should be sufficient to satisfy the disclosure requirement of 15c2-3(b), which makes all purchase orders conditional on completion of point-of-sale disclosure, and we propose that the Commission modify 15c2-3(b) accordingly.

Automated Phone Orders. We suggest that the final rules should provide for the alternative of allowing callers to opt-in to point-of-sale disclosure in response to an automated "prompt" that would lead to a recorded recitation of the point-of-sale disclosure, or transfer to another toll-free number for access to a live representative. The automated prompt would inform the customer essentially as follows: "To hear important sales information that you have a right to receive by law, press or say 1 now; to skip this information and continue, press or say 2." This would take place prior to completion of the transaction.

- o We believe that the automated phone prompts should be sufficient to meet the point-of-sale disclosure contemplated by 15c2-3(b) and that 15c2-3(b) should be amended to explicitly say so.

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[12] By "mail," we refer throughout this letter to the mailing services contemplated in the Proposing Release, including delivery by U.S. mail, messenger service or similar third-party delivery service.

[13] By "automated telephone," we refer throughout this letter to both automated touch-tone and automated speech recognition services.

- Websites. We request that the Commission amend proposed Rule 15c2-3 to permit customers transacting in covered securities through websites to receive all point-of-sale disclosure through prominent website links that will offer point-of-sale disclosure before completion of the transaction. We believe that providing website links should be sufficient to meet the point-of-sale disclosure contemplated by 15c2-3(b).

Phone Orders Placed by Telephone with Sales Representatives. Fidelity supports point-of-sale disclosure for *initial* representative-assisted phone orders. However, Fidelity anticipates that customers will become well familiar with point-of-sale disclosure and will request to opt out from having this information repeated to them on a regular basis as they add to existing positions. We believe that providing all of the required point-of-sale disclosures during each representative-assisted telephone order will likely frustrate most investors and impose an undue burden on placing trades through telephone interactions with sales representatives. The problem will be exacerbated in cases where a customer wishes to place multiple fund trades in a single call.

For example, if a customer wants to rebalance her mutual fund portfolio by selling down one fund and investing the proceeds in three other funds in which she already holds positions, we question whether it is helpful for the customer to be subjected to three rounds of point-of-sale disclosure prior to placing the multiple transaction order. Fidelity therefore requests that the final rules allow for flexibility for phone based interactions. In particular, the rules should allow our representatives to ask a customer, if he previously has received point of sale disclosure for a particular fund, whether he would like to hear point-of-sale disclosure or opt-out from hearing that disclosure.

- Similarly, we anticipate that customers will become familiar with point-of-sale disclosure terminology and will request to opt out from hearing recitation of defined terms and detailed explanations of fees and charges with which they are already familiar.

- We believe that providing a customer, in subsequent purchases of a fund, the choice of receiving oral point-of-sale disclosure or opting out of such disclosure should be sufficient to satisfy the disclosure requirement of 15c2-3(b).

- In-Person Meetings. Fidelity supports point-of-sale disclosure requirements for orders placed during in-person meetings between customers and representatives of covered persons (unless the transaction falls within our proposed exemption for Directly Sold Covered Securities).

E. Exception for Discretionary Accounts Managed by Affiliated Advisers. The Commission has proposed an exception to the proposed point-of-sale rules for discretionary accounts managed by brokers.

Fidelity's affiliated retail broker offers customers a managed account service, but the account is managed by another affiliate, a registered investment adviser, Strategic Advisers, Inc. We urge the Commission to extend the managed account exception to accounts managed by registered investment advisers who are affiliates of broker-dealers. Both broker-dealers and advisers are registered with the Commission, are subject to the Commission's inspection and record-keeping regulatory powers, and owe fiduciary duties to their customers. Extension of the managed account exception to advisers, we submit, would not undermine any investor protection or other public policy purpose advanced by the proposed rules.

We also suggest that, in cases where the point-of-sale disclosure requirements do not extend to a broker-dealer or adviser exercising investment management discretion on behalf of a customer, the final rules should make clear that there is no point-of-sale disclosure owed to that customer.

F. Third-Party Trading Authorization. Retail brokerage customers routinely grant full investment discretion or trading authorization to other types of third parties, apart from brokers or advisers. These may include certified public accountants, relatives, or attorneys. In instances where a third party is exercising authority to place an order in a covered security with a covered person, the final rules or adopting release should clarify that point-of-sale disclosure is owed to the party exercising investment discretion, not to the beneficial owner of the account. Confirmation of the trade, however, would be required to be provided to the record owner of the account at the address of record.

III. The Retirement Market Place

A. The Commission's Position on Retirement Plans. Under long-standing interpretations of the applicability of Rule 10b-10 to defined contribution and other retirement plans, the Commission has treated the fund's shareholder of record to be the plan itself, rather than the plan participant. In proposing Rule 10b-10 the Commission made clear that:

> "The rule is not intended to require the delivery of monthly or quarterly statements to participants in a plan where a trustee for the

> plans is the shareholder of record of the securities being purchased or sold. Paragraph (a) of the rule would require only the delivery of a confirmation to the plan trustee."[14]

In 1994, the Commission confirmed that:

> "As…noted in the release originally adopting Rule 10b-10, the Rule is not intended to require a broker-dealer dealing with the trustee of a plan to deliver statements to plan participants where the trustee is the shareholder of record of the securities being purchased or sold. In those instances, the Rule would require the broker-dealer to deliver a confirmation, or upon written request, a periodic report, only to the trustee. A beneficiary of the trust would be required to receive an immediate confirmation, or upon written request, the periodic report, only if that beneficiary was a beneficial owner of the trust assets on the books of the broker-dealer, enjoying the rights and privileges of beneficial ownership."[15]

This approach to confirmation requirements reflects the Commission's longstanding position on ERISA plans generally, that is, to look to the shareholder of record, the plan trustee. While the staff has recommended that the Commission seek legislation to amend the Securities Act, the Investment Company Act and the Exchange Act to extend prospectus delivery and disclosure requirements directly to plan participants, Congress has not done so.[16] We understand that the point-of-sale and confirmation proposals are consistent with the Commission's positions, maintained for nearly 30 years, concerning confirmation delivery to retirement plans.[17]

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[14] 1976 SEC LEXIS 814, supra note 15, at 6-8. See also Rule 10b-10, Exchange Act Release No. 13508, 1977 SEC LEXIS 1818 (May 5, 1977), adopting Rule 10b-10, in which the Commission stated: "As the Commission noted in proposing Rule 10b-10, the rule is not intended to require a broker dealing with the trustee of a plan to deliver statements to plan participants where the trustee is the shareholder of record of the securities being purchased or sold. Paragraph (a) of the rule would require such a broker only to deliver a confirmation to the plan trustee."

[15] Amendments to Rule 10b-10, Exchange Act Release No. 34962, 1994 SEC LEXIS 3503, *16 (November 10, 1994).

[16] Division of Investment Management, SEC, Protecting Investors: A Half Century of Investment Company Regulation, at 151 (May 1992).

[17] The Proposing Release is quite careful to point out that the Commission does propose to reverse one of its positions – also found originally in the 10b-10 adopting release and then reiterated in a 1979 no-action position – to the effect that prospectus delivery with a confirmation would provide adequate remuneration disclosure.

In keeping with the applicability of the confirmation rules to retirement plans, we understand that point-of-sale disclosure will be required to be provided to the plan trustee or sponsor of a retirement plan, rather than plan participants. We request that the Commission confirm in the adopting release for the proposed rules that point-of-sale disclosure should be made to shareholders of record rather than plan participants.

Further, we note that the Proposed Rules pertain to "covered securities" issued by investment companies. As plan participants do not hold investment company shares, but instead are participants in a retirement plan that holds the shares, we take it that the Commission does not view interests in a retirement plan as "covered securities" and we request that the Commission confirm this view in the adopting release as well.

B. Point-of-sale Disclosure for Plan Sponsors. Fidelity suggests that repeated point-of-sale disclosure for each daily order entered by a plan sponsor would be superfluous for retirement plan sponsors, given that plan sponsors must conduct extensive due diligence as part of their ERISA fiduciary duties before selecting a fund as a plan option. We urge the Commission to provide in the final rules that point-of-sale disclosure requirements are met when disclosure is made to the retirement plan sponsor at or prior to the time that the plan sponsor introduces a fund as a plan option.

IV. Institutional Market

A. A Proposed Institutional Exception. We believe that institutional customers, as sophisticated investors, do not need point-of-sale disclosure to reach informed investment decisions. Therefore, we support an exception for "institutional investors," as defined in NASD Conduct Rule 2211(a),[18] as recommended by the ICI. This exemption would also address funds of funds, where transmission of point-of-sale disclosure to a registered investment company investing in an underlying fund would be superfluous.

B. Registered Investment Adviser Channel. Fidelity's affiliated broker-dealers provide brokerage services to third parties who are registered investment advisers exercising investment discretion for their customers of Fidelity's retail broker-dealer. For the reasons cited above, we recommend that the final rules make clear that point of sale disclosure requirements are met if such disclosure is made to the party exercising investment discretion.

[18] NASD Conduct Rule 2211(a)(3) defines an institutional investor to include a bank, savings and loan association, insurance company, registered investment adviser registered with the Commission or with a state securities commission, a person with total assets of at least $50 million, a governmental entity or subdivision thereof, an employee benefit plan meeting the requirements of Section 403(b) or Section 457 of the Internal Revenue Code having at least 100 participants, a qualified plan as defined in Section 3(a)(12)(C) of the Exchange Act that has at least 100 participants, an NASD member or registered associated person of such member, or a person acting solely on behalf of any such institutional investor.

V. Intermediary Market

Fidelity manages a line of funds sold through financial intermediaries, who, under the proposed rules, are covered persons and subject to point-of-sale and confirmation disclosure requirements.[19] Our Fidelity Advisor Funds are multi-class funds, offering institutional shares, front-end load, level-load and contingent deferred sales charge shares. Some of these classes offer features such as sales-charge volume discounts, rights-of- accumulation and reinstatement privileges. Most share classes charge Rule 12b-1 fees. The amounts paid on each share class to the selling firm vary.

A. Deferred Sales Charges. We urge the Commission, in the final rules, to refrain from adopting the proposed exemption from point-of-sale disclosure requirements for deferred sales charges that are less than 1% of net asset value and in effect for less than one year. There simply is no principled basis for this proposed exemption. In any transaction subjecting a customer to a deferred sales charge, she is entitled to point-of-sale disclosure. This is true whether that charge is 1% and in effect for one year or is 0.99% and in effect for 51 weeks.

B. Comparison Range Disclosure. As proposed, Rule 15c2-2(e) and Sections B and C of Schedule 15C would require confirmations to include comparison range disclosure relating to revenue sharing payments and fund portfolio commissions, sales charges, sales fees, 12b-1 fees and service fees. Fidelity believes this proposal has the potential to be of significant benefit to investors but the Commission should defer adoption to allow for further study. Several private firms, including Lipper and Morningstar, have developed extensive databases of fund expenses that differ in their methods for defining peer groups for comparisons. No firm to our knowledge currently maintains a database of revenue sharing payments. If the SEC were to undertake to develop standardized peer group methodologies and specific cost figures for comparison before mandating comparison range disclosure, investor understanding of expenses would be markedly enhanced.

The development of such standards will likely be a significant undertaking, and we are concerned that the proposed rules may not reflect this. We therefore recommend that the Commission solicit further comment on comparison range disclosure separately from the point-of-sale and confirmation requirements, so that the time frame for implementation of each proposal, and the related costs and benefits, may be considered separately.

VI. Clearing Brokers

[19] Point-of-sale disclosure is likely to pose burdens for some intermediaries, particularly for smaller independent investment consultants who meet with customers in their homes.

We provide clearing firm brokerage services through our affiliate, National Financial Services LLC. We also distribute Fidelity Advisor Funds through intermediaries including brokerage firms, banks, insurance companies and other investment professionals that, in turn, offer the Advisor Funds to individuals and retirement plans.

A. Audit Requirement. The Commission has proposed that in order to take advantage of the point-of-sale exemption a clearing firm or primary distributor must "reasonably believe" that another broker-dealer has made point-of-sale disclosure. The reasonable belief standard may be satisfied through contractual arrangements and regular auditing practices conducted by the clearing firms or principal distributors. Fidelity is concerned over the prospect of having to audit thousands of intermediaries and introducing brokers. We request that the Commission eliminate the audit component of the proposed reasonable belief standard and permit contractual arrangements alone (typically, clearing and selling agreements) to satisfy the reasonable belief standard.

Intermediary Channel. Fidelity acts as a wholesaler of its Fidelity Advisor Fund line, sold through thousands of financial intermediaries. These intermediaries typically will conduct point-of-sale interactions, with disclosure required in keeping with the selling broker-dealer's duty to deal with its customers fairly. Absent modification of the proposed rules, principal underwriters of funds will be required to conduct repeated and costly audits of these intermediaries to confirm point-of-sale disclosure. The likely consequence of such a requirement not only will be significant costs and burdens for principal underwriters but also a narrowing of funds offered by intermediaries, who will seek to minimize the number of audits to which they are subject. These results, we submit, will not further the interests of investors.

- Clearing Brokerage. The proposed audit requirements also are likely to place considerable burdens and dislocations on clearing firms, creating new obligations at odds with the long accepted allocation of duties between introducing broker and clearing broker. Central to the clearing business model, reflected in the regulatory framework, has been the introducing firm's sole liability at the point-of-sale.

  As approved by the Commission in 1982, New York Stock Exchange Rule 382 permits clearing firms and their correspondents to allocate their respective responsibilities through clearing agreements. Amendments in 1999 ensured that the SEC and other regulators would have access to sufficient data to support monitoring and inspections. We urge that the point-of-sale disclosure rules reflect this approach.

> In particular, the final rules should allow for agreements between an introducing broker and clearing broker that assign to the former the duty to make point-of-sale disclosure to its customers. The final rules should refrain from imposing any audit requirement upon the clearing firm with regard to the introducing broker's adherence to this duty. Failure of the final rules to do so will unduly heighten the exposure of clearing brokers to liability that should be borne by introducing brokers, leading to higher expenses that will be passed on to introducing firms and ultimately to their customers.

B. Solicitation Practices. We ask that the Commission clarify in the adopting release that any introducing broker who solicits an order at point-of-sale cannot avoid its point-of-sale obligations unless a clearing firm or other broker-dealer expressly agrees to take on the sole obligation for confirmation disclosure. In the event of ambiguity in contractual arrangements between an introducing broker and a clearing broker, the burden should be on the former.

VII. Suggested Revisions to the Proposals Applicable in All Markets

Fidelity makes the following recommendations, applicable to all distribution channels.

A. Short-Term Transaction Fees. Covered persons should be required to disclose the terms of any short-term transaction fees that they retain as a form of compensation and should not be permitted to refer to any such fees as "redemption fees." To avoid confusing or misleading investors, the term "redemption fee" should apply only to fees remitted to funds.

B. Disclosure of Standard Definitions. We also ask that standard definitions be excluded from the confirmation, provided that these definitions have been provided in the point-of-sale disclosure. By the time a customer receives a confirmation, he has already placed his order and the information is duplicative. We recommend that Form N-1A be amended to include the definitions in the Statement of Additional Information, so that they will be available upon request. Since investors can always request an SAI, they will have ready access to the definitions if need be.

C. Definition of Revenue Sharing. Fidelity fully supports disclosure of revenue sharing payments made to an *unaffiliated* broker, dealer or municipal securities dealer of any associated person.

- Inter-company payments. Fidelity urges the Commission in the final rules or adopting release to clarify that revenue sharing does not include inter-company payments within a fund complex relating to the sale of

> proprietary funds, provided that such payments do not support differential compensation for sales personnel. These inter-company payments typically are necessary or desirable for regulatory or tax reasons, but in any event have no significance to the investor. For example, we note that when affiliated companies are located in different states, one fee payment will be divided, commensurate with the respective services provided, among such companies for the purpose of determining how tax liabilities should be allocated among the states in which these affiliates are paid. These payments "shared among" affiliates do not constitute "revenue sharing" in the generally understood meaning of that term. Further, inter-company transfer payments do not present potential conflicts of interest.

D. Extension of Rules to Banks. Potential of conflicts of interest in the sale of mutual funds is not limited to registered brokers, but applies to all financial intermediaries. Fidelity urges the Commission to expand the group of covered persons to include not only brokers, dealers and municipal securities dealers but also to banks functioning as brokers or dealers. Without such an expansion, banks would be afforded an inappropriate advantage and mutual fund investors would be disserved.

E. Inclusion of Exchange-Traded Funds (ETFs). ETFs generally would fall within our proposed exclusion for Directly Sold Covered Securities since they typically have no load or 12b-1 fees. But many ETFs are management investment companies and as such could engage in directed brokerage or differential representative compensation, or in similar arrangements that ought to be disclosed. Accordingly, blanket exemptions from the point-of-sale and confirmation rules for investment companies are not warranted.

Moreover, the mere fact of the existence of a secondary market for a fund's shares does not preclude the potential for conflicts of interest that ought to be disclosed. While existing ETFs may not present the need for point-of-sale and confirmation disclosure, we do not disregard the possibility that disclosure may be necessary in the future. We see no reason as a matter of public policy or competitive equity, for exempting an ETF when an equivalent index fund (which could be another class of the same ETF) with no secondary market would not be so exempted. Therefore, we believe that ETFs should be subject to the point-of-sale and confirmation requirements unless an exemption would apply, such as the one we propose above for Directly Sold Covered Securities.

F. Portfolio Securities Transactions: Coordination with Other Commission Rulemaking Proposals. After issuing the Proposing Release, the Commission issued proposals to prohibit the use of brokerage commissions to fund the distribution of mutual fund securities.[20] Also, the NASD has filed with the Commission proposed amendments

[20] See SEC Release No. IC-26356 (Feb. 24, 2004), for which comments are due May 10, 2004.

to NASD Rule 2830(k) that, if approved, would prohibit directed brokerage arrangements.[21] Fidelity urges that the Commission ban the practice of directed brokerage.

Assuming that the practice is not banned, Fidelity believes the Proposed Rules are ill-conceived as they relate to portfolio securities transactions. Consistent with best execution obligations, Fidelity does place trades for its managed funds with many brokers, most of which are likely to sell Fidelity Funds or Fidelity Advisor Funds. The Commission should amend the definition of "portfolio securities transactions" to mean only those effected, directly or indirectly, in consideration of the broker's sale of mutual fund shares. This amendment would allow investors to identify brokers that refuse to accept reciprocal directed brokerage and to distinguish them from those that do persist in this practice.

G. Conditional Customer Orders. In order to ensure fairness, the Commission should impose some time limit on a customer's right to rescind a transaction when a covered person fails to deliver point-of-sale disclosure. A customer should not be given the opportunity to track the price of the stock over a long-term period and seek a downward trend in the price as an opportunity to seek a rescission, particularly after receipt of a confirmation containing all of the information that would have been provided in point-of-sale disclosure. Moreover, in every commercial relationship the injured party has a duty to mitigate damages.[22] In order to eliminate doubt as to what an investor's duties are to mitigate losses, Fidelity suggests that proposed Rule 15c2-3(b) be modified to impose a 30-day limit on an investor's rescission right after the confirmation has been sent.

Additionally, we request that the Commission clarify in the final rules that the liability for failing to make point-of-sale disclosure rests with the broker-dealer, and not the fund. While this is inherent in a confirmation rule, the Commission is also amending Form N-1A and should take care to make explicit that funds are not liable for a broker-dealer's or other covered person's non-compliance with the proposed rules.

H. Exchange Transaction Requirements. Fidelity asks that the Commission clarify how covered persons would comply with point-of-sale requirements for exchange transactions. We suggest that the Commission direct covered persons to use the last calculated net asset value of the covered security to do an estimated calculation, and to fully disclose the basis of these calculations and that they are estimates. Assuming that

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[21] See Proposed Amendment to Rule Relating to Execution of Investment Company Portfolio Transactions, File No. SR-NASD-2004-027 (Feb. 10, 2004).

[22] Unless amended as proposed, the Commission's conditional order concept in 15c2-3(b) may render mutual funds a high risk product for brokers to sell, and will make them uncompetitive with individual securities, managed separate accounts, wrap fee programs and hedge funds.

only estimates are possible for most mutual fund transactions, we question the focus in the release on rounding errors.

VIII. Fund Prospectuses (Form N-1A)

The Commission has proposed to amend Form N-1A to require that if any revenue sharing payments are made by a mutual fund, the fund disclose in the prospectus the fact that specific information about revenue sharing payments to an investor's financial intermediary is included in the point-of-sale and confirmation disclosure. We fully support prospectus disclosure and amending Form N-1A, subject to the comments set out below.

A. Funds Should Not Be Liable for Broker-Dealer Disclosure Failures. Mutual funds are issuers subject to liability under the Securities Act of 1933. We are of the view that the prospectus should not be required to contain a statement declaring that investors *will* receive certain disclosure from a covered person, because it is not within the power of the fund or its distributor to deliver the requisite disclosure. A more appropriate disclosure along these lines would be that "the financial intermediary has a legal obligation to provide investors" with this information. Mutual fund issuers and their managements should not be liable under Section 11 and Section 12 of the Securities Act of 1933 in the event that a broker-dealer does not honor its Rule 15c2-2 and 15c2-3 duties.

B. Mutual Fund Prospectus Fee Tables and Rounding. The Commission proposed that covered persons disclose in a confirmation a comparison between the load charged and the load that should have been charged according to the prospectus to identify any discrepancies attributable to rounding. Fidelity believes that the most useful place to address rounding is in disclosure proximate to the fee table to the effect that actual amounts charged may vary from the percentage amounts disclosed in the fee table, due to rounding. Moreover, in the case of exchange transactions where estimates are likely to be used in all point-of-sale calculations, providing information aimed at highlighting rounding discrepancies would not serve any beneficial purpose. Therefore, we propose that the Commission dispense with this proposal as it relates to confirmation disclosure.

IX. Transitional Rules

Fidelity believes that the proposals, while very beneficial to investors, will require an extraordinary undertaking by the brokerage and mutual fund industries and therefore requests an 18 month transition period from the publication of the final rules to implement the necessary systems and process changes.

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We appreciate the opportunity to comment on this important initiative and congratulate the Commission for its proposal. If we may be of further assistance to the Commission, please contact either the undersigned or Stuart Fross at 617-563-7000.

Sincerely yours,

Eric D. Roiter

cc: The Honorable William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
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