FIF Financial Information Forum

April 12, 2004

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

Re: Proposed Rules 15c2-2 and 15c2-3 and Proposed Amendments to Rule 10b-10 (File S7-06-04)

Dear Mr. Katz:

The Financial Information Forum (FIF) Service Bureau Committee appreciates the opportunity to comment on the above referenced proposed new rules which would require broker/dealers to disclose additional information to investors on purchases of open-end mutual funds and other similar investment products. Formed in 1996, The Financial Information Forum is a brokerage industry organization dedicated to the improvement of brokerage industry information and transaction processing systems. Members of the FIF Service Bureau Committee are service bureaus that develop back office software and run data centers for approximately 1500 broker/dealers.

FIF members focus on critical issues and productive solutions to technology developments, regulatory changes, and other industry changes. The FIF Service Bureau Committee has previously worked closely with regulators and industry utilities on technical implementation considerations for such projects as OATS, INSITE, Decimalization, TRACE and the Patriot Act. We are currently working with NASD, MSRB and NSCC on the implementation of Real Time Trade Matching (RTTM) and with the NYSE on the Order Tracking System (OTS).

Proposed Rule 15c2-3 mandates disclosure in writing at the point of sale of various financial incentives that the registered representative and / or the broker/dealer may receive in connection with the purchase of a mutual fund by an investor. Proposed Rule 15c2-2 would require similar disclosures on the trade confirmation sent to the investor after the execution of the purchase. In addition, proposed amendments to Rule 10-b10 remove requirements for trade confirmations that currently relate to mutual fund trades, which would be superseded by the new Rule 15c2-2, while adding new requirements for confirmations of transactions in preferred stock and callable debt securities.

As service providers to brokerage industry, we would be directly engaged in modifying existing systems or building new ones to meet the requirements of these new rules. First, we would like to comment on the feasibility and cost of implementing the new proposed rules. Second, we would like to offer some observations from a business perspective of the objectives of the new proposed rules and suggest some alternatives that may achieve those objectives that are less costly.

Estimating Time and Costs

In Section IX of the release, the Commission estimates the one-time costs of compliance with new proposed Rules 15c2-2 and 15c2-3 would be $750 million and $450 million respectively. Despite the enormity of these numbers, we believe that these estimates may be too low.

Compliance with the Proposed Rules as written would require multiple projects. In the following section, some of our members have estimated costs of some of the projects we would expect to have to complete. The costs of just the projects we have estimated, which represent less than half of the work we see as required, are nearly $10 million per service bureau. As service bureaus that support multiple broker/dealers,

we offer our clients some economy of scale in that our work on one system benefits multiple broker/dealers. In the same way, some large clearing brokers provide the same economy for their introducing brokers. However, there are still a large number of self-clearing broker/dealers who maintain their own back office systems. Each of those firms would incur the same costs we would in building the systems infrastructure needed to comply with the proposed rules. Overall, we suspect that the Commission's overall estimate of one-time costs for compliance with the new rules is underestimated by 50% to 100%.

In calculating costs for these projects, the Commission used an hourly rate of $50 per hour, which, for this kind of system development, is far too low. For estimation purposes, we used between $100 and $150 per hour as the cost of systems development resources. If we have to hire consultants, which could result from an aggressive implementation date, that cost could increase to as much as $300 per hour.

Required Projects

The structure and capabilities of each broker/dealer or service bureau's existing systems would dictate the design of solutions for these new requirements; however, were the Proposed Rules and rule changes above to be approved and implemented in their current form, we see at least four major projects that would be required:

1. New Rules Database and Call Process – This project would identify all the data required to perform the calculations for the new mandatory disclosures. It would also include utilities to maintain data that does not currently exist elsewhere in the system and the rules for performing the calculations on a trade-for-trade basis. If some of the data required to perform the necessary calculations is available from outside sources (e.g. the mutual fund companies, NSCC's Networking process or a broker/ dealer's separate compensation system), this project could require interfaces to outside systems. In the event that interfaces are required, this project would likely be divided into separate sub-projects to deal with each required interface.

2. New Mutual Fund Confirmation Process – This project would create an entirely new process to build mutual fund trade confirmations according to the specifications of the new Schedule 15C.

3. Mutual Fund POS Disclosures / Mutual Fund Order Entry Process – This project would identify eligible orders and call the Rules Database for the required disclosures prior to acceptance of the order. It would also update the firm's books and records as needed with evidence of the required disclosures and interface with a print utility to produce a hard copy of the disclosures for the client.

4. Modify Current Trade Confirmation Process to Exclude Mutual Funds and Include New Requirements for Preferred Stock and Debt – Most broker/dealers currently have a process for producing trade confirmations to comply with Rule 10b-10 that is at least somewhat integrated for all products. This project would modify the broker/dealer's existing trade confirmation process to exclude mutual funds and include the new required data for preferred stock and debt.

New Disclosure Data and Rules - Both the new mutual fund trade confirmations and the point of sale disclosures are dependant upon data that for the most part does not already exist in a broker/dealer's books and records system. Both rules also require calculations to provide the required disclosures to the investor on a per-trade basis. In the Proposed Rules, The Commission has provided a template for each calculation, but there are clearly many details to be worked out to arrive at final formulas. Each of the new data elements required for a confirmation or a point of sale disclosure must be calculated based on a unique set of data. This new data would have to be integrated with the firm's Security Master Database that also must be cross-referenced by mutual fund family if the system does not already have that feature.

To assemble the required data, we would need to build utilities into the back office system for the broker/dealer to enter and maintain the data so that it would be available to both the order entry and trade

confirmation processes. Much of the data required, such as revenue sharing and dealer concession amounts do not already exist in a broker/dealer's back office system. So the broker/dealer would either have to identify a source from which this data is available, or enter and maintain it manually. In either case, the utilities to support this database would have to include audit trails and supervisory reports that would notify responsible parties when the necessary data is not available or is not current.

This first project has the potential to become enormously complex, particularly if some of the required data is housed in secondary systems or sourced from other vendors. An example of this situation is the data required to determine if the firm is offering differential compensation. Many firms only calculate commissions and fees to the customer level in their core back office system. To calculate payouts to individual registered representatives, they use stand alone software packages which use a download of daily trades as input. Since the payout ratios would be necessary to determine if the individual registered representative was receiving differential compensation on a particular trade, it would be necessary in this scenario to build a new interface to access that compensation data and determine if differential compensation was paid. Another example would be if a clearing broker and several of its introducing brokers had separate compensation arrangements with a mutual fund company. In this circumstance, the database would have to have two levels of revenue sharing data – one for the clearing firm and another for the introducing firm - that could be rolled up for customers of the introducing firm. If complications such as these did arise, we would probably initiate a separate project to address the additional requirements.

Using the $150 per hour rate and assuming no extra complications such as the two described above, one service bureau estimated this project as a six-month development effort costing $4 million. This estimate assumes that the resources (both human and programmatic) necessary to execute this project are available as soon as requirements for the project are finalized. Given the current regulatory environment, it is likely that there will be dependencies that will extend elapsed time to complete this project beyond the duration of the development effort. For a further discussion of *Dependencies and Their Impact on Time to Market*, please see the next section below.

Mutual Fund Confirmations **-** Currently, the production of trade confirmations for mutual fund trades in a broker's back office system is largely integrated with that of other investment products (equities, options, fixed income products, etc.). Each product has its own unique characteristics; but, for trade confirmations there are more similarities than differences, and the few differences can be accommodated in the confirmation production process.

Proposed Rule 15c2-2 introduces both new data requirements and a new confirmation format (Schedule 15C) that are so substantially different and unique to mutual funds, we think an entirely new process would be required. This new process to produce confirmations for mutual fund trades would have to run separate from and parallel to the existing processes that produce confirmations for other investment products. This approach reduces risk to the existing confirmation process and will likely reduce some development costs; however, it is likely to increase ongoing maintenance and production support costs. Running two processes that must handle some of the same data is inherently less efficient that having one process that can do both tasks.

Once the decision is made to create a new and separate process to produce the new mutual fund confirmations, the biggest challenges will be in formatting the confirmation according to the final specifications for Schedule 15C and making the process as technically efficient as possible to minimize the additional operational resources required to run two parallel confirmation production processes. Undoubtedly, different broker/dealers will opt for different presentations as much as they are allowed within the final rules. As service bureaus, we will likely work with our multiple clients to provide the data in a generic format that a broker/dealer can customize with their name, logo, etc. Some of our clients may want a greater degree of customization which could be provided by a specialized print vendor at some additional expense to the broker/dealer. One of our members estimated the development costs of this project at $1.5 million.

Point of Sale Disclosure **–** The point of sale disclosure requirements present a different set of development challenges than confirmations. First, this new process must be integrated with the broker/dealer's order entry process, which is inherently sensitive because of the risk associated with order taking and timely execution. Second, the new process must be capable of producing a customized written document for the investor. Finally, the new process may also have to be integrated with the broker/dealer's client account information database if the broker/dealer wants to maintain a record of disclosure and acknowledgement by the investor.

We have not estimated the time and effort required to complete this project; however, one of our service bureaus did estimate the cost of maintaining the data produced in the point of sale disclosures at $5 million annually.

Modify the Current Trade Confirmation Process - The fourth project would be primarily focused on modifying the broker/dealers existing process for trade confirmation to remove mutual funds and add the new requirements for preferred stocks and callable debt. This project would be much smaller that the other three, with cost estimates by one service bureau of just over $300,000.

Dependencies and Their Impact on Elapsed Time to Market

Other regulatory initiatives in progress that impact mutual fund business and systems will have a direct impact on time required to comply with the Proposed Rules. Multiple initiatives are currently underway to address issues in the mutual fund industry including proper application of breakpoints, after hours trading and hyperactive trading. When the Proposed Rules are put in their final form and the Commission chooses a mandatory date for compliance by broker/dealers, we urge you to consider the full scope of regulatory mandates in progress at that time.

Multiple mandatory changes create dependencies among projects and the resources available to complete them. Some work on related projects can be done concurrently and some cannot. For example, the Mutual Fund Confirmations and Point of Sale projects described above would be dependant on the Data and Rules project. Some of the work on these two projects could run concurrently with the development of the Data and Rules project, but a significant amount of work would have to wait until the Data and Rules project was complete and available.

Some resource constraints can be resolved by simply adding staff, but others cannot.   In some cases, the resource in question is a key part of the system, such as a trade processing system or a security master file. When key components such as these require changes for different projects, it is often necessary to limit the scope of changes at one time to those required for one project. Trying to complete changes to one process to satisfy requirements for two projects at one time introduces risk to both projects and increases the overall development costs.

In these circumstances, one project must be given precedence and be allowed to progress through testing and release before we start on the changes required for a second project. The result is that although the development effort required to complete a project may not change, the elapsed time to market will be extended because some of the work required cannot proceed until the resource (the program or the file) is available. As initiatives to address issues in the mutual fund industry such as proper application of breakpoints, prohibition of hyper-trading and mandatory disclosures progress, we expect to encounter these kinds of dependencies which will impact the dates by which we can complete work to comply with the new rules.

Business Objectives and Alternatives

In principal, we agree with the Commission's position that additional information should be made available to the individual investor if it creates a potential conflict of interest for the broker/dealer. The investor should be informed of situations like differential compensation to the registered representative and revenue sharing or portfolio brokerage arrangements with the broker/dealer.
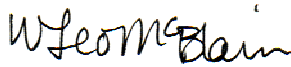
Our objections to the Proposed Rules are the scope and the enormous costs that these rules would impose on the industry. Overall, we believe that the Rules as proposed would create a significant disincentive for broker/dealers to market what might well be the most suitable investments for small investors.

Quantifying the financial incentives on a trade for trade basis seems excessive and frankly unnecessary. We believe that qualitative disclosure that such incentives exist (or do not exist) and free access to disclosure tools (such as a web based calculator or a toll free number) would serve to inform the individual investor adequately to make an informed investment decision.

The SIA has proposed that broker/dealers provide information about financial incentives via websites or toll free telephone numbers. Calculators could be developed and maintained relatively inexpensively that could calculate "what if" scenarios and provide investors with the same kind of data proposed by the Commission. If the rules for confirmations and point of sale disclosure were limited to a qualitative disclosure that particular incentives do or do not exist, this information could be integrated with existing order entry and confirmation processes relatively simply and at a reasonable cost.

We believe that the approach recommended by the SIA has merit and should be considered carefully. Should the Commission proceed with the Rules as currently proposed we believe that it would require a minimum of two years to implement all the provisions. By contrast, rules requiring simple qualitative disclosure at the point of sale and an additional trailer or trailers on trade confirmations could be implemented in a year or less from the publication of the final requirements.

Respectfully submitted,

W. Leo McBlain
Chairman
Financial Information Forum
mcblain@fif.com
212 422 8568

Thomas J. Jordan
Executive Director
Financial Information Forum
tjjordan@fif.com
212 652 4460