FINANCIAL SERVICES INSTITUTE

VOICE OF THE INDEPENDENT CONTRACTOR BROKER-DEALER

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VIA ELECTRONIC MAIL

April 12, 2004

Jonathan G. Katz, Secretary
U.S. Securities & Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: File No. S7-06-04 – Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities ("Proposed Rules")

Dear Mr. Katz:

The Financial Services Institute[1] ("FSI" or "the Institute") appreciates the opportunity to comment on the Proposed Rules that would require broker-dealers to provide their customers with targeted information at the "point of sale" and in transaction confirmations regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, unit investment trust ("UIT") interests (including variable life insurance and variable annuities), and municipal fund securities used for education savings (so-called "529 plans").

FSI strongly supports efforts to help investors get all the information they need in order to make informed decisions about investing in mutual funds. Investors need to have a complete picture of the costs of investing in a particular fund, and they need to be fully aware of all potential conflicts of interest on the part of the adviser recommending a fund. However, the Institute is very concerned that the Proposed Rules will not achieve their intended purpose and instead will make investing in mutual funds more confusing for the average investor. We are also concerned that the costs imposed on the broker-dealer community by the Proposed Rules would make it more expensive for the average investor and eliminate many investment choices.

The proposal raises a host of issues ranging from major policy considerations to technical and logistical problems. The following points are intended to highlight these issues:

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1 The Financial Services Institute, Voice of the Independent Contractor Broker-Dealer, was formed on January 1, 2004. Members of the Institute are broker-dealers and registered investment advisers that serve representatives who are independent contractors. As of March 31, 2004, the Institute has 82 member firms, averaging over 1,000 registered representatives per firm and nearly $100 million in Total Revenues per member firm. FSI was formed with the support and assistance of the Financial Planning Association (FPA™). Our vision is for independent contractor broker-dealers to be recognized as the preeminent providers of comprehensive financial services in America through their growing networks of highly competent independent financial professionals.

1. **Disclosure of "Important" Not Defined** - The objective of the Proposed Rules appears to be focused on a retail customer who does not understand the complexities of the securities industry, yet demands disclosure of far more detailed information than such a customer could reasonably be expected to comprehend or to use in his or her investment decision-making. The Proposed Rules create an open-ended obligation to disclose anything important, but the Commission has not adequately defined what is "important." The term is vague and subjective and should be either defined or deleted. The Commission appears to use "transparency" as a buzzword in the Proposing Release.

2. **Costs to Customer Already Disclosed** - Full disclosure about the out-of-pocket costs a customer will incur as a result of purchasing a Covered Security is essential in the principal-agency relationship between a broker-dealer and its customer, but

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already address those concerns. All other distribution-related costs paid, directly or indirectly, by a mutual fund complex are reflected in each fund's bottom line performance. Fund performance is a straightforward and a well-publicized benchmark that is easily understood by a retail investor. While all the cost data is academically interesting, the apparent target audience is ill-equipped to use the data but, ultimately will have to pay for it through increased brokerage costs.

3. **Distribution Costs Should Be Disclosed by Funds** - Disclosure of distribution costs is fundamentally the obligation of the mutual fund complex since it controls all of these costs and the myriad of ways in which those costs are incurred. Prospectus disclosure can identify those costs and the fund's historical performance and cost data simply and accurately report the effects of those costs. The data gathering, administrative and disclosure burdens (and related liability for data errors) is being unfairly transferred to the brokerage industry. A predicate underlying the SEC's reasoning is that more detailed disclosure will force the industry to lower costs, and that lower costs will result in better investment performance. Of course, it is the mutual fund industry that controls those costs and there are many more variables affecting investment performance. The SEC is likely underestimating the dramatically increased cost of obtaining and delivering these disclosures, which will be largely borne by investors.

4. **"Application-way Business" Negatively Impacted** – Many investors, after an initial mutual fund purchased with the assistance of a financial advisor, will make subsequent purchases or exchanges directly with the mutual fund or insurance company. This is known as "check and application" or "application-way" business, in which the execution, confirmation and clearance of the transaction is handled by the fund, not the broker-dealer. The broker-dealer learns of the transaction only when commission data is received, thus making point of sale disclosure virtually impossible. This alternative for investors would be substantially curtailed or eliminated by the Proposed Rules.

5. **Fund Companies Not Required to Provide Information to Broker-Dealers** – In order to comply with the disclosure requirements, broker-dealers would need additional information from mutual fund companies, which they are not mandated to provide by the Proposed Rules.

6. **Disclosure Requirements are Complex** - The required disclosures in the Proposed Rules are extremely complex and equally difficult for the average retail investor to comprehend. Forecasts of future hypothetical expenses may be confusing and could be potentially misleading. The quantity of information to be disclosed rises to the level of analyst information, rather than investor information. When given a one- or two-page disclosure document twice for each transaction, one wonders whether a retail customer would quickly become numb from the volume of data.

7. **Conflict Disclosures Unnecessarily Detailed for Retail Customers** - Disclosure of conflicts of interest are important to an investor's decision-making, but identifying conflict does not require the degree of detail prescribed by the Proposed Rules. The mandated level of detail is disproportionately expensive to obtain for firms, especially those with a parent controlling funds or variable products and multiple broker-dealers and investment advisers when judged by how the average retail investor could or would use the information. Specific dollar amounts over a short time frame have no context to reasonably enable the client's decision process relative to the potential for conflict. Also, it would be virtually impossible for firms to comply with the section of Proposed Rule 15c2-2 that requires disclosure of certain "anticipated" compensation. The disclosure requirements for conflicts of interest also cover sales contests, which may be short-lived and require nearly real-time updating in the disclosures.

8. **Disclosure Requirements are Repetitive** - The disclosure requirements are repetitive. They create many new disclosure requirements for broker-dealers to make not once but twice (and sometimes even three separate times in the case of certain oral point of sale disclosures). One-time disclosure should be sufficient if the disclosure is made in writing. Furthermore, disclosure must be made on a transaction-by-transaction basis, regardless of whether it is appropriate. Given the cost associated with implementing the Proposed Rules, there is little benefit in requiring disclosure of the same information three separate times, i.e., in the face-to-face meeting, in the prospectus, and on the confirmation. Moreover, customers cannot avoid the deluge of paper and information even if they would choose to do so.

9. **Institutional Investors and Professional Managers Treated the Same** – The Proposed Rules draw no distinctions between retail sales and sales to institutional investors or professional investment managers. Sophisticated investors understand the distribution costs and related conflicts. Independent investment managers would be buried by the volume of repetitive disclosures and most would incur substantial record-keeping costs of their own to manage these new records.

10. **Affiliate Arrangements & Practices Difficult to Track** - The Proposed Rules require disclosures of information about affiliates and compensation they receive in connection with the Covered Securities. It would be very difficult to track and report the compensation arrangements and practices of affiliates. Many "affiliated" broker-dealers have only a parent company in common, may or may not be wholly owned and do not have access to information about affiliated firms. They also do not know what the parent or its fund family entities are doing.

11. **Implementation Costs over $780,000 on Average per Broker-Dealer** - Compliance with the Proposed Rules would require extensive changes to existing

software systems, among other expenses. The SEC estimates that the one-time and annual cost to implement both of the Proposed Rules would total about $781,000, on average, per broker-dealer with an annual cost thereafter of about $540,000, on average, per broker-dealer. Actual costs would vary widely among independent contractor broker-dealers depending upon the capabilities of their internal or external data processing systems and arrangements. Assuming the Commission's cost estimates are accurate, these are significant additional costs for independent contractor broker-dealers that cannot readily be absorbed. Most, if not all, of these costs would ultimately be passed on to customers.

12. **Cost Estimates to Comply Not Realistic** - The SEC does not seem to have taken into account the full costs to broker-dealers that would be associated with implementing these Proposed Rules. The SEC's cost estimates focus on the requirements to report the prescribed data in point of sale and confirmation disclosures, but do not appear to recognize the substantial processes and cost of setting up systems and procedures to gather the data with the prescribed frequency (generally quarterly), especially with affiliated entities.

13. **Oral Disclosures Difficult to Present** - The SEC's analysis fails to address how the prescribed quantitative and qualitative data can be fairly and reasonably presented orally to a retail customer. The SEC envisions a one- or two-page point of sale disclosure, including explanatory material. How are retail customers likely to react to a 10+ minute recitation of numerical and statistical data, together with related explanations, over the telephone for each transaction?

14. **Timing of Some Disclosure Delivery is Problematic** – Under some circumstances envisioned by Proposed Rule 12c2-3, the "point of sale" delivery time would occur prior to the broker-dealer's having transaction-specific information used in calculating the prescribed disclosures.

15. **Rules Will Force Fewer Fund Options for Investors** - The complexity of the rules and disclosure requirements would prompt broker-dealers to reduce the number of mutual funds they offer for sale in order to minimize the number of funds about which the firm needs to maintain data.

16. **Prospectus Discounted as Disclosure Tool** - The Proposed Rules discount the prospectus as a disclosure tool. Most of the required information is more appropriately placed in a prospectus. Mutual fund companies are in the best position to accurately describe the costs which they directly or indirectly control.

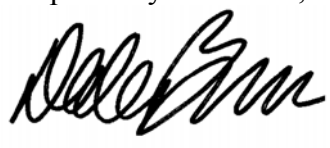
17. **Insurance Disclosures Not Coordinated With Insurance Regulators** - The Proposed Rules cover disclosure of information related to insurance business that is unrelated to variable insurance products. The Commission should coordinate with NAIC to address these issues. State insurance commissioners have regulatory responsibility for insurance products (see Section 301 of the Gramm-Leach-Bliley Financial Modernization Act).

18. **Customer's Right to Terminate Order Not Quantified** - The Proposed Rule 15c2-3 provision for a customer's right to terminate an order placed prior to disclosure does not indicate how long that termination right continues.

19. **Boilerplate Language Discouraged While Forms Proposed** - The Commission has also proposed forms for disclosure of the required information, despite its statement that firms should avoid the use of boilerplate language in its disclosures. This inconsistency needs to be addressed.

Again, thank you for the opportunity to comment on the Proposed Rules. Should you have any questions, please contact us at 770 933-6846.

Respectfully submitted,



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