THE FINANCIAL SERVICES ROUNDTABLE

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April 12, 2004

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

Re: 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:

The Financial Services Roundtable[1] (the "Roundtable") appreciates the opportunity to comment on the proposal issued by the Securities and Exchange Commission (the "Commission") on proposed confirmation requirements and point of sale disclosure requirements for transactions in certain mutual funds and other securities.

Background

The Commission is proposing two new rules and rule amendments under the Securities Exchange Act of 1934 that are designed to enhance the information broker-dealers provide to their customers in connection with transactions in certain types of securities. The proposed rule would require broker-dealers to make expanded disclosures in connection with the sale of mutual funds, variable annuities, variable life insurance policies and so-called "529 plan" securities. Brokers would be required to make extensive disclosures to clients in transaction confirmations for open-end mutual funds, unit investment trusts ("UITs") (including variable annuity contracts and variable life policies) and 529 plan securities. In addition, brokers would be required to make additional, unprecedented mandatory "point of sale" disclosure before these transactions could be completed. Furthermore, mutual fund prospectus disclosures concerning

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine accounting directly for $18.3 trillion in managed assets, $678 billion in revenue, and 2.1 million jobs.

funds' distribution arrangements with broker-dealers would be increased substantially.

The Roundtable supports enhanced disclosures to mutual fund investors. However, we believe the burdens created by this proposal would significantly outweigh any benefits to the investor. The Roundtable believes that proposal imposes extensive costs to the financial institutions, most of which will be passed on to retail investors. The end result is that mutual funds will be a less attractive investment and will be less available to all investors. In addition, the proposal would provide immaterial or misleading information to investors, and would distract investors from the more important information currently disclosed in the fund prospectus.

For these reasons, the Roundtable recommends that the Commission favor alternative disclosure of this information (*i.e.*, through websites, toll-free telephone numbers, *etc.*). These alternative methods would provide additional disclosure to the investor in a more cost effective manner. It would also allow investors to focus on the information in the mutual fund prospectus which will assist them in making informed investment decisions.

<u>The costs associated with the proposal significantly outweigh any benefit to the investor</u>

The Commission estimates that Rules 15c2-2 and 15c2-3 would cost the industry at least $1.3 billion to implement.[2] We believe that these estimates are far too conservative. The Securities Industry Association ("SIA") has estimated that the implementation costs of this rule will be approximately $500,000 per firm, and the annual costs of maintaining and updating these systems and procedures will also be on the order of $500,000 per firm.[3] We agree that this figure would be a more accurate depiction of the costs that would be associated with the implementation of this rule. The proposed rule would require firms to design systems to create an entirely new written disclosure document and ensure that the disclosure document is available for distribution to clients at every location in which the firm meets with clients. In addition, institutions would be required to establish supervisory and compliance procedures to ensure that the disclosures are made properly before a mutual fund order is accepted.

In the end, the investor would pay these significant costs. Brokerage firms would be left with no choice but to recoup their increased costs. These costs may be

[2] *See* Proposing Release, Initial Regulatory Flexibility Act Analysis Section D (sum of $850 million implementation cost estimate for Rule 15c2-2 and $450 million implementation cost estimate for Rule 15c2-3).
[3] SIA's estimate would result in an implementation cost of almost $2.7 billion for Rule 15c2-3, and an annual ongoing expense of approximately $3 billion.

passed on to investors in many different ways. Brokerage firms may choose to increase transaction fees for mutual fund trades, increase annual account fees for accounts holding mutual funds, or increase account minimum balance requirements. Brokerage firms may also demand increased amounts for 12b-1 fees or other types of revenue-sharing from mutual funds as a condition of carrying those funds. Since most of these costs would be incurred on per-transaction basis, the greatest impact would be felt by the small investors who invest a lesser amount every month in a few mutual funds.

The mutual fund industry would also be significantly harmed by these rules. The proposed rules could lead to a reduction in overall investment in mutual funds as investors choose to pursue other types of investments, such as common stocks, hedge funds, limited partnerships, bank collective trust funds, or insurance company separate accounts. These rules could also change the financial relationships between mutual funds and brokerage firms.

The proposed rules would make it more difficult for innovative, new mutual funds or fund families to be distributed. The result would be to increase barriers to entry and lessen competition in the mutual fund industry.

The cost and complexity of implementing these rules would fall disproportionately on smaller brokerage firms. Small firms will not be able to rely on their clearing firms to implement the rules. The burden of the point of sale disclosure rule will fall on a small firm, as will the burden of gathering the data necessary for the confirmation rule. Small firms will have the most difficulty in recouping those costs from their clients, and are most likely to see their profits reduced. Small brokerage firms will therefore have a particular disincentive to do business with mutual funds.

The Commission has not provided adequate justification for imposing expensive and burdensome point of sale disclosures. In particular, there has been no attempt to quantify the expected benefit of the proposed rules. The Commission concedes in the release for the proposed rules that the benefits "while qualitatively important, are necessarily difficult to quantify." Roundtable member companies believe that the Commission owes the investor a clearer explanation for a rule that would have such an enormous impact on the mutual fund industry.

<u>Alternatives disclosures would provide information to investors at a lower cost</u>

The Roundtable agrees with the Commission that additional disclosure is necessary. However, we oppose the proposed method of disclosure. While we agree with the NASD's Taskforce on Breakpoint Disclosure that the percentage amount of a front-end sales load for a particular mutual fund transaction (but not the precise dollar amount) should appear on the mutual fund confirmation itself, we recommend that brokerage firms be required to maintain website disclosure concerning their relationships with every mutual fund or mutual fund family available for purchase through that brokerage firm. This website disclosure should contain the basic information suggested in the proposal, such as front-end sales load, back-end sales load (by year), first-year asset-based sales charges, first-year asset-based service fees, sales fees and breakpoint information. For the investors who do not have access to a computer, we suggest that brokerage firms make the information available either by a toll-free telephone number or by mail in response to a client's request. Brokerage firms could be required to provide investors periodic reminders about the existence of this information, such as at the account opening, annually thereafter, and in each mutual fund confirmation.

The quantified portions of the website or toll-free telephone information should be presented both in terms of a standardized investment of $1,000 and with an assumed return of five percent per year. This type of disclosure is consistent with the Commission's requirement for prospectus disclosure of fund expenses, and will facilitate investors' comparison of the brokerage firm's relationships with different fund companies. As is the case with mutual fund expense disclosure, standardized expense disclosure is superior to personalized expense disclosure. The Commission has stated that personalized expense disclosure would not assist investors in making comparisons among funds because it would be based on different investment amounts and different rates of return. The Commission found the level of costs for individualized expense disclosures cannot be justified.[4]

Website disclosure would provide investors with substantially more information at the point of sale than would be provided by the Commission's proposed rule, and at a greatly reduced cost. Each mutual fund confirmation would contain a link to the website disclosure for investors who would like more detailed information. These changes to mutual fund trade confirmations: (i) would be substantially less expensive than the proposed rules, and (ii) would provide essentially the same information for investors in a format that is easier to understand than the proposed rules.

The Roundtable notes that the Commission has found website disclosures to be appropriate in a number of recent contexts. The Commission has required mutual funds to disclose on their websites their proxy voting records and month-end performance information. More recently, the Commission required that mutual funds disclose their portfolios on their websites quarterly. Similarly, the Commission required broker-dealers to disclose their order execution quality information on their websites rather than through mailing to each client. The

[4] Securities Act Rel. No. 8393 (Feb. 27, 2004).

recent research analyst reforms allow brokerage firms to make website disclosure about potential conflicts of interest, price charts, and the performance of the firm's research recommendations. The Commission has also required issuers to make certain information available by website. The Commission has thus recognized in multiple areas that website disclosure can be more cost-effective for investors. This can serve as an example for how point of sale disclosure for information relating to mutual fund sales practices can be affected.

<u>The Commission's proposed disclosures would distract investors from the mutual fund prospectus</u>

The Roundtable is concerned that the disclosure that would be required could confuse rather than inform investors. By highlighting the information twice every time an investment is made, the proposed rule could lead investors to place inappropriate emphasis on this information. This information would be disclosed in isolation, without the information most important to investors making investments in mutual funds: the fund's investment objectives, the risks it presents, its historical performance, and its expense ratio. This information and other information most material to a client's investment decision have traditionally been contained in the fund prospectus. The Commission has published for comment some half dozen proposals to expand and improve upon mutual fund prospectus disclosure. The Roundtable is concerned that investors will be less likely to consider the information contained in the prospectus if they first receive an extensive point of sale disclosure, and followed by brokerage firm disclosure (largely repeating the point of sale disclosure). The transaction disclosures may distract investors from the information that is most important to their investment decision.

The Roundtable believes that the proposed rule highlights the wrong data for inclusion in point of sale disclosures. One of the strongest correlations predicting a mutual fund's future performance is the size of its overall operating expense ratio. The Commission has concluded that the OER is best disclosed on a standardized basis in the fund prospectus. The proposed rule would call the investor's attention to expenses that are less relevant to an investor's decision. By focusing investors on broker compensation issues rather than the more important issues such as overall cost, a significant number of investors could be misled into choosing funds with higher operating expense ratios than they would otherwise choose.

The Roundtable believes that website disclosure would provide better information to investors than mandatory written point of sale disclosure, and would result in far lower costs being passed on to investors. Moreover, there is no precedent for requiring both point of sale and confirmation disclosure for every mutual fund transaction.

Variable products require different standards

Variable annuities and variable life policies are not like mutual funds. These products have different benefits and different terms. Due to the complexity of variable products (they include multiple investment options and have a two-tiered structure), the fact that sales compensation is paid by the insurer and not the underlying mutual funds, and there is no correlation between the sales compensation paid to the selling firm and the charges under the contract, the proposed rules are not workable, and in some cases are not relevant, for variable products. Some of the problems with applying the proposed rule to variable products include the following:

- Confirmations for variable products relate to transactions in multiple investment options, not a single retail fund.
- Investors purchase separate account units; they do not purchase shares of the underlying funds.
- Firms selling variable products are not paid in the same way mutual funds pay selling firms. The insurer or principal underwriter for the contract normally pays the selling firm out of its own assets or the underwriter or wholesaler of the underlying mutual fund may provide training or other non-cash compensation to the selling firm.
- Contract charges and surrender charges under the contracts are paid to the insurer, not to the selling firm.
- There is no relationship between the surrender charges and contract charges under the contract and compensation paid to the selling firm.
- Variable annuity funds do not have the same "share classes" as retail funds, and comparisons are difficult and would not represent the total charge structure imposed under the product.
- Variable product sales are complex and often involve numerous steps. Identifying the actual "point of sale" in that process is problematic.

The Roundtable recommends that a different approach be developed for the more complex structure of variable products.

Conclusion

Mutual funds have become an indispensable investment tool for Americans to save and build wealth. The Roundtable supports the Commission's efforts to reform the mutual fund industry in response to recent instances of abuse. The

Roundtable has been, and will continue to be, an active participant in this process. We agree with the majority of the recent proposals issued by the Commission. However, we believe the proposed rules on point of sale disclosure carry with them unintended negative consequences that would ultimately harm, not benefit, the investor.

These rules would create substantial costs that will be passed on to the investor. The cost of compliance (at least $55 per year per household under the Commission's own estimates, and $125 per household under SIA's estimate) is too high a price to pay for disclosure that provides little benefit to the investor. In addition, this disclosure distracts the investor from the most important information contained in the prospectus.

The Roundtable recommends utilizing web-based and toll-free telephone disclosure about brokerage firms' relationships with mutual fund companies, accompanied by reminders on confirmations about where investors can find this information. These methods of disclosure would be the most effective means to achieve the overall goal of disclosure.

If you have any further questions or comments on this matter, please do not hesitate to contact me or John Beccia at (202) 289-4322.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel