April 12, 2004

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

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

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on proposed Rules 15c2-2 and 15c2-3 under the Securities Exchange Act of 1934.[2] These rules would require broker-dealers selling mutual fund shares and other "covered securities"[3] to provide their customers a confirmation and a new point of sale disclosure document that include detailed information about distribution-related costs and conflicts of interests that may arise in connection with transactions involving these securities. In addition, the Commission has proposed related amendments to Form N-1A, the registration form for mutual funds, that are designed to improve prospectus disclosure concerning sales loads and revenue sharing arrangements.

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,595 open-end investment companies ("mutual funds"), 612 closed-end investment companies, 124 exchange-traded funds and 5 sponsors of unit investment trusts (UITs). Its mutual fund members have assets of about $7.554 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

[2] *See* SEC Release Nos. 33-8358; 34-49148; IC-26341 (Jan. 29, 2004) (the "Proposing Release"). The Commission's proposal also includes two new forms, Schedules 15C and 15D, that would establish the format of the required disclosures. Citations in this letter to the Proposing Release are to the version available on the Commission's website.

[3] The proposed rules would apply to all brokers, dealers, and municipal securities dealers (hereafter referred to collectively as "broker-dealers") that offer for sale or sell covered securities. "Covered security" would be defined to mean any security issued by an open-end investment company (mutual fund) that is not traded on a national securities exchange or on a facility of a national securities association, a UIT, other than a trust that is an exchange-traded fund or a trust sold in a secondary market transaction, and a municipal fund security (*e.g.*, a 529 plan security).

As indicated in the Proposing Release, distribution practices in the mutual fund industry have evolved significantly since 1977, when the Commission first adopted Rule 10b-10 under the Exchange Act, which today governs the information that must be provided to an investor in a confirmation. In recognition of this evolution, securities regulators are revisiting whether the conflicts of interest that may arise between broker-dealers and their customers in connection with covered securities transactions are being adequately addressed and disclosed under the federal securities laws. We note that, in addition to the Commission's proposal, the NASD has proposed to revise its rules to address these conflicts through greater disclosure.[4]

The Institute agrees that is it appropriate to enhance the disclosure provided to investors concerning these arrangements. Indeed, the Institute on several occasions has called for and supported requiring enhanced disclosure of revenue sharing arrangements to better enable investors to assess and evaluate a broker-dealer's recommendation to purchase shares of covered securities.[5] In addition, more generally, the Institute consistently has supported regulatory initiatives that are designed to improve the disclosure provided to investors, particularly disclosure that would enhance investors' awareness and understanding of mutual fund fees and expenses and the costs associated with investing in covered securities.[6]

The new confirmation and point of sale disclosure document proposed by the Commission will achieve these goals by greatly enhancing the disclosure provided to fund investors of the distribution-related costs they will bear. In particular, specific information relating to the amount of any sales loads and asset-based sales charges (commonly referred to as "12b-1 fees") will, for the first time, be provided to investors at the point of sale (*i.e.*, prior to

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[4] *See* NASD *Notice to Members* 03-54 (Sept. 2003) ("NTM 03-54"), which would require broker-dealers to provide point of sale disclosure of revenue sharing and differential cash compensation arrangements.

[5] The Institute previously recommended that the NASD require broker-dealers to provide investors with disclosure of these arrangements at the point of sale in order to assist investors in assessing the broker-dealer's conflicts of interest. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Joan C. Conley, Office of the Corporate Secretary, NASD Regulation, Inc., dated Oct. 15, 1997. The Institute subsequently recommended that the Commission amend Rule 10b-10 to require broker-dealers to disclose cash compensation at or before the time of a customer's initial purchase of mutual fund shares. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Ms. Annette L. Nazareth, Director, Division of Market Regulation, and to Mr. Paul F. Roye, Director, Division of Investment Management, Securities and Exchange Commission, dated May 8, 2000 (the "May 2000 ICI Letter"). Most recently, the Institute supported the NASD's proposal to require point of sale disclosure of revenue sharing and differential cash compensation arrangements. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Barbara Z. Sweeney, NASD, Office of the Corporate Secretary, dated Oct. 17, 2003.

[6] *See, e.g.*, Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated Feb. 23, 2004 (recommending enhanced disclosure relating to mutual fund portfolio transaction costs); Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated Feb. 14, 2003 (supporting a Commission proposal to require funds to provide dollar amount disclosure of their fees and expenses in shareholder reports); and Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Diane G. Klinke, Esq., General Counsel, Municipal Securities Rulemaking Board (MSRB), dated Apr. 1, 2002 (recommending that the MSRB consider adopting a new disclosure requirement to promote investor understanding of the state tax consequences associated with an investment in a 529 college savings plan).

their making an investment decision), as well as in the confirmation they receive on the transaction.[7] The Institute strongly supports the objectives of the Commission's proposal. We recommend several revisions, however, to ensure that the required disclosure will be meaningful to investors. In summary, the Institute recommends that the Commission revise the proposal to:

- Permit broker-dealers to omit from the proposed confirmation any items that would not require affirmative disclosure;
- Require disclosure concerning potential conflicts of interest only in the proposed point of sale disclosure document;
- Delete the proposed requirement relating to disclosure of portfolio brokerage arrangements in the confirmation and point of sale disclosure document in light of pending regulatory proposals to prohibit funds from taking into account distribution of fund shares when allocating fund brokerage;
- Delete the requirement to include in the confirmation "comparison range" disclosure inasmuch as requiring such information would raise a panoply of problematic implementation issues and the context of the information would be too limited to be useful to investors;
- Amend the definition of "revenue sharing" to better accomplish the Commission's intent of requiring disclosure of payments that might present a conflict of interest;
- Clarify that, for purposes of Rule 15c2-3, the "point of sale" occurs prior to the time the broker-dealer accepts an order from the customer to purchase covered securities;
- Clarify that an investor's right to terminate a covered securities transaction under Rule 152-3 ceases when the investor places an order after receiving the disclosure required by the rule;
- Add exceptions to Rule 15c2-3 to address concerns with the rule's application to direct sold funds, unsolicited transactions, subsequent purchases of the same covered security from the same broker-dealer, and institutional investors;
- Better tailor the exception in Rule 15c2-3 relating to primary distributors to the primary distributor's role in the transaction;
- Require Schedule 15D to include a legend that: advises an investor to consider the investment objectives and risks of the covered security carefully before investing; explains that the prospectus or offering document contains this and other information about the covered security; identifies a source from which the investor may obtain the prospectus or offering document; and states that such document should be read carefully before investing; and
- Provide an adequate transition period prior to enforcing compliance with the new rules.

In addition, the Institute recommends various technical revisions to the proposed rules and schedules. Each of these issues is discussed in more detail below.

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[7] We note that the obligation to provide to investors the disclosure required by the rules would be in addition to any other duties a broker-dealer has to its customers, *e.g.*, a duty to ensure that any covered security the broker-dealer recommends to the customer is suitable.

I. GENERAL COMMENTS ON PROPOSED RULE 15C2-2 AND SCHEDULE 15C

Under the Commission's proposal, confirmations relating to transactions involving covered securities would be subject to new Rule 15c2-2 rather than the confirmation requirements of Rule 10b-10 under the Exchange Act. Rule 15c2-2 would require transactions in covered securities to be confirmed as set forth in proposed Schedule 15C. Schedule 15C would require a confirmation to consist of six parts: Section A, which would include general information about the transaction (*i.e.*, customer name, account number, date of transaction, number shares bought or sold, etc.); Section B, which would require disclosure of amounts the investor pays directly or indirectly for purchases, including sales loads[8] and asset-based sales charges and service fees; Section C, which would require disclosure of amounts that the broker-dealer will receive from the fund or its affiliates as a sales fee or through revenue sharing or directed brokerage arrangements;[9] Section D, which would require "check the box" disclosure regarding whether the broker-dealer pays differential cash compensation based on sales of affiliated funds or based on sales of funds with a back-end load; Section E, which would require disclosure of breakpoint information; and Section F, which would provide investors with a list of "Explanations and Definitions" that are intended to assist the investor in understanding the information set forth on the confirmation. The Institute supports the Commission's proposal to adopt a confirmation rule tailored specifically for transactions in covered securities. We recommend various revisions to the proposal to better ensure that the information provided will be useful to investors.[10] Our recommended revisions are detailed below.

A. Short-Form Confirmation

Under the Commission's proposal, unless otherwise excepted, each transaction in a covered security would be subject to all of the requirements of proposed Rule 15c2-2 and Schedule 15C. To better serve investors, the Institute recommends that the Commission not require broker-dealers to utilize a "one-size-fits-all" confirmation without regard to whether the items of information in the confirmation would be relevant to the investor receiving it. In particular, we recommend that the Commission revise the proposal to allow broker-dealers to eliminate from their confirmations any information items that would not require affirmative disclosure.

For example, if a front-end load is assessed on the covered security, but not a back-end load, and if none of the remaining charges, fees, or payments that would be required to be

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[8] The Institute supports the Commission's proposal to withdraw a 1979 no-action letter issued to the Institute relating to confirmation of disclosure of mutual fund sales loads and related fees. *See Investment Company Institute* (pub. avail. Apr. 18, 1979). We concur with the Commission that mutual fund sales loads should be disclosed in the confirmation and, therefore, the relief granted by the 1979 letter is no longer necessary.

[9] As proposed, the information disclosed in Sections B and C of the Schedule would consist of the dollar amounts paid by the investor or to the broker-dealer, as applicable, as well as what percentage of the investor's investment this dollar amount represents and the industry norms (*i.e.*, range and median) of these percentages.

[10] The Institute also would expect these recommendations to reduce the very substantial costs of proposed Rule 15c2-2, which are estimated by the Commission to be approximately $2 billion a year.

disclosed pursuant to Sections B-D of Schedule 15C are applicable to the transaction, rather than requiring the broker-dealer to send a confirmation to the investor that includes the inapplicable information set forth in these sections with a response of "N/A," we recommend that the Commission permit the broker-dealer to omit these information items (including Sections C-D in their entirety) from the confirmation inasmuch as such disclosure would not be helpful to the investor.[11]

Our recommendation would better tailor the disclosure required in the confirmation to the specific transaction being confirmed and thus would permit investors, in appropriate circumstances, to receive confirmations that are simpler and shorter.[12] In addition to benefiting investors in these ways, we believe this approach would result in cost savings.

B. Conflict of Interest Disclosure

1. Revenue Sharing and Differential Compensation

Proposed Rule 15c2-2(c)(4) and (5) and Sections C and D of Schedule 15C would require a confirmation to include information about revenue sharing payments received by the broker-dealer and differential compensation payments the broker-dealer makes to its personnel in connection with the transaction. The Commission's intent in adding this information to the confirmation is to enable investors to better assess any conflicts of interest that may arise in connection with their purchase of a covered security. In light of this intent, we question the appropriateness of including these disclosures in the confirmation.

While the Proposing Release asserts that a confirmation "should inform an investor of the potential conflicts of interest that confront a broker, dealer, or municipal securities dealer,"[13] in our view, such information would be most relevant to the investor *prior* to making an investment decision, not at the time the trade is being confirmed. Indeed, by the time the investor receives the confirmation, the transaction has already been completed and the trade settled. We note that under the Commission's proposal, information about revenue sharing and differential compensation payments would be required under Rule 15c2-3 in the point of sale disclosure document. As such, investors would be able to assess the relevance of this information prior to making an investment decision, when it would be most meaningful. Given this, we do not believe that providing additional disclosure of this information in the

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[11] We additionally recommend that the Commission permit a broker-dealer to delete from Section F of Schedule 15C any definitions that would not be relevant to the information disclosed on the confirmation. For example, if the firm omitted Section B of Schedule 15C from its confirmation because it did not charge a load or assess asset-based sales charges or service fees, it should be able to omit from Section F of the confirmation information relating to "Price and NAV," "Amount of your investment," "Timing of sales loads," and "Asset-based fees."

[12] Appendix A to this letter is an example of a confirmation that would comply with this recommendation.

[13] Proposing Release at n.86.

confirmation would benefit an investor. We therefore recommend that Rule 15c2-2(c) be revised to delete the requirements relating to revenue sharing and differential compensation.[14]

In addition to our belief that the *timing* of confirmation disclosure of revenue sharing payments would mean that it would not be very useful to investors, we have serious concerns with the *substance* of the proposed disclosure concerning such payments. Most significantly, "revenue sharing" can encompass numerous and varied payment arrangements that often are not specifically or directly associated with a particular fund, let alone a particular transaction.[15] Payments may be made for a variety of different purposes, such as for inclusion on a broker-dealer's preferred list or in a sales program, to share the cost of educating the broker-dealer's registered representatives about certain funds, or to reimburse the broker-dealer for expenses incurred in connection with providing services to fund shareholders. Revenue sharing payments may be assessed on an annualized basis as a percentage of certain assets, the value of which may fluctuate over the course of a year. Some of the payments may relate to more than one fund. Some of them may be contingent in nature. All of these factors make it extremely difficult, if not impossible, to put quantitative information about such payments into any meaningful context for investors. Moreover, in no event would revenue sharing payments correspond with an investor's out-of-pocket costs. The Institute is concerned that attempting to reduce revenue sharing payments to a single dollar amount (and a percentage of the purchase amount) on a transaction confirmation, as proposed by the Commission, ignores these issues and creates the misimpression that the information being provided is very precise. As a result, the disclosure is likely to be misleading and/or confusing. For all of these reasons, if, despite our comments above, the Commission determines to require disclosure concerning revenue sharing arrangements in confirmations, such disclosure should be either general, narrative disclosure or in a qualitative format (similar to that proposed on Schedule 15D).

2. Portfolio Brokerage Commissions

Rule 15c2-2(c)(5)(ii) and Section C of Schedule 15C would require a broker-dealer to disclose "portfolio brokerage commissions." As explained in the proposed disclosure in Section F of Schedule 15C, "portfolio brokerage commissions" may give the broker-dealer a greater incentive to sell the shares of a fund that pays the broker-dealer to effect transactions for the fund's portfolio or in the portfolio of affiliated funds. As such, these commissions might present a conflict between the interests of the investor and those of the broker-dealer.

Consistent with our comments above, the Institute generally believes that the confirmation would not be the most appropriate document in which to disclose potential conflicts of interest. More importantly, however, we note that, since the issuance of the Proposing Release, the Commission has proposed amendments to Rule 12b-1 under the Investment Company Act of 1940 that would prohibit funds from taking distribution of fund shares into account when allocating brokerage precisely in order to eliminate this potential

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[14] Our specific comments on the proposed disclosure concerning revenue sharing and differential compensation in the point of sale disclosure document are discussed in Section D, below.

[15] Our comments on the proposed definition of "revenue sharing" are set forth in Section D, below.

conflict of interest.[16] The Institute supports prohibiting directed brokerage arrangements[17] and notes that if this proposed rule change is adopted, confirmation disclosure concerning portfolio brokerage commissions would not serve the purpose intended by the Commission.[18] Accordingly, we recommend that disclosure of this information be deleted from the Commission's confirmation and point of sale disclosure proposal.[19]

C. 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 sales charges, 12b-1 fees, service fees, sales fees, revenue sharing payments, and portfolio brokerage commissions. According to the Proposing Release, these disclosures are intended to "provide a mechanism to give investors additional context for evaluating the significance of certain required disclosures by requiring brokers, dealers, and municipal securities dealers to provide comparison information."[20] The Institute strongly opposes requiring confirmations to include this disclosure.[21]

First, we share the Commission's concerns with the feasibility of implementing such disclosures. Developing and implementing median/range information would raise a panoply of issues that would need to be resolved prior to implementing such a requirement. Some of these issues relate to ensuring that the median and range information set forth on the confirmation does, in fact, provide an appropriate context for evaluating the amounts paid by the investor. As noted in the Proposing Release, these issues include, but are not limited to,

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[16] *See* SEC Release No. IC-26356 (Feb. 24, 2004). Similarly, the NASD has filed with the SEC proposed amendments to NASD Rule 2830(k) that, if approved, would prohibit directed brokerage arrangements. *See Proposed Amendment to Rule Relating to Execution of Investment Company Portfolio Transactions*, File No. SR-NASD-2004-027 (Feb. 10, 2004).

[17] *See* Letter from Matthew P. Fink, President, Investment Company Institute, to The Honorable William H. Donaldson, Chairman, Securities and Exchange Commission, dated Dec. 16, 2003.

[18] For the same reason, the point of sale disclosure of such information also would be unnecessary.

[19] Alternatively, the Commission should defer action on proposed Rules 15c2-2 and 15c2-3 until such time as it has determined the outcome of the proposed amendments to Rule 12b-1 and had the opportunity to reconcile that proposal with the current proposal.

[20] Proposing Release at p. 30.

[21] Thus, even if the Commission disagrees with our recommendation above to delete the provisions of Section C of Schedule 15C relating to revenue sharing and/or portfolio brokerage commissions and retains this information in the confirmation, we recommend that the comparison range disclosure relating to these payments be deleted. Comparison range information concerning these items would be especially inappropriate because it would make what, in many cases, would be "apples to oranges" comparisons. For example, portfolio brokerage commissions will vary based upon the types of securities in which a fund group invests and on whether a particular broker-dealer is an active trader in those securities. In the case of "revenue sharing," because of the breadth of the scope of the term in the Commission's proposal (discussed further below), payments by a fund group to a broker-dealer may appear "high" simply because the broker-dealer is providing certain services, such as sub-transfer agent services, that do not relate in any way to distribution, to funds in the complex.

whether the median/range amounts should be calculated from the same "type" of security the investor purchased and what would constitute the same "type" — *e.g.*, should all mutual funds be grouped together or, instead, should they be categorized based upon the fund's investment objectives or investments? Moreover, along these same lines, we question the appropriateness of limiting this proposed disclosure to a comparison of *covered securities*. Many other competitive products may, in fact, have higher fees or charges associated with them. If the intent of including this information in a confirmation is, in part, to inform investors "how the position of [their broker-dealer] compares to industry practices,"[22] we question (1) why the Commission would limit its application to a comparison of covered securities and not include other investment products offered by the broker-dealer, such as wrap fee programs or separately-managed accounts; and (2) why such information would not be required in connection with the offering of these other products without regard to whether they are confirmed under proposed Rule 15c2-2 or Rule 10b-10.

Aside from our concern with the universe of investments that would be considered peers of the covered security for purposes of compiling the comparison ranges, we agree that there are numerous other issues that would need to be resolved including: who should make the determination of which median/range is the appropriate one to include on a particular confirmation; should these amounts be weighted to take into account sales; should the dollar amount of the investor's transaction be considered in the comparison information; who should calculate the medians and ranges and on what basis; how would the Commission go about gathering the information necessary to calculate these amounts; and how often must these amounts be revised to ensure they remain current. The number and scope of these issues exacerbate our concerns with the feasibility of implementing such a requirement.

Moreover, while the median/range information is intended to provide the investor some "context" about his or her investment, we submit that the proposed context may, in fact, be too limited to be meaningful. For example, assume the disclosure provided to the investor indicates that the fund the investor purchased is at the low end of the industry norms for loads, asset-based sales charges, service fees, and amounts the broker receives. What is the intended significance of this information to the investor? It would not necessarily mean the investor made a wise investment decision, as it ignores other information that is equally, if not more important (*e.g.*, investment objectives, risks and performance), none of which would be subject to any similar comparison disclosure.

In addition to the significant problems with this disclosure noted above, we are concerned, as discussed in more detail in Section IV of this letter, that including this information on the confirmation would either unduly delay implementation of Rule 15c2-2[23] or require a two-step implementation process – the first step being requiring a confirmation under Rule 15c2-2 without this information, and the second step being a confirmation with this information

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[22] Proposing Release at p. 30.

[23] As noted in the Proposing Release, if the Commission determines to require this disclosure, the Commission would be required to initiate additional rulemaking to implement the reporting requirements to permit the Commission "or its vendors" to gather information to calculate the appropriate medians and comparison ranges.

added. Moreover, once the initial median/ranges are initially determined, to ensure their relevance on an ongoing basis, they would have to be constantly updated, no doubt at a considerable expense.[24]

For these reasons, we strongly urge that the Commission not pursue including comparison range information on confirmations.

D. Definition of Revenue Sharing

Subsection (f) of proposed Rule 15c2-2 provides a definition of the term "revenue sharing," which is necessary for purposes of determining which payments trigger disclosure on the proposed confirmation and in the point of sale disclosure document. To achieve the intent of requiring disclosure regarding payments that may involve a conflict of interest on the part of the broker-dealer offering or selling a covered security to an investor, the Commission has deliberately proposed to define the term "revenue sharing" broadly. In particular, the Commission intends to "encompass payments that have a variety of labels – including payments that may be characterized as having purposes other than paying a [broker-dealer] for shelf-space."[25] Generally speaking, the proposed rules would require disclosure of payments made pursuant to an agreement or understanding between a "fund complex" and the broker-dealer.[26]

The Institute supports the Commission's goal, but we are concerned that the proposed definition in its current form sweeps far too broadly. As currently drafted, "revenue sharing" would cover *any* payments by *any* entity within a "fund complex" for *any* purpose (other than payments made by the issuer of the covered securities and dealer concessions and sales fees, which are specifically excepted), if the payments are made pursuant to an "arrangement or understanding." Thus, the definition would appear to cover payments made to a broker-dealer for services that are unrelated to the sale, distribution, or promotion of covered securities and/or unrelated to the particular covered securities that are the subject of the transaction. Moreover, "fund complex" also is defined very broadly, which exacerbates the problem.[27]

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[24] If, despite the many serious concerns raised, the Commission decides to require disclosure of comparison range information, a more cost-effective way of providing it to investors would be for the Commission to post it on its website, rather than requiring it to be printed on the confirmation.

[25] Proposing Release at p. 22.

[26] Specifically, proposed Rule 15c2-2(f)(16) would define "revenue sharing" to mean "any arrangement or understanding by which a person within a fund complex, other than the issuer of the covered security, makes payments to a broker, dealer or municipal securities dealer, or any associated person of the broker, dealer, or municipal securities dealer, excluding amounts earned at the time of sale that constitute a dealer concession or other sales fee and that are disclosed pursuant to paragraph (b)(4) of this section."

[27] Proposed Rule 15c2-2(f)(10) provides that "Fund complex shall include the issuer of the covered security (including the sponsor, depositor or trustee of a unit investment trust, and any insurance company issuing a variable annuity contract or variable life insurance policy), the issuer of any other covered security that holds itself out to investors as a related company for purposes of investment or investor services, any agent of any such issuer, any investment adviser for any such issuer, and any affiliated person (as defined by section 2(a)(3) of the Investment Company Act (15 U.S.C. 80-2(a)(3))) of any such issuer or any such investment adviser."

Based on the interplay of the two definitions, the proposal would require disclosure in the case of *any* payments made by any one of a potentially enormous universe of entities to a broker-dealer, without regard to the relevance of the particular entity making the payment or the purpose of the payment. Thus, for example, the proposed definitions would seem to trigger disclosure in the following circumstances:[28]

- In a confirmation of a purchase of a fund in Fund Complex A when a subadviser to that fund makes revenue sharing payments to the broker-dealer issuing the confirmation, even though those payments are made to promote the sale of shares of funds in Fund Complex B;

- In a confirmation of a purchase of a fund in Fund Complex A when Fund Complex A's unaffiliated third party transfer agent, which also serves as transfer agent for the funds in Fund Complex B, reimburses the broker-dealer issuing the confirmation for services provided to shareholders of funds in Fund Complex B;

- In a confirmation of a purchase of a fund in Fund Complex A when one or more other funds in Fund Complex A pay 12b-1 fees to the broker-dealer issuing the confirmation;[29] and

- In a confirmation of a purchase of a fund in Fund Complex A when another fund in the complex owns 5 percent of a portfolio company and that company, pursuant to an agreement or understanding with the broker-dealer, makes payments to the broker-dealer issuing the confirmation for any purpose (which could be completely unrelated to either fund).

These are but a few examples of innumerable instances in which disclosure would appear to be triggered even though it would not make sense and presumably is not what the Commission intended. We believe that the Commission's intent could be better accomplished by narrowing the definition of "revenue sharing" to capture only those payments made by entities within a fund complex that potentially could present the types of conflicts with which the Commission is concerned. More specifically, we recommend that the Commission revise the proposed definition of "revenue sharing" to provide as follows:

> *Revenue sharing* means any arrangement or understanding by which an investment adviser, principal underwriter, administrator, or transfer agent of an issuer of a covered

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[28] Although these examples relate to confirmation disclosure, the same concerns would arise with respect to point of sale disclosure because the required disclosure is based on the same definitions of "fund complex" and "revenue sharing."

[29] As indicated above, the proposed definition of "fund complex" includes both the issuer of the covered security and the issuer of any other covered security that holds itself out to investors as a related company for purposes of investment or investor services (*i.e.,* other funds in the complex). The proposed definition of "revenue sharing" excludes payments by "the issuer of the covered security" but does not exclude payments by other issuers of covered securities within the fund complex.

> security makes payments to a broker, dealer, or municipal securities dealer in connection with the sale or distribution of such covered security, including but not limited to: (i) any discount, concession, gross dealer concession, fee, service fee, commission, asset-based sales charge, loan, override, cash employee benefit; or (ii) any cash payment received as a condition for inclusion of the covered security on a preferred or select sales list; in any other sales program; or as an expense reimbursement. The term "revenue sharing" shall not include amounts earned at the time of the sale that constitute a dealer concession or other sales fee and that are disclosed pursuant to paragraph (b)(4)[30] of this section.

Our proposed definition would avoid inadvertently sweeping in payments that should not trigger disclosure because they do not involve any potential conflicts between the interests of the investor and those of the broker-dealer making the disclosure. It would do so by specifically identifying the entities within a fund complex whose payments to a broker-dealer could raise conflict of interest concerns[31] and by limiting the definition to payments made in connection with the sale or distribution of the particular covered security. The definition we propose is substantively similar to the definition of "cash compensation" under NASD rules, as proposed to be amended.[32] We note that, to the extent that broker-dealers eventually may be required to provide point of sale disclosure to investors concerning revenue sharing payments under both the Commission's rules and the rules of the NASD, these payments should be defined in a consistent manner.

II. SPECIFIC COMMENTS ON PROPOSED RULE 15C2-2 AND SCHEDULE 15C

In addition to the general comments above on proposed Rule 15c2-2 and Schedule 15C, the Institute has the following, more technical, comments on the proposal.[33] These comments are presented in the order of the proposed sections of Schedule 15C and the provisions in the proposed rule that correspond to such sections.

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[30] We note that the reference in the Commission's proposed definition of "revenue sharing" to "paragraph (b)(4)" should instead be a reference to "paragraph (c)(4)." (Paragraph (b)(4) requires disclosure of the number of shares or units of a covered security bought or sold in the transaction; Paragraph (c)(4) relates to the amount of dealer concession.)

[31] Under our proposal, a separate definition of "fund complex" would no longer be needed.

[32] Under the NASD's pending proposal to require point of sale disclosure concerning revenue sharing arrangements ("cash compensation"), the NASD proposes to amend the definition of "cash compensation" under its rules to mean "any cash payment received in connection with the sale or distribution of investment company securities, including but not limited to: (i) any discount, concession, gross dealer concession, fee, service fee, commission, asset-based sales charge, loan, override, cash employee benefit; or (ii) any cash payment received as a condition for inclusion of the investment company on a preferred or select sales list; in any other sales program; or as an expense reimbursement." *See* NASD *Notice to Members* 03-54 (Sept. 2003). To the extent the NASD's proposed definition is revised, we recommend that the Commission conform its definition to that adopted by the NASD to ensure consistency between the Commission's and NASD's respective disclosure requirements.

[33] Appendix B to this letter is an example of a confirmation that would comply with our recommended revisions to Schedule 15C.

A. Comments on Proposed Section A and Rule 15c2-2(b)

As proposed, Rule 15c2-2(b)(7) would, if applicable, require disclosure that the broker-dealer is not a member of the Securities Investor Protection Corporation (SIPC). This provision is substantively identical to the disclosure currently required by Rule 10b-10(a)(9). In 1995, the Commission staff responded favorably to a request from the Institute, on its behalf and on behalf of all brokers and dealers, to exempt from Rule 10b-10(a)(9) certain transactions involving mutual funds and UITs.[34] The Institute recommends that the Commission confirm the ability of broker-dealers to continue to rely on this exemption under proposed Rule 15c2-2(b)(7).

In addition, with respect to Section A of the proposed confirmation, the Institute recommends that the Commission:

- Clarify in the adopting release that, with respect to a 529 plan security, the "security issuer" is the entity currently included on a confirmation pursuant to MSRB Rule G-15(a)(i)(B)(1)(b);[35] and

- Require the information in Section A of Schedule 15C relating to "Commission/other compensation" and "Other charges" to be disclosed in Section B of the confirmation. This would result in these charges, which are paid by the investor, being listed with other amounts paid by the investor for the purchase. (With respect to sale transactions (*i.e.*, redemptions), however, such information should remain in Section A inasmuch as such transactions are not subject to the disclosure requirements in Section B.)

B. Comments on Proposed Section C and Rule 15c2-2(c)(4)-(5) and on Proposed Section D and Rule 15c2-2(c)(6)

As discussed above, the Institute recommends that the disclosure required by proposed Rule 15c2-2(c)(4), (5), and (6), as set forth in Sections C and D of Schedule 15C, be deleted and that disclosure concerning the types of payments addressed by these provisions (other than

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[34] In particular, the Institute sought an exemption from the rule "for transactions in shares of mutual funds and UITs where the customer sends funds or securities directly to or receives funds or securities directly from the fund, its transfer agent, its custodian, or other designated agent, regardless of whether such person is an associated person of the broker-dealer required to send the confirmation . . .." The staff granted the requested relief based on the following conditions: (1) the broker-dealer does not receive or handle in any form customer funds or securities in connection with the purchase or redemption of mutual fund or UIT shares, and the customer sends its purchase money directly to the fund or UIT, its transfer agent, its custodian, or its designated agent; and (2) checks are not made payable to the broker-dealer, and the broker-dealer does not handle customer checks in connection with the transaction. *See Investment Company Institute* (pub. avail. Aug. 1, 1995).

[35] MSRB Rule G-15 governs confirmations issued in connection with municipal fund securities. Subdivision (a)(i)(B)(1)(b) of the rule requires the confirmation to include "the name used by the issuer to identify such securities." In addition, to avoid inconsistent confirmation requirements, the Institute recommends that the Commission work with the MSRB to conform to Rule 15c2-2 the MSRB's existing confirmation requirements applicable to 529 plan securities.

directed brokerage) be provided in the point of sale disclosure document only. Our substantive comments on these disclosure elements are set forth in our discussion of the contents of the point of sale disclosure document below.

C. Comments on Proposed Section E and Rule 15c2-2(c)(1)

Section E of Schedule 15C bears the heading "Breakpoint discount information." We note, however, that there is no mention of "breakpoints" in the text beneath the heading. Instead, it discusses "sales load discounts." To avoid possible confusion, we recommend that the narrative disclosure in this section be revised in relevant part to read: "Many mutual fund companies offer sales load discounts, which are also known as "breakpoint discounts," to customers . . ." (underscored language added). Alternatively, the heading should be changed to read "Sales load discounts."

In addition, to avoid duplicative disclosure of the amount of the front-end sales load paid by the customer, we recommend that the Commission revise the legend that would be required in Section E in connection with a covered security with such a load. In particular, we recommend that the last sentence of this legend be revised to read as follows: "According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) entitles you to a sales load of ____% ~~. You were charged a sales load of ____%~~, which may vary from the sales load disclosed above ~~in the prospectus~~ due to rounding to the nearest penny." (Underscored language has been added; overstricken language deleted.)

D. Comments on Proposed Section F and Rule 15c2-2(f)

Section F would include "explanations and definitions" that are necessary for an investor to understand the information disclosed on the confirmation. We recommend the following revisions to this section:

- The heading in Section F of "Price and NAV" should instead be "Price" in order to ensure consistency between this section and Section A of the schedule; and

- Section F should be revised to delete definitions of items no longer needed as a result of other changes we recommend.[36]

E. Alternative Periodic Reporting

Subsection (d) of proposed Rule 15c2-2 would govern alternative periodic reporting. This subsection, which is consistent with the provisions in Rule 10b-10(e)(6)(ii) relating to the ability of "investment company plans" to issue quarterly account statements, would permit brokers-dealers to disclose the required confirmation information periodically, rather than on a

[36] These definitions include: "Disclosure of revenue sharing and portfolio brokerage commissions;" "What is revenue sharing?;" "What are portfolio brokerage commissions?;" "Special compensation for proprietary sales;" "Special compensation for shares with a back-end sales load;" and "Comparison ranges."

transaction-by-transaction basis, in certain limited instances involving transactions in a "covered securities plan" or in no-load open-end money market funds.[37] As proposed to be defined in the rule, the meaning of the term "covered securities plan" would be substantively identical to the definition of the term "investment company plan" currently in Rule 10b-10(d)(6). In 1993, the Commission staff issued to the Institute a no-action letter that permitted broker-dealers to treat certain reinvestment services, cross-reinvestment services, automatic investment plans, and systematic withdrawal plans as "investment company plans" for purposes of the quarterly statement provisions in Rule 10b-10.[38] The Institute recommends that the Commission clarify that, for purposes of the alternative periodic reporting requirements in Rule 15c2-2, the term "covered securities plan" includes the type of plans (*i.e.*, reinvestment services, cross-reinvestment services, automatic dividend reinvestment plans, automatic investment plans, and systematic withdrawal plans) that are currently permitted to issue quarterly account statements under Rule 10b-10's provisions relating to investment company plans.

III. GENERAL COMMENTS ON PROPOSED RULE 15C2-3 AND SCHEDULE 15D

The Institute supports the Commission's proposal to require broker-dealers to disclose to investors at the point of sale information about distribution-related costs and payments relating to the investor's purchase.[39] We believe such disclosure will assist investors in making informed investment decisions. Due to the variety of channels through which investors may effect transactions in covered securities, however, we are concerned with the rule's "one-size-fits all" approach to disclosure. To ensure that the rule is flexible enough to accommodate this variety but, at the same time, achieves the Commission's objective of providing an investor meaningful disclosure prior to effecting a transaction, we recommend several revisions to the Commission's proposal. In particular, as discussed in detail below, we recommend that the Commission: better tailor the definition of "point of sale" to situations involving a customer's effecting a transaction in a covered security; eliminate a provision conditioning the effectiveness of an order on an investor's subjective determination; limit the termination provisions in the rule; adapt the required disclosures to situations in which they will be meaningful to an investor; take into account certain other pending regulatory proposals; and improve and enhance the required disclosure.[40]

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[37] Proposed Paragraph (f)(5) would define "covered securities plan" as any plan for direct purchase or sale of a covered security pursuant to certain retirement or pension plans or other agreements or arrangements, including the automatic reinvestment of dividends.

[38] *See Investment Company Institute* (pub. avail. Jan. 7, 1993). According to the views of the staff as set forth in this letter, reinvestment services, cross-reinvestment services, automatic investment plans, and systematic withdrawal plans conducted in the manner set forth in the Institute's letter requesting no-action relief "constitute 'investment company plans' as defined in [Rule 10b-10]" and, "[a]ccordingly, broker-dealers that effect transactions pursuant to such services may confirm these transactions by means of quarterly account statements."

[39] As noted above, the Institute has previously supported requiring point of sale disclosure of revenue sharing and differential cash compensation arrangements. *See supra* note 5.

[40] Appendix C to this letter is an example of a point of sale disclosure document that would comply with our recommended revisions to Schedule 15D.

A. "Point of Sale"

As proposed, Rule 15c2-3(a) would require each investor purchasing a covered security to be provided, "at the point of sale," a disclosure document that conforms to proposed Schedule 15D. "Point of sale" would be defined in the rule to mean: (1) immediately prior to the time the broker-dealer accepts the order from the customer *and* (2) if the customer either has not opened an account with the broker-dealer or does not submit the trade to the broker-dealer, "at the time that the [broker-dealer] first communicates with the customer about the covered security, specifically or in conjunction with other potential investments." While the Commission's definition was drafted to avoid "disclosure gaps," we believe that, in attempting to close all such gaps, the resulting definition may be overly broad and narrowing it would better serve the Commission's intent.

We are concerned that, based on the ambiguity of the proposed definition, broker-dealers might be deemed to have disclosure obligations in situations where the broker-dealer either has had no direct contact with a customer or has not accepted a purchase order from the customer for a covered security. For example, it is not clear whether the part of the definition that refers to broker-dealers first communicating with customers would encompass advertisements by the broker-dealer that mention a covered security. While the broker-dealer may have no direct contact with a person reading an advertisement, under the proposed rule, this indirect contact (*i.e.*, when the dealer "first communicates" through the advertisement "with the customer about the covered security") might constitute a "point of sale" triggering the need for the broker-dealer to provide the requisite disclosure. Similarly, assume a customer walks into a broker-dealer's lobby and picks up brochures or other information on various investment alternatives offered by the broker-dealer, including information that mentions one or more covered securities, but does not open an account or even speak with an account representative. Under the proposed rule, this, too, might constitute a "point of sale" triggering the required disclosure. Complying with the proposed rule's disclosure requirements in either of these situation may well be impossible.

As discussed in the Proposing Release, Rule 15c2-3 is designed to enable investors to make better informed decisions *"prior to effecting transactions"* in covered securities. To avoid imposing on broker-dealers disclosure requirements that would be impossible to satisfy, the rule should only require the disclosure to be provided prior to the time the investor actually places, or attempts to place, an order with the broker-dealer (as provided in subdivision (f)(1)(i) of the rule) for the covered security on which the disclosure was based.[41] Limiting the definition in this way would, consistent with the Commission's intent, ensure that each investor receives the required disclosure prior to placing an order for a covered security.

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[41] We additionally recommend that the Commission not require that this disclosure be provided "immediately" prior to the transaction. For example, if the customer meets with the broker-dealer on Monday and receives the disclosure document and on Thursday calls the broker-dealer to place the trade on which the disclosure was provided, the broker-dealer's obligations under the rule should be deemed satisfied even though the disclosure did not occur "immediately" prior to the customer effecting the transaction.

B. Right of Termination

As provided in proposed Rule 15c2-2(b), a customer would have a right to terminate an order to purchase covered securities that is placed prior to the time when the broker-dealer provides the required disclosures to the customer (*i.e.,* the order would be an "indication of interest" until all required disclosure is provided). This provision further would require a broker-dealer to: (1) disclose to the customer the customer's right to terminate the transaction;[42] and (2) provide the customer "an opportunity to determine whether to place the order" once the required disclosure is provided. The Institute is concerned that expressly conditioning an effective order on the customer's subjective determination after receiving the required disclosure, as to whether he or she has had an opportunity to determine whether to place an order, would be very difficult to administer and highly susceptible to abuse.

For example, an investor who, for whatever reason, experiences buyer's remorse after purchasing a covered security would be able to disavow the trade on the basis that he or she was provided an insufficient opportunity within which to determine whether to place the trade.[43] In other words, enabling an investor to void a trade at any point in time – days or even years after purchasing a covered security – based solely on a claim that he or she was not provided a sufficient opportunity to review the required disclosure seems wholly inappropriate. Indeed, we are not aware of any other provision in Federal or state securities laws – or any provision under the rules of a self-regulatory organization – that expressly conditions the effectiveness of a trade on the investor's subjective determination that he or she had an opportunity to determine whether to place a trade. Enabling an investor to rely on this provision to void a trade weeks or years after it was placed would put broker-dealers in the untenable position of never being assured that the orders they have effected for covered securities are, in fact, "effective" and not merely indications of interest.

To avoid this result, we strongly recommend that the rule be revised to replace the provision conditioning an effective order on the investor "[having] had an opportunity to determine whether to place an order" with a provision expressly stating that a broker-dealer may consider effective any order to purchase a covered security that the broker-dealer receives from the customer after the disclosure required by paragraph (a) of the rule has been provided to such customer.

C. Scope of the Proposed Rule's Requirements

Proposed Rule 15c2-3 would make it unlawful for any broker-dealer to effect a transaction in covered securities for a customer without first providing the disclosure required

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[42] This disclosure would be in addition to the following legend proposed to be included on Schedule 15D: "YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT."

[43] Such a buyer may attempt to disavow a trade for reasons wholly unrelated to information disclosed on Schedule 15D (*e.g.,* due to a major decline in the market that occurred subsequent to the investor placing the trade).

by the rule. Subsection (e) of the proposed rule provides exceptions from these requirements for various transactions including, among others, transactions in a covered securities plan, reinvestment of dividends earned, and transactions in which the broker-dealer is exercising investment discretion. The Institute recommends that the Commission: include four additional transactional exceptions from the rule's requirements; revise the proposed exception for mutual fund primary distributors; and clarify the rule's application to UITs. Each of these recommendations is discussed below.[44]

1. Directly Sold Covered Securities

The Institute recommends that an exception be added to proposed Rule 15c2-3(e) for transactions in a covered security if: (1) the investor is not required to pay a sales load (either front-end or back-end); (2) the issuer will not be incurring any asset-based sales charges or asset-based service fees in connection with the transaction; (3) there are no "potential conflicts of interest" that would be required to be disclosed on Schedule 15D pursuant to Rule 15c2-3(a)(2)(i) and (ii); and (4) the broker-dealer does not pay any differential compensation that would be required to be disclosed on Schedule 15D pursuant to Rule 15c2-3(a)(2)(iii). In the absence of an exception, an investor who contemplates purchasing a covered security satisfying these conditions would receive a disclosure document that would include only negative disclosure, which would not appear to be very useful to the investor. Moreover, requiring the delivery of this document in such circumstances might actually disserve the investor by impeding his or her ability to effect the transaction until the disclosure is provided. For these reasons, we recommend that transactions satisfying all of the above-listed conditions be excepted from the proposed rule's requirements.

2. Unsolicited Transactions

The Institute further recommends that proposed Rule 15c2-3(e) provide an exception for unsolicited transactions – *i.e.,* those transactions in which the broker-dealer effecting the transactions does not make a recommendation to the customer.[45] This exception would accommodate those instances in which an investor has done his or her own investment research

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[44] In addition to recommending these additional exceptions, the Institute believes that the exception proposed in Subsection (e)(1) of the rule for mail, messenger, or third-party delivery transactions is unworkable in its current form. According to the Proposing Release, this exception "is intended to promote disclosure while avoiding the need to delay the execution of orders received via mail or similar services, given that it may not be possible to locate those customers, let alone provide disclosure." And yet, a prerequisite for relying on this exception is that the broker-dealer that has received the trade by mail must have provided to the customer "within the previous six months" the disclosure required by the rule. Broker-dealers that receive orders in the mail from, for example, a new customer that has had no previous discussions with the broker-dealer about buying a covered security would not be able to comply with this condition. Accordingly, we recommend that the Commission delete this disclosure requirement from this exception. We additionally recommend that the Commission delete the provision in this exception that would require a broker-dealer to provide an explanation of "how sales loads can reduce investment returns" (*i.e.,* Subsections (e)(1)(A) and (B)), inasmuch as this explanation would not be required in any other situation under the rule.

[45] This recommendation would address situations in which the transaction, though unsolicited, is subject to a load and/or asset-based sales fee that would preclude the broker-dealer from relying on the exception we propose for directly sold funds.

and made the decision to purchase a covered security without any recommendation of a broker-dealer effecting the transaction. In such instances, the point of sale disclosure would not serve its intended purpose.[46] Indeed, it is likely that an investor who has made his or her own investment decision on an unsolicited basis would not want to face possible delays or other inconveniences as a result of the requirements under the proposed rule.[47]

[46] According to the Proposing Release, the point of sale disclosure would provide investors with "information that they can use as they determine whether to enter into a transaction to purchase" a covered security. Proposing Release at p. 3. In the case of an unsolicited transaction, the investor has already made that determination.

[47] Requiring such disclosure in connection with unsolicited transactions, including those involving directly sold covered securities, would be especially inappropriate for customers who communicate their orders to purchase covered securities over the phone. In such instances, because the rule contains no provision allowing investors to opt out of receiving this disclosure, the customer may either (1) be forced to sit through a broker-dealer's reading of the required disclosure or (2) have the transaction delayed until the broker-dealer can provide the customer the required disclosure in writing.

3. Subsequent Purchases by the Investor of the Same Covered Security from the Same Broker-Dealer

The Institute additionally recommends that the rule provide an exception for subsequent purchases of the same covered security from the same broker-dealer provided that (1) the investor received the required disclosure in connection with a previous purchase of the security and (2) the information required to be disclosed has not changed since the disclosure was last provided to the investor. This exception is similar to the rule's proposed exception for transactions that are part of a covered securities plan but, unlike the Commission's proposed exception, our recommended exception would apply when the customer purchases the additional shares sporadically and not pursuant to a systematic investment plan. The rationale behind both exceptions would appear to be the same – *i.e.,* there is not a compelling need for a broker-dealer to repeat disclosure previously provided to the investor.

4. Institutional Investors

The Proposing Release requests comment on whether Rule 15c2-3 should provide an exception for transactions involving institutional investors. The Institute recommends that the rule include such an exception. It seems clear that the intended beneficiaries of the Commission's proposed rules are retail investors, not institutional investors. Because institutional investors typically are well-equipped to obtain information relevant to their investment decisions involving covered securities, we do not believe that it is necessary for the Commission to require the disclosures proposed by Rule 15c2-3 to be provided to them. Rather than subjecting such investors to disclosure standards that appear to be intended and designed for retail investors, we recommend that disclosures to institutional investors continue to be governed by the general anti-fraud standards under the federal securities laws. For purposes of this exception, we recommend that the rule include a definition of "institutional investor" that is identical to the definition of this term in NASD Conduct Rule 2110(a)(3), which governs the standards applicable to institutional sales material.[48]

5. Exception for Primary Distributors/Principal Underwriters

Proposed Rule 15c2-3(e)(2) would provide an exception from the rule's disclosure requirements for a fund's primary distributor provided that the primary distributor: (1) "did not communicate with the customer about the transaction other than to accept the customer's order;" and (2) reasonably believes that another broker-dealer has delivered the information required by the rule to the customer. According to the Proposing Release, this exception "is intended to preclude imposing unnecessary burdens on . . . primary distributors that do not

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[48] "Institutional investor" is defined in NASD Conduct Rule 2110(a)(3) to include a bank, savings and loan association, insurance company, registered investment company, investment adviser registered with the Commission or with a state securities commission, any other person with total assets of at least $50 million, governmental entities or subdivisions thereof, an employee benefit plan that meets the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and has 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, and a person acting solely on behalf of any such institutional investor.

solicit transactions, when the investor can be expected to receive the required disclosure from another [broker-dealer]."[49] The Institute strongly concurs with the Commission not subjecting all primary distributors to the rule's disclosure requirements. We recommend, however, that the Commission further tailor the obligations of primary distributor under the rule.[50]

A fund's principal underwriter might receive orders from a broker-dealer with which the underwriter has selling agreements, from broker-dealers with which the underwriter has no such selling agreements, and from investors directly – either through a so-called "check and application" process[51] or from an investor purchasing additional shares in an existing account.[52] We recommend that a principal underwriter's responsibilities under the rule take into account who transmits the transaction order. In particular, we recommend that the provisions in the proposed exception for clearing brokers and primary distributors (*i.e.*, Paragraph (e)(2)) be revised to delete any reference to primary distributors (thereby limiting this exception to

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[49] Proposing Release at p. 41.

[50] As a preliminary matter, we note that the term "primary distributor" is not defined in the rule or in the Exchange Act. Consistent with the Commission's intent in using this term, we recommend that the rule instead use the term "principal underwriter," and include a definition for this term that is identical to, or cross-references, that in Section 2(a)(29) of the Investment Company Act. As defined in Section 2(a)(29) of the Investment Company Act, a "principal underwriter" of or for any investment company other than a closed-end company, or of any security issued by such a company, is any "underwriter who as principal purchases from such company, or pursuant to contract has the right (whether absolute or conditional) from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company."

[51] The phrase "check and application" refers to situations in which the principal underwriter relies upon third-party selling broker-dealers to distribute its funds and, notwithstanding these arrangements, the principal underwriter receives an initial order (*i.e.*, an application to purchase shares together with a check to cover the purchase price) directly from an investor rather than from a selling broker-dealer. In such instances, the principal underwriter has not initiated the transaction nor recommended the security to the investor. Check and application transactions differ from transactions involving directly sold covered securities, discussed above, in that, with directly sold covered securities, the principal underwriter distributes shares directly to retail investors rather than through selling agreements with third-party broker-dealers. (In check and application transactions, the application will include the name of a third-party broker-dealer.)

[52] Infrequently, the principal underwriter may be the broker-dealer of record on an account (*e.g.*, so-called "orphan accounts"). In other instances, the existing account may be an account of the customer that is held at the selling broker-dealer and is subject to a "Networking arrangement." The term "Networking arrangements" refers to arrangements between broker-dealers and mutual funds to exchange information on an investor's account via the automated Networking service provided by the National Securities Clearing Corporation (NSCC). There are four "levels" of Networking arrangements in the mutual fund industry. The "level" of Networking arrangement agreed to between a fund's principal underwriter and its selling broker-dealers defines which entity is responsible for, among other things, shareholder contact. In Networking Levels 1 and 2, the broker-dealer has primary responsibility for shareholder contact (with respect to issuing confirmations and statements and servicing the shareholder's account), though a shareholder of an account opened by the broker-dealer can contact the fund's principal underwriter to purchase additional shares. In Networking Level 3, a broker-dealer has exclusive responsibility for shareholder contact and the fund's principal underwriter has no contact with the broker-dealer's account holders. In Networking Level 4, responsibility for various recordkeeping and reporting tasks for the customer's account may lie with either the broker-dealer or the fund's principal underwriter.

clearing brokers) and that a new provision be created in the rule to govern application of the rule's disclosure requirements to principal underwriters. We recommend such new provision provide as follows with respect to a registered broker-dealer that, in connection with a transaction in covered securities, acts as a fund's principal underwriter:

- If the principal underwriter receives an order from a broker-dealer with which the principal underwriter has a selling agreement, the principal underwriter shall be exempt from the rule's disclosure requirements provided that the selling agreement between the principal underwriter and the selling broker-dealer requires the selling-broker dealer to provide any disclosure required by Rule 15c2-3(a) to the investor;

- If the principal underwriter receives an order from a broker-dealer with which the principal underwriter does *not* have a selling agreement, the principal underwriter must either (1) provide the rule's required disclosure to the investor[53] or (2) have a reasonable belief that the selling broker-dealer has provided the required disclosure to the investor prior to accepting the order; and

- If the principal underwriter receives an order directly from an investor on an unsolicited basis, the principal underwriter would not be required to provide the customer disclosure in accordance with Schedule 15D or the rule. (The principal underwriter would, however, be required under Rule 15c2-2 to provide the investor a confirmation in compliance with that rule.) Because the principal underwriter in such transactions has not initiated the contact with the investor and the investor has placed the order without any input from or advice of the principal underwriter, it is unnecessary and inappropriate to condition the principal underwriter's acceptance of the order on the principal underwriter providing the required disclosure. Indeed, if the Commission were to require the principal underwriter to provide the disclosure prior to effecting the trade, to avoid the order being deemed an indication of interest, the principal underwriter would either have to reject the trade as not in good order or delay effecting the trade until such time as the principal underwriter could provide the point of sale disclosure document to the investor and have the investor confirm his or her interest in having the trade processed by the principal underwriter after receiving and reviewing the point of sale disclosure document. We submit that neither result would be in the best interests of the investor that placed the unsolicited trade with the principal underwriter.[54]

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[53] It is likely, however, that a primary distributor that provides the document under these circumstances may not have any information about the broker-dealer's differential cash compensation arrangements. Accordingly, in providing the required disclosure to the investor, the primary distributor should be permitted to replace the "check-the-box" disclosure of this information on Schedule 15D with a legend directing the investor to the broker-dealer to obtain this information.

[54] If the Commission adopts our above recommended exception for unsolicited transactions, that exception would obviate the need to address separately unsolicited transactions received by the primary distributor. If the Commission does not provide an exception for all unsolicited transactions, we strongly recommend that it at least provide a limited exception for unsolicited transactions received by the primary distributor to enable the primary distributor to process, without delay, a transaction requested by the customer in circumstances such as those discussed in the text.

We believe this approach, while more detailed than the Commission's proposed treatment of principal underwriters, would better align a principal underwriter's responsibilities under the rule to industry practices.

If the Commission does not make the change recommended above, we recommend that it address two issues relating to the exception for primary distributors (principal underwriters) in proposed Rule 15c2-3(e)(2). The first issue relates to the condition in the exception that the principal underwriter "did not communicate with the customer about the transaction other than to accept the customer's order." It is important that this exception accommodate situations in which the order received by the primary distributor contains incomplete information[55] (*i.e.* the order is not "in good order") or situations in which, once the order is processed, the primary distributor has a legal obligation to communicate with the customer (*e.g.*, to provide the investor the annual privacy notice required by Regulation S-P or tax reporting forms required by the Internal Revenue Service). In each instance, the communication between the primary distributor and the customer occurs *after* the primary distributor receives the order. In particular, we recommend that the Commission clarify in the adopting release that, as used in this provision, the prohibition against communicating with the investor does not include the primary distributor communicating with the customer as necessary either to ensure that the customer's order was in good order or to fulfill the primary distributor's legal obligations.[56]

The second issue that needs to be addressed relates to the condition in Rule 15c2-3(e)(2)(ii) that the primary distributor "reasonably believes that another broker, dealer or municipal securities dealer has delivered the information to the customer as required by [the rule]."[57] According to a footnote to the Proposing Release, a mutual fund's primary distributor "may demonstrate the requisite reasonable belief if its selling agreement[58] with those of other firms provides that the selling brokers, dealers or municipal securities dealers will deliver point of sale information, *and if the primary distributor audits the compliance of those other firms.*"[59]

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[55] For example, information items could either be missing from the application or the primary distributor may be required under USA PATRIOT Act rules to obtain additional identifying information from the customer prior to accepting the order.

[56] Alternatively, the Commission could revise Rule 15c2-3(e)(2), in relevant part, as follows: "did not communicate with the customer about the transaction prior to receipt of the order ~~other than to accept the customer's order~~." (Underscored language would be added; overstricken language would be deleted.)

[57] The consequence of the primary distributor *not* having the reasonable belief necessary to rely on this exception is that it would be unlawful for it to effect the transaction.

[58] It should be noted that sponsors of UITs typically do not have "selling agreements" with retail broker-dealers that offer the trust's shares to retail investors. Accordingly, we recommend that any provisions in the adopted rule or adopting release that relate to "selling agreements" instead use the more generic term "agreements." (With respect to the sale of mutual funds or UITs, pursuant to NASD Rule of Conduct 2830(c), selling agreements are only required if (1) a member of the NASD who is an underwriter sells securities to any broker-dealer at any price other than a public offering price and (2) the issuer invests primarily in securities issued by other investment companies.)

[59] Proposing Release at n.148 (emphasis added).

We question the basis for suggesting that a fund distributor may have to audit its selling broker-dealers in order to rely upon this exception. Not only would this be extremely burdensome to a fund's primary distributor,[60] but it is wholly unnecessary because the selling broker-dealers would have a separate legal obligation to comply with Rule 15c2-3 with respect to their customers. To the extent the selling broker-dealer has committed in its agreement with the primary distributor to provide this disclosure, the primary distributor should be able to rely upon this representation without having to incur the burden and expense of auditing all selling-broker dealers to verify the veracity of this representation.[61] We recommend, therefore, that the Commission's adopting release clarify that, for purposes of the exception proposed in Subsection (e)(2)(ii), a primary distributor may demonstrate its reasonable belief through provisions in its agreements with selling broker-dealers that require the selling broker-dealers to provide the point of sale disclosure to investors.[62]

6. UIT Transactions

As discussed above, Rule 15c2-3 would prohibit a broker-dealer from "effect[ing] a purchase of a covered security" without first making the disclosure required by the rule. It is unclear how this provision would apply in the case of certain UIT offerings. It is our understanding that fixed-income UITs, prior to being offered for sale to retail investors, are sold by the trust's principal underwriter or sponsor to various institutional investors including, for example, wholesaling broker-dealers or market-makers. Such broker-dealers, in turn, sell the units either to other broker-dealers or to retail investors.[63] The Institute recommends that the Commission clarify in the adopting release that, in these circumstances, the rule's prohibition against "effect[ing] a purchase of a covered security" unless the required disclosures are made would only apply to the transaction directly effected by the principal underwriter (unless otherwise excepted as institutional transaction, as recommended above) and not to transactions

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[60] Some primary distributors have thousands of selling agreements.

[61] We note that, according to the Proposing Release, in the case of clearing and carrying brokers, "[a]greements that specify the responsibilities of the parties with respect to point of sale disclosure, and associated recordkeeping, may form the basis for a reasonable belief." Proposing Release at n.148. With respect to primary distributors, however, the Proposing Release indicates that they may demonstrate their reasonable belief through selling agreements with other broker-dealer firms "*and* if the primary distributor audits the compliance of those other firms." *Id.* (Emphasis added.) No rationale is provided for establishing a more onerous standard for fund distributors than for clearing brokers.

[62] In the event the Commission adds to the rule exceptions for direct sold covered securities and unsolicited transactions, as recommended above, this clarification would be less necessary.

[63] Assume, for example, that New York City decides to issue a $200 million in bonds. In lieu of selling the bonds directly to the retail customers, New York City hires a broker-dealer (*i.e.*, a principal underwriter) to put together a trust consisting of these securities. The units of this $200 million trust are then sold in equal amounts by its principal underwriter to four different broker-dealers, Broker-Dealers A, B, C, and D. Broker Dealer A sells the entirety of its $50 million of the trust to an institutional investor, who, in turn, sells its units to various broker-dealers to sell to retail customers. Broker-Dealer B sells its shares directly to retail investors. Broker-Dealers C and D are market makers that sell their shares to other broker-dealers, that then sell them to retail investors.

involving the same units that are subsequently effected by other broker-dealers or other persons away from the principal underwriter.[64]

D. Contents of Point-of-Sale Disclosure Document

Rule 15c2-3(a) and Schedule 15D would govern the information that must be disclosed to the investor in the point of sale disclosure document. The Institute generally supports the scope of the proposed point of sale disclosure document, with two exceptions. First, as discussed in Section I.B.2., above, we recommend that the Commission eliminate the proposed disclosure relating to portfolio brokerage commissions. Second, we recommend adding narrative disclosure concerning other information investors should consider before purchasing covered securities. In addition, we suggest changing the format of some of the required disclosure to make it easier to read and understand.[65] The latter two recommendations are discussed below.

1. Additional Narrative Disclosure

While the Institute agrees that it is appropriate for the point of sale disclosure document to focus primarily on distribution-related costs and conflicts of interest, we recommend that the Commission add to Schedule 15D more general narrative disclosure. We recommend that the point of sale disclosure document be required to include a legend or statement that, in addition to encouraging an investor to consider the information set forth on Schedule 15D: (1) advises an investor to consider the investment objectives and risks of the covered security carefully before investing; (2) explains that the prospectus or offering document contains this and other information about the covered security; (3) identifies a source from which the investor may obtain the prospectus or offering document; and (4) states that such document should be read carefully before investing. This disclosure, which is similar to disclosure required in mutual fund advertisements,[66] would ensure that, at the point of sale, in addition to being provided information on sales-related costs and conflicts of interest, the investor is alerted to the availability of other information that should be considered prior to making an investment decision.

2. Format of the Disclosure

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[64] Broker-dealers purchasing the units from the trust's principal underwriter would have obligations under the rule to provided the required disclosure to any person purchasing such units from that broker-dealer unless otherwise excepted or unless sold in a secondary market transaction. (As defined, the term "covered security" would not include secondary market transactions of a trust's units.) Our clarification is necessary for the multiple transactions that, though they occur away from the trust's primary distributor, are considered to be trades in the primary market.

[65] We additionally recommend that the Commission clarify that the rule only requires inclusion of the "Account number" on the point of sale disclosure document if such number is available at the time the disclosure is made. This clarification is necessary because in some instances the document may be provided to a customer prior to the time the customer has established an account with the broker-dealer.

[66] See Rule 482(b)(1)(i) under the Securities Act of 1933.

The Institute recommends that the disclosure provided to investors be presented in a format that will best communicate the information the investor needs to know prior to making an investment decision. The proposed disclosure on Schedule 15D relating to the dollar amount of sales loads the investor will incur or is likely to incur if he or she purchases the covered security recommended by the broker-dealer satisfies this criterion and we support it.

With respect to the information on the form about potential conflicts of interest, we concur with the Commission that presenting this information in a qualitative, rather than a quantitative, format would better convey the information to the investor. Indeed, of concern to an investor prior to making an investment decision is the *existence* of a potential conflict of interest. Thus, it would not seem necessary for an investor to receive quantitative information on the extent of the conflict. Moreover, as discussed above, we believe that quantitative disclosure of revenue sharing payments would mislead and/or confuse investors. We recommend, however, that rather than requiring a broker-dealer to answer either "yes" or "no" to the conflicts of interest questions posed, a better approach would be the "check-the-box" format that has been proposed under Section D of Schedule 15C. This would seem to be more user-friendly than the format proposed by the Commission. Also, we recommend that the Commission revise the format of the headings in Section F so that they are listed according to the term being defined rather than having some listed as terms and others as questions – *e.g.*, change "What is revenue sharing?" to "Revenue sharing."

E. Manner of Disclosure

Proposed Rule 15c2-3(c)(2) would require, in part, that if the point of sale occurs through an oral (but not in-person) communication, the disclosures required by the rule must be provided orally. As such, it would appear that for transactions conducted over the telephone, the broker-dealer would be required to read to the investor the entire contents of proposed Schedule 15D. While the Proposing Release notes that the rule's provisions governing manner of disclosure "are geared to promote effective disclosure while accommodating practicality," in our view, requiring such oral disclosure over the telephone would be a most impractical and ineffective manner of disclosure and one likely to be off-putting to investors.

To avoid requiring an investor to sit through an oral recitation of the disclosure document,[67] we recommend that Rule 15c2-3(c)(2) be revised to provide that, in connection with an oral communication, other than an in-person communication, a broker-dealer should be required only to: (1) disclose, if applicable, any dollar amounts that must be disclosed pursuant to proposed Rule 15c2-3(a)(1) and (2) (*i.e.*, the quantitative information on sales loads and asset-based distribution fees); and (2) provide an oral summary of those "potential conflicts of interest" or "special compensation for [the broker-dealer's] personnel" that would result in affirmative disclosure under the rule (*i.e.*, proposed Rule 15c2-3(a)(2)).[68]

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[67] As mentioned above, an investor in this situation would not have the option of waiving the oral disclosure. Instead, until the broker-dealer provides the investor all of the requested disclosure, the investor's "purchase" of a covered security could only be treated by the broker-dealer as an "indication of interest" in the covered security.

[68] For example, if the answer to the questions asked on Schedule 15D under these headings was "No," the broker-dealer would not be required to include oral disclosure regarding these topics. Alternatively, if the fund paid its

III. PROPOSED AMENDMENTS TO FORM N-1A

A. Fee Table Disclosure; Impact of Breakpoints

The Commission proposes to revise the fee table in Form N-1A to show (1) the maximum front-end sales load as a percentage of NAV (rather than as a percentage of current offering price) and (2) any deferred sales load based on offering price at the time of purchase as percentage of NAV at the time of purchase.[69] The proposal would additionally require a fund to disclose in a footnote to the fee table, if applicable, that the actual maximum sales load that may be paid by an investor as a percentage of the net amount invested may be higher than the maximum sales load shown as a percentage of net asset value in the fee table, with an explanation for the variation and disclosure of the maximum sales load as a percentage of the net amount invested.[70] Also, the instructions to the Form would be revised to clarify that, if a fund imposes more than one type of sales load, the aggregate load should be shown in the fee table as a percentage of NAV.[71]

The Institute supports the Commission's proposal. We agree that disclosure of sales loads in the prospectus, to the extent practicable, should be consistent with that on confirmations.[72] We also think it will be beneficial to explain to investors that, as a result of rounding, sales loads shown in the prospectus as a percentage of the offering price or net asset value may be higher or lower than the actual sales load that the investor would pay as a percentage of the gross or net amount invested. The Commission has sought comment on its proposed placement of this disclosure – *i.e.*, whether it should be required in both the prospectus fee table and the table of front-end sales loads. While we believe this information would be useful to investors, we do not believe that it is necessary to include it in *both* the prospectus fee table and the table of front-end sales loads. Rather, requiring disclosure in either location should sufficiently alert investors to the impact rounding may have on their sales load.

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representatives more for selling proprietary securities and the investor was interested in purchasing such a security, the broker-dealer could satisfy its disclosure requirements by stating, "ABC Broker-Dealer pays its personnel more for selling this security to you because it's a proprietary security."

[69] For consistency, the Commission also has proposed to remove the current requirement that a deferred sales load based on NAV at the time of purchase be shown in the fee table as a percentage of offering price at the time of purchase.

[70] *See* proposed Instruction 4 to Item 8(a)(1) of Form N-1A. The Proposing Release provides an example in which an investor that starts out with $10,000 and pays a 5% front-end load on the gross amount would pay a sales load of $500. The sales load as a percentage of the net amount invested of $9,500 would be 5.26% ($500/$9,500 x 100%). The Commission's proposal would require the load to be disclosed as 5.26%.

[71] We note that this information would additionally be disclosed on the confirmation pursuant to Section E of Schedule 15C.

[72] We also urge the Commission, to the extent practicable, to make the terms used in Schedules 15C and 15D consistent with those prescribed by Item 3 of Form N-1A for the fee table in mutual fund prospectuses.

B. Revenue Sharing Disclosure

The Commission's proposal also would amend Form N-1A to require funds' prospectuses to contain disclosure regarding revenue sharing payments. Specifically, if any person within a fund complex makes revenue sharing payments, the fund would have to disclose that fact in its prospectus.[73] In addition, to the extent any such revenue sharing payments are made, the fund would be required to disclose that specific information about revenue sharing payments made to an investor's financial intermediary is included in the confirmation or periodic statement required under proposed Rule 15c2-2 and in the disclosure provided at the point of sale required under proposed Rule 15c2-3.

The Institute supports this proposal.[74] We agree with the Commission that it is neither necessary nor appropriate to require more detailed disclosure concerning revenue sharing arrangements in the prospectus.[75] The proposed prospectus disclosure, along with the disclosure that would be required to be provided to the investor at the point of sale in connection with the investor's particular transaction, should provide ample notice of any conflict of interest relating to revenue sharing that might impact the broker-dealer's recommendation of a particular covered security.[76]

On a related matter, we note that the NASD's rules currently require prospectus disclosure of cash compensation arrangements.[77] In light of the SEC's proposed prospectus disclosure requirements, upon adoption of the revisions to Form N-1A we recommend that the NASD rules be revised to eliminate the NASD's prospectus disclosure requirement as it will no longer be necessary.

IV. TRANSITION PERIOD

The Proposing Release does not specify the length of a transition period the Commission would expect to provide in the event it adopts the proposed new rules and schedules. The

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[73] We note that our comments above concerning the proposed definition of the term "revenue sharing" would apply equally to the use of this term in the context of prospectus disclosure. *See* Section I.D, above.

[74] Consistent with our comments above recommending that the Commission not require disclosure of revenue sharing payments in confirmations, however, we recommend that the Commission revise proposed paragraph (c) in Item 8 of Form N-1A to delete the reference to the "written notification or periodic statement required under rule 15c2-2 under the Securities Exchange Act."

[75] The Institute previously expressed concerns to Commission staff that detailed prospectus disclosure of cash compensation payments would be inappropriate inasmuch as it would run contrary to the Commission's mutual fund prospectus simplification initiatives, would entail severe practical problems, and would result in disclosure that would be largely irrelevant to any given investor. *See* the May 2000 ICI Letter, *supra* note 5.

[76] Furthermore, if the NASD adopts its proposed amendments to NASD Rule 2830, broker-dealers would be required to provide additional written disclosure to investors at the point of sale concerning revenue sharing and differential cash compensation arrangements. *See supra* note 4.

[77] *See* NASD Rule 2830(l)(4).

Institute strongly recommends that, because of all the changes to a broker-dealer's policies, procedures, and systems that these rules and schedules will necessitate,[78] the Commission provide a sufficiently long transition period prior to enforcing compliance with the new rules. Our recommendation regarding the length of this transition period depends on the scope of disclosure that will be required under the Commission's final rules.

To the extent the Commission requires inclusion on the confirmation of quantitative information relating to revenue sharing, for example, such disclosure would necessitate a broker-dealer compiling data over a one-year period in order to compute the required information. Accordingly, the Commission's transition period should provide broker-dealers an adequate period of time within which to make the substantial revisions that are necessary to capture the required information from their own systems and, as necessary, from the systems of issuers of covered securities and their affiliates, compute the information required to be disclosed, and import it to their confirmations.[79] In determining a compliance date for the new rules we encourage the Commission to work with broker-dealers to develop an appropriate timetable for implementation.

In setting the compliance date, the Commission should take into account not only the changes to broker-dealers' systems necessitated by the current proposal, but also other recent Commission initiatives that are either impacting or, upon adoption, will likely impact, the systems, policies, and procedures utilized by broker-dealers in connection with the offer and sale of covered securities.[80] We are concerned that failure to consider these other Commission initiatives that are also impacting broker-dealers may result in unduly and unnecessarily stressing broker-dealers' operational and compliance systems.

Regardless of the transition period provided by the Commission, we recommend that the Commission not deem these rules effective until such time as the Commission coordinates this regulatory initiative with other regulatory initiatives of the Commission and the NASD that may impact the disclosure that would be required under this initiative, as discussed above.[81]

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[78] As discussed in the Proposing Release's discussion of "Costs," these changes include, but are not limited to, software development, the re-programming and updating of confirmation delivery systems, compliance officers and others to oversee and maintain confirmation delivery systems (including development and implementation of policies and procedures and training of representatives and call center personnel), printing and typesetting, calculation of revenue sharing amounts, providing system updates, producing the point of sale disclosure document for various media, developing recordkeeping systems, etc. Proposing Release at pp. 60-64.

[79] To the extent the Commission adopts the Institute's recommendations that would limit the quantitative disclosures required on the confirmation and enable broker-dealers to better tailor their required confirmation and point of sale disclosures to the investor receiving them, a shorter transition period of a year after the final rules' adoption should be adequate.

[80] *E.g.*, proposed amendments to Rule 22c-1 and proposed new Rule 22c-2 under the Investment Company Act, relating to pricing of mutual fund shares and imposition of a mandatory redemption fee, respectively.

[81] We also recommend that the Commission defer adoption of the proposed rules until such time as the legislative outlook becomes clearer to avoid broker-dealers having to adjust their implementation of the Commission's rules with any intervening federal legislation relating to disclosure of conflicts of interest by broker-dealers.

This recommendation is intended to ensure that broker-dealers are not subjected to disparate, fragmented, and perhaps conflicting or inconsistent disclosure requirements that may result in investor confusion.[82] We also recommend that the Commission not deem these rules effective until broker-dealers can be assured that, once they begin the process of implementing the new rules' requirements, these requirements are not expected to change in the near term. This recommendation is to address concerns relating to comparison range information and is intended to ensure that the transition period for these rules not begin until such time as the Commission has determined whether the redesigned confirmation is going to include this information. We are concerned that failure to await this determination might result in a two-step implementation process in which broker-dealers are required to redesign their confirmations twice, at considerable expense each time – the first time without the comparison range information; the second time to add such information.

Finally, we understand that the Commission plans to obtain investor input on the proposed confirmation and point of sale disclosure document through focus groups.[83] The Institute strongly recommends that the Commission not seek feedback from focus groups until the Commission has revised its proposal based upon the comments it receives in response to its Proposing Release. This would ensure that the feedback obtained from the focus groups is more meaningful – indeed we would encourage the Commission to vet revised versions of its proposed Schedules 15C and 15D with focus groups. In addition, however, we strongly recommend that, in conducting focus groups, the Commission expressly seek input on the value to investors of this enhanced disclosure. As noted in the Proposing Release, implementation of the proposed rules would result in substantial costs. Inasmuch as these costs may ultimately be borne by the investors that receive this disclosure, we believe investors should be asked whether they would be willing to pay for this enhanced disclosure (*i.e.*, incur the additional costs that are likely to result from this enhanced disclosure). Indeed, failing to raise this issue with focus groups would, in our view, skew the results and not provide a fair assessment of the investors' view of the value to them of the enhanced disclosure.

* * *

The Institute appreciates the opportunity to comment on the Commission's proposal. If you have any questions concerning these comments or would like additional information, please contact the undersigned at (202) 326-5824, Frances Stadler at (202) 326-5822, or Tamara Salmon at (202) 326-5825.

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[82] For example, as discussed above, the Commission and the NASD each have outstanding proposals that, if adopted, would prohibit directed brokerage arrangements, thereby rendering moot the need to require disclosure of such arrangements under proposed Rules 15c2-2 and 15c2-3; the NASD has an outstanding proposal relating to revenue sharing and differential cash compensation arrangements that should be considered by the Commission as it contemplates imposing additional point of sale disclosure requirements on broker-dealers; and NASD Rule 2830 currently requires prospectus disclosure of cash compensation arrangements, which requirements are not entirely consistent with the Commission's proposed amendments to Form N-1A.

[83] *See, e.g.*, "SEC Reaches for Feedback on Disclosure Wording," *Ignites* (Feb. 23, 2004).

Sincerely,

Amy B.R. Lancellotta
Acting General Counsel

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

Paul F. Roye, Director
Cynthia M. Fornelli, Deputy Director
Division of Investment Management

Catherine McGuire, Chief Counsel
Office of the Chief Counsel
Division of Market Regulation

Attachments

APPENDIX A

Sample Confirmation for a Purchase of a Covered Security with a Front-end Sales Load and No Asset-Based Sales Fees or Payments Involving Potential Conflicts of Interest*

ACME Clearing Inc.

Fees and Payments Associated with your Investment

General Information:

Customer:	John Doe	Type of security:	Mutual fund
Account Number:	1234-5678	Net Asset Value (NAV)	$18.17
Date of transaction:	1/1/05	Price (NAV plus load):	$18.93
Type of transaction:	Purchase	Amount paid/received:	$8,000.00
No. shares bought/sold	422.610	Amount of your investment/sale:	$7,678.82
Security issuer:	BBB Fund		
Class (if applicable)	A		

What you paid for your purchase:

Front-end sales load **$321.18,** *which is equivalent to 4.18% of your investment*

Amounts that AAA Introducing Broker-Dealer will receive from the fund or its affiliates:

SALES FEE AAA INTRODUCING BROKER RECEIVED FOR YOUR PURCHASE: **$300**, *WHICH IS THE EQUIVALENT OF 3.91% OF YOUR INVESTMENT*

Breakpoint discount information

Many mutual fund companies offer sales load discounts, which are also known as "breakpoint discounts," to customers who have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) entitles you to a sales load of 4.17%, which may vary from the sales load disclosed above due to rounding to the nearest penny in the transaction.

* We have omitted Section F from this sample confirmation as well as from Appendices B and C.

APPENDIX B

Revised Version of Schedule 15C
Reflecting the Institute's Proposed Revisions

Schedule 15C – Front Page

<Name of broker, dealer or municipal securities dealer>
Fees and Payments Associated with Your Investment

A. General Information

Customer:	Symbol:
Account Number:	CUSIP number:
Date of transaction:	Type of security:
Type of transaction:	Net Asset Value (NAV):
No. shares bought/sold:	Price (NAV plus load):
Security issuer:	Amount paid/received:
Class (if applicable):	Amount of your investment/sale:

B. What you pay (directly or indirectly) for purchases

Front-end sales load: $xxx, which is equivalent to ___% of your investment

Back-end sales load:
<If applicable> If you sell these shares in ___ year(s), you will pay $___, <if applicable> *or* ***___% of your investment, whichever is less*** <or if applicable> (*which equals* ***___% of your investment***)
<repeated as necessary>

Estimated first-year asset-based sales charges: $xxx, which is equivalent to ___% of your investment

Estimated first-year asset-based service fees: $xxx, which is equivalent to ___% of your investment

Commission/other compensation:

Other charges:

C. Amounts that your broker will receive from the fund or its affiliates

Sales fee <broker-dealer> received for your purchase: $xxx, which is equivalent to ___% of your investment

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D. Breakpoint discount information

<If applicable because a front-end sales load was paid> Many mutual fund companies offer sales load discounts, which are also known as "breakpoint discounts," to customers who have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) entitles you to a sales load of ____%, which may vary from the sales load disclosed above due to rounding to the nearest penny in the transaction.

<If applicable because no front-end sales load was paid> Many mutual fund companies offer sales load discounts, which are also known as "breakpoint discounts," to customers who have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) would have entitled you to a sales load of ___% of net asset value (NAV) had you bought a share class that is not subject to a front-end sales load, but is subject to annual asset-based sales charges of ___% of NAV for a period of ___ years.

APPENDIX C

Revised Version of Schedule 15D Reflecting the Institute's Recommended Revisions

<Name of broker, dealer or municipal securities dealer>

Name _____
Account number, if applicable _____
Date _____
Security under Consideration _____
Class _____
Amount of contemplated transaction _____
_____

Sales Load and what we will be paid up front

Front-end sales load	$ _____
Back-end sales load	$ _____
Amount of sales fee we will receive from the fund	$ _____
Estimated first year asset-based distribution or service fees that we will receive from the fund	$ _____

Potential Conflicts of Interest – Revenue Sharing Arrangements

The fund's affiliates make additional payments to us, such as revenue sharing.	**Yes** ☐	**No** ☐

Special Compensation for our Personnel

If this is a "proprietary" security issued by an affiliate, we will pay more to our personnel for selling it to you.	**Yes** ☐	**No** ☐	**N/A** ☐
If this security carries a back-end sales load, we will pay more to our personnel for selling it to you.	**Yes** ☐	**No** ☐	**N/A** ☐

Please consider the investment objectives, risks, charges and expenses of your investment before investing. For this and other information on the investment, ask you broker-dealer how you can obtain a free prospectus or other offering document that contains this information. Read it carefully before you invest.

ASK BEFORE YOU BUY! This document contains information that your broker-dealer is required to provide you about potential transactions in certain investments, such as mutual funds, variable annuities or "529 plans." It tells you about the investment's sales-related costs, and about the incentives your broker-dealer and its personnel have to sell you this investement. YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT.

Please consider the investment objectives, risks, charges and expenses of your investment before investing. For this and other information on the investment, ask you broker-dealer how you can obtain a free prospectus or other offering document that contains this information. Read it carefully before you invest.

ASK BEFORE YOU BUY! This document contains information that your broker-dealer is required to provide you about potential transactions in certain investments, such as mutual funds, variable annuities or "529 plans." It tells you about the investment's sales-related costs, and about the incentives your broker-dealer and its personnel have to sell you this investement. YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT.

SOME THINGS TO KNOW ABOUT LOADS: Sometimes share classes that do not have a front-end load have higher fees – which makes them more expensive for the long-term investor. Also, many mutual funds companies offer sales load discounts for investments over a certain level. Sometimes family or household holdings can count toward these discounts. To find out more, talk with your broker or financial advisor, or check the fund's prospectus or website.