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April 12, 2004

**DELIVERY BY HAND**

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

Re: **Release Nos. 33-8358; 34-49148; IC-26431 (File No. S7-06-04); *Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds***

Dear Mr. Katz:

This letter is submitted on behalf of several clients that serve as administrators and record keepers for participant-directed, defined contribution retirement plans. Our clients are pleased to have the opportunity to offer their comments on the proposal (the "Proposal") set forth in the release referenced above (the "Release") to adopt proposed Exchange Act Rule 15c2-2 (the "Proposed Confirmation Rule") and proposed Exchange Act Rule 15c2-3 (the "Proposed POS Rule," together, the "Proposed Rules") establishing new confirmation and point-of-sale disclosure requirements for transactions in mutual funds and other securities ("covered securities").

While our clients support the broad goal of increasing investor access to information about covered securities transactions, they are very concerned that many aspects of the Proposed Rule are poorly suited to the retirement plan market and do not appear to account for its unique distribution structure. To assist the Commission in its consideration of the Proposal, we are offering the following on behalf of our clients:

1. Background information concerning the nature and operation of the retirement plan market with respect to broker-dealer involvement;

2. Observations concerning aspects of the Proposal that we believe are not workable for or relevant to securities transactions in the retirement plan market; and

3. Suggestions for alternate treatment of securities transactions in the retirement plan market.

**Nature and Operation of Retirement Plan Market**

Retirement plans administered by our clients generally invest in a line-up of mutual funds, variable insurance contracts, fixed insurance contracts or collective investment trusts, or some combination of the foregoing, and in some cases may also invest in employer stock. Thus, some of the common investments for retirement plans would fall into the category of "covered securities" under the Proposal and transactions in those securities would be subject to the Proposed Rules. However, the sales context in which retirement plans invest in covered securities is vastly different from the sales context contemplated by the Proposed Rules. More particularly, the Proposed Rules appear to assume that the customer effecting a transaction in a covered security is a retail investor receiving a recommendation from a broker-dealer to effect that transaction. That is simply not the case for retirement plan investments in covered securities. A few points about the nature of the retirement plan "customer" and the "securities sales process" in the retirement plan market may help to illustrate the differences.

First, for most plans, such as those established pursuant to Section 401 of the Internal Revenue Code or governmental plans, the "customer" is the plan trustee or other plan decision-making body that determines which investments will serve as allocation options for plan participant contributions. For some plans, such as plans established pursuant to Section 403(b) of the Internal Revenue Code ("403(b) plans"), the plan participants may be deemed to be the customer for purposes of the federal securities laws. However, in the case of many 403(b) plans, the employer still plays the key role of determining which investments will be made available as allocation options for plan participant contributions and allocations.

Second, in the case of plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), which can include 403(b) plans (collectively, "ERISA plans"), the plan trustee or plan decision-making body has fiduciary responsibility for the selection of plan investment options. In light of this responsibility, many plan trustees or decision-making bodies employ pension consultants and other advisers to assist them in the analysis and selection of plan investment options, an undertaking that can involve several months or more and usually entails a "request for proposal" process. Further, because giving advice to an ERISA plan may cause a broker-dealer to be deemed to be a fiduciary, most broker-dealers are careful to structure any information they provide to a plan decision-maker on potential investments in a manner so as to avoid fiduciary status. In short, they generally avoid giving any recommendations regarding investments to plan decision-makers. Even in the case of 403(b) plans, pursuant to which participants themselves may have a customer relationship with a broker-dealer initiated through an enrollment process, the broker-dealer may structure its activities to avoid making recommendations to plan participants with respect to allocations among the investment options made available by the employer.

Third, a broker-dealer effecting securities transactions for a retirement plan often may provide brokerage services under an "alliance" arrangement with other parties providing other services to the retirement plan, such as the administration of the retirement plan and record-keeping of participant accounts. In such arrangements, often the broker-dealer's role is limited to the

transmission and processing of orders for the retirement plan's investments, based on the processing by the plan administrator or record keeper of contributions, allocations and withdrawal requests under the plan. In many cases, the broker-dealer may be affiliated with the record keeper or other service provider. In such cases, it has long been customary for the parties providing services under alliance arrangements, such as broker-dealers and record keepers, to provide aggregate information on compensation arrangements in the context of the administrative services agreement or similar agreement with the employer or plan. Often, these agreements contain information about the full range of fees and costs for all of the parties, including broker-dealers, providing services to the retirement plan. Further, many plan service providers, partly in response to disclosure requirements set forth in ERISA, have developed alternate disclosure vehicles for the communication of compensation-related information.

Finally, on a day-to-day basis, retirement plan transactions in securities generally are the result of processing multitudinous transactions under the terms of a plan, such as contributions due to payroll deductions, participant reallocations, withdrawals due to termination of service, and so forth, and cannot be easily tied to a single investment decision on any person's part. In other words, a plan's purchase of shares of a given mutual fund on a given day may not be directly related to an investment decision on the part of the plan customer.

**Observations on Application of Proposed Rules to Broker-Dealers Providing Services in the Retirement Plan Market**

1. **Point of Sale Construct Inapposite for Retirement Plan Market.** The Proposed POS Rule offers a definition of "point of sale" that raises more questions than it answers in the case of retirement plan transactions in covered securities. More particularly, the Proposed POS Rule defines "point of sale" in part as the point in time immediately prior to the acceptance of an order from the customer or, in the case of transactions for customers who have not yet opened an account or where the broker-dealer does not accept the order, when the broker-dealer first communicates with the customer about the covered security, specifically or in conjunction with other potential investments. As indicated above, the process followed by many plan decision-makers in considering plan investment options can be a lengthy and involved process, often entailing an "RFP" process, making it very difficult to determine when "point of sale" occurs for purposes of a broker-dealer's involvement in that process. Further, at the time when an investment option is first communicated, the sales compensation may not yet be known. For example, in some cases, the plan decision-maker may specify a particular covered security it would like to include in the plan, and the broker-dealer proposed to be responsible for the transmission of plan orders may then have to negotiate a selling agreement with the sponsor or distributor for that security. Also, the particular share class or sales compensation may not be set until the overall plan service arrangements are established. In other words, the Proposed POS Rule does not appear to accommodate the business realities of the retirement market.

Moreover, the Proposed POS Rule appears to require periodic disclosure for so long as investments are made in a covered security. Retirement plans clearly contemplate ongoing transactions in the underlying investments as contributions are made in accordance with an

employer's payroll deduction and plan contribution schedule, which can entail intervals with a frequency of a weekly, bi-weekly, monthly or semi-monthly or some other similar interval basis. Under the definition of "point of sale" in the Proposed POS Rule, a broker-dealer involved in the transmission and processing of investments in covered securities under a retirement plan could be required to provide a POS disclosure statement in connection with each order taken by the broker-dealer for the purchase of shares of a covered security. We question the utility of such disclosure.

**2. Confirmation Disclosures about Multiple Broker-Dealers Not Relevant to Plan Decision-Makers.** The Proposed Confirmation Rule would apply to "every broker-dealer that effects a transaction in a covered security, including transactions effected by more than one broker-dealer."[1] This would appear to require that customers receive information about broker-dealer compensation for *each* broker-dealer participating in or receiving compensation for a transaction in a covered security, which the Release asserts would allow investors to evaluate potential conflicts of interest.[2] Plan transactions in mutual fund shares may generate sales compensation for several broker-dealers, who may be unrelated to one another. For example, the broker-dealer serving as principal underwriter for the mutual funds in which a retirement plan invests may receive sales compensation relating to the plan's purchase of fund shares. Moreover, for any given transaction, the involvement of most of these broker-dealers is passive and limited solely to the receipt of compensation, without an opportunity to impact a customer's point of sale investment decision. We question whether there is a conflict of interest for these broker-dealers warranting a mandate to disclose to the retirement plan customer the compensation that each of them receives.

**3. Systems Implementation Very Costly.** Even assuming that disclosure of information concerning compensation received by multiple broker-dealers might be useful to retirement plan customers, the infrastructure needed to gather it would be extremely costly. We believe that the costs required to retool current systems and implement new ones to gather, track and process the required information on a single confirmation would be enormous, if indeed the systems and data feeds could be established at all. This would be particularly true for "unbundled" plans in which the record keeper, enrolling broker-dealer, and principal underwriters for the investment options are not affiliated, and therefore have different information and data processing systems. Inevitably, many of the costs associated with developing and reconciling these systems may be borne by plan participants, who will not receive a concomitant benefit.

**4. No Flexibility in Providing Compensation Disclosure.** The Proposed Confirmation Rule mandates that the sales compensation payable to a broker-dealer in connection with covered securities be disclosed in a confirmation conforming to a prescribed format. The Proposed Confirmation Rule offers no flexibility for broker-dealers to utilize formats and disclosure vehicles that may make more sense in the particular circumstances. As noted above, it has long been customary in the plan market for broker-dealers to utilize the administrative services

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[1] 69 Fed. Reg. at 6456.

[2] 69 Fed. Reg. at 6457.

agreement or similar agreement with an employer or plan to provide compensation-related information for the full range of services provided, including both broker-dealer and non-broker-dealer services. The Proposal would disrupt the continuation of that practice, without any meaningful justification. The odd result is that plan decision-makers would be provided with an additional (and costly) disclosure document of limited relevance to its decision-making process, even though it already receives an integrated disclosure of the full range of costs associated with a retirement plan funding, servicing and administration arrangement.

Moreover, the Proposed Confirmation Rule assumes that a transaction in a covered security would occur in isolation and would not be related to any other securities transaction. As explained above, in many cases, a securities transaction under a retirement plan can involve simultaneous transactions in covered securities and non-covered securities. For example, for a given day, the net effect of plan transactions could entail a redemption from a mutual fund and corresponding purchase of employer stock. However, because the transaction in employer stock would remain subject to Rule 10b-10 under the Proposal, different confirmation requirements would apply to the two plan transactions.

**Suggested Alternate Treatment**

Given the concerns and observations discussed above, we believe that the appropriate resolution would be to exempt transactions in covered securities effected for retirement plans from the Proposed Rules, and allow them to continue to be subject to the existing Rule 10b-10 disclosure framework. We note that there is precedent for exempting a particular class of investors, such as retirement plans, from the scope of new rules. For example, in adopting amendments to the broker-dealer record keeping rules that added additional requirements for certain customer accounts, the Commission limited the scope of the new requirements to accounts for natural persons as to which the broker-dealer maintaining the accounts is required to make a suitability determination under the applicable rules of a self-regulatory organization.[3] Also, Regulation S-P excludes from the definition of "consumer" or "customer" an individual who is a beneficiary of a trust or a plan participant in an employee benefit plan, in effect exempting plan participants from the regulation's requirements.[4] In the release announcing the adoption of Regulation S-P, the Commission justified this exclusion based on the unique status of plan participants, in part due to the protections accorded them under other regulatory regimes.[5]

Other rules applicable to broker-dealers also have drawn distinctions in the case of retirement plans. For example, the Department of Treasury, recognizing that retirement accounts are less susceptible for use in financing terrorism or money laundering, excluded accounts opened for the purpose of participating in an employee benefit plan established pursuant to ERISA from the definition of an "account" when adopting the Customer Identification Program rules applicable

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[3] *See* Rule 17a-3(a)(17)(D) under the Exchange Act.

[4] *Id.*

[5] *See* Ex. Act Rel. No. 34-42974, Privacy of Consumer Financial Information (Regulation S-P) (June 22, 2000), 65 Fed. Reg. at 40334.

to broker-dealers.[6] The NASD, as well, has recognized that institutional investors warrant different considerations under its suitability rule, and has adopted IM-2310-3, Suitability Obligations to Institutional Customers, which defines an "institutional investor" as any entity other than a natural person, and suggests that the guidance set forth in the interpretation is more appropriately applied to a customer with at least $10 million invested in securities in the aggregate in its portfolio and/or under management – the type of customer that many retirement plans represent.

In light of the historical precedent, and considering the limited benefits and potentially enormous costs associated with implementing the systems necessary to comply with the Proposed Rules, we respectfully recommend that the Commission consider revising the Proposed Rules to exempt transactions in covered securities purchased or sold in connection with retirement plans from their scope, with the effect that such transactions would continue to be subject to Rule 10b-10.

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We and our clients appreciate the opportunity to provide our clients' views to the Commission. We and our clients also appreciate your consideration of our clients' comments and positions. Please do not hesitate to call me at (202) 383-0197 if you or other members of the Commission staff have any questions about our comments or would like to discuss further any of the issues we have raised on behalf of our clients.

Sincerely,

Susan S. Krawczyk

[6] 31 CFR Part 103.122(a)(1(ii)(b); *see also* Ex. Act Rel. 34-47752, Section II.A, Customer Identification Programs for Broker-Dealers (Apr. 29, 2003).