STEPHEN A. KEEN

January 3, 2006

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: File Number S7–06–04

Dear Mr. Katz:

I was pleased to read Chairman Cox's speech to the Economic Club of New York on December 12, 2005. I was particularly interested in his introspective remarks regarding the needless complexity of some of the Commission's regulations. I was puzzled, however, by his reference to the above-referenced proposed point-of-sale disclosure regulations[1] in the context of an argument for simplification. As proposed, the Point of Sale Regulations would increase the paperwork associated with mutual funds sold by broker in order to provide mostly redundant information. Thus, the Point of Sale Regulations would seem to represent another example of the type of regulations decried by the Commissioner in his speech.

Ignites has reported that the Commission plans to repropose the Point of Sale Regulations for a third time. Their report has prompted me to write this letter in support of such a reproposal. Indeed, I would urge the Commission to make these proposed regulations their first objective in the Chairman's newly declared "all-out war on complexity."[2]

I firmly believe that there are simpler, and better, approaches to disclosing "when a broker has a special financial stake in selling [mutual funds]" than the Point of Sale Regulations. In fact, it appears to me that the mutual fund expense disclosures required by the proposed regulations (which will largely duplicate information already contained in mutual fund prospectuses and shareholder reports) will obscure the more limited disclosure of the broker's "financial stake." Failure to keep your eye on the ball (by looking to solve a number of tangentially related issues with one document), can contribute as much to complex and confused regulation as "shoddy and hurried thinking" or "poor draftsmanship."

The initial release proposing "point-of-sale" disclosure defined the problem quite plainly:

> The proposed new rules respond to concerns that investors in mutual fund shares… lack adequate information about certain distribution related costs, as well as certain distribution arrangements, that create conflicts of interest

[1] *Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds*, Investment Company Act Release No. 26778, 70 Fed. Reg. 10521 (Mar. 4, 2005) (hereinafter, the "Point of Sale Regulations").

[2] These comments are based on over twenty-years of experience as a securities attorney and as an investor. The views expressed are my own; they should not be attributed to my law firm or to any of my current or former clients.

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> for brokers, dealers, municipal securities dealers, and their associated persons.[3]

Yet the Point of Sale Regulations would do little to address these concerns. Take the "model" point-of-sale disclosure attached to the Point of Sale Regulations for example. The models for Class A and B shares would require, by my count, 32 elements of data—only three of which address the broker's potential conflicts of interest. The models do not attempt to quantify the broker's "financial stake."

Most amazingly, the Point of Sale Regulations would not require the broker to disclose that it will retain a portion of the front-end load charged on Class A shares or will receive an advanced commission for selling Class B shares. Even the model confirmations are couched in terms of fees charged by the mutual fund rather than fees paid to the broker. One could imagine an unsophisticated investor reviewing the model point-of-sale disclosure and concluding that the "nice young broker" was recommending mutual funds out of the goodness of the broker's heart. I cannot understand how this serves to communicate the broker's financial stake in the transaction.

A simpler alternative would be to apply the existing rules, specifically the confirmation requirements of Rule 10b-10, to mutual fund transactions. A Rule 10b-10 confirmation provides a customer with a definitive statement of her dealings with her broker. It provides, among other things, the following basic information:

- The terms of the transaction, including the date, quantity and price;
- Whether the broker acted as an agent for the customer, agent for another person, or agent for both the customer and another person; and
- The amount of remuneration received by the broker from the customer, and the source and amount of any other remuneration received by the broker/dealer in connection with the transaction.

Currently, confirmations for mutual fund transactions set forth the terms of the transaction, but may omit some or all of the information regarding for whom the broker acted as agent and the amount and sources of the broker's compensation. However, Rule 10b-10 does not contain a general exception for mutual fund transactions (although the Point of Sale Regulations would create such an exception). Rather, as the Initial Release made clear, the Commission sought to avoid duplication of disclosure by permitting the broker to omit information "so long as the customer receives a fund prospectus that adequately discloses that information."[4]

Expansion of the types and sources of remuneration paid to brokers in mutual fund transactions have called the adequacy of prospectus disclosure into question. A simple response would be to require brokers to supplement this information in the confirmation to the extent the prospectus is inadequate. Mutual funds cannot possibly devise a prospectus that would provide any sort of transaction specific information. This leaves the broker's confirmation as a logical means of disclosure.

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[3] *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; Proposed Rule*, Investment Company Act Release No. 26341, 60 FED. REG. 6438, 6439 (Feb. 10, 2004) (hereinafter, the "Initial Release").

[4] Initial Release at 6442.

One objection to this simple approach is that the investor receives the disclosure after the transaction—too late to factor into his investment decision. This same objection could be leveled at confirmations of other securities transaction. In my experience, however, brokers freely provide a list of the various commission rates and fees that they charge for other securities transactions, both in paper form and on their websites. This may be due to market forces, or to the fact that I will see these fees and charges in my confirmations, or both. Who knows what pre-transaction disclosure might have been prompted by consistent application of Rule 10b-10 to mutual fund transactions? I suspect that, if the Commission had adopted such an approach instead of proposing new regulations, it would already know the answer and could evaluate whether additional disclosure rules are necessary.

Other objections to the simple application of Rule 10b-10 to mutual fund transactions are implicit in some of the comments to the Initial Release. Specifically:

> Some securities industry commenters discussed the difficulty of placing quantitative information about compensation on confirmations, and emphasized the cost required to convey compensation information from selling brokers to firms that issue confirmations or to other entities that prepare confirmations on behalf of selling broker (as well as the fact that investors ultimately may be expected to bear the bulk of those costs). A number of commenters stated that confirmation disclosure of broker-dealer compensation and conflicts of interest would be duplicative of the point of sale disclosure, and that disclosure of compensation and conflicts could be done more effectively through broker/dealer Internet web sites. Some securities industry commenters also stated that the proposed method of quantifying revenue sharing payments would be misleading, and that the disclosure of differential compensation was unclear and not well tailored to those payments.[5]

The first objection is surprising, given the amount of quantitative information currently conveyed to those preparing confirmation for other types of securities transactions. With the rise of competitive commissions and wrap-fee accounts, the remuneration paid by customers to brokers for these transactions varies greatly. Yet brokers have found some means of putting the correct information into their confirmations. If inclusion of other types of remuneration in the confirmation proves intractable, perhaps the underlying arrangement is also too complicated for the average customer to understand. The Commission is not obligated to bend its disclosure rules to accommodate every third-party compensation arrangement a broker might devise.

The second objection presupposes that the Commission requires point-of-sale disclosure and that the confirmation would largely duplicate this disclosure. However, application of Rule 10b-10 to mutual fund transactions would not create a new point-of-sale requirement. Even if the Commission determines that point-of-sale disclosure is necessary, duplication could be avoided by focusing the point-of-sale disclosure on the *rates* being charged and the confirmation on the actual *amount* received in the transaction. This would be in contrast to the largely redundant model confirmations proposed in the Point of Sale Regulations.

The remaining objections might be true of the Point of Sale Regulations, but would not apply to the current confirmation rule. Rule 10b-10 simply requires that the confirmation disclose "the source and amount of any other remuneration received or to be received by the broker in connection with the transaction." No particular format or wording is required. The

[5] Point of Sale Regulations at 10535.

broker is free (or actually, required by other provisions of Rule 10b) to provide this information in a manner that will not mislead customers.

As much as I would enjoy commenting on the Chairman's observations on interactive disclosure (it could be even more far reaching than he suggests) or the appropriate use of focus groups by regulators (if investors already knew what was important, they probably would not need the Commission to protect them), I will try to set a good example by keeping my comments brief. Put simply, I believe that, before proposing an entirely new set of regulations, the Commission should first determine if the consistent application of Rule 10b-10 to mutual fund transactions would prompt adequate disclosure of the broker's "financial stake" in the transaction. If, in addition, the Commission believes that disclosure of mutual fund fees and expenses requires improvement, it should realize that this problem is not limited to investors who purchase mutual funds through brokers. Thus, requiring point-of-sale disclosure from brokers will not fully address this issue.

Cordially,

Stephen A. Keen