The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 17247

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DRAFT COMMENT LETTER ON SEC PROPOSED CONFIRMATION AND POINT OF SALE DISCLOSURE RULES; CONFERENCE CALL SCHEDULED FOR APRIL 1ST

[17247] March 18, 2004 TO: 529 PLAN ADVISORY COMMITTEE No. 10-04 SEC RULES COMMITTEE No. 26-04 SMALL FUNDS COMMITTEE No. 19-04 UNIT INVESTMENT TRUST COMMITTEE No. 10-04 RE: DRAFT COMMENT LETTER ON SEC PROPOSED CONFIRMATION AND POINT OF SALE DISCLOSURE RULES; CONFERENCE CALL SCHEDULED FOR APRIL 1ST As we previously advised you, in January, the Securities and Exchange Commission published for comment two new rules under the Securities Exchange Act of 1934: (1) Rule 15c2- 2, which would govern the content of confirmations issued in connection with transactions involving “covered securities;” and (2) Rule 15c2-3, which would require broker-dealers and municipal securities dealers to provide investors point of sale disclosure in connection with such transactions.* Generally speaking, as defined in these new rules, the term “covered securities” would include mutual funds, UITs, and 529 plan securities. As proposed, the new confirmation and point of sale documents would include detailed information about distribution-related costs and conflicts of interest that may arise in connection with covered security transactions. The Commission has also proposed new Schedules 15C and 15D, which would provide the format to be used in making these disclosures. On February 17th, we held a conference call to discuss the Commission’s proposal. Based upon the issues raised during this call, the Institute has drafted the attached comment letter, which is briefly summarized below. In addition, following the summary, we list several issues on which we specifically request your input. Comments on the proposal must be filed with the Commission by April 12th. The Institute will hold a conference call on Thursday, April 1st at 2:30 p.m. Eastern Time to discuss the draft comment letter. The dial-in number for the call is 1-800-857-4830 and the pass code is 41154. If you plan to participate in the call, please send an e-mail to Deborah Washington at Deborah@ici.org. If you are unable to participate in the call, please provide your comments on the draft letter to the undersigned before the call by phone (202-326-5825), fax (202-326-5839) or e-mail (tamara@ici.org). * See Memorandum to 529 Plan Advisory Committee No. 3-04, SEC Rules Committee No. 13-04, Small Funds Committee No. 9-04, and Unit Investment Trust Committee No. 8-04 [No. 17047], dated Feb. 3, 2004. 2 I. Comments on the Proposed Confirmation Rule, Rule 15c2-2 Generally speaking, the Institute’s comment letter on proposed Rule 15c2-2 recommends that the Commission: • Permit the use of short-form confirmations in instances in which the investor is not required

to pay, directly or indirectly, any of the charges or fees that would be required to be disclosed on longer, more detailed confirmation the Commission has proposed; • Not require the proposed disclosure relating to revenue sharing and differential compensation (and, instead, only require this information be provided to investors in the point of sale disclosure document); • Not require disclosure of portfolio brokerage commission in the confirmation in light of pending regulatory proposals that would render such disclosure moot; and • Not require the "comparison range disclosure" information inasmuch as the context of the information is too limited to be useful to investor and, as a result, may unduly and inappropriately influence investors in their investment decisions. The Institute's letter also includes various technical comments on the proposed rule, and recommends that the Commission clarify the continued ability of broker-dealers to rely on two no-action letters issued under Rule 10b-10 relating to SIPC disclosure and covered securities plans. Attached as Appendices A and B to the Institute's letter are examples of confirmations that would be compliant with our recommended revisions. II. Comments on Proposed Point of Sale Disclosure Rule, Rule 15c2-3 As proposed, Rule 15c2-3, which would require delivery of a disclosure document at the point of sale prior to effecting a transaction in covered securities, would provide various exceptions from the rule's requirements. The Institute's letter recommends that the proposed rule be revised to include four additional exceptions and that the Commission clarify its proposed exception for primary distributors. In particular, we recommend excepting transactions involving: (1) direct sold funds, in which no meaningful information would be required to be disclosed under the rule; (2) unsolicited transactions in which the investor has made his or her investment decision prior to contacting the broker-dealer to effect the transaction; (3) subsequent purchases by the investor of the same covered security from the same broker-dealer when the information disclosed pursuant to Rule 15c2-3 has not changed; and (4) institutional investors. With respect to primary distributors, the Institute's letter recommends that the Commission clarify that reliance upon this exception does not require the primary distributor to conduct an annual audit of selling broker-dealers in order to form a reasonable belief that such selling broker-dealers are distributing the required point of sale disclosure document as required by the rule. With respect to the content of the point of sale disclosure document, the letter recommends that it be revised to include a legend or statement, similar to the legend required in a Rule 482 advertisement, that: (1) advises an investor to consider the investment objectives 3 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. The letter also recommends that the disclosure relating to conflicts of interest be set forth in a check-the-box format (as has been proposed for some of the Schedule 15C disclosure), and that broker-dealers providing the disclosure through oral, but not in-person, communications be permitted to summarize the qualitative information that the rule would require be disclosed. Attached as Appendix C to the Institute's letter is an examples of a point of sale disclosure document that would be compliant with our recommended revisions. III. Form N-1A Amendments With respect to the Commission's proposed amendments to Form N-1A, the letter recommends that the Commission not require prospectus disclosure in both the fee table and the sales load table of information relating to the impact of rounding on sales loads. The letter also recommends that, upon adoption of the proposed revisions to Form N-1A, the Commission recommend to the NASD that it eliminate its rules relating to prospectus disclosure of revenue sharing arrangements as no longer necessary. IV. Transition Period The letter recommends that the Commission permit a one-year transition period prior to enforcing compliance with the rule. We additionally recommend, however, that this period not begin

to run until there is certainty regarding whether comparison range disclosure would be required. V. Institute Request for Member Input We welcome your input on all aspects of the draft letter but are particularly interested in your views on the following issues, each of which we expect to discuss in our April 1st conference call: • Should we retain in the letter our recommendation that institutional investors be excepted from the point of sale disclosure document? If so, should we recommend a definition of “institutional investor?” • Are there additional issues we should raise relating to our recommended exception from the point of sale disclosure document for primary distributors? • The term “primary distributor” is not defined in the rule. Should it be? • Is a one-year transition period reasonable? • During our last call, members seemed to support including the disclosure of the impact of rounding on computation of the sales load. In addition to putting this information on the confirmation, the Commission has proposed to require it in the prospectus as a footnote to the fee table. The Commission has sought comment on whether similar disclosure should also be added as a footnote to the table of front-end sales loads in the prospectus. Our letter recommends that the information be disclosed in connection with either the fee table or the sales load table, but not both. Do you concur with this view? If 4 so, would you prefer to see this disclosure in a footnote to the fee table or in a footnote to the sales load table? • The proposed definitions of “fund complex” and “revenue sharing” seem overly broad for purposes of the proposed rules. (See Rule 15c2-2(f)(10) and (16), respectively.) Do you concur and, if so, how would you recommend they be narrowed? • Similarly, the rules’ proposed definition of “differential compensation” seems narrower than the proposed definition of “differential cash compensation” in NASD Rule 2830. (In particular, the SEC’ proposed definition only includes those differential compensation arrangements relating to covered securities with a deferred sales load (but not a front-end load) and affiliated funds.) Should we comment on this inconsistency and, if so, how should we recommend that these two definitions be made consistent? • Are there any additional issues that should be included in our letter? Tamara K. Salmon Senior Associate Counsel Attachment (in .pdf format)
