The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 17383

April 14, 2004

INSTITUTE COMMENT LETTER ON SEC PROPOSED CONFIRMATION AND POINT OF SALE DISCLOSURE RULES

[17383] April 14, 2004 TO: 529 PLAN ADVISORY COMMITTEE No. 14-04 SEC RULES COMMITTEE No. 33-04 SMALL FUNDS COMMITTEE No. 23-04 RE: INSTITUTE COMMENT LETTER ON SEC PROPOSED CONFIRMATION AND POINT OF SALE DISCLOSURE RULES 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 that would govern transactions in "covered securities:" (1) Rule 15c2-2, which would govern the content of confirmations issued in connection with such transactions; and (2) Rule 15c2-3, which would require broker-dealers and municipal securities dealers to provide to investors at the point of sale a disclosure document containing specified information.1 The Commission has also proposed new Schedules 15C and 15D that would provide the format to be used in making these disclosures. 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. A broker-dealer that fails to provide the required point of sale disclosure document would be prohibited from effecting the covered securities transaction requested by the customer and must, instead, treat such transaction as an indication of interest until the disclosure is provided. The Institute recently filed the attached comment letter on the proposal with the Commission.2 While the letter supports the Commission's proposal, it recommends various revisions to it. With five exceptions, the letter we filed with the Commission, which is briefly summarized below, is substantively similar to the draft letter we previously circulated and discussed during an April 1st conference call.3 The five revisions made to the letter since our April 1st conference call are additional recommendations that the Commission: 1 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 Attached to the Institute's letter were three appendices that reflect how the confirmation and point of sale documents would look if the Commission adopts our recommended revisions to the proposed rules. 3 See Memorandum to 529 Plan Advisory Committee No. 10-04, SEC Rules Committee No. 26-04, Small Funds Committee No. 19-04, and Unit Investment Trust Committee No. 10-04 [No. 17247], dated Mar. 18, 2004. 2 • Revise the definition of "revenue sharing" to (1) only include payments made to the broker-dealer by a fund's investment adviser, principal underwriter, administrator, or transfer agent and (2) conform it to the NASD's definition of "cash compensation" so that the definition only

includes payments made in connection with the sale, distribution, or promotion of the issuer's securities; • Utilize the term "principal underwriter" in lieu of "primary distributor" in proposed Rule 15c2-3 and revise the treatment of such persons under the rule. In particular, we recommend that the Commission except primary distributors from the point of sale disclosure requirements in connection with orders received from (1) broker-dealers with which the principal underwriter has an agreement to distribute covered securities and (2) customers on an unsolicited basis; • Tailor the disclosure requirements for a principal underwriter of a unit investment trust in recognition of the unique manner in which certain UITs (e.g., fixed income trusts) are distributed; • 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; and • Clarify that an investor's right to terminate a covered securities transaction under Rule 15c2-3 ceases when the investor places an order after receiving the disclosure required by the rule. The remaining issues raised in our comment letter are briefly summarized below. 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 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; and • 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. 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. 3 II. Comments on Proposed Point of Sale Disclosure Rule, Rule 15c2-3 As discussed above, proposed, Rule 15c2-3 would require delivery of a disclosure document at the point of sale prior to effecting a transaction in covered securities. The Institute's letter recommends that the proposed rule be revised to: • Add four additional exceptions to address concerns with the rule's application to directly 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; and • 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. III. Form N-1A Amendments 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; and • Upon adoption of the proposed revisions to Form N-1A, the Commission recommends to the NASD that it eliminate its requirements relating to prospectus disclosure of revenue sharing arrangements as no longer necessary. IV. Transition Period The letter does not recommend a specific transition period for the new rules. Instead, it recommends that the Commission work with broker-dealers to develop an appropriate timetable for implementation of the rules, taking into account other pending regulatory initiatives that may impact broker-dealers' operational and compliance systems or that may impact the contents of the Commission's proposed Schedules 15C and 15D (e.g., the pending proposals by the SEC

and the NASD to prohibit directed brokerage). Tamara K. Salmon Senior Associate Counsel Attachments (in .pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (http://members.ici.org) and search for memo 17383, or call the ICI Library at (202) 326-8304 and request the attachments for memo 17383.
