The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 18636

March 7, 2005

SEC SUPPLEMENTAL REQUEST FOR COMMENT ON PROPOSED REVISIONS TO CONFIRMATION AND POINT OF SALE DISCLOSURE DOCUMENTS

[18636] March 7, 2005 TO: BANK AND TRUST ADVISORY COMMITTEE No. 3-05 RE: SEC SUPPLEMENTAL REQUEST FOR COMMENT ON PROPOSED REVISIONS TO CONFIRMATION AND POINT OF SALE DISCLOSURE DOCUMENTS In January 2004, the Securities and Exchange Commission proposed new confirmation and point of sale disclosure documents for transactions involving mutual funds, unit investment trusts, 529 plan securities, and variable annuity products (collectively referred to as "covered securities").1 In response to the feedback the Commission received on its proposal, it now seeks comment on revised versions of these documents and additional issues raised by commenters.2 The Commission's Supplemental Release is summarized below. Comments must be filed with the Commission within 30 days of publication in the Federal Register. The Institute will hold a conference call on Thursday, March 10th at 2:30 p.m. EST to discuss the Supplemental Release. The dial-in number for the call is 888-730-9139, and the pass code is 28646. If you plan to participate in the call, please send an e-mail to Jennifer Odom at jodom@ici.org. If you are unable to participate in the call, please provide your comments before the call to the undersigned by phone (202-326-5825), fax (202-326-5839) or e- mail (tamara@ici.org). SUMMARY OF THE COMMISSION'S SUPPLEMENTAL RELEASE The Supplemental Release is divided into six parts. Part I discusses the background of the Commission's proposal and provides an overview. Part VI renews the Commission's request for comment on the previous proposal.3 The remaining four parts discuss possible 1 See SEC Release Nos. 33-8358, 34-49148, and IC-26341, dated January 29, 2004 ("Proposing Release"). A copy of the Proposing Release is available on the SEC's website at www.sec.gov/rules/proposed/33-8358.htm. 2 See SEC Release Nos. 33-8544, 34-51274, and IC-26778, dated March 1, 2005 ("the Supplemental Release"). A copy of the Supplemental Release is available on the SEC's website at: http://www.sec.gov/rules/proposed/33-8544.pdf. A copy of the attachments to the Commission's Supplemental Release is available at: http://www.sec.gov/rules/proposed/33-8544.pdf. Cites in this memorandum to the Commission's Supplemental Release are to the version available on the Commission's website. 3 According to the Supplemental Release, in its evaluation of further rulemaking action, the Commission will consider all comments received in response to the Supplemental Release and the Proposing Release. 2 improvements to the proposed point of sale disclosure document (Part II), possible improvements to the proposed confirmation document (Part III), requiring broker-dealers to provide Internet disclosure of information

about revenue sharing and differential compensation practices (Part IV), and whether changes should be made to the previously proposed revisions to Form N-1A relating to revenue sharing (Part V). Each of these parts is discussed below. I. PART II, THE PROPOSED REVISED POINT OF SALE DOCUMENT Under the Commission's original proposal, broker-dealers would be required to deliver a disclosure document at the point of sale before a customer purchases a covered security. Unlike the previous proposal, which included one point-of-sale document template that was to be used for all covered security transactions, the current version includes a new and different template for shares classes A, B, and C of a mutual fund or 529 savings plan as well as for variable annuity products. These new templates are included as Attachments 1-7 to the Supplemental Release. Significant changes to these documents from the original proposal include: • Combined use of standardized and transaction-specific cost disclosure – the revised document would disclose the costs associated with a standardized $1000, $50,000, and $100,000 investment. A broker-dealer also would also be required, upon an investor's request, to provide the costs associated with the anticipated investment amount. As originally proposed, disclosure would be based on the investor's actual amount of investment, unless it was unknown to the broker-dealer, in which case the costs were to be provided based on a hypothetical investment of $10,000. • Presentation of sales fee disclosure – sales fees would have to be disclosed in both dollars and as a percentage of the amount invested. The original proposal only required disclosure of the dollar amount of the sales fee. Also, for securities with a front-end load, the revised document would require disclosure of the net amount invested. Instead of referring to "breakpoint disclosure," the revised document would alert investors to any possible "volume discounts." • Comprehensive annual cost disclosure – unlike the original proposal, which only required disclosure of distribution-related costs, the revised proposal would require disclosure of "comprehensive information about all the costs of owning the securities," including the management fees and "other expenses" disclosed in an investment company's prospectus. Any flat annual fees, such as an account fee, also would be required to be disclosed. • Share class and pricing structure disclosure – the revised proposal would require the disclosure to be tailored to the share class or pricing structure applicable to the covered security being considered by the investor, hence the various versions of the document in the Attachments. Also, a broker-dealer would be required to provide the disclosure with respect to all share classes the investor is considering purchasing. • Revenue sharing arrangement disclosure – as with the original proposal, the revised document would disclose whether the broker-dealer participates in a 3 revenue sharing arrangement with the issuer or its affiliates. Unlike the original proposal, the revised document would disclose an Internet website or toll-free phone number where customers can obtain more detailed supplemental information about such arrangements, including the amounts and sources of the payments. (See discussion under Part IV below for more on this supplemental information requirement.) • Sales incentive compensation – as with the original proposal, the revised point-of- sale document would disclose whether the broker-dealer's personnel are paid more for selling the covered security than for selling other covered securities or for selling one class over another. Unlike the original proposal, broker-dealers would have to include on the form an Internet website or toll-free phone number where customers can obtain more detailed information about such differential compensation. (See discussion under Part IV below for more on this supplemental information requirement.) Unlike the original version, the revised point-of-sale disclosure document would include disclosure encouraging customers to consider all costs, goals, and risks before investing. This disclosure would direct customers to the issuer's prospectus or official statement for more information and inform the customer that such document can be obtained from the broker- dealer or through a specified website address or telephone number. Also, unlike the original proposal, the Supplemental Release clarifies that a broker-

dealer may omit from the document any information that does not apply to a particular investor. II. PART III, THE PROPOSED REVISED CONFIRMATION In the Proposing Release, the Commission proposed one template, Schedule 15C, to be used as the confirmation for all covered security transactions. Schedule 15C would require detailed disclosure of the specific dollar and percentage amount the investor paid in loads, asset-based sales charges, and asset-based service fees. It also required dollar and percentage disclosure of the sales fees, revenue sharing amounts, and portfolio brokerage commissions the broker-dealer would receive from the issuer or its affiliates. In addition to providing the above information in both dollar and percentage amounts, the Schedule required disclosure of industry ranges of such percentages to provide the investor some context for the percentages disclosed. Finally, Schedule 15C required qualitative disclosure of differential compensation arrangements and disclosure of breakpoint discount information. In response to feedback on its original proposal, the Commission proposes revisions to the confirmation to better tailor its contents to the covered security transaction being confirmed. Attachments 8-10 to the Supplemental Release are the revised confirmations for mutual fund purchases involving Class A, B, and C shares, respectively; Attachments 11-13 are the revised confirmations for transactions involving Class A, B, and C shares in a 529 savings plan, respectively; and Attachment 14 is the revised confirmation for variable annuity transactions. The revised confirmations omit the comparison range information but include information about the management fees and other expenses incurred in connection with the investment stated both as a percentage and a dollar amount. The revised confirmations would replace the original proposal's quantitative disclosure relating to dealer concessions, revenue sharing, and differential compensation with qualitative disclosure. This disclosure would be 4 accompanied by disclosure informing the investor about a website or toll-free phone number where the investor could obtain more detailed information on the broker-dealer's arrangements and practices in these areas. III. PART IV, PROPOSED INTERNET DISCLOSURE OF BROKER COMPENSATION PRACTICES As discussed above, the Commission has proposed to supplement the qualitative information on the proposed point-of-sale disclosure document and confirmation relating to a broker-dealer's conflicts of interest through quantitative disclosure that would be available on a website or through a toll-free telephone number. (The toll-free number would be used for investors to request the quantitative information be mailed to them.) This quantitative disclosure would include information about: • revenue sharing payments, including those that might offset broker-dealer expenses connected with fund distribution; • other payments out of issuer assets that may provide incentives for broker-dealers to distribute covered securities; • special compensation-related conditions that broker-dealers place on fund distribution; • broker-compensation (i.e., dealer concessions); and • a broker-dealer's differential compensation practices. To avoid vague or generic terms, the Commission would require the use of clear and consistent labels for the various types of compensation received by a broker-dealer. Attachment 15 illustrates how such Internet-based disclosure might look. Page 1 of Attachment 15 shows the compensation all broker-dealers would receive from the various share classes for selling a particular mutual fund. Page 2 of Attachment 15 shows the compensation the particular broker-dealer effecting the transaction would receive, broken down by payment stream and source. Disclosure of transaction-based and asset-based revenue sharing payments received by the broker-dealer would be expressed per $1000 of the security sold. The disclosure of the broker-dealer's additional revenue sharing payments and income stream would be depicted retrospectively in terms of the total dollars received in the prior fiscal year, along with a statement of the value of the covered securities that the broker-dealer sold during that period. The broker-dealer would also be required to disclose a reasonable estimate of the revenue sharing payments it expects to receive during the current fiscal year as well as the amount of payments it received in the

prior fiscal quarter. 5 IV. PART V, PROSPECTUS DISCLOSURE OF REVENUE SHARING PAYMENTS The Commission’s original proposal included amendments to Form N-1A to improve disclosure of revenue sharing payments. These amendments would require “brief” disclosure in the prospectus of whether any person within a fund complex makes revenue sharing payments. If so, the prospectus would have to direct investors to the disclosure regarding revenue sharing in the point-of-sale disclosure document and confirmation. The Supplemental Release seeks comment on whether it would be appropriate or necessary to require revenue sharing disclosure beyond that originally proposed. For example, it asks whether the Commission should require fund prospectuses to include a brief description of revenue sharing payments and include information such as the services provided in return for these payments; the factors considered in determining the payments to be made; and the basis on which such payments are made. * * * * Tamara K. Salmon Senior Associate Counsel

---