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SEC PROPOSES NEW FUND AND 529 PLAN CONFIRMATION AND POINT OF SALE DISCLOSURE RULES; CONFERENCE CALL SCHEDULED FOR FEB. 17TH

[17047] February 3, 2004 TO: 529 PLAN ADVISORY COMMITTEE No. 3-04 SEC RULES COMMITTEE No. 13-04 SMALL FUNDS COMMITTEE No. 9-04 UNIT INVESTMENT TRUST COMMITTEE No. 8-04 RE: SEC PROPOSES NEW FUND AND 529 PLAN CONFIRMATION AND POINT OF SALE DISCLOSURE RULES; CONFERENCE CALL SCHEDULED FOR FEB. 17th The Securities and Exchange Commission has published for comment two new rules and rule amendments under the Securities Exchange Act of 1934 that are intended to enhance the information broker-dealers provide to their customers in connection with transactions in mutual funds, unit investment trusts, and 529 plan securities.1 In particular, the Commission has proposed: (1) Rule 15c2-2 to govern the contents of confirmations issued in connection with transactions involving these securities; and (2) Rule 15c2-3 to require broker-dealers and municipal securities dealers to provide investors point of sale disclosure in connection with such transactions. Also included in the Proposing Release are amendments to Rule 10b-10, which currently governs mutual fund and UIT confirmations, to exclude from its scope those entities that would be subject to Rule 15c2-2, and amendments to Form N-1A to enhance the disclosure required relating to sales loads and revenue sharing arrangements. As part of this rulemaking process, the Commission also stated its intent to withdraw a no-action letter issued to the Institute in 1979 that related to confirmation disclosure of mutual fund sales loads and related fees.2 Proposed Rules 15c2-2 and 15c2-3 and the amendments proposed to Form N-1A are summarized below. Comments on the proposal must be filed with the Commission within 60 days of publication in the Federal Register. The Institute will hold a conference call on Tuesday, Feb. 17th at 3:00 p.m. EST to discuss the proposed amendments. The dial-in number for the call is 888-577- 8991, and the pass code is 10595. 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, before the 1 See SEC Release No. 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. Cites in this memorandum to the Proposing Release are to the version available on the Commission’s website. Please note that p. 89 of the Proposing Release has live links to Schedules C and D that have also been proposed. 2 See Investment Company Institute (Pub. Avail. Mar. 19, 1979) (staff took the position that, with respect to mutual fund transactions, a broker-dealer could satisfy its Rule 10b-10 disclosure obligations without providing customers with a transaction-specific

document that discloses information about loads or third-party remuneration, so long as the customer received a fund prospectus that adequately disclosed that information). In July 2003, the Joint NASD/Industry Task Force on Sales Charge Breakpoints issued a report that, in part, recommended that the Commission revisit the position stated in this 1979 no-action letter. 2 call, please provide your comments on the proposed amendments to the undersigned by phone (202-326-5825), fax (202-326-5839) or e-mail (tamara@ici.org). 2 I. PROPOSED NEW RULE 15c2-2 – CONFIRMATION DISCLOSURE A. Scope As proposed, Rule 15c2-2 would apply to transactions by broker, dealers, and municipal securities dealers on behalf of customers in covered securities. "Covered security" would be defined in Paragraph (f)3 of the new rule to mean: (1) any security issued by an open-end investment company that is not traded on a national securities exchange; (2) any security issued by a unit investment trust (UIT), other than either an exchange-traded fund (ETF) that is traded on a national securities exchange or facility of a national security transaction or a UIT that is the subject of a secondary market transaction; and (3) any municipal fund security that is issued pursuant to a qualified tuition program under Section 529 of the Internal Revenue Code. The proposed rule would make it unlawful for any broker, dealer, or municipal securities dealer to fail to comply with the rule's disclosure requirements. The rule would include a preliminary note to clarify that the confirmation disclosure requirements in the rule would not be determinative of, and would not exhaust, a broker's, dealer's, or municipal securities dealer's disclosure obligations under the antifraud provisions of the federal securities laws or under any other legal requirements. B. Disclosure Requirements Paragraphs (b) – (e) of the proposed rule set forth the disclosures that must be included on confirmations for transactions involving covered securities. According to the Proposing Release, while such disclosures must be made "in a manner that is consistent with Schedule 15C under the Exchange Act," the proposed rule would not preclude additional disclosures, as appropriate.4 The proposed disclosure requirements are as follows: • General Disclosure Requirements – Paragraph (b) would set forth the general disclosure requirements of the rule and would require each confirmation to disclose: • The date of the transaction (Paragraph (b)(1)); • The issuer and class of the "covered security" (Paragraph (b)(2));5 • The net asset value (NAV) of the shares and units and, if different, their public offering price (POP) (Paragraph (b)(3));6 3 Paragraph (f) of the proposed rule defines various terms used in proposed Rules 15c2-2 and 15c2-3, including, in addition to covered security: asset-based sales charges; asset-based service fee; completion of the transaction; covered securities plan; dealer concession; differential compensation; fund complex; gross dealer concession; and revenue sharing. 4 Proposed Schedule C may be obtained through the live link to the Schedule on p. 89 of the Proposing Release. Attachments 1-3 to the Proposing Release are samples of disclosure that would be compliant with proposed Schedule C. 5 While these requirements are similar to the requirements of Rule 10b-10(a)(1), Rule 15c2-2 would additionally require disclosure of class when necessary to identify the security. 6 Rule 10b-10 only requires disclosure of the POP. 3 • The number of shares of a covered security purchased or sold by the customer; the total dollar amount paid or received in the transaction; and, the net amount of the investment bought or sold in the transaction, which would be equal to the number of shares or units bought or sold multiplied by the NAV of those shares or units (Paragraph (b)(4));7 • Any commission, markup, or other remuneration the broker, dealer, or municipal securities dealer will receive from the customer in connection with the transaction (Paragraph (b)(5)).8 This item "would require separate disclosure of commissions or other compensation from the customer . . . when a broker, dealer, or municipal securities dealer, such as a fund 'supermarket,' charges its customer a commission or service fee for purchasing a fund;"9 • In connection with any sale of a covered security, any deferred sales load incurred by the customer (Paragraph (b)(6)); and • When applicable, that the broker, dealer, or municipal

securities dealer effecting or clearing the transaction or carrying the customer's account is not a member of SIPC (Paragraph (b)(7)). • Additional Required Disclosures – Paragraph (c) would set forth additional disclosures that would be required in the confirmation when customers purchase covered securities. These additional disclosures include: • Cost disclosure – Paragraph (c)(1) would require disclosure of the amount of any sales load that the customer has incurred or will incur at the time of purchase, expressed in dollars and as a percentage of the net amount invested, together with one of two alternative disclosures set forth in Schedule C. These two alternatives are: (1) if the customer will incur a sales load at the time of sale, information about the availability of breakpoints, including specified information relating to the sales load; or (2) if the customer will not incur a sales load at the time of the sale, information about the availability of breakpoints as reflected in Schedule C with regard to a different class of the covered security, including a statement of the sales load that the customer would have incurred at the time of sale if the transaction had been in that different class of the covered security;10 • Deferred sales load – Proposed Paragraph (c)(2) would require disclosure of the potential amount of deferred sales loads (other than a deferred sales load of no more than one percent that expires no later than one year after purchase, when no other sales load would be incurred). According to the Proposing Release, this provision would 7 Rule 10b-10 only requires disclosure of the number of shares bought or sold. 8 According to the Proposing Release, the disclosure that would be required by this paragraph is distinct from dealer concessions and other types of sales fees the broker, dealer, or municipal securities dealer may receive from the fund or its primary distributor, and distinct from any sales load paid by the customer. Also, this Paragraph would not require disclosure of compensation the dealer received from the issuer or distributor of the covered security, or from other third parties, rather than directly from the customer. 9 Proposing Release at p. 17. 10 According to the Proposing Release, "In other words, for transactions in share classes without a front-end sales load, the proposed paragraph would require disclosure of information about the sales load that would have been charged had a share class with a front-end load been purchased." Proposing Release at p. 19. 4 require disclosure "on a year-by-year basis for as long as the deferred load may be in effect, [of] information about the maximum amount of the load expressed in dollars . . . and the maximum deferred sales load as a percentage of [NAV] at the time of purchase or sale, as applicable;"11 • Asset-based sales charges and service fees – Proposed Paragraph (c)(3) would require disclosure of any asset-based sales charges and service fees paid in connection with the customer's purchase of covered securities, including any 12b-1 fees or service fees incurred by issuers, even when the issuer itself does not directly pay these fees but instead invests in other covered securities that incur these fees (e.g., when the issuer of a 529 plan security does not pay a 12b-1 fee but invests plan assets in mutual funds that incur such fees);12 • Sales fee disclosure/dealer concessions – Proposed Paragraph (c)(4) would require disclosure of any dealer concession that the broker, dealer, or municipal securities dealer earns in connection with the transaction, expressed in dollars and as a percentage of the net amount invested; • Revenue sharing and portfolio brokerage disclosure – Proposed Paragraph (c)(5) would require disclosure of information related to revenue sharing payments13 and portfolio securities transaction commissions (including soft dollars) received by the broker, dealer, or municipal securities dealer. This disclosure must include information about two types of arrangements: (1) revenue sharing payments from persons within the fund complex; and (2) commissions, including riskless principal compensation, associated with portfolio securities transactions on behalf of the issuer of the covered security, or other covered securities within the complex. This information, which would include amounts directly and indirectly earned from the fund complex, would be required to be disclosed on the basis of the firm's sales on behalf of the fund complex, rather than on a fund-by-fund basis. The amounts would have to be disclosed as a

percentage of the total NAV represented by such broker's, dealer's, or municipal securities dealer's total sales of covered securities (as measured by 11 Proposing Release at p. 20. 12 According to the Proposing Release, . . . because the amount of rule 12b-1 or similar fees would be linked to [NAV], a broker, dealer, or municipal securities dealer would rarely, if ever, know in advance what amount of those fees would be attributable to the shares purchase in a particular transaction. . . . The proposed rule therefore would require brokers, dealers, and municipal securities dealers to disclose asset-based sales charges and asset-based service fees as a percentage of net asset value, and also to disclose an estimate of the total annual dollar amount of asset-based sales charges and asset-based service fees that would be associated with the shares purchased if net asset value were to remain unchanged (and assuming that the level of fees paid out of assets under a rule 12b-1 plan or similar distribution arrangement remains unchanged). Proposing Release at p. 20. 13 As defined in proposed Paragraph (f)(16), "revenue sharing" would include any understanding or arrangement by which a person within a fund complex, other than the issuer of the covered security, pays a broker, dealer, or municipal securities dealer, or any of their associated persons, apart from dealer concessions or other sales fees that would be required to be disclosed pursuant to proposed Paragraph (b)(4). As such, this term would include, for examples, payments for "shelf space," or payments that have the effect of reimbursing broker-dealers for expenses that they would incur in the normal course of business, or that exceed the expenses that the broker-dealers actually incur. 5 cumulative NAV) on behalf of the fund complex over the four most recent calendar quarters, updated each calendar quarter. This disclosure would also be required to set forth the total dollar amount of revenue sharing or portfolio brokerage commissions that the broker, dealer, or municipal securities dealer may expect to receive in connection with the transaction, calculated by multiplying that percentage by the net amount invested in the transaction. Firms would have 30 days to update the information following the end of the calendar quarter; and • Differential compensation disclosure – Proposed Paragraph (c)(6) would require disclosure of whether a broker, dealer, or municipal securities dealer pays differential compensation14 to associated persons related to purchases of two specific types of securities: (1) covered securities that carry a deferred sales load (other than a deferred load of no more than one percent that expires no later than one year after purchase, when no other sales load would be incurred) and (2) shares of "proprietary covered securities" that are issued by an affiliate of the broker, dealer, or municipal securities dealer. If a customer purchased a proprietary covered security that carries a deferred sales load, both disclosures would be required. The proposed rule would also provide for affirmative, negative, or "not applicable" disclosure about differential compensation to alert customers to the presence of compensation practices that provide incentives leading to conflicts for associated persons. • Alternative Requirements for Periodic Reporting – Proposed Paragraph (d) would set forth alternative requirements for periodic reporting. In particular, the Paragraph would permit brokers, dealers, and municipal securities dealers to disclose the required confirmation information periodically, rather than on a transaction-by-transaction basis, in certain limited instances involving transactions in a "covered securities plan" or in no-load open-end money market funds.15 This Paragraph would require a broker, dealer, or municipal securities dealer to provide quarterly disclosure for transactions involving covered securities plans and monthly disclosure for money market fund transactions subject to the periodic disclosure alternative. This disclosure must include, in addition to the disclosure required under Paragraphs (b), (c)(1) and (c)(4) to the extent applicable, (c)(5), (c)(2), (c)(3), each purchase or redemption, effected for or with, and each dividend or distribution credited to or reinvested for, the account of such customer during the period and the total number of shares or units of the covered security in the customer's account. Prior to a broker, dealer,

or municipal securities dealer taking advantage of this periodic disclosure alternative, it must provide the customer with written notification and provide the customer with at least one written disclosure document consistent with the general and purchase-specific disclosure standards of the proposed rule. • Median Information and Comparison Ranges – Paragraph (e) would set forth the "median information and comparison ranges" for the types of information required by Paragraphs (b), (c), and (d). This provision, which would provide investors information about where the costs and payments of the customer's broker, dealer, or municipal 14 The proposed definition of "differential compensation" would be different depending on whether a deferred sales load is imposed or whether the customer is purchasing proprietary securities. 15 Proposed Paragraph (f)(5) would define "covered securities plan" as any plan for direct purchase or sale of a covered security pursuant to certain retirement or pension plans or other agreements or arrangements, including the automatic reinvestment of dividends. 6 securities dealer fall in comparison to the medians of these amounts and ranges in the marketplace, is intended to provide investors additional context within which to evaluate the significance of the required disclosure. If this provision is adopted, the Commission would plan to publish the medians and comparison ranges (in percentage form) in the Federal Register from time to time.16 Firms would have to update median and percentage range information on their confirmations within 90 days after such publication. C. Disclosures Required of Transactions Effected by Multiple Firms A customer whose transactions are effected by more than one broker, dealer, or municipal securities dealer may receive a single confirmation under the proposed rule provided the brokers, dealers, or municipal securities dealers that are involved in effecting the transaction enter into a written agreement – disclosed to the customer upon establishment of the account or of the arrangement between the firms – that determines the responsibilities of each firm, including the responsibility to provide confirmation to the customer.17 The confirmation received by the customer must include specific disclosure of sales fees, revenue sharing, and portfolio brokerage commissions received by each broker, dealer, or municipal securities dealer that was involved in effecting the transaction.18 As noted in the Proposing Release, this may require a broker, dealer, or municipal securities dealer that receives sales fees, revenue sharing, or portfolio brokerage "to convey responsive information to the firm that sends out the confirmation, which may require enhancement of existing flows of information."19 II. PROPOSED NEW RULE 15c2-3 – POINT OF SALE DISCLOSURE A. Scope Proposed Rule 15c2-3 is intended to provide investors transaction-specific information about distribution-related costs and remuneration arrangements that may lead to a conflict of interest for their broker, dealer, or municipal securities dealer prior to the time the investor makes an investment decision. The rule would make it unlawful for any broker, dealer, or municipal securities dealer to effect a purchase of any covered security unless such person delivers to the customer, at the point of sale20 and prior to effecting the transaction, a disclosure document that includes specified quantified 16 With respect to the disclosure of loads, asset-based sales charges and service fees, and dealer concessions, the Commission would publish the median of, and the ranges associated with 95% of the transactions involving the same type of covered security (i.e., mutual fund, UIT, or 529 plan). In the case of disclosure of revenue sharing and portfolio brokerage, the medians and ranges would be determined based on 95% of the brokers, dealers, or municipal securities dealers that distribute the same type of covered security. 17 These situations would include, for example, introducing-clearing arrangements, and arrangements in which a broker that solicits persons at their workplace as part of an employer-sponsored marketing arrangements is paid for transactions effected by the customer when the customer opens an account at another firm. 18 According to the Proposing Release, "It is important that an investor see information about those types of remuneration specifically attributed to each broker, dealer or municipal securities dealer, so

the investor may evaluate conflicts of interest." Proposing Release at p. 32. 19 Proposing Release at p. 32. 20 The rule would define "point of sale" differently depending on the relationship between the broker, dealer, or municipal securities dealer and the customer. In some instances, the point of sale will be when the customer opens an account with the dealer. In other instances the point of sale may be when the dealer first recommends the covered security to the investor or otherwise discusses it. 7 information regarding distribution-related costs and dealer concessions and qualitative information about revenue sharing, portfolio brokerage commissions, and differential compensation.21 The disclosures required by the rule must be provided in writing using proposed Schedule 15D, supplemented by oral disclosure if the point of sale occurs at an in-person meeting (e.g., at a seminar or meeting).22 If, however, the point of sale occurs through means of an oral communication other than at an in-person meeting (e.g., by telephone), the information must be disclosed orally at the point of sale. For orders placed over the internet, the disclosures may be provided via the internet. Like proposed Rule 15c2-2, proposed Rule 15c2-3 would include a preliminary note stating that the point of sale disclosure requirements are not determinative of, and do not exhaust, a broker's, dealer's, or municipal securities dealer's disclosure obligations under the antifraud provisions of the federal securities laws or under any other legal requirements. B. Required Disclosure 1. Sales Load and Dealer Concession Information Pursuant to proposed Paragraph (a)(1) of Rule 15c2-3, the disclosure document must include the following information by reference to the value of the purchase or, if the value is not reasonably estimable at the time of disclosure, by reference to a model investment of $10,000: (i) an estimate of the amount of any sales load that the customer would incur at the time of purchase; (ii) an estimate of the amount of any asset-based sales charge and asset-based service fees that, in the year following the purchase, would be incurred by the issuer; (iii) an estimate of the maximum amount of any deferred sales load that would be associated with the shares or units purchased if held by the investor for less than one year, along with a statement of how many years a deferred sales load may be in effect; and (iv) the amount of any dealer concession that the broker, dealer, or municipal securities dealer would earn at the time of sale in connection with the transaction. 2. Revenue Sharing, Portfolio Brokerage Commissions, and Differential Compensation Paragraph (a)(2) of the rule would require the broker, dealer, or municipal securities dealer to state whether it receives revenue sharing or portfolio brokerage commissions from the fund complex. Also, if the covered security charges a deferred sales load or is a proprietary covered security, the dealer must additionally disclose whether it engages in specified differential compensation practices related to the covered securities purchased. C. Miscellaneous Provisions 1. Customer's Right to Terminate the Transaction Paragraph (b) of the rule would provide that a customer's order to purchase covered securities that is received prior to the customer being provided the disclosure required by this rule shall be treated as an indication of interest until the required disclosure is made and the customer is provided 21 Because sale transactions do not raise the same special cost and conflict concerns, Rule 15c2-3 would only apply to transactions in which a customer purchases a covered security. 22 Proposed Schedule 15D would provide the format for the required disclosure. A copy of Schedule D may be obtained though the live link to the Schedule on p. 89 of the Proposing Release. Attachments 4 and 5 to the Proposing Release set forth examples of point of sale disclosure that would be consistent with Schedule 15D. 8 the opportunity to determine whether to place the order. This provision additionally would require the broker, dealer, or municipal securities dealer to disclose these rights to the customer. 2. Recordkeeping Paragraph (d) of the proposed rule would require a broker, dealer, or municipal securities dealer, at the time of disclosing the information required by the rule, to make records of communications and records of such disclosure sufficient to demonstrate compliance with the rule. Such

records must be maintained as required by Rule 17a-4(b) under the Exchange Act.23 Records of oral communications shall be kept in accordance with Rule 17a-4(f) under the Exchange Act for the period specified in Rule 17a-4(b) under the Act. 3. Exceptions Proposed Paragraph (d) would provide exceptions from the rule's requirements for the following: (i) transactions resulting from orders received via U.S. mail, messenger delivery, or similar third-party delivery if certain specified conditions are met, including that the broker, dealer, or municipal securities dealer has provided the customer a statement containing specified information within the previous six months; (ii) a broker, dealer, or municipal securities dealer that clears transactions on behalf of another broker, dealer, or municipal securities dealer, or that serves as the primary distributor of a covered security with respect to transactions in which the broker, dealer, or municipal securities dealer did not communicate with the customer other than to accept the customer's order and reasonably believes that another broker, dealer, or municipal securities dealer has provided the customer the disclosure; (iii) transactions as part of a covered securities plan provided that the broker, dealer, or municipal securities dealer provides the required disclosure prior to the first transaction in any covered security that is purchased as part of the plan; (iv) reinvestment of dividends earned; or (v) transactions in which the broker, dealer, or municipal securities dealer is exercising investment discretion. III. FORM N-1A AMENDMENTS The Commission has proposed to amend Form N-1A, as follows: • The fee table required by Form N-1A would be revised to require the maximum front-end sales load to be shown as a percentage of NAV rather that as a percentage of current offering price, as is currently required; • The fee table would be required to show a deferred sales load based on offering price at the time of purchase as a percentage of NAV at the time of purchase. For consistency, the Commission has also proposed to remove the current requirement that a deferred sales load based on NAV at the time of purchase be shown in the fee table as a percentage of offering price at the time of purchase; • The Instructions to the Form would be revised to clarify that if a fund imposes more than one type of sales load, the aggregate load should be shown in the fee table as a percentage of NAV; • The prospectus would be required to alert investors to the fact that, as a result of rounding, sales loads shown in the prospectus as a percentage of NAV or offering price may be higher or lower than the actual sales load that an investor would pay as a percentage of the net or gross amount invested; 23 Section 17a-4(b) requires that records be preserved for not less than three years, the first two years in an easily accessible place. 9 • A footnote to the fee table would be required to disclose, if applicable, that the actual maximum sales load that may be paid by an investor as a percentage of the net amount invested may be higher than the maximum sales load shown as a percentage of NAV in the fee table. The footnote would be required to explain briefly the reason for this variation and disclose the maximum sales load as a percentage of the net amount invested. This footnote requirement would apply to front-end and back-end sales loads, as well as to cumulative sales loads where more than one type of sales load is imposed. The Commission has also proposed to require similar footnote disclosure with respect to the table of front-end sales loads that is required elsewhere in the prospectus; and • If any person within a fund complex makes revenue sharing payments, the fund would be required to disclose that fact in its prospectus and state that specific information concerning such payments is included in the disclosures required by proposed Rules 15c2-2 and 15c2-3. Tamara K. Salmon Senior Associate Counsel

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