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April 4, 2005

Via Electronic Mail to Rule-Comments@sec.gov

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth St. N.W.
Washington, D.C. 20549-0609

Re: Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, Reopening of Comment Period and Supplemental Request for Comments, File No. S7-06-04

Dear Mr. Katz:

Pillsbury Winthrop Shaw Pittman, LLP represents various financial institutions and broker-dealer entities. In the interest of these clients, we submit this comment letter on the Commission's proposal (the "Proposal") to adopt Rules 15c2-2 and 15c2-3 (the "Proposed Rules") requiring broker-dealers and municipal securities dealers to provide customers purchasing mutual funds, variable annuities, and 529 college savings with specific disclosures at the point-of-sale and in confirmation statements. We appreciate the opportunity to submit comments in response to the Commission's reopening of the comment period for this Proposal.

We acknowledge the Commission for seeking to promulgate new regulations to govern mutual fund and variable annuity sales practices – especially for proposing guidance concerning the disclosure of cost-sharing arrangements between broker-dealers and product sponsors. Over the years, these types of arrangements have become an important part of the way mutual fund and variable annuity distribution is financed. We, therefore, applaud the Commission for addressing this important area of the law through deliberate rulemaking, and encourage the Commission's efforts to carefully weigh the costs and benefits of imposing enhanced disclosure requirements upon broker-dealer firms.

Indeed, as the NASD acknowledged in its August 1997 Notice to Members 97-50, the rules governing such arrangements have been vague, and "interpretive ambiguity has resulted in a wide array of disclosure practices by issuers … ranging from specific to

very general disclosure or, in some cases, no disclosure." These ambiguous guidelines have presented several compliance challenges for law-abiding firms. For example, broker-dealers are generally unable to set prices or adjust their commissions in connection with mutual fund and variable annuity sales. Therefore, many have relied upon cost-sharing arrangements with product sponsors to offset increasing expenses associated with the proliferation of mutual fund and variable annuity products, and the resulting need for the technologies and infrastructure required to bring this broad array of products to the investing public. In coordinating these arrangements, these firms have relied upon longstanding guidance received from regulators and courts that sanctions such programs if they are disclosed in a mutual fund company prospectus or statement of additional information. Recent enforcement activity, however, has disrupted these widespread arrangements by targeting broker-dealers that have relied upon prospectus disclosures, and charging that because the issuers used language that was overly vague or general to describe these programs, the distributors failed to sufficiently inform customers about the potential conflicts of interest such arrangements may create.

Customers have directly benefited from the enhanced training of registered representatives and the large selection of mutual fund products that these cost-sharing arrangements have helped to finance. Yet, despite the many benefits that mutual funds and variable annuities provide to typical retail consumers, the current uncertain regulatory environment and recent enforcement activity has created incentives to shift broker-dealer sales efforts to alternate products. On the other hand, while efficient regulations could bring greater certainty into the market for these popular products, the enhanced disclosure requirements considered in the Proposal threaten to greatly increase the cost to broker-dealers of distributing mutual funds, variable annuities, and 529 plans, due to the increased compliance expenses associated with the proposed disclosure requirements. This new set of costs imposed by the Proposed Rules could itself provide broker-dealers with significant financial incentives to sell alternate products.

We, therefore, appreciate the Commissions careful and thoughtful approach to developing a cost-effective regulatory structure for enhanced disclosure in the sale of mutual funds, variable annuities, and 529 college savings plans.

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I. The Commission Should Issue A Revised Proposal Before Adopting Any Final Rules

We note that the Commission's March 1, 2005 release ("Release") on the Proposal has been deemed a "reopening of the comment period." We appreciate the thoughtfulness of the Commission's approach, and the thorough effort to address widespread concerns over the original Proposal. The release, nonetheless, makes several important changes from the original Proposal, including different formatting and content requirements for the proposed standard disclosure documents. We anticipate, of course, that after considering additional comments received during this "reopening of the comment period," that the Commission will issue a revised Proposal containing the regulatory text of the proposed final rule, along with the cost-benefit analysis and other inquiries required by the Administrative Procedures Act, Regulatory Flexibility Act, National Securities Markets Improvement Act, the Paperwork Reduction Act, etc. We look forward to an opportunity to comment upon the revised final Proposal once it has been formulated.

II. The Commission Should Not Shift Disclosure Costs From Product Mutual Fund And Variable Annuity Companies To Broker-Dealers

The Release fails to answer one of the fundamental questions posed by the NASD in its August 1997 Notice to Members 97-50, namely: "Should the responsibility for providing the disclosure fall upon the [fund company] the retail broker/dealer and/or the salesperson?" We believe that a balanced approach would require mutual fund and variable annuity companies to distribute product-specific information on share classes, fees, and expenses in an standardized format through a centralized clearinghouse that could be readily accessed by broker-dealers and incorporated into point-of-sale and confirmation disclosure forms.

Traditionally, most disclosure costs have been borne by the companies that issue products subject to the Proposed Rules, and the information deemed relevant to the investing public has been disclosed in prospectuses and statements of additional information prepared by and at the expense of these companies. This is an efficient framework. The mutual fund and variable annuity companies sponsoring these products are the best source of information about the products they sponsor, and the market participants best

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able to assemble this information so it can be made available to investors. For example, variable annuity companies have direct access to the complex, detailed information regarding underlying fund expenses that the Proposed Rules contemplates providing to investors. These companies also have the ability to adjust management and administrative fees to offset the increased cost of an enhanced disclosure regime, and can take advantage of economies of scale to spread the compliance costs across the entire population of investors.

The Proposal, however, does not address the responsibility of product sponsors to make basic fee and expense information available a readily accessible format. To the contrary, the apparent presumption in the Proposal seems to be that broker-dealers and salespersons should bear legal and financial responsibility for creating the enhanced disclosure documents contemplated by the Proposed Rules. This approach would shift the financial burden of disclosing detailed information from companies that issue mutual fund and variable annuities to distributors of those products. Yet, while direct contact with clients makes broker-dealers an efficient conduit for information at the point-of-sale, product sponsors are the best source of information about their products. Broker-dealers, on the other hand, must either pay a vendor to aggregate and provide breakdowns of product expenses and fees, or they must pay their own employees to extract such information from prospectuses and statements of additional information.

Moreover, broker-dealers already face several challenges to maintaining profitability in connection with mutual fund and variable annuity sales. For example, the rising popularity of No Transaction Fee (NTF) funds greatly reduces broker-dealer revenues from these products. Such pressures would be aggravated if the Commission were to foist the full expense of an enhanced disclosure regime upon broker-dealer firms, further minimizing their incentives to make a broad array of mutual funds and variable annuities available to their customers. We, therefore, urge the Commission to consider what responsibilities the mutual fund and variable annuity providers should bear in aggregating information that must be disclosed to customers under the Proposed Rules.

We further urge the Commission to establish some type of centralized clearinghouse where product sponsors could update fee and expense information in connection with their products, and broker-dealers could readily access that information for incorporation

into disclosure forms for dissemination to their customers. The cost associated with assembling this information is of serious concern to our broker-dealer clients. Absent some type of centralized, authoritative clearinghouse, broker-dealers would be required to gather data from prospectuses and statements of additional information at their own expense, and every firm offering a company's product would be required to duplicate this effort. This system would impose a heavy financial burden upon broker-dealers generally, and especially upon smaller, independent firms. The probable result is that less products would be made available to the public, and that broker-dealers would have added incentives to only sell products from companies willing to participate in some sort of cost-sharing arrangement that would offset the increased disclosure expenses, thereby limiting the investment choices available to customers.

Moreover, the duplicative, labor-intensive approach contemplated by the Proposal and the Release – in which every broker-dealer firm must assemble information from prospectuses and statements of additional information to provide to customers – would be imprecise and result in inevitable errors as specific cost and fee information was transposed from offering materials to point-of-sale disclosure documents. At a minimum, this raises liability risks that that should be protected through some sort of "safe harbor," and we encourage the Commission to limit private rights of action based upon *any* unintentional errors made required disclosure forms.

III. The Commission Should Avoid Information Overload, While Providing Cost-Effective Disclosures At The Point Of Sale

The Commission is rightly concerned about "information overload" in promulgating its new disclosure requirements. Customers may benefit from enhanced disclosure at the point of sale, but the information given to customers should be limited to information that impacts their purchasing decisions. For example, the expense ratio of a given fund provides a straightforward indicator of the overall costs that a customer must bear to maintain his or her investment over time. There is little benefit, however, in breaking down the expenses into various categories for "Distribution fees," "Management fees," and "Other expenses," as the forms attached to the Release suggest. For customers interested in this level of detail, the information is readily available in prospectus documents.

Similarly, customers are interested in other facts, such as the historical returns of a given investment, and the risk factors involved in purchasing an investment vehicle. Accordingly, we suggest that the Commission adopt the "Profile Plus" approach established by the NASD's Mutual Fund Task Force. Using a centralized clearinghouse in which sponsors transmit and update data about their products, broker-dealers would be able to generate forms that include this helpful information, along with the information about fees and expenses that is recommended by the Release.

The Release further considers requiring broker-dealers to provide *transaction specific* information, upon request, at the point of sale. Presumably, this would require salespersons to fill-in the blank boxes contained in the proposed disclosure forms. For our broker-dealer clients, this requirement is impractical, and would greatly increase the costs, and risks, of compliance. Among other things, sales personnel should not be required to make mathematical computations. This approach is prone to error, and would greatly increase the amount of time that representatives need to spend to conduct mutual fund and variable annuity transactions. Additionally, this would heighten liability risks, and provide added incentives to promote alternate products. Therefore, transaction-specific disclosure should not be required.

If, however, the Commission requires the disclosure of transaction-specific information, then it should be implemented through a centralized calculator, similar to the "529 College Savings Plan Expense Calculator" the "Mutual Fund Expense Analyzer" available on the NASD's website. Such an instrument could be made available to investors online, and integrated with the centralized clearinghouse for product information that is discussed above.

IV. The Commission Should Adopt Online Disclosure As The Industry Standard

The Proposal and the Release each contemplate that broker-dealers provide customers with written point of sale disclosure forms for all products, and product share classes, "under consideration." This is a heavy burden, and the number of paper documents provided in an average sales discussion would be overwhelming to the average investor, and would provide powerful incentives for salespersons to limit the number of investment alternatives that they discuss with their customers.

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We, therefore, urge the Commission to adopt online disclosure as the industry standard. This modern approach was recommended by the NASD's Mutual Fund Task Force in connection with its "Profile Plus" proposal, and strikes an appropriate and cost-effective balance to enhancing current disclosure practices. In any event, requiring mandatory disclosure in a standardized format for all products and share-classes "under consideration" is an ambiguous and unwieldy standard, which would hamper efforts to educate customers about a wide range of investment choices. Therefore, while we anticipate that salespersons might find disclosure forms to be helpful tools in educating their customers, we recommend that the SEC only *require* broker-dealers to provide point-of-sale disclosure forms for products that a customer has indicated the intent to purchase.

V. The Commission Should Limit The Required Disclosure For Telephone Orders

Customers purchasing mutual funds, variable annuities, and 529 plans over the telephone would be easily overwhelmed if the Commission required broker-dealers to provide detailed disclosure orally, especially if such disclosures had to be made for every product and share class "under consideration." Accordingly, telephonic disclosure should be limited to very basic information that is useful to customers in evaluating their investment decisions. Thus, we recommend that, in connection with telephone orders, broker-dealers only be required to provide basic information about the products customers actually indicate the intent to purchase, while referring customers to a website where they can find additional information about such products, and others they might be considering. More specifically, required telephonic disclosure should be limited to: (i) the location of the website where additional information can be found; (ii) the amount of sales charges and ongoing expenses, expressed as a percentage, for products the customer expresses the intent to purchase; and (iii) the existence of promotional incentives and/or differential compensation programs in connection with products the customer expresses and intent to purchase.

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VI. The Commission Should Limit The Required Disclosure Concerning Cost-Sharing Arrangements

Another question raised by the NASD in its August 1997 Notice to Members 97-50, and still unresolved, is "What information and level of detail should be included" in disclosures about cost-sharing arrangements. As discussed above, these programs have become instrumental in the distribution of mutual funds, variable annuities, and 529 plans, and serve to offset the considerable expense of making a wide array of such products available to the public. Moreover, unlike differential compensation programs, which produce direct conflicts-of-interest for salespersons at the point-of-sale, cost-sharing arrangements are typically conducted at an entity-to-entity level, and may not even be known to the sales force. The Commission should make a distinction between contributions by mutual funds and variable annuity companies that create potential conflicts-of-interest, and those that do not.

We, therefore, encourage the Commission to distinguish the payment of networking fees, ticket-charge rebates, and other contributions that merely offset administrative expenses at the corporate level, which do not have a material impact upon salesperson recommendations, from programs in which firms actually agree to promote a particular fund family or product within its sales platform, which do create a potential conflict-of-interest at the point-of-sale. Furthermore, requiring disclosure of the actual dollar amounts firms receive through such cost-sharing arrangements, presented in a vacuum without any information about the volume of sales or assets under management, does not serve any meaningful purpose. Instead, we believe that any such information should be disclosed in basis-points, and on a website, so it can be considered in light of the customers' actual investment.

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If you have any questions or would like to discuss any of these issues further, please contact the undersigned at 213-488-7582 (Clifford C. Hyatt) or 213-488-7271 (David L. Stanton).

Sincerely,

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