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Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 240 and 274

[Release Nos. 33–8358; 34–49148; IC–26341; File No. S7–06–04]

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Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing two new rules and rule amendments under the Securities Exchange Act of 1934 that are designed to enhance the information broker-dealers provide to their customers in connection with transactions in certain types of securities. The two new rules would require broker-dealers to provide their customers with targeted information, at the point of sale and in transaction confirmations, regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, unit investment trust interests (including insurance securities), and municipal fund securities used for education savings. The Commission is also proposing conforming amendments to its general confirmation rule, as well as amendments to that rule to provide investors with additional information about call features of debt securities and preferred stock. Finally, the Commission is proposing amendments to Form N–1A, the registration form for mutual funds, to improve disclosure of sales loads and revenue sharing.

DATES: Comments must be submitted on or before April 12, 2004.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–06–04; this file number should be included on the subject line if E-mail is used. Comment letters will be available for inspection and copying in the Commission's Public Reference Room at the same address. Electronically submitted comment letters will be posted on the Commission's Internet Web site (*http://www.sec.gov*).[1]

FOR FURTHER INFORMATION CONTACT: With respect to Securities Exchange Act rules 10b–10, 15c2–2, and 15c2–3, contact Catherine McGuire, Chief Counsel, Paula R. Jenson, Deputy Chief Counsel, Joshua S. Kans, Special Counsel, or David W. Blass, Attorney, at 202/942–0073, Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549–1001.

With respect to Form N–1A, contact Tara L. Royal, Senior Counsel, Office of Disclosure Regulation, at 202/942–0721, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''SEC'' or ''Commission'') is publishing for comment proposed rules 15c2–2 and 15c2–3, as well as amendments to rule 10b–10 under the Securities Exchange Act of 1934 (''Exchange Act'') and proposed amendments to Form N–1A under the Securities Act of 1933 (''Securities Act'') and the Investment Company Act of 1940 (''Investment Company Act'').

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I. Executive Summary

The Commission is publishing for comment two proposed new rules and rule amendments under the Exchange Act. The proposed new rules seek to improve investor access to material information about investments in open-end management investment company securities, unit investment trust interests, and municipal fund securities used for education savings. The proposals would accomplish that by requiring brokers, dealers and municipal securities dealers[2] to make additional disclosures, beyond those currently required, in transaction confirmations that they provide to customers at the time of a transaction, and also by requiring point of sale disclosure of material information prior to the transaction.

The proposed new confirmation rules would require brokers, dealers and municipal securities dealers to provide customers with information about distribution-related costs that investors incur when they purchase those types of securities. The confirmation rule proposals would also require disclosure of distribution-related arrangements involving those types of securities that pose conflicts of interest for brokers, dealers and municipal securities dealers, as well as their associated persons. These disclosures would promote more informed decision-making by investors in securities issued by open-end management investment companies (also referred to here as ''mutual funds'' or ''funds''), interests issued by unit investment trusts or ''UITs'' (including insurance company separate accounts that offer variable annuity contracts and variable life insurance policies) and securities issued by education savings ''529'' plans.

The proposed new point of sale disclosure rule would require brokers, dealers and municipal securities dealers to provide point of sale disclosure to customers about costs and conflicts of interest. In contrast to confirmation disclosure, which a customer will not receive in writing until after a transaction has been effected, point of sale disclosure would specifically require that investors be provided with information that they can use as they determine whether to enter into a transaction to purchase one of those types of securities.

The proposed new point of sale disclosure and confirmation rules and rule amendments also would clarify that the rules do not provide safe harbors for activity that would violate the antifraud provisions of the federal securities laws or other legal requirements.

[1] We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

[2] These proposed rules would apply to banks that act as municipal securities dealers in transactions involving municipal fund securities.

We are also proposing amendments to the Commission's general confirmation rule to require broker-dealers to provide customers with additional information in connection with transactions in callable preferred stock and debt securities, and to make additional conforming and technical changes to the rule.

Finally, we are proposing to amend Form N–1A, the registration form used by mutual funds to register under the Investment Company Act and to offer their securities under the Securities Act, to require improved disclosure regarding sales loads and revenue sharing arrangements.

In proposing this rule, we have requested comments on a variety of issues. We wish to emphasize that we particularly hope to receive comments from investors. As part of this proposed rulemaking, we have also proposed new forms for confirmation disclosure and point of sale disclosure. We want to know whether the forms clearly communicate the information that investors need to make investment decisions, and whether the forms will provide investors with the information they need, at the time they need it.

II. Introduction

The Commission is proposing new rule 15c2–2 under the Exchange Act, which would govern the obligations of brokers (including municipal securities brokers),[3] dealers and municipal securities dealers to disclose transaction-related information in confirmations or other documents when customers buy or sell certain investment company securities and municipal fund securities.[4] The Commission also is proposing new rule 15c2–3 under the Exchange Act, which would govern the obligation of brokers, dealers and municipal securities dealers to disclose information to investors prior to effecting transactions in those securities.

The proposed new rules respond to concerns that investors in mutual fund shares, UIT interests (including certain insurance company separate accounts that issue variable insurance products) and municipal fund securities used for education savings lack adequate information about certain distribution-related costs, as well as certain distribution arrangements, that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated persons. Those costs and other distribution arrangements have evolved substantially since 1977, when the Commission adopted its general confirmation rule, rule 10b–10.[5] We believe that disclosure of information about those costs and conflicts can help investors make better informed investment decisions.

Proposed rule 15c2–2 would require specific confirmation disclosure of information about front-end and deferred sales fees (''loads'') and other distribution-related costs that directly impact the returns earned by investors in mutual fund shares, UIT interests and 529 plan securities. It also would require brokers, dealers and municipal securities dealers to disclose their compensation for selling those securities, and to disclose information about revenue sharing arrangements and portfolio brokerage arrangements that create conflicts of interest for them. Moreover, the proposed rule would require brokers, dealers and municipal securities dealers to inform customers about whether their salespersons or other associated persons receive extra compensation for selling certain fund shares or fund share classes.

As part of this rulemaking process, the Commission intends to withdraw a no-action letter that the Commission's Division of Market Regulation granted to the Investment Company Institute (''ICI'') in 1979, related to confirmation disclosure of mutual fund sales loads and related fees.[6] The relief granted by that letter is inconsistent with proposed rule 15c2–2, which would mandate specific disclosure of load information on customer confirmations.

To avoid redundancy with proposed new rule 15c2–2, we are also proposing to modify rule 10b–10 to exclude certain transactions in mutual fund shares and UIT interests from the rule's scope, and to make other changes consistent with proposed rule 15c2–2.[7] In addition, we are proposing to modify rule 10b–10 to clarify, consistent with proposed rule 15c2–2, that the rule does not provide a safe harbor for activity that would violate the antifraud provisions of the federal securities laws or other legal requirements.

Because confirmation disclosure does not provide information to investors prior to transactions in securities—*i.e.*, at the time they make investment decisions—we also are proposing new rule 15c2–3 to require brokers, dealers and municipal securities dealers to provide point of sale disclosure to customers prior to effecting transactions in mutual fund shares, UIT interests and 529 plan securities. The proposed rule would enable investors to see transaction-specific information about distribution-related costs, and about remuneration arrangements that lead to conflicts of interest for their brokers, dealers or municipal securities dealers. That information would enable investors to better understand the costs and conflicts associated with investments in those securities prior to entering into transactions, which should promote better informed investment decision-making. The Commission also proposes to amend Form N–1A[8] to require improved disclosure by mutual funds regarding sales loads and revenue sharing arrangements.

In addition, the Commission also proposes to amend rule 10b–10 to require broker-dealers to disclose whenever preferred stock can be called by the issuer. Rule 10b–10 requires similar disclosure for transactions in debt securities that are callable by the issuer. The Commission further proposes to amend rule 10b–10 to require disclosure of the date of first call for certain transactions in callable debt securities.

[3] The term ''broker'' as used in this release also includes municipal securities brokers.

[4] The existing confirmation rule, Exchange Act rule 10b–10, would continue to govern broker-dealers' confirmation obligations for transactions in other securities.

[5] Rule 10b–10 was adopted in 1977, and it became effective the next year following amendments. *See* rule 10b–10 Adopting Release, Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977); Exchange Act Release No. 15219 (October 6, 1978), 43 FR 47495 (October 16, 1978) (amendment related to odd-lot differentials, mark-ups and mark-downs in certain riskless principal transactions, market maker status and procedures for periodic disclosure). Rule 10b–10 replaced the Commission's previous confirmation rule, rule 15c1–4, which had been limited to transactions conducted over-the-counter. Prior to the adoption of rule 10b–10, transactions on national securities exchanges were confirmed pursuant to self-regulatory organization rules. *See* New York Stock Exchange (''NYSE'') rule 409(c) (rescinded on October 6, 1978 upon effectiveness of rule 10b–10).

Rule 10b–10 subsequently has been amended several times. *See* Exchange Act Release No. 19687 (April 18, 1983), 48 FR 17583 (April 25, 1983) (related to yield, call and redemption information for debt securities, and monthly statements for transaction in money market fund shares); Exchange Act Release No. 22397 (September 11, 1985), 50 FR 37648 (September 17, 1985) (related to price and mark-up information for principal transactions in reported securities); Exchange Act Release No. 34902 (October 27, 1994), 59 FR 55006 (November 2, 1994) (related to disclosure of receipt of payment for order flow); Exchange Act Release No. 34962 (November 10, 1994), 59 FR 59612 (November 17, 1994) (related to unrated securities, price and mark-up information for principal transactions in Nasdaq small-cap and regional stock exchange-listed securities, non-SIPC broker-dealers, and factors that affect yield for asset-backed securities); Exchange Act Release No. 46471 (September 6, 2002), 67 FR 58302 (September 13, 2002) (related to securities futures products in futures accounts).

[6] *See* Letter regarding Investment Company Institute (March 19, 1979, available April 18, 1979).

[7] Rule 10b–10 does not apply to transactions in municipal securities.

[8] 17 CFR 239.15A and 274.11A.

III. Special Request for Comments From Investors

Brokers may have conflicts of interest when they sell mutual funds and other investments. For instance, your broker may get paid more if you purchase one fund over another, or the broker may receive other fees or payments from a fund for selling its shares.

We have proposed two new forms that would require brokers to tell you how much you must pay when you buy a particular fund and how much your broker and the firm will receive for selling that fund. These two forms are designed to provide you with information at two points in time—either orally or in writing immediately before your broker places the order (which is also called the ''point-of-sale'') and in a written confirmation statement after the transaction occurs. The purpose of the forms is to give you enough information so that you can understand what conflicts your broker and the firm have. That way, when a broker recommends a particular fund, you can assess with full knowledge whether the investment is better for you or for your broker.

We want to know whether the forms clearly communicate the information you need to make your investment decisions. If not, why not? We further want to know whether the forms will provide you with the information you need at the time you need to receive it. If not, when would you want to receive the information? Finally, we would like to know what improvements, if any, you would make to the forms.

IV. Improved Confirmation Disclosure for Transactions in Mutual Fund Shares, Unit Investment Trust Interests and 529 Plan Interests

A. Investors Need Better Disclosure About Distribution-Related Costs and Conflicts

1. Types of Distribution-Related Costs and Conflicts

This proposal is intended to improve investors' ability to obtain information about costs and conflicts arising from transactions in mutual fund shares, UIT interests, and municipal fund securities used for education savings.[9] Open-end management investment company shares and UIT interests are securities issued by investment companies that are registered with the Commission under the Investment Company Act.[10] Municipal fund securities—which are popularly known as ''529'' plans after the section of the Internal Revenue Code that governs the federal tax treatment of those securities—are issued by tuition programs that are sponsored by state governments to provide investment vehicles that parents and others can use to save for educational expenses.[11] While 529 plan securities differ from mutual fund shares because the states that issue those securities are not registered under the Investment Company Act, municipal fund securities can provide investors with investment alternatives that are similar to those provided by mutual fund shares. Moreover, the assets that underlie municipal fund securities may be invested in shares of registered investment companies.[12]

a. *Distribution-related costs.* Mutual fund investors may, directly or indirectly, incur distribution-related costs that can reduce their investment returns. The type and amount of those costs often vary among funds and among share classes issued by the same fund.[13] Some mutual funds issue share classes that impose sales fees, or loads, on investors when they purchase the fund shares (''front-end'' sales loads). Mutual funds may also sell share classes with sales loads that investors must pay when they redeem fund shares (''deferred'' or ''back-end'' sales loads).[14] The amount of the deferred sales load, generally calculated as the lesser of a percentage of the value of the initial investment or the account's value upon redemption, typically declines each year that the investor holds the shares, and eventually disappears entirely. Some mutual funds also use their assets to pay distribution-related expenses, including compensation of broker-dealers in connection with distributing fund shares, under plans adopted pursuant to rule 12b–1 under the Investment Company Act (''12b–1 fees'').[15] Sales loads and asset-based sales charges and service fees reduce the returns that investors earn on their mutual fund investments. Not all mutual funds are sold subject to front-end or deferred sales loads or impose asset-based sales charges and service fees.

b. *Conflicts-of-interest.* As discussed in detail below, broker-dealers that sell mutual fund shares to customers may participate in distribution arrangements that create conflicts of interest for the broker-dealers as well as their personnel. Those arrangements can give broker-dealers a heightened financial incentive to sell particular funds or share classes, and therefore may lead a broker-dealer to provide some groups of funds with heightened visibility and access to the broker-dealer's sales force, or otherwise influence the way that broker-dealers and their associated persons market those funds or share classes to customers. Those arrangements therefore pose special confirmation disclosure issues. Moreover, some of those arrangements may violate NASD rules, and the failure to disclose relevant information about those arrangements—regardless of whether disclosure specifically is required by the confirmation rules—also may violate the antifraud provisions of the federal securities laws.

As part of those distribution arrangements, broker-dealers that sell mutual fund shares generally earn sales fees from the fund's principal

[9] These proposed rules are written to exclude transactions in exchange-traded funds (''ETFs''), even though ETFs technically are open-end investment companies or unit investment trusts. ETF transactions would remain subject to the confirmation requirements of rule 10b–10.

[10] Open-end management investment companies are defined in Section 5(a)(1) of the Investment Company Act, and unit investment trusts are defined in Section 4(2) of that Act.

[11] The definition of ''municipal fund security'' under the rules of the Municipal Securities Rulemaking Board (''MSRB'') also encompasses interests in local government investment pools. This proposal, however, would not apply to broker-dealer transactions involving interests in those investment pools. *See* Proposed paragraph (f)(12) of rule 15c2–2.

[12] Commission rules and rules of National Association of Securities Dealers, Inc. (''NASD'') address broker-dealer practices for distributing mutual funds. Commission rules and rules of the MSRB address broker-dealer (including municipal securities dealer) practices for distributing municipal fund securities.

[13] *See* Investment Company Act Section 18(f) and rule 18f–3 thereunder (relating to multiple share classes of open-end investment companies).

[14] Based upon information filed publicly with the Commission on Form N–SAR, the Commission staff estimates that for the one year period between September 2002 and August 2003, investors in open-end investment companies paid more than $6.7 billion in aggregate sales loads, consisting of approximately $4.9 billion in front-end sales loads and $1.8 billion in deferred sales loads. In addition, funds and their affiliates paid about $13 billion in marketing and distribution payments pursuant to 12b–1 plans.

[15] Rule 12b–1 permits a fund's board of directors to adopt a plan to use fund assets to finance activities that primarily are intended to result in the sale of the fund's shares. NASD rule 2830 bars member broker-dealers from offering or selling securities of investment companies other than variable contracts if annual asset-based sales charges exceed 0.75% of net asset value, or if annual service fees for ''personal service and/or maintenance of shareholder accounts'' exceed 0.25% of net asset value. *See* NASD rule 2830(b)(8), (b)(9), (d)(2)(E), and (d)(5). That rule also restricts NASD members from distributing shares of funds that have excessive front-end or deferred sales loads. *See* NASD rule 2830(d).

Mutual fund principal underwriters use deferred sales loads in conjunction with rule 12b–1 fees. Usually, the deferred sales load is intended to recover amounts that the principal underwriter advances to a selling broker-dealer to compensate it for mutual fund share transactions if the customer redeems its shares before the underwriter can recover such amounts through the rule 12b–1 fee.

underwriter at the time of sale. Alternatively, the principal underwriter may pay the selling broker-dealer sales fees attributable to a particular sales transaction over time, for as long as the customer holds the shares purchased.[16] The amount of those sales fees is not uniform, however, and a broker-dealer may receive a higher fee for selling a particular dollar amount of shares issued by one fund rather than shares issued by another fund, or for selling one share class rather than other share classes issued by the same fund and available to the customer.

Broker-dealers also may be paid in other ways for distributing fund shares, such as through revenue sharing payments from a fund's investment adviser.[17] In some cases, a broker-dealer may receive payments from a fund or a fund's affiliates that are characterized as service fees, recordkeeping and transfer fees, seminar sponsorships or other types of payments that ostensibly compensate the broker-dealer for costs that it incurs as part of its mutual fund distribution activities.[18] Broker-dealers may also be compensated for distribution through receiving commissions for portfolio transactions executed on behalf of the fund or affiliated funds, even though the broker-dealer may not necessarily execute those transactions.[19]

These types of distribution-related arrangements may give broker-dealers heightened incentives to market the shares of particular mutual funds, or particular classes of fund shares. Those incentives may be reflected in a broker-dealer's use of ''preferred lists'' that explicitly favor the distribution of certain funds, or they may be reflected in other ways, including incentives or instructions that the broker-dealer provides to its managers or its salespersons.[20] Such incentives create conflicts between broker-dealers' financial interests and their agency duties to customers.[21]

In addition to conflicts of interest at the firm level, associated persons of broker-dealers face conflicts arising from financial incentives that promote the sale of some shares or share classes—or differential compensation.'' Associated persons may receive higher commissions when they sell shares of a particular fund than they would if they sold the same dollar amount of the shares of another fund.[22] They may also receive higher commissions when they sell a particular class of shares within a fund than they would if they sold the same dollar amount of another share class within that same fund.[23] Other forms of differential compensation may include a broker-dealer waiving certain fees or reimbursement of certain expenses ordinarily borne by an associated person, when the associated person sells the shares of particular mutual funds. Broker-dealers may also sponsor sales contests that provide cash compensation to representatives and managers for meeting certain sales goals.[24] Associated persons, moreover,

[16] Spreading the payment of sales fees over time is the customary method for compensating selling broker-dealers for sales of class C mutual fund shares.

[17] Revenue sharing arrangements may encompass multiple revenue streams. For example, an adviser within a fund complex may give a broker-dealer one set of payments that is linked to the broker-dealer's recent sales of shares issued by that fund complex (which would give the broker-dealer an incentive to sell more shares of that fund complex), together with another set of payments that is linked to the asset-based fees that the adviser earns in connection with shares of a fund complex held by customers of a broker-dealer (which would give the broker-dealer an incentive to keep its customers invested in that fund complex).

We understand that fund investment advisers typically make revenue-sharing payments to selling broker-dealers at the rate of between 0.20% and 0.25% of the annual gross sales of shares of a fund complex made by a broker-dealer, and between 0.01% and 0.05% of the net asset value of shares of a fund complex held by customers of a broker-dealer.

[18] The payments may be made either to the broker-dealer or to its affiliates. At times those payments may compensate the broker-dealer for work that it performs on behalf of the fund, and that the broker-dealer otherwise would not be required to perform, such as mailing certain documents (other than the prospectus) to customers. At other times, those payments may offset the broker-dealer's expenses in connection with activities that it would be required to perform in any event, such as educating personnel and maintaining records.

[19] The amount of commissions that a broker-dealer earns through portfolio brokerage arrangements often is based on its total sales of all funds issued by that mutual fund complex. Payments of portfolio brokerage commissions, however, are not invariably linked to distribution. Some mutual funds may direct portfolio transactions to a particular broker-dealer for execution without reference to the broker-dealer's success in distributing fund shares.

Broker-dealers, at times, may also execute portfolio securities transactions on a principal basis. In those cases, the firms would be compensated through mark-ups rather than through commissions.

[20] We recently took action against Morgan Stanley DW Inc. in connection with several of those practices, for violations of rule 10b–10 and the antifraud provisions of Section 17(a)(2) of the Securities Act. Morgan Stanley entered into special marketing arrangements with several funds, and was compensated in part through revenue sharing payments and portfolio brokerage commissions. In return, Morgan Stanley placed participating funds on preferred lists and otherwise specially promoted them through its sales system. Morgan Stanley also specially promoted proprietary, or affiliated, funds. Moreover, in calculating manager compensation, which it based in part on branch profitability, Morgan Stanley allocated lower overhead costs in connection with the sale of proprietary or other favored funds than it allocated in connection with the sale of less favored funds. As discussed below, Morgan Stanley also paid special incentives to registered representatives in connection with the sale of proprietary and other favored funds. Morgan Stanley's failure to disclose those practices to customers violated rule 10b–10 and Section 17(a)(2). *See In the Matter of Morgan Stanley DW Inc.*, Securities Act Release No. 8339 (November 17, 2003).

At the same time, the Commission sanctioned Morgan Stanley under Section 17(a)(2) in connection with its sale of class B mutual fund shares. Morgan Stanley failed to adequately disclose certain features that could make class A shares more attractive to customers than the class B shares it sold. Also, Morgan Stanley failed to adequately follow its compliance procedures governing large purchases of class B shares. *See id.*

The NASD also has sanctioned Morgan Stanley for regulatory violations arising from its marketing arrangements on behalf of participating funds. The NASD determined that Morgan Stanley violated NASD rule 2830(k), which prohibits a member firm from favoring the distribution of particular mutual fund shares on the basis of brokerage commissions to be paid by the fund companies and which also prohibits a member firm from allowing sales personnel from sharing in directed brokerage commissions. *See* NASD, ''Disciplinary and Other NASD Actions,'' December 2003, at D18 (available on the Internet at *http://www.nasdr.com/pdf-text/0312dis.pdf*).

[21] Revenue sharing arrangements not only pose potential conflicts of interest, but also may have the indirect effect of reducing investors' returns by increasing the distribution-related costs incurred by funds. Even though revenue sharing is paid to broker-dealers directly by fund investment advisers, rather than out of fund assets, it is possible that some advisers may seek to increase the advisory fees that they charge the fund to finance those distribution activities. It is not clear whether that has occurred. *See* U.S. General Accounting Office, *Mutual Funds: Greater Transparency Needed in Disclosures to Investors* (June 2003) at 39 (discussing uncertainty about how revenue sharing has affected fund fees). Moreover, revenue sharing arrangements may prevent some advisers from reducing their current advisory fees.

We have noted that fund assets would be indirectly used for distribution ''if any allowance were made in the investment adviser's fee to provide money to finance distribution.'' *See* Investment Company Act Release No. 16431 (June 13, 1988) at text accompanying note 124.

[22] If the associated person is paid a fixed percentage of the broker-dealer's fee, then he or she may earn more to sell one fund instead of another when the broker-dealer receives a higher fee for selling the first fund. Also, in some circumstances, an associated person may receive a higher percentage of the broker-dealer's compensation when he or she sells a fund that is favored by the broker-dealer (such as a fund that is affiliated with the broker-dealer or that pays revenue sharing to the broker-dealer). The latter arrangement was a factor in the Commission's recent action against Morgan Stanley, as associated persons whose annual production exceeded $1 million received a 42% payout to sell favored products but only a 40% payout to sell other products. *See In the Matter of Morgan Stanley DW Inc.*, *supra* note 20. Associated persons with lower annual production also received higher payouts to sell favored products.

[23] Associated persons may earn more when they sell class B shares than when they sell the same dollar amount of class A shares of the same fund. Because class B shares are not associated with breakpoint discounts that can reduce the distribution costs that investors pay, broker-dealers often receive higher sales fees for distributing class B shares.

[24] NASD rules prohibit non-cash compensation through sales contests for mutual funds and variable products, except under certain conditions.

Continued

may receive additional fees in the years after a sale, such as fees that some funds pay to broker-dealers for providing shareholder services.[25] Each of those types of arrangements may motivate broker-dealer personnel to promote the sale of some funds over others. The funds that are favored by those arrangements may include proprietary funds that are affiliated with the broker-dealer, or funds whose advisers pay revenue sharing to the broker-dealer. Differential compensation may give the associated person an incentive to improperly limit the range of mutual fund choices presented to customers, or may affect the associated person's recommendations.

UITs, which include certain insurance company separate accounts that issue variable insurance products (*i.e.*, variable annuity contracts and variable life insurance policies),[26] are subject to similar distribution-related costs and conflicts.

c. *Costs and conflicts related to 529 plans.* Compensation practices for municipal fund securities used for education savings, or ''529'' plans, raise many of the same issues. Those securities may be sold subject to loads that can reduce the returns they produce. At times, brokers, dealers and municipal securities dealers that distribute municipal fund securities also may participate in distribution-related arrangements that create conflicts of interest for them, including revenue sharing payments and the use of portfolio commissions to reward distribution. In some cases, a broker, dealer or municipal securities dealer chooses to distribute only the municipal fund securities issued by a particular state, and does not provide its customers with the opportunity to invest in 529 plans issued by other states, even though those other plans may have lower loads or lower expense ratios, or may provide state income tax benefits that are absent from the plans being offered.

The associated persons of brokers, dealers and municipal securities dealers selling 529 plans may also receive incentives, such as differential compensation, that create conflicts of interest for them. Moreover, in contrast to NASD rules applicable to the distribution of mutual fund shares, associated persons of brokers, dealers and municipal securities dealers are not generally precluded from receiving non-cash compensation for selling municipal fund securities.[27]

2. Current Confirmation Disclosure Requirements for Mutual Funds and Municipal Fund Securities

Rule 10b–10 under the Exchange Act requires broker-dealers to disclose specific information to their customers about securities transactions.[28] While the rule generally directs broker-dealers to disclose the required information at or before the completion of each securities transaction,[29] broker-dealers may also disclose the information monthly or quarterly in limited situations, such as when a customer has entered into a periodic plan for purchasing mutual fund shares.[30] The rule requires disclosure of, among other information, the identity of the security, the number of shares purchased or sold, and the price at which the transaction was effected. When a broker-dealer acts as the customer's agent, it must also disclose the amount of the remuneration it receives from the customer. For agency transactions in which the broker-dealer also participates in the distribution of the securities, it must disclose the source and amount of remuneration that it receives from third parties.[31]

The Commission and its staff have taken the position, with respect to mutual fund transactions, that a broker-dealer may satisfy its rule 10b–10 obligations without providing customers with a transaction-specific document that discloses information about loads or third-party remuneration, so long as the customer receives a fund prospectus that adequately discloses that information. This position had its genesis in a statement by the Commission when it adopted rule 10b–10. In response to comments related to the rule's disclosure requirement about third-party remuneration, the Commission suggested that prospectus disclosure would be an adequate substitute for confirmation disclosure, explaining:

> [I]n the case of offerings registered under the Securities Act of 1933, the final prospectus delivered to the customer should generally set forth the information required by the proviso with respect to source and amount of remuneration. * * *
>
> In such situations the information specified in the proviso need not be separately set forth in the confirmation.[32]

In other words, the Commission was of the view that broker-dealer disclosure of third-party remuneration would be redundant if the customer received a prospectus disclosing that information.[33]

The Commission's staff reflected that position in a 1979 letter to the Investment Company Institute, in which the Division of Market Regulation stated that it would not recommend enforcement action against broker-dealers that did not provide transaction-specific disclosure about mutual fund

Those rules, however, do not regulate contests that result in cash awards. *See* NASD Notice to Members 99–81 (September 1999). The NASD sanctioned Morgan Stanley for violating the non-cash compensation rules to promote the sale of proprietary mutual funds and selected variable annuities. Prohibited sales contests within the firm offered a variety of rewards, including tickets to Britney Spears and Rolling Stones concerts. *See* NASD, ''Disciplinary and Other NASD Actions,'' October 2003, at D18–D19 (available on the Internet at *http://www.nasdr.com/pdf-text/0310dis.pdf*).

[25] A fund may pay a service fee of up to 0.25% to a broker-dealer out of fund assets pursuant to rule 12b–1 plans. *See supra* note 15. Associated persons may receive some of those fees. The Commission's recent action against Morgan Stanley also noted that associated persons received a portion of the ongoing revenue sharing payments that fund complexes provided to Morgan Stanley. *See In the Matter of Morgan Stanley DW Inc., supra* note 20.

[26] Although most variable insurance products are issued by insurance company separate accounts that are structured as UITs, some are issued by insurance company separate accounts that are structured as open-end management investment companies. Because proposed rules 15c2–2 and 15c2–3 would apply to transactions involving interests in UITs and open-end companies, they would encompass transactions in both types of variable insurance products.

[27] In contrast to NASD rules, MSRB rules do not generally bar associated persons from receiving non-cash compensation. The MSRB has noted, however, that its fair dealing rule and other customer protection rules do apply to the marketing of 529 plans. *See* Municipal Securities Rulemaking Board, *Application of fair practice and advertising rules to municipal fund securities* (May 14, 2002).

[28] Rule 10b–10 applies to broker-dealer transactions in all securities, excluding U.S. Savings Bonds and municipal securities. The MSRB has a separate confirmation rule that governs member transactions in municipal securities, including municipal fund securities. *See* MSRB rule G–15.

[29] Rule 10b–10 defines ''completion of the transaction'' by reference to rule 15c1–1 under the Exchange Act. *See infra* note 125.

[30] *See* Rule 10b–10(a) (general disclosure requirement) and rule 10b–10(b) (periodic reporting alternative).

[31] *See* Rule 10b–10(a)(2)(i)(B) (customer remuneration) and Rule 10b–10(a)(2)(i)(D) (third party remuneration). In the mutual fund context, third party remuneration generally is paid by the fund and its affiliates. Rule 10b–10 also requires disclosure of the mark-ups and mark-downs that a broker-dealer earns on transactions involving a contemporaneous sale and purchase when it acts as a principal for its own account in a transaction, other than as a market maker. *See* Rule 10b–10(a)(2)(ii)(A).

[32] *See* Rule 10b–10 Adopting Release, *supra* note 5, at n.41.

[33] Of course, this applies only to information disclosed in a prospectus that is delivered to customers at or before completion of the transaction. The requirements of rule 10b–10 cannot be satisfied via disclosure in a document that is not delivered at or before completion of the transaction, such as a statement of additional information (''SAI''). The SAI is part of a fund's registration statement and contains information about a fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System.

loads and related charges, so long as the customer received a prospectus that ''disclosed the precise amount of the sales load or other charges or a formula that would enable the customer to calculate the precise amount of those fees.'' [34]

The Commission later discussed how Rule 10b–10 disclosure obligations apply to mutual fund transactions in an *amicus* brief filed with the Second Circuit in 2000.[35] That brief focused on the adequacy of prospectus disclosure by broker-dealers that received third-party remuneration—in the form of rule 12b–1 payments from funds and revenue sharing payments from fund investment advisers—in connection with sweeping customer funds into money market accounts. We concluded that the prospectus disclosure at issue substituted for confirmation disclosure, when the prospectuses included the information required to be disclosed by Form N–1A, including the maximum rule 12b–1 fees payable by the funds as a percentage of net assets, and noted the presence of ''significant amounts'' of non-rule 12b–1 payments by the funds' investment advisers. In arriving at that conclusion, we interpreted the rule 10b–10 Adopting Release as establishing the general principle that ''delivery of a prospectus containing sufficient disclosure can satisfy a broker-dealer's obligations under Rule 10b–10.'' Recognizing that ''there is no precise standard as to how much disclosure the Rule currently requires,'' we went on to note that the staff's 1979 letter, with its ''precise amount'' standard for prospectus disclosure of loads and related fees, did not apply to third-party remuneration because precision was not necessary to inform customers about conflicts of interest.

While the Commission has never directly addressed the disclosure of payments to a broker-dealer in the form of portfolio brokerage commissions, the same principles apply. Currently, if a prospectus is not delivered at or before completion of the transaction, or if the prospectus fails to disclose the fact that the fund pays portfolio brokerage commissions to broker-dealers that participate in distribution, or fails to disclose information about the degree of the resulting conflict, then the transaction confirmation must provide information about the source and amount of those payments.[36]

In one case before the Second Circuit, we viewed the disclosures at issue as meeting the requirements of rule 10b–10, but we went on to state: ''We are not saying that this is necessarily all the disclosure about these types of fees that should be required as a matter of policy.'' [37] We also noted that we had directed the staff to make recommendations to us about whether to require new disclosures or to refine the existing disclosures.[38] The Second Circuit also questioned whether the prospectus disclosure at issue adequately placed investors on notice about the receipt of those payments and any resulting conflicts of interest.[39] The rules we propose today address those concerns.

3. Concerns About the Adequacy of Current Disclosure Practices

The disclosure rules we are proposing are designed to respond to the ways in which the mutual fund industry and its distribution practices have evolved in the years since the 1977 adoption of rule 10b–10 and the staff's 1979 letter to the ICI.

During the past quarter century, the number of mutual fund customers, the value of mutual fund investments, and the number of mutual funds all have increased exponentially.[40] The public increasingly has placed retirement savings into mutual funds through individual retirement accounts and other retirement plans. In addition, distribution costs and broker-dealer conflicts have grown more complex. Since 1980, many funds have offered multiple share classes, including class B shares with deferred sales loads that can have the effect of obscuring the distribution costs borne by investors. Many mature funds continue to rely on rule 12b–1 fees to pay for distribution, even though those fees were intended by the Commission to be short-term tools for helping funds gather assets. The increase in the number of mutual funds has made broker-dealer ''shelf space'' more critical to investment companies, leading to revenue sharing and other distribution arrangements that quietly compensate broker-dealers for distribution. The growth of funds affiliated with broker-dealers has also generated special broker-dealer marketing incentives to promote the distribution of those affiliated ''proprietary'' funds. In addition, the development of fund ''supermarkets'' sponsored by broker-dealers has led to related arrangements in which a fund or its affiliates compensates broker-dealers in ways that are not generally disclosed to investors. Moreover, the introduction of highly promoted 529 plans has brought many new investors into products that themselves invest in mutual funds and that are associated with similar distribution-related costs and conflicts.

Those changes raise significant concerns about the adequacy of current disclosure practices. For example, we are concerned that some investors may misunderstand the costs associated with purchasing mutual fund shares and 529 plan securities because they lack transaction-specific confirmation and point of sale information about loads and fees.

In late 2002, in response to learning that some mutual fund investors did not receive appropriate volume discounts on the front-end sales loads they paid—commonly known as ''breakpoint discounts''—NASD, the ICI, and the Securities Industry Association (''SIA'') convened a task force to recommend industry-wide changes relating to breakpoints.[41] The task force issued a report in July 2003 recommending, among other changes, that mutual fund confirmations include front-end sales

[34] *See* Letter regarding Investment Company Institute, *supra* note 6. That 1979 letter referred both to the agency disclosure and the principal disclosure requirements of rule 10b–10.

Although in 1994 the staff indicated that it intended to withdraw the 1979 letter, the letter currently remains in effect. The staff was concerned that confirmations that do not disclose any transaction charges could mislead customers who might not look to the prospectus for a full description of the remuneration. *See* Letter regarding Investment Company Institute (March 16, 1994). The mutual fund industry commenced discussions with the staff noting that some mutual funds impose transaction charges over the duration of or at the end of the investment, and asserted that disclosing the transaction charges through prospectus fee tables was more accurate than trying to estimate them on the confirmation at the beginning of the investment. As a result of that dialogue, the staff decided not to withdraw the letter.

[35] *See* Commission brief, *Cohen* v. *Donaldson, Lufkin & Jenrette Securities Corp.,* reported as *Press* v. *Quick & Reilly, Inc.,* 218 F.3d 121 (2d Cir. 2000) (No. 97–9159) (''*amicus* brief''). The Commission filed the brief in two separate dockets that were consolidated before the Second Circuit.

[36] *Id.* at 10–12, 21, 24–28.

[37] *Id.* at 24.

[38] *See id.*

[39] *See Press* v. *Quick & Reilly, Inc.,* 218 F.3d 121, 129 (2d Cir. 2000).

[40] Industry data indicates that between 1977 and 2002, the number of mutual funds increased from 477 to 8,256, total fund assets increased from $49 billion to $6.4 trillion, and the number of shareholder accounts increased from 8.7 million to 251 million. The magnitude of the changes, however, is likely greater than what those figures depict. The earlier figures include data for funds that invested in other mutual funds, while the latter figures exclude that data. *See* Investment Company Institute, *Mutual Fund Fact Book* (43rd ed., 2003) at 63.

[41] Mutual funds typically offer discounts on front-end sales loads assessed on class A shares if the amount of an investor's investment in the fund reaches certain pre-determined ''breakpoint'' levels. Examinations by the Commission staff and self-regulatory organizations determined that many investors did not receive the breakpoint discounts to which they were entitled.

load disclosure.[42] The task force also recommended that the Commission staff revisit its 1979 letter to the ICI.[43] While the task force was studying the issue, the Commission also received a rulemaking petition on behalf of a mutual fund customer asking the Commission to require broker-dealer confirmations to specifically disclose the front-end sales loads that customers incur with mutual fund transactions.[44]

Our concerns, however, go beyond the adequacy of front-end load disclosure. More complete disclosure also may help customers understand the costs associated with purchasing fund share classes that carry deferred sales loads, as well as the potential conflicts of interest that broker-dealers and their associated persons have in connection with the sale of those share classes. For example, when the amount invested reaches certain breakpoint discount levels, associated persons of broker-dealers generally are paid more for selling class B shares than for selling shares of other classes. Because class A shares typically carry front-end sales loads while class B shares do not, some investors may be inclined to purchase class B shares believing that they are cheaper, even though class B shares generally carry contingent deferred sales loads and higher 12b–1 fees. NASD has issued an alert informing investors that, before purchasing class B shares, ''you should determine whether this investment is in your interest, and not just in the interest of your broker or adviser who may receive higher commissions from the sale of Class B shares than other classes of fund shares.''[45] In fact, questions have been raised about whether class B shares ever would be appropriate for most investors.[46] Recent enforcement actions have underscored how those types of compensation arrangements produce conflicts of interest that lead associated persons of broker-dealers to act against the interests of their customers.[47]

Investors also lack information about whether their broker-dealers receive revenue sharing or other third-party remuneration to distribute particular mutual funds. Prospectus disclosure does not identify which individual broker-dealers receive revenue sharing, let alone quantify those arrangements. Yet the magnitude of revenue sharing payments—estimated in 2001 to be $2 billion annually[48]—suggests that those arrangements influence the mutual fund choices that broker-dealers and their representatives present to investors. Prospectus disclosure, moreover, is not designed to inform investors about whether their particular broker-dealers are compensated in other ways for distributing fund shares, such as by receiving commissions for fund portfolio brokerage transactions.

Broker-dealer compensation practices related to proprietary funds raise additional disclosure issues. In 1994, a committee was formed at the request of the Commission's Chairman to examine securities industry compensation practices, identify actual and perceived conflicts of interest, and identify ''best practices'' for controlling those conflicts. The committee raised a number of concerns in its 1995 report, including concerns about the practice of offering higher payouts for selling proprietary mutual funds. It recommended that broker-dealers pay identical commissions to registered representatives for selling proprietary and non-proprietary products within a product category.[49] While some broker-dealers followed that recommendation, its adoption has not been uniform.[50]

In September 2003, NASD requested comment on proposed rules to require member firms to disclose certain information about revenue sharing and differential compensation to customers at account opening or, if no account is established, at the time the customer first purchases shares of an investment company.[51] Stating that those compensation arrangements could create conflicts of interest for broker-dealers and their associated persons, NASD added, ''Disclosure of revenue sharing and differential cash compensation arrangements would enable investors to evaluate whether a registered representative's particular product recommendation was inappropriately influenced by these arrangements.'' The Commission will consider the proposal in the event that NASD submits it as a proposed rule change. We note, however, that NASD's proposal is geared to giving customers generalized access to information about revenue sharing and differential compensation at the time the customer is evaluating potential mutual fund investments. That particular focus would complement the disclosures we propose today—which would improve disclosure of transaction-specific information about distribution-related costs and arrangements that lead to conflicts of interest. Investors who have access to relevant transaction-specific information about those costs and conflicts of interest should be better prepared to scrutinize the adequacy of the investment choices presented by their broker-dealers as well as the recommendations their broker-dealers make.[52]

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[42] ''Confirmations should reflect the entire percentage sales load charged to each front-end load mutual fund purchase transaction. This information would enable investors to verify that the proper charge was applied.'' Report of the Joint NASD/Industry Task Force on Breakpoints (July 2003) at 10 (footnote omitted) (''Task Force Report'') (available at *http://www.nasdr.com/breakpoints_report.asp).*

[43] *See id.*

[44] *See* Letter to Jonathan Katz, Secretary, Commission, from Donna Matheney, Vice President, Joe Becks & Associates, Inc., January 22, 2003. The petition was written on behalf of a company profit sharing plan that was invested in mutual funds.

[45] *See* NASD Investor Alert, ''Class B Mutual Fund Shares: Do They Make the Grade?'' (June 2003).

[46] *See* ''Why B Shares Deserve to Get an 'F': These Broker-Sold Funds are a Bad Deal,'' *Wall Street Journal,* July 2, 2003 at D1.

[47] In one matter, the Commission affirmed a NASD disciplinary action against an associated person of a broker-dealer who placed a customer into class B shares of a mutual fund instead of the more appropriate class A shares. The associated person testified that he generally recommended that his clients purchase class B shares because he received higher commissions for selling that class. The Commission affirmed the NASD's conclusion that the associated person violated NASD suitability requirements and standards of conduct requirements. *See In the Matter of Wendell D. Belden,* Securities Exchange Act Release No. 47859 (May 14, 2003).

In another matter, the Commission sanctioned a broker-dealer for failing to adequately supervise an associated person who inappropriately placed investors into class B shares to generate higher commissions. *See In the Matter of Prudential Securities, Inc.,* Securities Exchange Act Release No. 48149 (July 10, 2003).

As discussed above, we found that Morgan Stanley violated the antifraud provisions of Section 17(a)(2) of the Securities Act by placing customers into class B shares without adequately disclosing information about the relative costs of class A and class B shares. *See In the Matter of Morgan Stanley DW Inc., supra* note 20.

[48] *See* ''How high can costs go?,'' *Institutional Investor,* May 2001 at 56.

[49] ''Of particular concern is the practice of firms offering higher payouts when [registered representatives] sell proprietary mutual funds instead of funds of a similar class managed by outside investment companies. (Proprietary funds are those created and/or managed by the firm.) This differentiation raised the question: Is the [registered representative] rendering objective advice or simply maximizing commission income?''

Report of the Committee on Compensation Practices (April 10, 1995) at 7–8 (available at *http://www.sec.gov/news/studies/bkrcomp.txt*). The committee was chaired by Daniel Tully of Merrill Lynch & Co., and its report commonly is known as the ''Tully report.''

[50] As discussed above, Morgan Stanley had a practice of paying associated persons a higher percentage payout for selling proprietary funds or other funds that were favored by the firm. *See In the Matter of Morgan Stanley DW Inc., supra* note 20. This was not a unique situation, as other broker-dealers also provide associated persons with higher percentage payouts for selling proprietary funds.

[51] *See* NASD Notice to Members 03–54 (September 2003).

[52] The SIA recently submitted suggestions to the staff for amending rule 10b–10 to provide additional disclosure about revenue sharing and differential compensation related to purchases of mutual fund shares. *See* Letter from Stuart

B. New Rule and Proposed Amendments Regarding Cost and Conflict Disclosure

1. Proposed Rule 15c2–2

To provide investors with adequate access to information regarding the costs of their investments, as well as the conflicts of interest their broker-dealers face, the Commission is proposing a new rule to require brokers, dealers and municipal securities dealers to provide their customers with certain information in connection with certain transactions in mutual fund shares, UIT interests and 529 plan shares. Because those securities have special distribution and compensation practices, the Commission is proposing to address those disclosure requirements in a new rule, rather than in rule 10b–10. A broker, dealer or municipal securities dealer that misstates information in a confirmation delivered pursuant to proposed rule 15c2–2 with an intent to mislead may be subject to liability under the antifraud provisions of section 10(b) and rule 10b–5.

Proposed rule 15c2–2 would retain much of the disclosure framework of rule 10b–10, while also providing customers of brokers, dealers and municipal securities dealers with targeted cost and conflict information that is relevant to purchases and sales of those securities.[53] Accordingly, the preliminary note to proposed rule 15c2–2 would explain that the rule requires brokers, dealers and municipal securities dealers to provide specified information in writing to customers at or before completion of a transaction in certain investment company securities or municipal fund securities. The preliminary note also would state that rule 10b–10 would continue to set forth the confirmation requirements that apply to broker-dealer transactions in other securities. More generally, as is the case under current law, disclosure provided pursuant to the proposed rules would not derogate from a broker-dealer's other legal obligations to customers, such as in the context of making recommendations or suitability determinations.

a. *No safe harbor from antifraud provisions or other legal requirements.* Proposed rule 15c2–2, like rule 10b–10, would not function as a safe harbor for non-disclosure that constitutes deception or that otherwise violates a securities firm's legal obligations. Rather, it would provide a minimal benchmark for disclosing certain costs and conflicts related to the distribution of these securities, in a manner that would be accessible to investors and that could fit on a single piece of paper. In setting forth the minimum level of disclosure, the proposed rule also would not preclude additional disclosures, as appropriate. While we believe the information required to be disclosed under the proposed rule is material to investors, there may be other information that is material for purposes of alerting investors about the costs of these transactions and the conflicts raised by them.[54] That is true even in instances where the confirmation rules specifically address the categories of information at issue, but do not require disclosure of the information in question.

Accordingly, we propose to make that point explicit in the preliminary note to proposed rule 15c2–2. Currently, the preliminary note to rule 10b–10 explains that the confirmation disclosure requirements do not exhaust a firm's obligation under the general antifraud provisions of the federal securities laws to disclose additional information to a customer at the time of the customer's investment decision. We are aware, however, that a court has interpreted rule 10b–10 to limit disclosure obligations in a way that is inconsistent with our intent.[55] To clarify our intent, the preliminary note to proposed rule 15c2–2 would state that the confirmation 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.[56]

b. *Securities transactions covered.* The disclosure requirements of proposed rule 15c2–2 would apply to transactions by brokers, dealers and municipal securities dealers[57] on behalf of customers in ''covered securities.'' Proposed paragraph (f)(6) of rule 15c2–2 would define the term ''covered security'' as: (i) Any security issued by an ''open-end company,'' as defined by section 5(a)(1) of the Investment Company Act, that is not traded on a

Strachan, Chair, Investment Company Committee, SIA, to Paul Roye, Director, Division of Investment Management, Commission, October 31, 2003. This letter will be available in the public comment file.

The SIA recommends that, when applicable, confirmations should include a statement indicating that associated persons may have received additional compensation in connection with the purchase. The SIA further suggests that when a broker-dealer has received a cash payment ''as a condition for inclusion of the investment company on a preferred or select sales list, or similar grouping, in connection with any other sales program, or as a reimbursement of advancement of expenses,'' then the confirmation should contain a statement indicating that it ''may have received a cash payment relating to the distribution.'' In either case, the SIA suggests that the disclosure should also indicate that the customer can obtain ''further information'' by calling a toll-free or collect telephone number or by visiting a website. As discussed below, we are taking a different approach.

[53] While Exchange Act rule 10b–10 does not apply to transactions in municipal securities, transactions in 529 plan interests nonetheless pose cost and conflict concerns similar to those associated with transactions in mutual fund shares and UIT interests. Including municipal fund securities within the ambit of rule 15c2–2 therefore would promote a consistent disclosure framework.

[54] While the confirmation rules require delivery of information at *or* before a securities transaction, the antifraud provisions of the securities laws at times require a broker, dealer or municipal securities dealer to disclose particular information before a securities transaction. *See Ettinger* v. *Merrill Lynch Pierce Fenner & Smith, Inc.,* 835 F.2d 1031, 1036 (3d Cir. 1987); *Krome* v. *Merrill Lynch & Co.,* 637 F. Supp. 910, 916 (S.D.N.Y. 1986).

Moreover, the Commission recently sanctioned Morgan Stanley for violating certain antifraud provisions of the Securities Act with respect to its sale of class B mutual fund shares, based in part on a failure to disclose material information about differences between class B and class A shares. The Commission did not sanction Morgan Stanley for those omissions under rule 10b–10. *See In the Matter of Morgan Stanley DW Inc., supra* note 20.

[55] The Second Circuit, in *Press* v. *Quick & Reilly, Inc.,* 218 F.3d 121 (2d Cir. 2000), expressed the view that the confirmation requirements of rule 10b–10 also could determine which information is material under the antifraud standards of rule 10b–5 under the Exchange Act. The court reasoned that the Commission ''has decided precisely'' what disclosure was needed with regard to conflicts of interest arising from third-party payments to broker-dealers, and concluded that ''we will not undermine the SEC's interpretation of its regulation by requiring even greater disclosure about that conflict of interest under the general antifraud provisions of Rule 10b–5.'' *Id.* at 131–32. We recognize the importance of the principle that guided the court. That principle, however, is not what we intended when we adopted rule 10b–10. Even if a confirmation rule specifically addresses a particular practice, a broker, dealer or municipal securities dealer could provide enough disclosure to satisfy that rule, but nonetheless violate the antifraud provisions of the securities laws through its omission of material information to its customer in a particular transaction or under particular arrangements. When we adopt confirmation rules, we cannot consider all information that will be material in a particular transaction, and we do not determine that additional information is not material under the antifraud provisions. The confirmation rules cannot account for the variety of conflicts that are encompassed by the antifraud provisions. *See SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 195 (1963) (noting that Congress intended ''securities regulation 'enacted for the purpose of avoiding frauds' '' to be construed ''not technically and restrictively, but flexibly to effectuate its remedial purposes''). Similarly, with regard to other courts that have looked to rule 10b–10 in a more general context, we emphasize that rule 10b–10 was not intended to limit a broker-dealer's obligation to disclose information, or otherwise to limit a broker-dealer's responsibilities to its customers. *See, e.g., Orman* v. *Charles Schwab & Co.,* 179 Ill. 29 282, 688 N.E.2d 620 (Ill. 1998), *cert. denied,* 523 U.S. 1075 (1998).

[56] As discussed below, we also propose to amend the preliminary note to rule 10b–10 to be consistent with this language.

[57] As the preliminary note to the rule would make clear, municipal securities brokers would be subject to the proposed rule because they are a type of ''broker.'' *See* Exchange Act Section 3(a)(31) (definition of ''municipal securities broker'').

national securities exchange;[58] (ii) any security issued by a ''unit investment trust,'' as that term is defined by Section 4(2) of the Investment Company Act, other than an ETF that is traded on a national securities exchange or facility of a national securities association, or a unit investment trust that is the subject of a secondary market transaction;[59] and (iii) any ''municipal fund security.'' Proposed paragraph (f)(12) of rule 15c2–2 would define a ''municipal fund security'' as any municipal security that is issued pursuant to a qualified state tuition program as defined by Section 529 of the Internal Revenue Code [26 U.S.C. 529], and that is issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act, would constitute an investment company within the meaning of Section 3 of the Investment Company Act.[60]

• The Commission requests comment on the proposed definition of ''covered security,'' including whether the definition appropriately encompasses all the types of securities having distribution practices that warrant targeted confirmation disclosure of information about distribution-related costs and conflicts.

• The Commission seeks comment on whether proposed rule 15c2–2 should encompass transactions in all UIT interests, given the differences in distribution practices between UIT interests and other securities within the scope of the proposed rule. While some UIT interests are associated with revenue sharing (*e.g.*, revenue sharing with respect to the underlying funds of variable annuity contracts and variable life insurance policies), commenters are invited to address the extent to which revenue sharing and other arrangements that raise conflict of interest issues are not associated with the distribution of UIT interests.

• The Commission also seeks comment about whether proposed rule 15c2–2 should also apply to other types of investment company securities, such as ETF shares. Commenters moreover are invited to address whether the rule also should apply to closed-end investment companies generally, or to particular closed-end companies such as ''interval funds'' that make regular repurchase offers.[61] Do transactions in closed-end company shares at those times raise the types of costs or conflicts that warrant proposed rule 15c2–2's disclosure requirements?

• We also request comment about whether persons other than brokers, dealers or municipal securities dealers also should be required to deliver confirmations to investors pursuant to proposed rule 15c2–2. Commenters are invited to discuss whether other persons that participate in the distribution of covered securities—such as banks—are subject to the same or similar conflicts of interest as brokers, dealers and municipal securities dealers. Commenters also are invited to discuss whether the Commission should propose rules to require those other persons to disclose confirmation information on or before the completion of such transactions.

• In addition, the Commission requests comment on whether a transitional period is necessary to make adjustments necessary to deliver confirmations that comply with proposed rule 15c2–2.

c. Schedule 15C and the form of disclosure. Proposed rule 15c2–2 would require brokers, dealers and municipal securities dealers to disclose a range of cost and conflict information arising from transactions in covered securities. To be effective, this information would have to be disclosed in a manner that is clear and that provides useful context to investors.[62] Thus, paragraph (a) of proposed rule 15c2–2 would require a broker, dealer or municipal securities dealer to make the required disclosures (other than disclosures subject to the periodic disclosure alternative, discussed below) in a manner that is ''consistent with Schedule 15C'' under the Exchange Act. Proposed Schedule 15C, which is set forth at Figure 1, would establish the format for disclosing the required information to investors. While much of the form would be standardized, we have included flexibility to accommodate implementation costs as well as the fact that confirmations are business forms traditionally utilized by brokers, dealers and municipal securities dealers for their own business purposes. Proposed Schedule 15C has six main parts: A, general information; B, distribution-cost information; C, broker-dealer compensation information; D, differential compensation information; E, breakpoint discount information, and F, explanations and definitions. Proposed paragraph (f)(4) of rule 15c2–2 would provide that the term ''consistent with Schedule 15C'' means using Schedule 15C, or using a similar layout of disclosure so long as: (i) All information specified in Schedule 15C is set forth in the confirmation; (ii) information specified in Sections B through F of Schedule 15C (if applicable) is included with no change, including the use of bold print for data items printed in bold in Schedule 15C, and in the order set forth in Schedule 15C; and (iii) information specified in Section A of Schedule 15C is displayed prominently.

Proposed Schedule 15C would not only provide the format for disclosing quantitative information about a transaction, but also would provide definitions and explanatory information intended to help make the quantitative information more useful to investors. By supplementing the required disclosures with explanations of the meaning of terms such as net asset value,[63] revenue sharing and portfolio brokerage commissions, and by explaining why investors may wish to scrutinize information about revenue sharing and differential compensation, proposed Schedule 15C is intended to help give investors the tools they need to ask the

[58] That definition excludes securities issued by exchange traded funds (''ETFs''). Although ETFs are open-end management investment companies or unit investment trusts, they do not present the same disclosure concerns as other open-end investment companies or UITs. Rather then being sold and redeemed through retail transactions, large blocks of ETF shares are created and redeemed through the exchange of large blocks of the underlying securities. Retail investors then can buy or sell ETF shares on the secondary market. Broker-dealers that effect retail transactions in ETFs generally charge commissions that are disclosed on the confirmations. Moreover, we do not believe that ETFs pose the same type of potential conflicts of interest that are associated with traditional open-end fund shares. We therefore do not believe it is necessary to include ETFs within the scope of the rule.

[59] Broker-dealers may buy and sell UITs on the secondary market, following their initial distribution. Because proposed rule 15c2–2 focuses on disclosure of costs and conflicts when covered securities are distributed, we would except secondary market transactions in UITs from the rule's scope.

[60] Section 2(b) of the Investment Company Act excludes the United States, states and certain other government-related instrumentalities and corporations from the scope of that Act.

Because our proposed definition of ''municipal fund security'' does not encompass interests in local government investment pools, it would differ from the way the term is defined in MSRB rule D–12.

[61] In general, shares of closed-end investment companies are distributed through one-time underwritings, rather than on an ongoing basis. The broker-dealers that distribute the shares are compensated through the receipt of underwriting fees, and practices such as revenue sharing may not be present. As a result, transactions in those securities generally may not raise the same disclosure issues as transactions in open-end investment companies. Some closed-end investment companies, however, may offer to repurchase their shares on a periodic basis. *See, e.g.,* Investment Company Act section 23(c) and rule 23c–3 thereunder.

[62] As discussed below, certain arrangements that raise cost and conflict concerns raise special disclosure challenges, particularly with regard to disclosure of deferred sales loads, revenue sharing and portfolio brokerage commissions.

[63] When we use the term ''net asset value'' in this release, it includes ''accumulation unit value'' in the case of variable insurance products.

right questions and to make informed decisions. Attachments 1, 2 and 3 to this proposal set forth examples of confirmations that are consistent with Schedule 15C.

• We are not at this time proposing a form for disclosures made pursuant to proposed rule 15c2–2's periodic disclosure alternative. Because of the variance in the types of transactions that could be disclosed pursuant to this alternative, we do not believe that a standardized disclosure form would be appropriate. We request comment, however, on whether standardized disclosure should be required with respect to periodic disclosures. If so, should the format follow Schedule 15C? In the event a customer invests in multiple securities, including mutual fund shares, UIT interests and 529 plan securities, should the information pertaining to each be in a separate section? Alternatively, should there be separate forms for each category of investment? Commenters are invited to send prototype forms reflecting their view.

• The Commission also requests comment on whether proposed Schedule 15C is an appropriate template for disclosing information to customers. The Commission also requests comment on whether disclosure should be required to be in the exact form of proposed Schedule 15C, rather than merely consistent with it.

• The Commission further requests comment on whether it is appropriate for the proposed form of Schedule 15C to combine quantitative information with explanatory and definitional information. Commenters are invited to address the issue of whether the inclusion of both types of materials may conflict with the business purposes that confirmations fundamentally address. Commenters also are invited to discuss whether there are preferable alternatives for providing explanatory and definitional information that would permit investors to fully use the information set forth in the confirmation.

d. *General and purchase-specific disclosure requirements.* As outlined above, the disclosure requirements of proposed rule 15c2–2 in large part are based on existing rule 10b–10, with modifications to alert customers to targeted information about the special cost and conflicts raised by transactions in mutual fund shares and municipal fund securities.

Paragraph (a) of proposed rule 15c2–2 would provide that it is unlawful for any broker, dealer or municipal securities dealer to effect any customer transaction in, or to induce any customer purchase or sale of, any covered security unless the broker, dealer or municipal securities dealer complies with the requirements set forth in paragraphs (b), (c), (d) and (e) of the rule. Paragraph (b) would set forth general disclosure requirements under the rule. Paragraph (c) would set forth additional disclosures that customers shall receive when they purchase mutual fund shares, UIT interests and municipal fund securities, because purchase transactions implicate the costs and conflicts associated with the distribution of these securities. Paragraph (d) would set forth alternative requirements for periodic reporting. Paragraph (e) would set forth the requirement to disclose median information and comparison ranges for the types of information required under paragraphs (b), (c) and (d).

i. *General disclosure requirements.* Proposed paragraphs (b)(1) and (b)(2) of rule 15c2–2 would require disclosure of the date of the transaction, and the issuer and class of the covered security. Those requirements are similar to the requirements of rule 10b–10(a)(1). While rule 10b–10(a)(1) does not specifically mention share class, disclosure of class, when applicable, is necessary to identify the security.

Proposed paragraph (b)(3) of rule 15c2–2 would require disclosure of both the net asset value of the shares or units and, if different, their public offering price.[64] Rule 10b–10(a)(1) only requires disclosure of price. Fund share classes that charge front-end sales loads are sold to investors at a public offering price that exceeds the net asset value by the size of the load. Providing customers with information about both price and net asset value would help them verify whether they are obtaining the benefit of any applicable breakpoints, and would make the costs associated with front-end sales loads more transparent in general.

Proposed paragraph (b)(4) of rule 15c2–2 would require disclosure of the number of shares of a covered security purchased or sold by the customer. It also would require 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 net asset value of those shares or units. Rule 10b–10(a)(1) requires disclosure of the number of shares. Specific disclosure of the dollar value of the transaction—equal to the number of shares bought or sold multiplied by the transaction price—would help safeguard against misunderstandings about the value of the transaction. Confirmations already typically contain information about the dollar value of the transaction, together with the price of the shares and the number of shares bought or sold.

Proposed paragraph (b)(5) of rule 15c2–2 would require disclosure of any commission, markup or other remuneration the broker, dealer or municipal securities dealer will receive from the customer in connection with the transaction. Rule 10b–10(a)(2)(i)(B) already requires disclosure of remuneration from customers. This remuneration is distinct from dealer concessions and other types of sales fees that a broker, dealer or municipal securities dealer may receive from the fund or its primary distributor. Remuneration from customers also is distinct from any sales load that the customer may pay in connection with a transaction. Both of those would be disclosed separately.[65] Under proposed paragraph (b)(5), a broker, dealer or municipal securities dealer often would not be required to disclose any information because the firm would receive all of its compensation from the issuer or distributor of the covered security, or other third parties, rather than directly from the customer. Proposed paragraph (b)(5) would require separate disclosure or commissions or other compensation from the customer, however, 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.[66]

Proposed paragraph (b)(6) of rule 15c2–2 would require disclosure, for any transaction in which a customer

[64] This discussion's references to ''share'' and ''per-share'' information also apply to ''unit'' and ''per-unit'' information connected to transactions involving UITs.

[65] Proposed paragraph (c)(4) of rule 15c2–2, discussed below, would require disclosure of dealer concessions and other types of sales fees received from the issuer, its agent or primary distributor, or others. Brokers, dealers or municipal securities dealers would not receive those fees directly from customers, although the fees may be funded by sales loads paid by customers.

Proposed paragraphs (c)(1) and (c)(2) of rule 15c2–2, also discussed below, would require disclosure of front-end and deferred sales loads that the customer would incur in connection with the transaction.

[66] In some cases, a broker, dealer or municipal securities dealer itself may impose a special fee on a customer that sells a mutual fund share shortly after purchase, to discourage short-term trading. Paragraph (b)(5) would not require disclosure of that type of fee at the time of purchase, unless the amount and timing of the fee is reasonably foreseeable to the firm at the time of purchase (such as because the broker, dealer or municipal securities dealer is aware of the customer's intent to sell). This paragraph, however, would require disclosure of that type of fee when it is incurred at the time of the subsequent sale.

sells a covered security, of the amount of any deferred sales loads incurred by the customer. Rule 10b–10 does not explicitly require that disclosure, although rule 10b–10 does require disclosure of price, and the deferred sales load charged to a customer at the time of sale does affect the effective price that the customer receives. Disclosure of the deferred sales loads that customers incur when they sell their shares would make those distribution costs more transparent.[67]

Proposed paragraph (b)(7) of rule 15c2–2, when applicable, would require disclosure of the fact that a broker, dealer or municipal securities dealer is not a member of the Securities Investor Protection Corporation (''SIPC''), or that the broker, dealer or municipal securities dealer clearing or carrying the customer account is not a member of SIPC.[68] That disclosure would not be required, however, if the customer sends funds or securities directly to, or receives funds or securities directly from, the issuer or its transfer agent, custodian, or other designated agent that is not an associated person of the broker, dealer or municipal securities dealer, and if that other person would provide disclosure on behalf of the broker, dealer or municipal securities dealer. This would be consistent with the disclosure requirement of rule 10b–10(a)(9).[69]

• The Commission requests comment on whether these proposed general disclosure requirements would provide customers with adequate information about transactions in covered securities. Commenters particularly are invited to discuss whether all of these proposed general disclosure requirements are appropriate to transactions in securities that have a substantial insurance component, such as variable life insurance policies.[70]

• Commenters may also wish to discuss whether all of these proposed general disclosure requirements are appropriate to transactions in variable annuities. Commenters are invited to discuss any issues they believe are relevant to the application of proposed rule 15c2–2 to variable insurance products, as well as any modifications they believe could improve the proposed rule's effectiveness as applied to variable insurance products. Specifically, commenters may wish to address whether alternative or additional disclosure requirements would provide investors with more useful information for transactions in variable insurance products. In addition, we invite comment on whether to use a single confirmation for transactions in both the contract or policy and the underlying funds. Commenters should address whether such a single confirmation is appropriate under the federal securities laws.

ii. Additional Disclosures For Purchases. Proposed rule 15c2–2(c) would require additional disclosures when customers purchase covered securities.

(a) Cost disclosure. Proposed paragraph (c)(1) of rule 15c2–2 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,[71] together with information about the potential relevance of breakpoint discounts. Specifically, proposed paragraph (c)(1)(i) would apply if the customer will incur a sales load at the time of sale, and would require disclosure of information about the availability of breakpoints as reflected in Schedule 15C with regard to the covered security, including a statement about what is the applicable sales load that is set forth in the prospectus, in light of any breakpoint discount and the value of the securities position. In determining the value of the position that may be subject to a breakpoint discount, the broker-dealer should consider net asset value, public offering price, historic cost or any other measurement that reflects the covered security's particular method of providing breakpoint discounts. This proposed paragraph therefore requires disclosure not only of the sales load actually incurred at the time of purchase, but also the sales load that should have been charged based on the availability of breakpoint discounts.[72]

[67] Proposed paragraph (c)(2) of rule 15c2–2, discussed below, would separately require prospective disclosure, in the confirmation, of the potential amounts of the deferred sales load that the customer may incur when he or she later sells the shares. Proposed paragraph (b)(6), in contrast, would require disclosure of deferred sales loads actually incurred at the time of sale.

[68] SIPC is a private-sector, nonprofit membership corporation that Congress created under the Securities Investor Protection Act of 1970 to help protect customers of failed broker-dealers. Generally, all broker-dealers registered with the Commission must be members of SIPC. If a broker-dealer fails and is unable to meet its obligations to customers, SIPC steps in as quickly as possible and, within certain limits, returns cash and securities to customers. Broker-dealers who sell only shares of mutual funds are exempt from the requirement to be a member of SIPC.

If disclosure of SIPC membership is adopted, it may be placed in the part A (general information) of Schedule 15C.

[69] We are proposing conforming changes to rule 10b–10.

[70] We note that customers who purchase a variable life insurance policy will buy an insurance component as well as make an investment, and that the investment component initially may be relatively small. That would be reflected in disclosure of net amount invested.

[71] The fee table set forth in the front of a fund prospectus expresses front-end sales loads as a percentage of the offering price, pursuant to Item 3 of Form N–1A, which governs prospectus content. A separate table in the prospectus expresses the front-end sales loads as a percentage of both the offering price and the net asset value, pursuant to Item 8(a)(1) of Form N–1A. The differences between those two amounts is significant. For example, a front-end sales charge that equals 5.75% of the public offering price would equal approximately 6.10% of net asset value. We are proposing to amend the prospectus fee table to require disclosure of loads as a percentage of net asset value. *See infra* section VI.

We also note that industry practice is to round the public offering price to two decimal places when calculating the number of shares purchased, and to round the number of shares purchased to three decimal places. That rounding practice can lead to an actual front-end sales load as a percentage of gross amount invested or net amount invested that is higher or lower than the sales load disclosed in the prospectus as a percentage of offering price or net asset value. *See infra* note 154 and accompanying text. Accordingly, as discussed below, the Commission is proposing prospectus disclosure requirements to address these differences. Proposed rule 15c2–2 would require disclosure of the load as a percentage of the net amount invested in the transaction, regardless of that rounding practice. Attachment 1 illustrates the practical impact of the rounding practice. The front-end sales load in that example is 4.0% of the public offering price. Rounding, however, causes the sales load charged on that $8,000 purchase to equal $321.18, rather than $320. The impact of the rounding practice can be more significant when net asset value is relatively low.

[72] Broker-dealers who sell fund shares to retail customers must disclose breakpoint discount information to their customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints. A failure to do so can result not only in the customer being deprived of a benefit to which he or she is entitled, but also in the broker-dealer and representative receiving increased commissions at the customer's expense. *See In the Matter of Application of Harold R. Fenocchio for Review of Disciplinary Action Taken by NASD,* 46 SEC 279 (1976) (registered representatives had a responsibility to make certain that a letter of intent was filed with the mutual fund or, at the very least, to inform the clients of their rights of accumulation). Because of the large number of mutual funds offering different discounts and employing different criteria for determining breakpoint eligibility, many broker-dealers have experienced operational challenges and other difficulties in assuring that customers consistently receive the applicable discounts. Nevertheless, each broker-dealer is responsible for exercising due care, based on information reasonably ascertainable by the broker-dealer, to provide the appropriate breakpoint discounts.

Part E of Attachment 1, which illustrates a confirmation for a transaction in class A shares with a front-end sales load, states the front-end sales load set forth in the prospectus. Note that the $8,000 purchase in that example is entitled to a breakpoint discount. This could be because the current purchase should be considered in conjunction with other purchases by the investor or the investor's family under rights of accumulation, or because it is subject to a letter of intent.

Alternatively, proposed paragraph (c)(1)(ii) would apply if the customer will not incur a sales load at the time of sale, and would require disclosure of information about the availability of breakpoints as reflected in Schedule 15C 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. 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.[73]

Proposed paragraph (f)(17) of rule 15c2–2 would define ''sales load'' to have the meaning set forth in Section 2(a)(35) of the Investment Company Act.[74] Proposed paragraph (f)(13) would define ''net amount invested'' to mean the price paid to purchase the covered securities less any applicable sales loads. Proposed paragraph (f)(18) of rule 15c2–2 would define ''securities position'' to mean the value of the purchase of covered securities; the value of securities that are subject to rights of accumulation under the terms of the prospectus with respect to the covered security or a related class of the covered security, to the extent known by the broker, dealer or municipal securities dealer, including the value of such securities purchased in other accounts or by other persons; and the value of any such securities that are the subject of letters of intent that may be considered in computing a breakpoint with respect to the covered security or a related class of the covered security.

As discussed above, any sales load that an investor may pay to a fund's principal underwriter is distinct from the commission that the investor may pay to a broker, dealer or municipal securities dealer.[75] Providing customers with information about the amount of the sales load they pay when they purchase covered securities would enable them to more effectively monitor potential breakpoint discounts and would make the impact of distribution costs generally more transparent. Moreover, brokers, dealers and municipal securities dealers are well positioned to provide load information to customers on a transaction-by-transaction basis. Confirmation disclosure should make this information more readily accessible to customers, rather than expecting them to turn to a prospectus to calculate the amount of the load paid.[76]

Proposed paragraph (c)(2) to rule 15c2–2 would require disclosure of the potential amount of deferred sales loads[77] (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).[78] We recognize that broker-dealers would rarely, if ever, know in advance when an investor may redeem those shares, and therefore would generally not be able to disclose the specific amount of a deferred sales load. Investors nonetheless have an interest in seeing transaction-specific information about the potential cost of deferred sales loads. Deferred sales loads cannot exceed a specified percentage of the net asset value or the offering price at the time of purchase.[79] In practice, a deferred sales load may equal the lesser of a specified percentage of the net asset value at the time of purchase ''which can be calculated as a dollar amount by multiplying that percentage by the net asset value and the number of shares purchased ''or a specified percentage of the net asset value at the time of sale. Accordingly, proposed paragraph (c)(2) would require the broker, dealer or municipal securities dealer to disclose, on a year-by-year basis for as long as the deferred load may be in effect, information about the maximum amount of the load expressed in dollars. Proposed paragraph (c)(2) also would require disclosure of the maximum deferred sales load as a percentage of net asset value at the time of purchase or sale, as applicable.[80] This not only would improve the transparency of distribution costs, but also would promote balanced comparisons between the distribution costs associated with front-end load share classes and those associated with deferred sales load share classes.

Proposed paragraph (c)(3) of rule 15c2–2 would require disclosure of any asset-based sales charges and service fees paid in connection with the customer's purchase of covered securities. Proposed paragraph (f)(1) of rule 15c2–2 would define ''asset-based sales charges'' as all asset-based charges incurred in connection with the distribution of a covered security, paid by the issuer or paid out of assets of covered securities owned by the issuer. roposed paragraph (f)(2) of rule 15c2–2 would define ''asset-based service fee'' as all asset-based amounts paid for personal service and/or the maintenance of shareholder accounts by the issuer, or paid out of assets of covered securities owned by the issuer. Those terms would encompass rule 12b–1 fees and any similar types of distribution or service fees incurred by issuers. Those terms, moreover, would be broad enough to require disclosure when the issuer of the covered security itself does not directly pay these fees, but instead invests in other covered securities that incur those fees.[81] We recognize that because the amount of rule 12b–1 or similar fees would be linked to net asset value, 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 purchased in a particular transaction. This amount could be particularly uncertain because a fund's board of directors may later determine not to renew the fund's rule 12b–1 plan. The

[73] Part E of Attachments 2 and 3, which illustrate confirmations for transactions in class B shares with a deferred sales load, state what would have been the front-end sales loads associated with the purchase of class A shares of that dollar amount. The $8,000 purchases in those examples would have been entitled to breakpoint discounts on front-end sales loads. As noted, brokers, dealers and municipal securities dealers must have procedures in place to determine the availability and level of breakpoint discounts. *See supra* note 72. Disclosure of information about front-end sales loads as part of confirmations for the purchase of share classes that carry deferred sales loads in no way immunizes a broker, dealer or municipal securities dealer from its suitability obligations or any other requirements.

[74] Section 2(a)(35) of the Investment Company Act generally defines ''sales load'' as the difference between the price of a security to the public and that portion of the proceeds from its sale that is received and invested or held for investment by the issuer, less any portion of such difference deducted for expenses or fees.

[75] An investor who pays a sales load often will not have to separately pay a commission. In some circumstances, however, such as certain transactions through a broker-dealer's mutual fund ''supermarket,'' an investor may have to pay both.

[76] If this proposed provision is adopted, it would supercede the 1979 letter to the ICI. *See supra* note 6.

[77] Deferred sales loads include surrender charges on variable contracts.

[78] At times, purchases of class A shares of more than $1 million will not carry any front-end sales load due to the availability of breakpoint discounts, but a deferred sales load of up to one percent is imposed for up to one year to discourage short-term holdings. That type of deferred sales load does not raise the disclosure issues that this proposed rule seeks to address.

[79] *See* Investment Company Act rule 6c–10.

[80] Attachment 2 depicts confirmation disclosure of a transaction in a fund share that carries a deferred sales load that equals a specified percentage multiplied by the minimum of the net asset value at the time of purchase or time of redemption. Attachment 3 depicts confirmation disclosure of a transaction in a fund share that carries a deferred sales load that equals a specified percentage multiplied by the net asset value at the time of purchase.

[81] For example, while the issuer of a 529 plan may not pay rule 12b–1 fees, the plan assets may be invested in mutual funds that incur those fees. Similarly, mutual funds underlying variable insurance contracts may also pay 12b–1 fees. In those cases, the confirmation would have to disclose information about those fees, even though they are not directly paid by the issuer.

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).

• The Commission requests comment on whether these requirements would provide customers with an appropriate amount of information about the amount of distribution-related costs they or the issuer would incur in connection with their purchases. If not, please describe additional disclosure that would be helpful. Commenters are specifically invited to comment on whether the proposed requirements related to deferred sales loads would provide disclosure that is sufficiently clear to customers.

• The Commission also requests comment on whether these requirements would appropriately be applied to all types of covered securities, or whether in certain circumstances the disclosure requirements should be modified or eliminated. Commenters in particular may wish to address how disclosure of front-end loads as a percentage of the net amount invested would apply to securities which include a life insurance component, such as variable life insurance policies, and whether alternative disclosure requirements would be preferable for those products.[82] Commenters also may address whether all of these requirements are appropriately applied to variable annuities. Commenters should address whether and how up-front bonus payments on variable insurance products and the recapture of such bonus payments should be disclosed.

• The Commission further requests comment about how proposed Schedule 15C could best disclose sales loads and asset-based fees in percentage terms, based on the customer's investment. This disclosure needs to reflect the fact that while front-end sales loads will equal a percentage of the *present value* of the securities being purchased, deferred sales loads and asset-based fees can be a function of the *future value* of those securities. How can Schedule 15C best state those percentages in a way that is accurate and readily understood?[83]

(b) Sales fee disclosure. Proposed paragraph (c)(4) of rule 15c2–2 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. Proposed paragraph (f)(8) of rule 15c2–2 would define ''dealer concession'' as fees that the broker, dealer or municipal securities dealer will earn at the time of the sale, in connection with the transaction, from the issuer of the covered security, an agent of the issuer, the primary distributor, or any other broker, dealer or municipal securities dealer. That amount would be distinct from the commission that the broker, dealer or municipal securities dealer may receive directly from the customer, as well as any load that the investor may pay to the fund's principal underwriter.[84] Because a dealer concession constitutes part of the broker's, dealer's or municipal securities dealer's financial stake in selling the security to the customer, the amount of that stake is relevant to customers so they can better scrutinize the adequacy of the investment options with which they were presented, as well as any recommendations they received.

• The Commission requests comment about whether this requirement is adequate to inform customers about the incentives associated with sales fees and, if not, suggestions as to how it could be modified to do so.

(c) Revenue sharing and portfolio brokerage disclosure. Proposed rule 15c2–2 also seeks to put customers on notice about the existence of arrangements that lead to conflicts of interest, and provide information about the degree of those conflicts. That goal cannot be satisfied by superficial changes, such as boilerplate confirmation language that may attract the attention only of those investors who already are attuned to the potential impacts of revenue sharing. For this reason, the proposed rule would place quantified information about the arrangements directly in front of investors, so they may immediately evaluate its importance and determine whether to seek additional information.

Proposed paragraph (c)(5) of rule 15c2–2 would require disclosure of information related to revenue sharing payments and portfolio securities transaction commissions received by the broker, dealer or municipal securities dealer. The proposed rule specifically would require disclosure of information about two types of arrangements: (i) Revenue sharing payments from persons within the fund complex; and (ii) 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 fund complex.[85] Because revenue sharing and portfolio brokerage arrangements may be linked in part or in whole to a firm's success in distributing securities on behalf of an entire fund complex, the information would be disclosed on the basis of the firm's sales on behalf of the fund complex, rather than on a fund-by-fund basis.[86]

Proposed paragraph (f)(16) of rule 15c2–2 would define ''revenue sharing'' as any arrangement or understanding by

[82] Because variable life insurance initially may have a relatively small investment component, disclosure of the front-end sales load as a percentage of net asset value may result in a relatively high disclosed percentage.

[83] Proposed Schedule 15C states those amounts (as well as dealer concession, revenue sharing and portfolio brokerage commissions, *see infra*) as a percentage of ''your investment.'' The note on the reverse of proposed Schedule 15C explains that the term ''your investment'' generally is based on current values, but in the case of deferred sales loads and asset-based fees may be based on future values. The use of the single term ''your investment'' is intended to be simple to understand, while flexible enough to accommodate the fact that present values and future values both can be relevant.

[84] As noted above, commissions would be disclosed pursuant to proposed paragraph (b)(4) of rule 15c2–2. Front-end and deferred loads would be disclosed pursuant to proposed paragraphs (c)(1) and (c)(2) of that rule.

For transactions in share classes that impose a front-end sales load, the dealer concession is likely to be smaller than the amount of the load, because the fund's primary distributor generally will retain some of the load to pay its own expenses. For transactions in share classes that impose a deferred sales load, the amount of the dealer concession may be linked to the expected amount of asset-based sales charges (*e.g.*, 12b–1 fees) and of deferred sales loads associated with the shares.

[85] Although these disclosures would be consistent with the requirements of rule 10b–10(a)(i)(D) regarding third-party remuneration, the rule 10b-10 disclosure requirements have been interpreted in the context of the prospectus disclosure principles that the Commission articulated in the 1977 release adopting that rule. *See supra* text accompanying note 5. Because we conclude that prospectus disclosure is inadequate in this context, those interpretations—which permit prospectus disclosure to satisfy the requirements of rule 10b–10—would not apply to disclosure requirements under new rule 15c2–2.

[86] A confirmation should inform an investor of the potential conflicts of interest that confront a broker, dealer or municipal securities dealer. Because the relationships that can lead to those potential conflicts typically are established on a fund complex basis, rather than on a fund-by-fund basis, it is appropriate to disclose those relationships on a fund complex basis. Given that a prospectus is a fund-specific document, a prospectus is particularly inappropriate for disclosing information about those arrangements.

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 associated person of the broker, dealer or municipal securities dealer, apart from dealer concessions or other sales fees that would be disclosed pursuant to paragraph (b)(4). This definition of revenue sharing would encompass payments that have a variety of labels—including payments that may be characterized as having purposes other than paying a broker, dealer or municipal securities dealer for ''shelf space.'' For example, in responding to NASD's recent proposal regarding disclosure of revenue sharing and differential compensation, the SIA stated that revenue sharing arrangements are used to reimburse broker-dealers for a variety of expenses, such as reviewing fund prospectuses.[87] While recognizing that brokers, dealers or municipal securities dealers incur expenses in connection with selling and distributing mutual fund shares and maintaining customers accounts, just as they incur expenses in connection with selling other types of securities and maintaining those customer accounts, payments that arguably reimburse firms for these expenses may still influence the firms to promote the sale of particular funds. Moreover, payments that have the effect of reimbursing broker-dealers for expenses that they would incur in their normal course of business, or that exceed the expenses the broker-dealers actually incur, act as subsidies that create conflicts of interest. The proposed definition of revenue sharing excludes payments made by the issuer of the covered security, because those other payments, such as payments for transfer agent services, do not raise the same conflict of interest concerns that are the subject of this proposed rulemaking.[88]

Proposed paragraph (f)(14) of rule 15c2–2 would define ''portfolio securities transaction'' as any transaction involving securities owned by the issuer of a covered security, or owned by any other issuer within the same fund complex. The required disclosure of commissions associated with portfolio transactions would include disclosure of commissions received by a broker, dealer or municipal securities dealer as part of a ''soft dollar'' arrangement. Proposed paragraph (f)(10) of rule 15c2–2 would define ''fund complex'' to include the issuer of the covered security (including the sponsor, depositor or trustee of a unit investment trust, and any insurance company issuing a variable annuity contract or variable life insurance policy), the issuer of any other covered security that holds itself out to investors as a related company for purposes of investment or investor services, any agent or investment adviser for such issuer, and any affiliated person of any such issuer or any such investment adviser.[89]

For both revenue sharing and portfolio brokerage commissions, a broker, dealer or municipal securities dealer would be required to disclose information about amounts directly or indirectly earned from the fund complex by: (A) The broker, dealer or municipal securities dealer; (B) any associated person (as defined in Sections 3(a)(18) and 3(a)(32) of the Exchange Act) that is a broker, dealer or municipal securities dealer, and (C) if the covered security is not a proprietary covered security, any other associated person. Proposed paragraph (f)(15) of rule 15c2–2 would define the term ''proprietary covered security'' as any covered security as to which the broker, dealer or municipal securities dealer is an affiliated person, as defined by Section 2(a)(3) of the Investment Company Act, of the issuer, or is an associated person of the issuer's investment adviser or principal underwriter, or, in the case of a covered security that is an interest in a UIT, is an associated person of a sponsor, depositor or trustee of the covered security.

Those amounts should be disclosed as a percentage of the total net asset value represented by such broker's, dealer's or municipal securities dealer's (including brokers, dealers and municipal securities dealers that fall in category (B) above) total sales of covered securities (as measured by cumulative net asset value) on behalf of the fund complex over the four most recent calendar quarters, updated each calendar quarter. The required disclosure also would 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.[90]

By requiring disclosure of information about amounts paid to affiliates, as well as information about amounts paid directly to the broker, dealer or municipal securities dealer, the proposed rule would inform investors about the firm's conflicts of interest even when the firm does not directly receive payment. Amounts received by affiliates that are not brokers, dealers or municipal securities dealers would not be included with respect to transactions involving proprietary covered securities, to avoid requiring disclosure of management fees and other payments between funds and investment advisers and any other service providers that are associated with the broker, dealer and municipal securities dealer.[91]

Moreover, to the extent that the broker, dealer or municipal securities dealer has entered into a revenue sharing arrangement or understanding that would result in a specific amount of remuneration in connection with purchases of the covered security, the broker, dealer or municipal securities dealer would have to disclose that expected remuneration as a percentage

[87] *See* Letter from Stuart Strachan, Chairman, Investment Company Committee, SIA, to Barbara Sweeny, NASD, October 17, 2003 (available at http://www.sia.com/2003_comment_letters/pdf/NASD10–17–03.pdf). The letter identified the following categories of reimbursement of broker-dealer expenses: ''Customer Sub-accounting'; mailing disclosure documents; maintaining websites; reviewing prospectuses, statements of additional information and other ''marketing materials'; implementing changes initiated by funds, such as systems and procedures changes, and communicating changes to registered representatives and customers; and ''overseeing and coordinating fund wholesaler activities.''

[88] In contrast, we believe that investors should be informed about portfolio brokerage commissions even though they are subject to regulation under Section 12 of the Investment Company Act and oversight by the fund's board of directors. We believe that prospectus disclosure requirements for such payments are not specific enough to place the brokerage customer on notice of the conflicts of interest that they present to particular brokers, dealers and municipal securities dealers.

[89] The term ''affiliated person'' of another person is defined by Section 2(a)(3) of the Investment Company Act to include, among others, officers, directors, partners or employees of the other person, and persons directly or indirectly controlling, controlled by or under common control with the other person, and investment advisers to investment companies.

The definition of ''fund complex,'' by including any agent of the issuer, may at times encompass the selling broker, dealer or municipal securities dealer that is required to make disclosure under this rule. The amounts of revenue sharing to be disclosed under this provision would apply only to payments made to the broker, dealer or municipal securities dealer by other persons within the fund complex.

[90] The twelve month disclosure period is intended to accommodate the fact that certain payment streams associated with revenue sharing may be annual in nature, such as sponsorship of seminars and other events held by brokers, dealers and municipal securities dealers. At the same time, requiring the information to be updated quarterly is intended to permit the disclosure to reflect any changes in a distribution relationship.

[91] In any event, when a broker, dealer or municipal securities dealer is affiliated with a fund family, revenue sharing may be less significant as a distribution incentive.

of the net amount invested in the covered securities, and would have to disclose the total dollar amount of remuneration it may expect to receive in connection with the transaction.[92]

Disclosing information about revenue sharing and portfolio brokerage commissions in the context of the firm's total sales on behalf of a fund complex, instead of simply disclosing the absolute dollar values the firm has received from the fund complex, would enable customers to see information about a firm's selling stake in a standardized manner, regardless of whether a customer's particular broker, dealer or municipal securities dealer is large or small, and regardless of whether the covered security is issued by a large or small fund complex.[93] Disclosure of this information would alert customers to the existence and magnitude of revenue sharing and portfolio commission arrangements that cause conflicts of interest for brokers, dealers and municipal securities dealers and their associated persons. At the same time, disclosure of the particular arrangements applicable to the transaction will provide information to investors about the most direct incentives for such transactions.

Proposed rule 15c2–2 is not intended to preempt or otherwise negate other provisions of law that may apply. We note that NASD rule 2830(k)(1) bars broker-dealers from favoring the distribution of funds that pay portfolio brokerage commissions.[94] We wish to stress that the proposal to require broker-dealers to disclose information about receipt of portfolio brokerage commissions in no way should be read to condone favoring distribution of funds that pay portfolio brokerage commissions, and would not prevent a broker-dealer from being held liable for violating that NASD rule. Moreover, a mutual fund that uses brokerage commissions to promote the distribution of another mutual fund may also be in violation of the Investment Company Act. Nor would proposed rule 15c2–2 protect a firm from other forms of liability, such as liability under agency law principles.

- The Commission requests comment on whether the proposed definition of revenue sharing appropriately encompasses all distribution arrangements that pose conflicts of interest to brokers, dealers and municipal securities dealers. Commenters particularly are invited to discuss whether the definition should include additional distribution-related arrangements that lead to conflicts of interest, such as distribution-related payments to other affiliates of brokers, dealers and municipal securities dealers. Commenters also are invited to discuss whether the definition should exclude certain arrangements that compensate brokers, dealers or municipal securities dealers for actual expenses they incur (such as mailing expenses) as part of activities that they would not generally be expected to perform as part of a securities business.
- In addition, commenters are invited to provide information about which specific payment streams would be encompassed by the proposed definition of revenue sharing, the dollar value of those payment streams, and the uses of those payments.
- Commenters also are invited to discuss whether the rule should use a term other than ''revenue sharing,'' given that the proposed disclosure requirement would encompass more than the traditional use of the term ''revenue sharing'' in the mutual fund industry, which is limited to payments from an investment adviser to the broker, dealer or municipal securities dealer. Commenters suggesting alternative terms should explain why those are preferable. Moreover, commenters are invited to discuss whether the definition of revenue sharing appropriately excludes payments made by the issuer of the covered security, and whether the proposed rule should require disclosure of payments made out of the issuer's assets, such as transfer agent payments, that lead to conflicts, regardless of whether those payments already would be accounted for in fund financial statements and are subject to oversight by the fund's board of directors.
- More generally, the Commission requests comment on whether the proposal for disclosure of revenue sharing and portfolio brokerage arrangements would provide sufficient information to investors. Commenters particularly are invited to discuss whether firms should be required to disclose absolute dollar amounts of revenue sharing and portfolio commissions, in addition to or in lieu of disclosing those payments in percentage terms and in terms of the amount of the transaction. Commenters also are invited to discuss whether these arrangements more appropriately should be disclosed on a different basis than for 12 month periods, updated quarterly. We request comment on whether the proposed approach takes sufficient account of the fact that revenue sharing arrangements at times may consist of separate revenue streams arising from a firm's new sales of fund shares and its prior sales of fund shares. Given that it is conceivable that a fund complex may pay different levels of revenue sharing depending on the fund, or may pay revenue sharing only in connection with selected funds, commenters are invited to discuss whether the proposed approach can be improved to account for differences in revenue sharing practices between different funds in the same complex.
- Commenters also are invited to discuss whether, when calculating revenue sharing and portfolio brokerage commissions as a percentage of a broker's, dealer's, or municipal securities dealer's sales on behalf of a fund complex, that percentage should be based on all sales, or whether certain transactions such as transactions involving money market funds should be excluded from the denominator used to calculate those percentages. We also request comment on whether there are alternative ways to effectively inform investors of material information about arrangements that lead to conflicts of interest, while posing lower disclosure costs. In that regard, commenters may wish to discuss whether investors can be adequately informed about revenue sharing and portfolio commission arrangements through disclosures of approximate percentage ranges or dollar ranges, possibly in conjunction with checkboxes. Finally, commenters are invited to discuss whether disclosure of portfolio brokerage commissions is appropriate given existing restrictions on those relationships influencing fund distribution.[95]

(d) Differential compensation disclosure. Proposed paragraph (c)(6) of rule 15c2–2 would require disclosure of whether a broker, dealer or municipal securities dealer pays differential compensation to associated persons related to purchases of two specific

[92] Section C of Schedule 15C would provide space for disclosure of additional remuneration.

[93] For example, a one hundred thousand dollar annual revenue sharing payment from a mutual fund family may pose more of a potential conflict of interest to a firm that annually sells ten million dollars worth of shares for that fund complex than it would pose to a firm that annually sells fifty million dollars worth of shares for that fund family.

[94] NASD rule 2830(k)(1) bars member firms from favoring funds on the basis of brokerage commissions received or expected from any source. That restriction has not been uniformly followed. *See supra* note 20 (discussing NASD action against Morgan Stanley). Moreover, NASD rule 2830(k)(4) restricts member firms from disseminating information about its receipt of commissions from fund complexes other than to certain management personnel. In proposing required disclosure of portfolio brokerage commission arrangements, we do not intend to provide any comfort for relationships or activities that are barred by existing rules.

[95] *See* discussion of NASD rule 2830(k)(1), *supra* note 94.

types of securities: (i) 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),[96] and (ii) 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 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.

Disclosure of differential compensation would be limited to transactions in those two types of securities because of the special concerns they raise. Securities that carry a deferred sales load—such as class B shares—may appear more appealing to investors than shares with a front-end sales load, but their long-term costs may be greater and the personnel of a broker, dealer or municipal securities dealer may be more highly compensated for selling them, particularly when the same investment in a share class with a front-end sales load would have been entitled to a breakpoint discount. Moreover, a broker, dealer or municipal securities dealer may pay its personnel extra compensation for selling securities of issuers affiliated with the broker, dealer or municipal securities dealer. While a broker, dealer or municipal securities dealer also may pay extra compensation for selling securities that generate revenue sharing, revenue sharing would be disclosed elsewhere on the confirmation.

The proposed rule would define the term ''differential compensation'' differently depending on the securities transaction at issue. With respect to customer purchases of a class of covered security associated with 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), proposed paragraph (f)(9)(i) of rule 15c2–2 would define ''differential compensation'' as any form of higher compensation (including total commissions, reimbursement or avoidance of charges or expenses, or other cash or non-cash compensation) that a broker, dealer or municipal securities dealer can be expected to pay to any associated person in connection with the sale of a stated dollar amount of that class of covered security over the next year, based on its current practices and assuming no change in the shares' net asset value if applicable, compared with the compensation that the associated person would have been paid over the next year in connection with the sale of the same dollar amount of another class of the same security that is associated with a front-end sales load.[97] The broker, dealer or municipal securities dealer would have to disclose the existence of differential compensation related to securities with a deferred end sales loads whenever any associated person—salesperson or supervisor—is paid more to sell a security that has a deferred sales load—*i.e.*, differential compensation.[98] Disclosure of those incentives should be useful to investors, especially given the recent instances in which associated persons were found to have inappropriately placed customers into class B shares to increase their own compensation.[99] Investors have an interest in knowing whether salespersons or other associated persons have those higher incentives.[100] The proposed rule only relates to remuneration expected to be paid in the next year when identifying the presence or absence of differential compensation, because short-term compensation reflects the associated person's most immediate financial incentive and because of the difficulty of estimating the near-term value of later revenues. We note, however, that an associated person may receive significant compensation after the first year for selling some share classes.[101]

In the case of customer purchases of proprietary covered securities, proposed paragraph (f)(9)(ii) of rule 15c2–2 would define ''differential compensation'' as: (A) Any practice by which a broker, dealer or municipal securities dealer pays an associated person a higher percentage of the firm's gross dealer concession in connection with selling a proprietary covered security than the percentage of the gross dealer concession that the firm would pay in connection with selling the same dollar amount of any non-proprietary covered security offered by the firm; and (B) other practices of a broker, dealer or municipal securities dealer that cause an associated person to earn a higher rate of compensation in connection with selling a proprietary covered security, such as additional cash compensation or the imposition, allocation, or waiver of expenses, overhead costs, or ticket charges. That aspect of the proposed rule takes percentage payment rates into account, rather than absolute dollar amounts, because that would lead to more effective disclosure.[102] Proposed paragraph (f)(11) of rule 15c2–2 would define the term ''gross dealer concession'' as the total amount of any discounts, concessions, fees, service fees, commissions, or asset-based sales charges received by the broker, dealer or municipal securities dealer from the issuer in connection with the sale and distribution of a covered security, other than portfolio brokerage commissions for transactions effected on behalf of the

[96] As noted, some large purchases of class A shares will carry a deferred sales load of up to one percent is imposed for up to one year to discourage short-term holdings. Those sales do not raise the conflict concerns that differential compensation disclosure is intended to capture.

[97] Typically, class B shares are subject to a decreasing deferred sales load for several years following purchase. The amount of the deferred sales load, usually calculated as the lesser of a percentage of the value of the initial investment or the account's value, declines each year that the customer holds the shares and eventually disappears entirely. Some class C shares are subject to a deferred sales load for the first year after purchase. Generally, this disclosure requirement would apply to investor purchases of class B shares. Purchases of class A shares of $1 million or more typically are subject to a one percent deferred sales load for one year, but those purchases generally would not be within the scope of this requirement.

When a customer purchases a class B share, the question of whether an associated person receives differential compensation should take into account the remuneration he or she would have earned from the sale of class A shares.

Class B shares often carry relatively high 12b–1 fees, but may automatically convert into class A shares (which generally carry lower 12b–1 fees) several years after purchase. Class C shares also generally carry relatively high 12b–1 fees, and usually do not automatically convert to a class of shares with lower 12b–1 fees. The Commission's Internet site contains an online calculator that illustrates the impact of loads and other costs on the relative total returns earned on mutual fund investments in different share classes for different holding periods. The calculator is located at *http://www.sec.gov/investor/tools/mfcc/mfcc–int.htm.*

[98] For example, suppose that an associated person is paid a fixed 50% payout of the dealer concession received by a selling broker-dealer in connection with the sale of fund shares, and that the dealer concession received by the firm for selling $200,000 of a particular mutual fund's shares is 4% for class B shares and 2.5% for class A shares. In that case, the associated person would receive a commission of $4,000 for selling the class B shares, but only $2,500 for selling the class A shares. That would amount to $1,500 (or 60%) higher compensation for selling the customer class B shares.

[99] *See supra* note 20.

[100] *See supra* note 49.

[101] Broker-dealers that sell class C shares may receive a relatively modest upfront dealer concession, followed by a portion of the long-term 12b–1 fees that are paid on those shares. Because class C shares generally do not automatically convert to a share class associated with lower 12b–1 fees, unlike class B shares, the broker-dealer's and its associated person's post-first year compensation for selling class C shares may be particularly significant.

[102] Because some non-proprietary securities can have a relatively modest payout, a focus on dollar amounts would invariably lead to ''yes'' disclosures.

issuer.[103] As discussed above in the context of revenue sharing, proposed paragraph (f)(15) of rule 15c2–2 would define the term ''proprietary covered security'' as any covered security as to which the broker, dealer or municipal securities dealer is an affiliated person, as defined by Section 2(a)(3) of the Investment Company Act, of the issuer, or is an associated person of the issuer's investment adviser or principal underwriter, or, in the case of a covered security that is an interest in a UIT, is an associated person of a sponsor, depositor or trustee of the covered security. The broker, dealer or municipal securities dealer would be required to disclose the existence of differential compensation related to the sale of proprietary funds because investors would benefit from knowing whether salespersons or other associated persons may receive higher incentives, which create conflicts of interest for them.[104]

The proposed rule would not require brokers, dealers or municipal securities dealers to identify all instances in which an associated person has a higher financial stake to sell the shares of one fund than another. Rather, the proposed rule is targeted toward transactions in securities without front-end sales loads and proprietary securities because other aspects of the proposed rule 15c2–2 should provide customers with information about other conflicts of interest facing the broker, dealer or municipal securities dealer. This point of sale proposal is intended to alert customers to additional information about the existence conflicts that otherwise would be hidden.[105]

- We seek comment on whether this proposal would adequately place customers on notice about the conflicts associated with differential compensation. We specifically request comment on whether brokers, dealers and municipal securities dealers should be required to disclose payment of differential compensation in contexts other than transactions involving shares with deferred sales loads and proprietary covered securities (such as in the context of fund complexes that pay revenue sharing to the broker, dealer or municipal securities dealer).
- We also specifically request comment about whether the proposed approach for defining differential compensation in transactions involving securities with a deferred sales load—which focuses on compensation per dollar of covered security sold, rather than on compensation as a percentage of the dealer concession—should apply to other transactions in light of the fact that dealer concessions can vary widely among funds.[106]
- We also request comment on whether the definition of ''proprietary covered security'' is sufficiently broad. We further request comment on whether firms should be required to disclose information about their receipt of ongoing asset-based payments from funds (sometimes known as ''trailing commissions''), or information about their payment of those fees to associated persons.[107] We moreover request comment on whether firms should be required to account for remuneration received after the first year when determining whether associated persons receive differential compensation in connection with selling share classes without a front-end load.
- Finally, we request comment on whether, in addition to disclosure about the fact that associated persons receive differential compensation, customers should receive information about the amount of any differential compensation received by associated persons. If so, how should the differential compensation be quantified? What time period or periods would be most relevant and useful to investors?

iii. Provisions not included in general and purchase-specific requirements. Proposed rule 15c2–2 would not incorporate several provisions of rule 10b-10 that do not appear material to customer transactions in mutual fund shares, UIT interests and municipal fund securities. In particular, proposed rule 15c2–2 would not require disclosure of whether the broker, dealer or municipal securities dealer is acting in the capacity of agent or principal[108] because those firms would act in an agency capacity for the transactions at issue. For the same reason, the rule 10b-10 disclosure standards for principal transactions[109] would not be incorporated into proposed rule 15c2–2. Proposed rule 15c2–2 also would not incorporate requirements for disclosing information about the person from whom the security was purchased,[110] payment for order flow,[111] odd-lot differentials[112] and several requirements specific to transactions in debt securities.[113]

- The Commission requests comment on whether it would be appropriate to include any of those requirements in proposed rule 15c2–2. Commenters who

[103] Revenue sharing is not encompassed by the term ''gross dealer concession'' because it is not paid by the issuer. These proposed rules contain separate definitions for the terms ''gross dealer concession'' and ''dealer concession.'' The term ''gross dealer concession'' would determine the baseline for identifying whether associated persons are paid differential compensation (through a higher percentage payout) in connection with the sale of proprietary securities. That term focuses on amounts that the broker, dealer or municipal securities dealer receives from the issuer. The term ''dealer concession'' would govern the obligation of a broker, dealer or municipal securities dealer, under proposed paragraph (c)(4) of rule 15c2–2, to disclose the sales fee that it earns from the issuer or issuer's agent, or from the primary distributor or another broker, dealer or municipal securities dealer.

[104] For example, a firm would have to disclose the existence of differential compensation when an associated person receives a 50% payout of the firm's gross dealer concession in connection with selling $200,000 of a proprietary fund, if the associated person's percentage payout associated with the sale of $200,000 of any other fund would be less than 50%. The firm also would have to disclose differential compensation if an associated person benefits from any practice that compensates him or her in connection with selling the proprietary fund, or reimburses his or her expenses in connection with selling the proprietary fund, if the same programs or practices are not uniformly available in connection with the sale of all other funds.

[105] For example, while firms may provide higher percentage payouts to associated persons in connection with selling mutual funds associated with revenue sharing, other requirements of proposed rule 15c2–2 should place investors on notice about the firms' potential conflicts associated with that practice. Also, while an associated person could have a heightened financial interest in selling non-proprietary funds associated with relatively high dealer concessions (for example, if the associated person is compensated by receiving a particular percentage of the dealer concessions), the proposed requirement that the broker, dealer or municipal securities dealer disclose the sales fee it receives would provide the customer with information about the relative size of the firm's financial stake in the sale.

[106] As proposed, the rule would not require disclosure of all differences in financial incentives. If an associated person is paid a specified percentage payout of the gross dealer concession received by the broker, dealer or municipal securities dealer, then differences in the dealer concession paid on behalf of specific funds can lead to significant differences in compensation. For example, if a proprietary fund offers a dealer concession of 4.0% for selling $100,000 of class A fund shares, while another nonproprietary fund offers a dealer concession of 2.5% for selling the same amount of class A fund shares, then the broker, dealer or municipal securities dealer would earn $4,000 for selling the proprietary fund and $2,500 for the selling the nonproprietary fund. If an associated person is paid 50% of the firm's gross dealer concession, then his or her compensation would be $2,000 for selling the proprietary fund and $1,250 for selling the nonproprietary fund. That $750 difference in compensation represents a potential conflict of interest, but would not be identified if differential compensation related to that transaction is identified solely by reference to percentage payouts.

[107] As noted above, funds may pay ongoing service fees of 0.25% of assets under their 12b–1 plans. Brokers, dealers and municipal securities dealers may pay some or all of those amounts to salespersons as ''trailing commissions.'' Although the fees may be depicted as service fees, they may be viewed by registered representatives as deferred compensation for sales.

[108] *See* rule 10b–10(a)(2).

[109] *See* rule 10b–10(a)(2)(ii).

[110] *See* rule 10b–10(a)(2)(i)(A).

[111] *See* rule 10b–10(a)(2)(i)(C).

[112] *See* rule 10b–10(a)(3).

[113] *See* rule 10b–10(a)(4).

believe that proposed rule 15c2–2 should be expanded to encompass transactions in additional types of securities also should address what additional disclosure provisions such inclusion would require.

e. *Periodic disclosure alternative.* Proposed paragraph (d) of rule 15c2–2 would permit brokers, dealers and municipal securities dealers to disclose the required information periodically, rather than transaction-by-transaction, in certain limited circumstances involving transactions in a ''covered securities plan'' or in no-load open-end money market funds. This provision is based on the periodic disclosure requirements of rule 10b–10(b), but modified to be consistent with the targeted disclosure standards of proposed rule 15c2–2. Proposed paragraph (f)(5) of rule 15c2–2 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.[114] While this definition in large part would be analogous to the rule 10b-10 definition of ''investment company plan,'' it also would encompass arrangements for automatic reinvestment of dividends or other distributions paid by the issuer of a covered security. The periodic disclosure alternative of proposed rule 15c2–2 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.[115]

This disclosure would encompass summary information designed to inform investors about costs and conflicts, consistent with the general and purchase-specific disclosure requirements in other provisions of proposed rule 15c2–2. In general, it would require disclosure of the same types of information that are required by paragraphs (b) and (c), but some information would be disclosed in summary form that reflects all transactions within a period, rather than each individual transaction. Proposed paragraph (d)(2) of rule 15c2–2 would require disclosure of each transaction, and of the total number of shares in the customer's account at the end of the period. It would further require, for each transaction, disclosure of the general information related to date, issuer and class of the security, price and net asset value, number of shares, the total amount paid or received and the net amount of the investment bought or sold, commissions from the customer, deferred sales load charges, and SIPC membership.[116] Also, to the extent applicable, it would require disclosure of information about front-end sales loads charged to the customer,[117] and about dealer concessions received by the firm.[118] As of the date of the final purchase or reinvestment during the period, the provision would require disclosure of information about revenue sharing and portfolio brokerage commission arrangements [119] and about differential compensation.[120] Based on the total value of the purchases and reinvestments during the period, and the net asset value at the end of the period, the rule would also require disclosure of information related to deferred sales loads [121] and to asset-based sales charges and service fees such as rule 12b–1 fees.[122]

Proposed paragraph (d)(3) of rule 15c2–2 would require a broker, dealer or municipal securities dealer to provide the customer with written notification before it could take advantage of the periodic disclosure alternative. Moreover, the broker, dealer or municipal securities dealer would be required to provide the customer with at least one written disclosure document consistent with the general and purchase-specific disclosure standards at the time of each purchase of a particular security within a covered securities plan, prior to relying on the periodic disclosure alternative.[123] This latter requirement is intended to help customers to receive timely notice about the costs and conflicts raised by purchases involving each security that is the subject of the covered securities plan.

- The Commission requests comment on whether any periodic disclosure alternative is appropriate, in light of the distribution-related concerns associated with covered securities.
- The Commission also requests comment on whether this proposal strikes the right balance between alerting investors to the distribution-related issues associated with these securities and minimizing firms' cost of disclosure. Should we require periodic disclosures to be made more frequently? If so, commenters are requested to suggest alternative time frames and their reasons for believing they would provide more meaningful information to investors.
- We also request comment about whether permitting some categories of information to be disclosed in summary fashion is appropriate, or if broker-dealers should be required to provide all the transaction-by-transaction information otherwise required by the rule in the periodic statements.

f. *Other provisions and definitions.* Proposed paragraph (g) of rule 15c2–2 would permit the Commission to exempt any broker, dealer or municipal securities dealer from the provisions of the rule with regard to any transactions or any class of transactions, when the Commission finds that firm will provide alternative procedures to effect the purposes of the rule. Rule 10b–10 has a similar exemptive provision.[124]

[114] This alternative would apply to three general types of arrangements: (i) individual retirement or individual pension plans; (ii) agreements for purchasing covered securities at the public offering price, or redeeming covered securities at the applicable redemption price, at specified time intervals and setting forth the commissions or charges to be paid by the customer; or (iii) other arrangements by which a group of two or more customers engage in periodic purchases of covered securities through a person designated by the group, subject to specific notice requirements.

As discussed below, we are proposing conforming amendments to the periodic disclosure provisions of rule 10b–10.

[115] Because the definition of ''covered securities plan'' encompasses reinvestment of dividends and other distributions paid by issuers of covered securities, proposed rule 15c2–2 would permit quarterly disclosure related to those reinvestment transactions. This would encompass covered security dividend reinvestment activity that has been the subject of exemptive relief under rule 10b–10. *See, e.g.*, Letter regarding Newbridge Securities (February 20, 1997) (providing for monthly disclosure in connection with dividend reinvestment transactions involving mutual funds and other securities); Letter regarding Edward D. Jones & Co. (August 1, 2003) (providing for quarterly disclosure in connection with dividend reinvestment transactions involving money market funds).

We do not propose at this time to amend rule 10b–10 in a corresponding way to provide for quarterly disclosure in connection with dividend reinvestment programs involving other securities.

[116] Those are set forth in paragraph (b) to proposed rule 15c2–2.

[117] Those are set forth in paragraph (c)(1) to proposed rule 15c2–2.

[118] Those are set forth in paragraph (c)(4) to proposed rule 15c2–2.

[119] Those are set forth in paragraph (c)(5) to proposed rule 15c2–2.

[120] Those are set forth in paragraph (c)(6) to proposed rule 15c2–2.

[121] Those are set forth in paragraph (c)(2) to proposed rule 15c2–2.

[122] Those are set forth in paragraph (c)(3) to proposed rule 15c2–2.

[123] In other words, if a covered securities plan encompasses purchases of three separate mutual funds, the broker, dealer or municipal securities dealer would have to provide a purchase-specific disclosure upon the first purchase of each of those funds. Subsequent purchases of each particular fund would not require the purchase-specific disclosure, because the customer already has been alerted to the costs and conflicts at issue.

[124] The Commission, acting by authority delegated to its staff, has granted a significant number of exemptions under rule 10b–10. Persons who have received those exemptions would not be automatically exempt from the provisions of proposed rule 15c2–2. As discussed above, however, the periodic disclosure alternative

Continued

Proposed paragraph (f)(3) of rule 15c2–2 would also use the same definition of the term ''completion of the transaction'' as is found in rule 10b–10.[125] In addition, proposed paragraph (f)(7) of rule 15c2–2, consistent with rule 10b–10, would provide that the term ''customer'' does not include any broker, dealer or municipal securities dealer.[126] Because the two confirmation rules have parallel goals, it is appropriate for those definitions to be the same.

g. *Comparison range disclosure.* Proposed paragraph (e) of rule 15c2–2 would provide a mechanism to give investors additional context for evaluating the significance of certain required disclosures by requiring brokers, dealers and municipal securities dealers to provide comparison information. In many cases, including disclosures about sales loads, asset-based sales charges and service fees, revenue sharing and portfolio brokerage commissions, investors could benefit from knowing how the position of the broker, dealer or municipal securities dealer compares to industry practices. Investors may obtain that context if they are provided information about where costs and payments fall in comparison to the median and ranges in the marketplace. In the case of disclosures of loads, asset-based sales charges and service fees, and dealer concessions, these comparisons would be based on the median of, and the ranges associated with, 95 percent of the transactions involving the same type of covered security (*i.e.*, mutual fund, unit investment trust or 529 plan). In the case of disclosures of revenue sharing and portfolio brokerage, these would be the medians and the ranges associated with 95 percent of the brokers, dealers or municipal securities dealers that distribute the same type of covered security. Median and 95th percentile range information are accepted statistical methods that, applied here, would provide a snapshot about whether a cost or conflict is typical or is an outlier. The Commission would publish the medians and comparison ranges from time to time in the **Federal Register**.[127] The Commission would publish those medians and ranges in percentage form. Firms would have to update median and percentage range information on their confirmations within 90 days of their publication. If adopted, this requirement would not take effect until 90 days after the Commission publishes the initial schedule of comparison ranges.

- We request comment about the utility and implementation of this proposal to disclose median and comparison range information. For example, in calculating comparison ranges related to loads and dealer concessions, to what extent is it appropriate to take into account the type of security (such as equity fund, debt fund, money market fund, or blend) that is the subject of the transaction. Are there specific categories of covered securities that would lead to the fairest ''apples to apples'' comparisons? Should all UITs be in a single category, or would it be necessary, for example, to separate variable annuities, variable life insurance, and other UITs? Should issuers of covered securities, or brokers, dealers or municipal securities dealers, be able to select the comparison category applicable to particular securities, or should the Commission assign covered securities to specific categories? Should median and percentile range information related to covered securities be weighted to account for the relative sales of covered securities? In other words, should covered securities that are more highly sold have a higher weight in calculating the medians and 95th percentile ranges? Similarly, should median and range information related to brokers, dealers and municipal securities dealers be weighted to account for relative sales by those firms? In other words, should brokers, dealers and municipal securities dealers that sell more covered securities have a higher weight in calculating the medians and 95th percentile ranges? Should transactions be compared to other transactions of a similar dollar amount? Moreover, should confirmations disclose comparison information that is more specific than medians and 95th percentile ranges, such as by stating the percentile rank of the loads, other costs or compensation associated with a transaction? Should the Commission be responsible for analyzing the information used to calculate medians and comparison ranges, or should the Commission permit or require the disclosure of median and comparison range information published by a vendor or other third-party source? Should the Commission establish standards for vendors or other third parties to derive and publish that information?

We recognize that implementing these reporting requirements for medians and comparison ranges will require additional rulemaking to implement reporting requirements to permit the Commission or its vendors to gather information to calculate appropriate medians and comparison ranges.

- What entities should be required to disclose information that is necessary to calculate median and comparative range information? In particular, should investment companies or brokers, dealers and municipal securities dealers be required to provide us with information to expedite the calculation of comparison ranges?

There will be additional opportunity to comment about those requirements at the time of a reporting requirement proposal. If we conclude that publication of median and comparison range information is not feasible due to implementation issues, then brokers, dealers and municipal securities dealers would not be required to disclose median and comparative range information.

If we conclude that comparative information would be useful to investors in this context, we may consider implementing comparative information disclosure requirements in other contexts, as well.

h. *Disclosures about transactions effected by multiple firms.* The requirements of proposed rule 15c2–2 would apply to every broker, dealer or municipal securities dealer that effects a transaction in a covered security, including transactions effected by more than one broker, dealer or municipal securities dealer. As is the case today, customers whose transactions have been effected in the context of an introducing-clearing arrangement nonetheless may receive a single confirmation if the two brokers, dealers or municipal securities dealers enter into a written agreement—disclosed to the customer—that determines the responsibilities of each, including the responsibility to provide confirmations to customers.[128]

provisions of proposed rule 15c2–2 encompass dividend reinvestment activities that have been the subject of several of those exemptions under rule 10b–10. *See supra* note 115.

[125] Rule 10b–10(d)(2) defines ''completion of the transaction'' by reference to rule 15c1–1 under the Exchange Act. Rule 15c1–1 defines that term by reference to the time of payment, delivery, transfer or bookkeeping entry, depending on the specific circumstances.

[126] Rule 10b–10(d)(1) provides that the term ''customer'' does not include a broker or dealer.

[127] Our goal is to do this annually.

[128] In an introducing-clearing relationship, both the introducing firm and the clearing firm effect the transaction and are subject to confirmation requirements. The agreement between the two firms would be provided to customers upon the establishment of the account or the establishment of the introducing-clearing arrangement, and the customers thereafter have a reasonable expectation of the responsibilities of both the introducing broker-dealer and the clearing broker-dealer in transactions effected for their accounts. *See* NYSE rule 382 and NASD rule 3230.

Although a customer may receive a single confirmation for a transaction effected as part of an introducing-clearing arrangement, proposed rule 15c2–2 would require specific disclosure of sales fees, revenue sharing and portfolio brokerage commissions received by any broker, dealer or municipal securities dealer that effects a transaction. 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. Thus, a single confirmation still shall separately disclose the sales fees, revenue sharing and portfolio brokerage commissions earned by each firm.[129] That 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. There are other instances in which a broker, dealer or municipal securities dealer may effect transactions in covered securities in conjunction with another broker, dealer or municipal securities dealer. For example, a broker, dealer or municipal securities dealer may solicit persons at their workplaces, as part of an employer-sponsored marketing arrangement, to invest in covered securities. Although the broker, dealer or municipal securities dealer that solicits transactions may be paid on a transaction-basis, the customer accounts may be opened at a different firm. Proposed rule 15c2–2 would require disclosure of payments to the broker, dealer or municipal securities dealer soliciting the transaction, even if it does not maintain the account.[130]

• We request comment on whether proposed rule 15c2–2 would result in adequate disclosure of information about distribution-related costs and conflicts connected with transactions effected by more than one broker, dealer or municipal securities dealer. Commenters are invited to discuss any potential implementation issues associated with the proposed rule, including any operational challenges or difficulties that the requirement may pose to introducing and clearing firms or other firms that together effect securities transactions. Commenters may also wish to discuss the application of the proposed rule to the principal underwriter or distributor of a covered security.

2. Amendments to Rule 10b-10

Because proposed rule 15c2–2, if adopted, would govern confirmation disclosure of purchases and sales in investment company securities, we also propose to amend rule 10b-10 to exclude those securities.[131] In particular, we propose to amend paragraph (a) of rule 10b-10 to provide that the rule does not apply to securities excluded by paragraph (g) of the rule. Proposed paragraph (g) would provide that rule 10b-10 does not extend to transactions in: (i) U.S. Savings Bonds, (ii) municipal securities, and (iii) any other security that is defined as a ''covered security'' by rule 15c2–2. Transactions in savings bonds and municipal securities already are excluded from the application of rule 10b-10. The Commission also proposes amending the preliminary note to rule 10b-10 to clarify the application of the rule.[132]

Two other changes to rule 10b-10 are necessary to accommodate the addition of proposed rule 15c2–2. First, we propose to modify paragraph (a)(9) of rule 10b-10, which, when applicable, requires disclosure when a broker-dealer that effects a transaction is not a member of SIPC. As currently written, that paragraph contains an exception for certain transactions in open-end investment companies and UITs. Because proposed rule 15c2–2 would encompass transactions in those securities, we propose eliminating that exception from rule 10b-10.[133]

Second, we propose to modify the periodic reporting alternative permitted by paragraph (b) of rule 10b-10. That alternative applies to transactions effected pursuant to a ''periodic plan'' or ''investment company plan,'' or to transactions in no-load money market funds. Because the latter two categories would be encompassed within the periodic alternative of rule 15c2–2, we propose deleting them from the scope of the periodic alternative of rule 10b-10. Because the term will no longer be used in the rule, we also propose removing the definition of ''investment company plan'' from rule 10b-10.

Finally, we propose to modify the preliminary note of rule 10b-10 to be consistent with the preliminary note of proposed rule 15c2–2. As explained above, this would reflect the fact that the confirmation disclosure requirements are not determinative of, and do not exhaust, a broker-dealer's disclosure obligations under the antifraud provisions of the federal securities laws or under any other legal requirements.

V. Point of Sale Disclosure for Transactions in Mutual Fund Shares, Unit Investment Trust Interests and 529 Plan Interests

In addition to the tailored confirmation requirements of rule 15c2–2, the Commission is also proposing rule 15c2–3, which would require brokers, dealers and municipal securities dealers to provide customers with specified information at the point of sale—prior to the time they purchase mutual fund shares, UIT interests and 529 plan securities. Investors, therefore, would have this information before they finalize their investment decision to purchase a covered security, regardless of whether the transaction is solicited or unsolicited. The proposed rule would not apply to transactions in which an investor sells a covered security, because those transactions do not raise the same special cost and conflict concerns.

The new rule is designed to be consistent with the existing obligations of brokers, dealers and municipal securities dealers under the antifraud provisions of the securities laws, which at times require a broker, dealer or municipal securities dealer to disclose information about particular costs and conflicts prior to effecting a transaction in a covered security.[134] It is also

[129] Attachments 1–3 hereto provide models for confirmations sent by clearing firms on behalf of themselves and introducing firms that receive sales fees, revenue sharing and portfolio brokerage commissions. Generally, so long as the fees that a clearing firm receives in connection with a transaction do not constitute sales fees, revenue sharing and portfolio brokerage commissions, the clearing firm would not have to separately state that it does not receive that type of remmeration.

[130] Absent an agreement disclosed to the customer, it is unlikely that the selling broker, dealer or municipal securities dealer would be able to send a single confirmation jointly with another firm effecting the transaction. *See* Office of Compliance Inspections and Examinations, Commission, ''Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds'' (September 22, 1998) at n.78. The Commission, however, will consider requests for exemptive relief permitting joint confirmations in circumstances where the customer may reasonably consent to such use.

[131] As noted, rule 10b–10 already exempts transactions in municipal securities.

[132] Specifically, the preliminary note to rule 10b–10 would be amended to note that rule 15c2–2, not rule 10b–10, governs disclosure requirements related to transactions in open-end management investment company shares, interests in unit investment trusts, and municipal fund securities used for education savings.

[133] Proposed rule 15c2–2 would not apply to secondary market transactions in interests in UITs. That does not preclude this proposed amendment to rule 10b–10, however, because secondary market transactions in UITs would not fall within the scope of the ''investment company plan'' exception of rule 10b–10.

[134] For example, the antifraud provisions at times require disclosure prior to transactions about

Continued

intended to supplement the prudent business ethic of firms that assure their customers will be apprised of key facts prior to sales, to avoid surprises and broken trades. Point of sale disclosure should also complement confirmation disclosure, which provides a retrospective record of the complete terms of a transaction for customers to assess in determining whether the transaction occurred as described and whether they received any applicable breakpoint discounts.[135] A broker, dealer or municipal securities dealer that misstates information in a point of sale disclosure with an intent to mislead may be subject to liability under the antifraud provisions of section 10(b) and rule 10b-5.

The preliminary note to proposed rule 15c2–3, consistent with the preliminary note to proposed rule 15c2–2 and the proposed amendment to the preliminary note of rule 10b-10, would state 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.

Paragraph (a) of proposed rule 15c2–3 would provide that it is unlawful for any broker, dealer or municipal securities dealer to effect a purchase of any covered security for a customer unless the broker, dealer or municipal securities dealer delivers to the customer, at the point of sale, quantified information regarding distribution-related costs and the dealer concession that would be connected with the purchase, along with qualitative information about revenue sharing, portfolio brokerage commissions and differential compensation.

A. Securities Transactions and Persons Covered

The point of sale disclosure requirements of proposed rule 15c2–3 would govern purchase transactions in the same securities that are subject to the confirmation requirements of proposed rule 15c2–2, because those are the securities that raise the cost and conflict issues that warrant this type of disclosure requirement. Accordingly, the disclosure requirements of proposed rule 15c2–3 would apply to transactions in ''covered securities.'' Paragraph (f)(2) of proposed rule 15c2–3 provides that the term ''covered security'' has the meaning set forth in rule 15c2–2.

- We request comment on whether this proposed rule appropriately encompasses the types of securities that raise distribution-related concerns that warrant point of sale disclosure. Commenters specifically are invited to address whether this type of disclosure requirement could have the effect of directing investors away from mutual funds and related securities.[136]
- We also request comment about whether persons other than brokers, dealers or municipal securities dealers also should be required disclose information to investors prior to transactions in covered securities. Commenters are invited to discuss whether other persons that participate in the distribution of covered securities—such as banks—are subject to the same or similar conflicts of interest as brokers, dealers and municipal securities dealers. Commenters also are invited to discuss whether the Commission should propose rules to require those other persons to disclose specific information to investors prior to transactions, or to disclose confirmation information on or before the completion of such transactions.
- Commenters may also wish to discuss whether the point of sale disclosure requirements of proposed rule 15c2–3 would be appropriate to transactions in variable annuities. Commenters are invited to discuss any issues they believe would be relevant to the application of proposed rule 15c2–3 to variable insurance products, as well as any modifications they believe could improve the proposed rule's effectiveness as applied to variable insurance products. Specifically, commenters may wish to address whether point of sale disclosure would provide investors with more useful information for transactions in variable insurance products. In addition, we invite comment on whether point of sale disclosure is appropriate at or prior to the time the contract or policy is entered into or at the time the underlying funds are allocated. Commenters should address whether such point of sale disclosure is appropriate under the federal securities laws.

B. Timing of Disclosure

Proposed rule 15c2–3 would require the broker, dealer or municipal securities dealer to deliver information at the point of sale. Proposed paragraph (f)(1) of the rule would define ''point of sale'' differently depending on the relationship between the broker, dealer or municipal securities dealer and the customers that it solicits. Generally, the time of the point of sale would be immediately prior to the time that the broker, dealer or municipal securities dealer accepts the order from the customer. In the case of transactions in which the customer has not opened an account with the broker, dealer or municipal securities dealer, or in which the broker, dealer or municipal securities dealer does not accept the order from the customer—such as may be the case with workplace marketing of 529 plans—the point of sale would be the time that the broker, dealer or municipal securities dealer first communicates with the customer about the covered security, specifically or in conjunction with other potential investments.

This definition of point of sale is geared to be as simple as possible while avoiding disclosure gaps. For most transactions, the time of disclosure is based on the time that the broker, dealer or municipal securities dealer receives the order from the customer—a standard that should allow customers to consider material information when they make their investment decisions. That standard would not work, however, in the case of brokers, dealers or municipal securities dealers that solicit transactions in covered securities—and receive compensation in connection with those transactions—without opening accounts for or handling orders from the investors who make those purchases.[137] Because the investors solicited by those firms instead would contact another broker, dealer or municipal securities dealer or the issuer to complete those transactions, it would not be feasible to trigger the disclosure obligations of those soliciting brokers,

revenue sharing and portfolio brokerage arrangements, and about the cost differences between various mutual fund share classes. *See generally In the Matter of Morgan Stanley DW Inc., supra* note 20.

[135] As noted above, the confirmation also serves as a record of previous transactions that customers can assess in determining whether to make further investments with the same broker-dealer in the same mutual fund or similar type of security. Confirmation disclosure can be particularly valuable with respect to transactions in mutual fund shares and municipal fund securities, given that customers often invest in those securities through a regular course of purchases. Moreover, brokers, dealers and municipal securities dealers may supplement the disclosures required by proposed rule 15c2–2 by providing their customers with additional information about costs and conflicts, using media such as the Internet.

[136] Other than in connection with transactions in ''penny stocks,'' the rules we have promulgated under the Exchange Act generally do not specifically require a broker, dealer or municipal securities dealer to disclose particular information prior to transactions. *See* Exchange Act rules 15g–2 to 15g–5. As discussed above, however, the antifraud provisions of the federal securities laws may mandate certain disclosures prior to transactions.

[137] Those may include brokers, dealers or municipal securities dealers that market covered security investments in the workplace of potential investors.

dealers or municipal securities dealers on the time that an order is accepted.[138] Those soliciting firms therefore would disclose the required information at the time they recommend the security or otherwise discuss the investment.

• We request comment on the point of sale definition, and more generally on the question of when, prior to transactions, should disclosure be provided to customers. Commenters specifically are invited to address whether alternative times of disclosure would be more effective. In their responses, commenters may wish to discuss alternatives such as at the time of account opening or shortly thereafter, at the time a broker, dealer or municipal securities dealer solicits a transaction, on a periodic or annual basis, or at certain other times. Commenters also may wish to address whether early disclosure that is not specific to a particular contemplated transaction would be an adequate substitute for disclosure later in time (but prior to the transaction) that does contain information that is specific to the transaction being contemplated.

• In addition, commenters are invited to discuss how to harmonize point of sale disclosure requirements with NASD's proposal to require member firms to disclose information about revenue sharing and differential compensation.[139] Commenters further are invited to discuss whether the proposed point of sale disclosure requirement would impact the need for the transaction confirmation requirements we propose in rule 15c2–2. For example, would the transaction confirmation disclosures we propose be less necessary if the point of sale disclosure requirements of proposed rule 15c2–3 were combined with additional periodic disclosures that inform customers about distribution-related costs and conflicts of interest, such as quarterly account statements from the broker, dealer or municipal securities dealer? Commenters are invited to provide empirical information to support their views.

• In addition, the Commission requests comment on whether a transitional period is necessary to make adjustments necessary to deliver confirmations that comply with proposed rule 15c2–3.

[138] In fact, the broker, dealer or municipal securities dealer may not even know the identities of the persons whom it solicits until after the investment is made and it is paid for helping make the sale.

[139] *See supra* text accompanying note 51.

C. Information Requirements

Proposed paragraph (a) would require a broker, dealer or municipal securities dealer to deliver quantitative information about distribution-related costs that the investor may bear and the dealer concession that the broker, dealer or municipal securities dealer may expect to receive in connection with the transaction, combined with qualitative information about practices that lead to conflicts of interest in connection with the transaction. This proposed scope of information is intended to give investors useful context for evaluating whether to proceed with a possible investment, while accommodating practicalities of disclosure.

Proposed paragraph (a)(1) specifically would require the broker, dealer or municipal securities dealer to inform its customer about the distribution-related costs that the customer would be expected to incur in connection with the transaction, with separate disclosure about: the amount of sales loads that would be incurred at the time of purchase; estimated asset-based sales charges and asset-based service fees paid out of fund assets in the year following the purchase if net asset value remained unchanged; and the maximum amount of any deferred sales load that would be associated with the purchase if those shares are sold within one year (other than deferred sales loads of no more than one percent that expire no later than one year after purchase, when no other sales load would be incurred on that transaction), along with a statement about how many years a deferred sales load may be in effect. Proposed paragraph (a)(1) also would require the broker, dealer or municipal securities dealer to disclose the dealer concession or other sales fees it would expect to receive in connection with the transaction. Those amounts would be disclosed by reference to the value of the purchase, or, if that value is not reasonably estimable at the time of the disclosure, by reference to a model investment of $10,000.

Proposed paragraphs (a)(2)(i) and (a)(2)(ii) would require the broker, dealer or municipal securities dealer to state whether it receives revenue sharing or portfolio brokerage commissions from the fund complex. Proposed paragraph (a)(2)(iii) would require the broker, dealer or municipal securities dealer to state whether it pays differential compensation in connection with transactions in the covered security, if the covered security charges a deferred sales load or is a proprietary covered security.

The definitions of the terms ''asset-based sales charge,'' ''asset-based service fee,'' ''dealer concession,'' ''differential compensation,'' ''portfolio securities transaction,'' ''revenue sharing'' and ''sales load'' would be the same as the definitions used in proposed rule 15c2–2. Proposed paragraph (f)(2) of rule 15c2–3 would cross-reference those definitions.

Like the confirmation provisions of proposed rule 15c2–2, the point of sale provisions of proposed rule 15c2–3 are not intended to preempt or negate any other provisions of law that may apply.[140]

• The Commission requests comment about the form and specificity of the information that should be disclosed at the point of sale. Commenters specifically are invited to discuss whether information about costs and information about conflicts both are appropriate elements of point of sale disclosure. Commenters may also wish to discuss whether the proposed combination of qualitative and quantitative disclosure is appropriate, and whether the choice of quantitative or qualitative disclosure is appropriate in each instance. In that regard, should all of the disclosures be qualitative? Alternatively, should all of the disclosures be quantitative?

• Commenters also are invited to address whether this proposed rule should encompass additional categories of information, and whether the cost of providing certain types of information is justified by the benefits to investors. Commenters further are invited to address whether, if applicable, the broker, dealer or municipal securities dealer should be required to identify the type of differential compensation (*e.g.,* related to sales of proprietary securities, or related to sales of securities without a front-end load) it pays in connection with transactions in the covered security. Commenters further are invited to address whether a broker, dealer or municipal securities dealer should be required, at the point of sale, to deliver the same information that is required be disclosed in a transaction confirmation under proposed rule 15c2–2.

• In addition, commenters are invited to address whether disclosure related to breakpoint discounts would be

[140] As noted above, NASD rule 2830(k)(1) bars member firms from favoring funds on the basis of brokerage commissions received or expected, and NASD rule 2830(k)(4) restricts member firms from disseminating information about its receipt of commissions from fund complexes other than to certain management personnel. *See supra* note 94. In proposing required disclosure of portfolio brokerage commission arrangements, we do not intend to provide any comfort for relationships or activities that are precluded by existing rules.

warranted as part of point of sale disclosure. In that regard, we note that broker-dealers already are required to provide information about breakpoint discounts to customers.[141]

• Commenters moreover are invited to discuss whether additional point of sale disclosures are appropriate when a broker, dealer or municipal securities dealer recommends that an investor sell a covered security that the investor currently owns, and invest in or ''switch to'' a different covered security. At times, a broker, dealer or municipal securities dealer may recommend switching of securities even if the investor would incur extra fees to make the switch, or even if the investor has already incurred a front-end sales load on the covered security he or she currently owns. While this is a complex issue that is addressed by other rules including the antifraud provisions of the federal securities laws and self-regulatory organization sales practice rules and related guidance,[142] we seek comment on the extent to which additional specific confirmation or point of sale disclosure should be required, and possible disclosure alternatives.

D. Customers' Right To Terminate Orders Made Prior to Disclosure

Proposed paragraph (b) of rule 15c2–3 would provide that an order made prior to the disclosure required by paragraph (a) must be treated as an indication of interest until after the point of sale information is disclosed, and customers have received an opportunity to terminate any order following disclosure of the information. It further would provide that the broker, dealer or municipal securities dealer shall disclose this right to the customer at the time it discloses the information required under the paragraph to the customer. This provision is intended to enable customers to consider material information prior to a transaction being finalized. Based on the information, customers may conclude that it would be prudent to explore alternative investments, such as investments that carry lower distribution-related costs. In that case, the customer may determine not to make the order effective.

Because disclosure of information is necessary for orders to be effective, we expect that brokers, dealers and municipal securities dealers would engage in careful procedures to ensure that only effective orders are conveyed to the issuer, and would be required to keep appropriate records demonstrating compliance with the rule, as discussed below.[143]

• We request comment on this proposed provision. Commenters specifically are invited to address how customers may terminate orders made prior to receiving point of sale disclosure, and whether the rule should specify how customers may terminate orders.

E. Manner of Disclosure

Proposed paragraph (c) generally would require the broker, dealer or municipal securities dealer to give or send the information to the customer in writing using Schedule 15D, supplemented by oral disclosure if the point of sale occurs at an in-person meeting. If the point of sale occurs through means of an oral communication other than at an in-person meeting, however, then the information shall be disclosed to the customer orally at the point of sale.

Attachments 4 and 5 to this proposal set forth examples of point of sale disclosure that are consistent with Schedule 15D. Like Schedule 15C for confirmation disclosure, Schedule 15D provides the format for the required disclosure accompanied by materials that will help permit the customer to evaluate the significance of the disclosure information.

Those requirements are geared to promote effective disclosure while accommodating practicality. For example, if the broker, dealer or municipal securities dealer took the customer's order over the telephone, then oral disclosure over the telephone would be required. If the broker, dealer or municipal securities dealer took the customer's order over the Internet, then the Internet could be used to provide the required disclosure.[144] If the broker, dealer or municipal securities dealer solicited the transaction in a seminar or meeting, then the firm would have to provide the disclosure orally and in writing. A written disclosure document that provides information consistent with the confirmation disclosure requirement of rule 15c2–2 generally also would satisfy this requirement.

• We request comment on these proposed requirements about the manner of disclosure. Commenters particularly are invited to discuss whether customers should have the right to receive this information in writing as a supplement to oral disclosure, when the rule otherwise would only require oral disclosure.[145]

• Commenters also are invited to discuss whether Schedule 15D is an appropriate form for written disclosures, and whether the explanatory information accompanying Schedule 15D is appropriate.

• Commenters further may wish to discuss whether the rule should require the broker, dealer or municipal securities dealer to obtain from the customer a signed acknowledgement of having received point of sale disclosure, and, if so, what would be the appropriate exceptions to that requirement. Commenters also should discuss appropriate practices or safeguards that may be necessary to prevent brokers, dealers, or municipal securities dealers from delivering point of sale disclosure in a manner that undermines its purpose.

F. Recordkeeping

Proposed paragraph (d) of rule 15c2–3 would require brokers, dealers or municipal securities dealers, at the time they disclose information required by this rule, to make records of communications and their disclosure sufficient to demonstrate compliance with the delivery requirements of paragraphs (a) and (b). The brokers, dealers or municipal securities dealers

[141] When we recently proposed rules to require open-end management investment companies to disclose enhanced information about breakpoint discounts, we pointed out that a ''broker-dealer who sells fund shares to retail customers must disclose breakpoint information to its customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints.'' *See* Securities Act Release No. 8349 (December 17, 2003), 68 FR 74732 (December 24, 2003).

Moreover, the joint NASD/industry task force on breakpoints recommended that broker-dealers provide disclosure statements to investors at the time of or prior to the confirmation of the initial purchase of front-end load fund shares, and thereafter on a periodic basis or at the time of or prior to the confirmation of subsequent purchases. *See* Task Force Report, *supra* note 42 at 14–15.

[142] For instance, broker-dealer recommendations related to investment switching would be subject to NASD rule 2310, regarding suitability.

NASD Notice to Members 99–35 (May 1999), which discussed the responsibility of members related to sales of variable annuities, noted that member firms may develop an analysis document or use a state-authorized form in connection with the replacement of variable annuities. If the firm uses that type of document, then it ''should include an explanation of the benefits of replacing one contract for another variable contract,'' and the document should be signed by the customer, the registered representative and the registered principal. We note, of course, that any practice that provides information about the ''benefits'' of switching, without discussing the costs of switching, may be inconsistent with the antifraud provisions of the federal securities laws.

[143] For example, brokers, dealers and municipal securities dealers may limit their exposure to losses resulting from violations of the rule by maintaining records demonstrating that the customer received the disclosure information.

[144] The use of electronic media to deliver the required disclosure is subject to applicable legal requirements.

[145] If the customer were to conclude the purchase, then this supplementary disclosure may arrive at roughly the same time as the confirmation.

would have to preserve those records and for the period specified in Exchange Act rule 17a–4(b), or, in the case of records of oral communications and their disclosures, in accordance with Rule 17a–4(f) and for the period specified in Exchange Act rule 17a–4(b) with regard to similar written communications and records.

Often maintaining a copy of the disclosure document that was provided to the customer can satisfy this requirement. In the case of disclosure solely by means of oral communications, this provision would require the broker, dealer or municipal securities dealer to have compliance procedures in place that are adequate to demonstrate that it provided the required disclosure.[146]

• We request comment on this recordkeeping requirement. Commenters are invited to discuss whether, in the case of information that only is delivered orally, the rule should require electronic copies. Commenters also are invited to address, in the case of oral disclosures, what records or procedures would be necessary to demonstrate compliance with the rule. Also, should the recordkeeping provisions of proposed rule 15c2–3(d) instead be included in rules 17a–3 and 17a–4, the Commission's books and records rules?

G. Exceptions

Proposed paragraph (e) of rule 15c2–3 would except several types of transactions from the rule's scope. First, proposed paragraph (e)(1) would conditionally except transactions resulting from orders that a customer placed via U.S. mail, messenger delivery or a similar third-party delivery service. Proposed paragraph (e)(1)(i) would provide that the exception is available only to brokers, dealers or municipal securities dealers that meet the requirements of proposed paragraph (e)(1)(ii), discussed below, and that the broker, dealer or municipal securities dealer must have, within the prior six months, provided the customer with information about the maximum potential size of sales loads and asset-based sales charges and service fees associated with covered securities sold by that broker, dealer or municipal securities dealer, as well as statements about whether the broker, dealer or municipal securities dealer receives revenue sharing or portfolio brokerage commissions or pays differential compensation. Proposed paragraph (e)(1)(ii) of the rule would further specify that the exception in paragraph (e)(1) is available only to brokers, dealers or municipal securities dealers that are not compensated for effecting transactions for customers that do not have accounts with that broker, dealer or municipal securities dealer.[147] This proposed exception is intended to promote disclosure while avoiding the need to delay the execution of orders received via mail or similar services, given that it may not be possible to quickly locate those customers, let alone provide disclosure.

• We request comment on this proposed exception, and particularly if the scope of the exception is appropriate.

Proposed paragraph (e)(2) of rule 15c2–3 would except a clearing broker, dealer or municipal securities dealer, or a fund's primary distributor, from having to disclose information under the rule if the clearing firm or the primary distributor did not communicate with the customer about the transaction other than to accept the customer's order, and if that clearing or distributing firm reasonably believed that another broker, dealer or municipal securities dealer (such as an introducing firm or a selling firm) has delivered the information to the customer required by rule 15c2–3. The clearing or distributing firm could demonstrate this ''reasonable belief'' if it has entered into an agreement providing for the other broker, dealer or municipal securities dealer to make the required point of sale disclosures, supplemented with appropriate auditing practices.[148] This proposed exception in paragraph (a)(2) is intended to preclude imposing unnecessary burdens on clearing firms and on primary distributors that do not solicit transactions, when the investor can be expected to receive the required disclosure from another broker, dealer or municipal securities dealer.

• We request comment on whether this proposed exception avoids unnecessary duplication of disclosure and whether it is tailored appropriately. Commenters specifically are invited to discuss, based on their experiences, what types of agreements, certification or verification would be appropriate for establishing a ''reasonable belief.''

Proposed paragraphs (e)(3) through (e)(5) of rule 15c2–3 would provide additional targeted exceptions. Proposed paragraph (e)(3) would provide an exception for transactions effected as part of a covered securities plan, as defined under proposed rule 15c2–2, so long as the broker, dealer or municipal securities dealer provides disclosure consistent with proposed rule 15c2–3 prior to the first purchase of any covered security as part of the plan. Proposed paragraph (e)(4) would provide an exception for reinvestments of dividends earned. Proposed paragraph (e)(5) would provide an exception for transactions in which the broker, dealer or municipal securities dealer exercises investment discretion. Paragraph (f)(2) of proposed rule 15c2–3 provides that the term ''covered securities plan'' has the meaning set forth in proposed rule 15c2–2. We believe that transactions that would be excluded by these three proposed exceptions do not link the customer's investment decision to the customer's communications with the broker, dealer or municipal securities dealer in a way that establishes a compelling need for point of sale disclosure.

• We request comment on those proposed exceptions. Commenters are also invited to discuss whether additional exceptions may be appropriate. Commenters particularly are invited to discuss whether the proposed rule should have an exception for institutional orders and, if so, what the appropriate scope of such an exception would be.

H. Definitions

As noted above, proposed paragraph (f)(1) of rule 15c2–3 would define the term ''point of sale.'' Proposed paragraph (f)(2) would define the terms ''asset-based sales charges,'' ''asset-based service fee,'' ''covered securities plan,'' ''covered security,'' ''dealer concession,'' ''differential compensation,'' ''fund complex,'' ''portfolio securities transaction,'' ''revenue sharing'' and ''sales load'' by

[146] Broker-dealers are required to maintain copies of outgoing communications relating to their business for a period of not less than three years, the first two years in an easily accessible place. *See* rule 17a–4(b)(4).

[147] As discussed above with respect to the definition of point of sale, brokers, dealers or municipal securities dealers that may be paid for effecting transactions without having to open accounts with those customers would have to provide disclosure at the time they recommend or discuss the investment, regardless of how the investor ultimately transmits the order.

[148] The rules of the NASD and the NYSE require clearing and carrying agreements to specify the responsibilities of each party with respect to a number of matters, including confirmations and statements, as well as maintenance of books and records. *See* NASD rule 3230, NYSE rule 382. Agreements that specify the responsibilities of parties with respect to point of sale disclosure, and associated recordkeeping, may form the basis for a reasonable belief.

A fund's primary distributor may enter into arrangements with other brokers, dealers or municipal securities dealers to sell interests in the fund. That primary distributor may demonstrate the requisite reasonable belief if its selling agreement with those other firms provides that the selling brokers, dealers or municipal securities dealers will deliver point of sale information, and if the primary distributor audits the compliance of those other firms.

referring to the definition of those terms in proposed rule 15c2–2. Paragraph (f)(2) also would define the term ''customer'' by reference to the definition in proposed rule 15c2–2.

VI. Prospectus Disclosure

The Commission is proposing to amend Form N–1A in order to enhance disclosure of sales loads. Currently, a fund is required to disclose the maximum sales loads as a percentage of offering price in the fee table that is located in the front of the prospectus.[149] In addition, elsewhere in the prospectus, a fund is required to include a table of front-end sales loads at each breakpoint, shown as a percentage of both the offering price and the net amount invested.[150]

The Commission is proposing to amend the fee table to require the maximum front-end sales load to be shown as a percentage of net asset value rather than as a percentage of offering price.[151] The proposed amendment would make disclosure of front-end sales loads in the prospectus fee table consistent with that in the confirmation that would be required by proposed rule 15c2–2. For consistency, the proposed amendments would also remove the current requirement that a deferred sales load based on net asset value at the time of purchase be shown in the fee table as a percentage of offering price at the time of purchase. Instead, the proposed amendments would require that a deferred sales load based on offering price at the time of purchase be shown in the fee table as a percentage of net asset value at the time of purchase.[152] Similarly, we are proposing to revise the instructions to the fee table to clarify that if a fund imposes more than one type of sales load (*e.g.*, a deferred sales load and a front-end sales load), the aggregate load should be shown in the fee table as a percentage of net asset value.[153]

We believe that disclosure of sales loads as a percentage of net asset value rather than offering price would better help investors to understand the true costs of investing in a load fund. This method would present sales loads as a percentage of the net amount invested in the fund, rather than a percentage of the sum of the net amount invested in the fund plus the load. For example, if an investor started with $10,000 and paid a 5% front-end load on the gross amount, the load would be $500. The net amount invested would be $9,500 ($10,000–$500), and the load as a percentage of the net amount invested would be 5.26% ($500/$9,500 x 100%). The fee table currently requires the load to be disclosed as 5%. Our proposed amendment would require the load to be disclosed as 5.26%.[154]

The Commission is also proposing to amend Form N–1A to require disclosure in the fund prospectus that would alert investors to the fact that sales loads shown in the prospectus as a percentage of the net asset value 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. This difference is a result of rounding.[155]

Specifically, we are proposing to require a fund to disclose in a footnote to the fee table, 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 net asset value 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.[156] The footnote requirement would apply to front-end and back-end sales loads, as well as cumulative sales loads where more than one type of sales load is imposed.

We are also proposing to require similar footnote disclosure with respect to the table of front-end sales loads that is required elsewhere in the prospectus.[157] Our proposal would require a fund to disclose in a footnote to the table of front-end sales loads, if applicable, that the actual front-end sales load that may be paid by an investor as a percentage of the gross or net amount invested at any breakpoint may be higher or lower than the applicable load in the table of front-end sales loads. The footnote also would be required to explain briefly the reason for this variation and to disclose the range of the actual front-end sales loads at each sales load breakpoint as a percentage of the gross and net amount invested.[158]

- The Commission requests comment on the proposed amendments to the fee table and front-end sales load table of Form N–1A. In particular, the Commission requests comment on the proposed requirement that the fee table of the prospectus disclose the sales loads as a percentage of net asset value rather than offering price. Commenters are specifically invited to comment on whether continuing to require disclosure of sales loads in the fee table as a percentage of offering price may confuse investors if the confirmation that would be required by proposed rule 15c2–2 requires sales loads to be shown as a percentage of net amount invested. Which presentation better reflects costs to investors? Which presentation is easier for investors to use and understand?
- Commenters are also invited to comment on whether the proposed disclosure alerting investors to the fact that, as a result of rounding, sales loads shown in the prospectus as a percentage of the offering price or net asset value

[149] Item 3 of Form N–1A.

[150] Item 8(a)(1) of Form N–1A.

[151] Proposed Item 3 of Form N–1A (fee table caption).

[152] Proposed Instruction 2(a)(i) to Item 3 of Form N–1A.

[153] Proposed Instruction 2(a)(ii) to Item 3 of Form N–1A.

[154] As described below, there are differences attributable to rounding between sales loads as a percentage of net and gross amount invested, on the one hand, and sales loads as a percentage of net asset value and offering price, on the other. Because prospectus disclosure does not relate to a particular amount invested, it must be based on net asset value or offering price rather than net amount invested or gross amount invested.

[155] For example, if the net asset value per share is $1.98 and the applicable sales load is 4.25% of the offering price, the offering price would be calculated as follows: $1.98/(1.00 – 0.0425), which equals $2.07 when rounded to two decimal places. The number of shares purchased is determined by dividing the gross amount invested by this offering price. Thus, if the gross amount invested is $30,000, the number of shares purchased is 14,492.754 (rounded to three decimal places) ($30,000/$2.07). The net amount invested would be the number of shares purchased, multiplied by the net asset value per share, or $28,695.65 (14,492.754 × $1.98), and the remaining $1,304.35 would be deducted as a sales load. This $1,304.35 is equivalent to 4.35% of the gross amount invested of $30,000, rather than the 4.25% sales load shown as a percentage of offering price.

As a second example, if the net asset value per share is $7.78 and the applicable sales load is 5.75% of the offering price, the offering price would be calculated as follows: $7.78/(1.00 – 0.0575), which equals $8.25 when rounded to two decimal places. If the gross amount invested is $30,000, the number of shares purchased is 3,636.364 (rounded to three decimal places) ($30,000/$8.25). The net amount invested would be the number of shares purchased, multiplied by the net asset value per share, or $28,290.91 (3,636.364 × $7.78), and the remaining $1,709.09 would be deducted as a sales load. This $1,709.09 is equivalent to 5.70% of the gross amount invested of $30,000, rather than the 5.75% sales load shown as a percentage of offering price.

[156] Proposed Instruction 2(a)(iv) to Item 3 of Form N–1A. For example, if the maximum front-end sales load shown as a percentage of net asset value is 6.10%, but the maximum front-end sales load that may be paid by an investor may range between 6.00% and 6.20% of the net amount invested, the fund would be required to disclose the maximum 6.20% figure in the footnote.

[157] Proposed Instruction 4 to Item 8(a)(1) of Form N–1A.

[158] For example, if the front-end sales load is 6.10% of net asset value and 5.80% of offering price, but the front-end sales load that may be paid by an investor may range between 6.00% and 6.20% of the net amount invested and 5 .70% and 5.90% of the gross amount invested, the fund would be required to disclose these sales load ranges of 6.00%–6.20% of net amount invested and 5.70%–5.90% of gross amount invested.

may be higher or lower than the actual sales load that an investor would pay as a percentage of the gross or net amount invested is appropriate. Is this disclosure necessary for both sales loads disclosed as a percentage of net asset value and sales loads disclosed as a percentage of offering price? Should this disclosure be required with respect to both front-end sales loads and deferred sales loads? Should this disclosure be required in both the prospectus fee table and the table of front-end sales loads?

• The Commission also requests comment on whether it is possible to quantify the variation between sales loads disclosed as a percentage of net asset value or offering price and the amounts that investors will pay as a percentage of net or gross amount invested, as would be required by the proposals. If it is possible to quantify this variation, should the fee table and the table of front-end sales loads, rather than a footnote, contain the sales loads that an investor would pay as a percentage of net or gross amount invested after rounding is taken into consideration?

The Commission is also proposing to amend Form N–1A to require that a mutual fund include brief disclosure in its prospectus regarding revenue sharing payments, in order to direct investors to the disclosure regarding revenue sharing that we are proposing to require in the confirmation and point of sale disclosure. If any person within a fund complex makes revenue sharing payments, the proposed amendment would require a fund to disclose that fact in its prospectus.[159] For this purpose, ''fund complex'' and ''revenue sharing'' would have the meanings set forth in proposed rule 15c2–2(f)(10) and (15). If any such revenue sharing payments are made, the fund would also be required to disclose that specific information about revenue sharing payments to an investor's financial intermediary is included in the confirmation or periodic statement required under proposed rule 15c2–2 and in the disclosure provided at the point of sale required under proposed rule 15c2–3.

• The Commission requests comment on whether this proposed requirement for prospectus disclosure regarding revenue sharing payments, including the reference to the confirmation and periodic statement required under proposed rule 15c2–2, and the point of sale disclosure required under proposed rule 15c2–3, would provide useful information to investors.

• We also request comment on whether additional prospectus disclosure requirements regarding revenue sharing payments would be appropriate. Should we adopt similar prospectus disclosure requirements regarding portfolio securities transaction commissions?

• The Commission further requests comment on whether amendments parallel to those being proposed for Form N–1A should be made to Forms N–3,[160] N–4,[161] and N–6,[162] the registration forms for separate accounts that offer variable annuity contracts and variable life insurance policies. In particular, the Commission invites comment on whether the prospectus fee tables of these registration forms should disclose sales loads as a percentage of accumulation unit value or net amount invested. Would such a requirement be appropriate for separate accounts that offer variable life insurance policies, given that significant deductions may be made from premium payments for these policies for the cost of insurance, in addition to deductions for sales loads?

• Commenters are also invited to comment on whether the actual sales loads paid by investors in variable insurance products may be higher or lower than the sales loads disclosed in the prospectuses for these products as a result of rounding. If so, would disclosure regarding the effects of rounding parallel to that proposed for mutual funds be appropriate?

• The Commission further requests comment on whether the proposed prospectus disclosure regarding revenue sharing payments, including the reference to the confirmation and periodic statements required under proposed rule 15c2–2 and the point of sale disclosure required under proposed rule 15c2–3, would be appropriate for the registration forms for variable insurance products. Are revenue sharing payments to financial intermediaries made in connection with these products, other than those made in connection with underlying funds?

VII. Disclosure Related to Transactions in Callable Preferred Stock and Callable Debt Securities, and Other Amendments to Rule 10b–10

In addition to the amendments to rule 10b–10 noted above, we are also proposing to amend rule 10b–10 in connection with transactions involving callable preferred stock and callable debt securities. Finally, we propose to amend the rule to delete an expired transition period related to the confirmation of transactions involving securities futures products.

A. Proposed Amendment Related to Transactions in Callable Preferred Stock

We are proposing to amend rule 10b–10 to require broker-dealers that effect transactions in shares of preferred stock to inform customers about whether the issuer of the stock has reserved the right to repurchase—or call—the shares. Currently, paragraph (a)(4) of Rule 10b–10 requires broker-dealers that effect transactions in callable debt securities to disclose the fact that the debt security may be subject to redemption in advance of maturity, and that the redemption may affect the yield of the debt security. Rule 10b–10, however, does not require similar disclosure for transactions in preferred stock that is callable.

Information about whether shares of preferred stock are callable is material to investors. Investors often purchase shares of preferred stock for their dividend yield. If the preferred stock is callable and is repurchased by the issuer, then the investor may not be able to reinvest his or her proceeds in an instrument with an equivalent yield. This is particularly significant given that issuers are most likely to call preferred stock when interest rates are declining. Confirmation disclosure of this material information could alert an investor to any misunderstandings about the rights associated with the preferred stock, promote the timely resolution of problems, and better enable the investor to evaluate potential future transactions involving that security.

Accordingly, we propose amending rule 10b–10 to redesignate current paragraph (a)(4) as ''(a)(4)(A),'' and add a new paragraph (a)(4)(B) that would require a broker-dealer that effects a transaction in callable preferred stock to disclose to the customer that the preferred stock may be repurchased at the election of the issuer and that additional information is available upon request.

• The Commission requests comment about whether this proposal would

[159] Proposed Item 8(c) of Form N–1A.

[160] 17 CFR 239.17a and 274.11b. Form N–3 is used by all insurance company separate accounts offering variable annuity contracts that are registered under the Investment Company Act as management investment companies.

[161] 17 CFR 239.17b and 274.11c. Form N–4 is used by all insurance company separate accounts offering variable annuity contracts that are registered under the Investment Company Act as unit investment trusts.

[162] 17 CFR 239.17c and 274.11d. Form N–6 is used by all insurance company separate accounts offering variable life insurance policies that are registered under the Investment Company Act as unit investment trusts.

provide adequate notice to investors. Commenters are specifically invited to address whether transaction confirmations also should state that the callability of preferred stock may affect the yield earned on that stock. The Commission is particularly interested in learning more about current industry practice regarding the disclosure of the callable nature preferred stock and whether broker-dealers already disclose such information as a matter of prudent business practice on confirmations or in some other way highlight such information to their customers.

• Moreover, commenters are invited to address whether transaction confirmations should provide additional disclosures about preferred stock, such as disclosures about annual yield, yield-to-redemption and, if callable, the fixed price at which the preferred stock may be repurchased and the date or dates upon which the issuer may repurchase the preferred stock.[163]

• Commenters also may wish to address whether confirmation disclosure of such information would serve as a useful means of informing customers as to the investment features of preferred stock.

B. Proposed Amendment Related to Transactions in Callable Debt Securities

We also are proposing to amend rule 10b–10 to require disclosure of the first date on which a debt security may be called. Currently, paragraph (a)(6) of rule 10b–10 requires a broker-dealer that has effected a transaction in a debt security on the basis of yield-to-call to disclose, among other information, the type of call, the call date and the call price. In practice, a bond may be subject to call on a series of dates. As a result, although a confirmation may state what the bond's yield-to-call would be if the bond is called on one of those dates, the confirmation may not inform a customer about the first possible date on which a bond is subject to call. We believe this may confuse investors who are not otherwise aware that a bond may be called on a date earlier than the one specified on the confirmation. The possibility of earlier call can subject the investor to additional reinvestment risk, because the investor likely would be left with worse alternatives for reinvesting the proceeds if the issuer calls the security when prevailing interest rates decline.

We considered the adequacy of yield-to-call disclosure in the early 1980s, when we proposed and adopted amendments to rule 10b–10. In proposing the amendments, we noted that investors could be surprised by the early redemption of investments in long-term debt securities. We concluded, however, in light of the variety and number of call provisions, that ''a legend advising the customer that he may request information from his broker-dealer is a sensible approach to this problem.''[164] Nonetheless, a confirmation does not provide optimal disclosure if it specifically identifies one call date, but requires an investor to contact the broker-dealer to find out the first call date.[165]

In our view, disclosure of the first date upon which a debt security may be called would provide customers with meaningful information that would help avoid confusion. We therefore propose amending rule 10b–10 to provide for that additional disclosure. Specifically, we propose to amend paragraph (a)(6)(i) to require a broker-dealer that effects a transaction in a debt security on the basis of yield-to-call to disclose the date upon which the debt security may first be called.

• We request comment on whether this proposal would provide adequate notice to investors, and whether additional information should be disclosed on the confirmation related to the impact of callability on yield. Commenters are requested to address to what extent broker-dealers currently disclose call information in connection with transactions involving debt securities and whether broker-dealers already disclose the first possible call date as a matter of prudent business practice on confirmations or in some other way highlight such information to their customers.

C. Outdated Transitional Provisions Related to Security Futures Product Transactions

Paragraph (e) of rule 10b–10 contains a conditional exception from the general requirements of the rule for certain transactions in securities futures products. Transitional provisions permitted broker-dealers to take advantage of that exception up to June 1, 2003 without having to comply with specific conditions. Because those transitional provisions no longer are in effect, we are proposing to delete subparagraph (2) of paragraph (e) of rule 10b–10, and make corresponding technical changes.

VIII. Paperwork Reduction Act Analysis

Certain provisions of proposed Exchange Act rules 15c2–2 and 15c2–3, the amendments to Exchange Act rule 10b–10, and the amendments to Form N–1A contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[166] The Commission has submitted them to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The collections of information under proposed rules 15c2–2 and 15c2–3 are new. The title for the new collection of information under proposed rule 15c2–2 is ''Rule 15c2–2 Confirmation of transactions in open-end management investment company shares, unit investment trust interests, and municipal fund securities used for education savings''. The title for the new collection of information under proposed rule 15c2–3 is ''Rule 15c2–3 Point-of-sale disclosure for purchase transactions in open-end management investment company shares, unit investment trust interests, and municipal fund securities used for education savings''. The OMB has not yet assigned a control number to the new collections of information under proposed rules 15c2–2 and 15c2–3. In addition, the Commission is revising the collection of information entitled ''Rule 10b–10 Confirmation of Transactions,'' OMB Control Number 3235–0444 and the collection of information entitled ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies,'' OMB Control No. 3235–0307. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

[163] Paragraphs (a)(5) and (a)(6) of rule 10b–10 require yield disclosure for transactions in debt securities. Paragraph (a)(5) requires disclosure of yield to maturity for transactions in debt that are effected on the basis of dollar price. Paragraph (a)(6) requires disclosure of yield to maturity, current yield or yield to call for transactions in debt that are effected on the basis of yield.

[164] Exchange Act Release No. 19687 (April 18, 1983), 48 FR 17583 (April 25, 1983).

[165] Consistent with the discussion above, we note that a broker-dealer has an obligation to disclose material information to investors that goes beyond the information that is strictly required to be disclosed in the confirmation.

[166] 44 U.S.C. 3501, *et seq.*

A. Rule 15c2–2

1. Collection of Information in Connection With Certain Transactions Involving Open-End Management Investment Company Securities, Unit Investment Trust Interests, and Municipal Fund Securities Used for Education Savings

As discussed previously in this release, proposed rule 15c2–2 would apply to transactions in mutual fund shares, UIT interests and 529 plan securities. The proposed rule would require brokers, dealers and municipal securities dealers to make certain of the disclosures that rule 10b–10 currently requires them to make. Thus, brokers, dealers and municipal securities dealers would no longer be required to comply with the requirements of rule 10b–10 when effecting transactions in the securities covered by proposed rule 15c2–2. Proposed rule 15c2–2 would require brokers, dealers and municipal securities dealers to disclose targeted information about the costs and conflicts of interest connected with those transactions. In particular, they would be required to disclose (a) information about loads and other distribution-related costs that directly impact the returns earned by investors in those securities; (b) information about compensation of brokers, dealers and municipal securities dealers for selling those securities and information about revenue sharing arrangements and portfolio brokerage arrangements that create conflicts of interest for them; and (c) information about whether their associated persons receive extra compensation for selling proprietary fund shares or certain fund share classes. Brokers, dealers and municipal securities dealers would provide this information to customers in the form of written confirmations.

2. Proposed Use of Information

The purpose of proposed rule 15c2–2 is to provide investors in mutual fund shares, UIT interests and 529 plan securities with the relevant information currently required by rule 10b–10, as well as information about certain distribution-related costs and certain distribution arrangements that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated persons. In addition to certain basic transaction information currently required by rule 10b–10, proposed rule 15c2–2 specifically would require confirmation disclosure of information about loads and other distribution-related costs that directly impact the returns earned by investors in those securities. It also would require brokers, dealers and municipal securities dealers to disclose their compensation for selling those securities, and to disclose information about revenue sharing arrangements and portfolio brokerage arrangements that create conflicts of interest for them. Moreover, the proposed rule would require brokers, dealers and municipal securities dealers to inform customers about whether their salespersons or other associated persons receive extra compensation for selling certain covered securities.

The new rule's more targeted informational requirements would provide investors in mutual fund shares, UIT interests and 529 plan securities with important information about their brokers', dealers' or municipal securities dealers' conflicts of interest and about distribution costs that can reduce their investment returns. In addition, the Commission, the self-regulatory organizations, and other securities regulatory authorities would be able to use records of confirmations delivered pursuant to proposed rule 15c2–2 in the course of examinations, and investigations, as well as enforcement proceedings against brokers, dealers and municipal securities dealers. However, no governmental agency would regularly receive any of the information described above.

3. Respondents

By its terms, proposed rule 15c2–2 potentially would apply to all of the approximately 5,338 brokers, dealers and municipal securities dealers that are registered with the Commission and that are members of NASD. It would also potentially apply to approximately 62 additional municipal securities dealers.[167] It is important to note, however, that only those brokers, dealers and municipal securities dealers that effect transactions in mutual fund shares, UIT interests and 529 plan securities would have to comply with the provisions of proposed rule 15c2–2. Although the staff believes some brokers, dealers and municipal securities dealers do not effect transactions in mutual fund shares, UIT interests or 529 plan securities, the staff is unable to estimate the number of such brokers, dealers and municipal securities dealers and has, therefore, assumed that all brokers, dealers and municipal securities dealers effect such transactions. This assumption may result in the paperwork burdens and costs of proposed rule 15c2–2 being overstated.

4. Reporting and Recordkeeping Burden

The Commission staff estimates that there are 1 billion confirmations delivered annually to customers in connection with securities transactions involving mutual fund shares, UIT interests and 529 plan securities.[168] Rule 10b–10 currently requires broker-dealers to deliver confirmations to customers in connection with transactions in mutual fund shares and UIT interests. In addition, brokers, dealers and municipal securities dealers are required under the rules of the MSRB to deliver confirmations to customers in connection with transactions involving municipal fund securities.[169] The Commission staff does not anticipate that a significant number of new confirmations would be required to be generated if proposed rule 15c2–2 is adopted. The proposed rule would, however, require additional information in confirmations that would otherwise be required to be delivered under Exchange Act rule 10b–10 and MSRB rule G–15.

The Commission staff estimates that brokers, dealers and municipal securities dealers would have a one-time burden associated with reprogramming software and otherwise updating systems in order to enable confirmation delivery systems to generate the information required under proposed rule 15c2–2.[170] We understand that some brokers, dealers and municipal securities dealers have developed their own proprietary confirmation delivery systems, which would need to be reprogrammed and updated to comply with proposed rule 15c2–2. As a general matter, medium-sized and smaller firms, but also some larger firms, use third-party service providers, or vendors, to generate the data necessary to send confirmations.[171] They may also use vendors to actually send confirmations to investors. Therefore, the firms' vendors would be required to reprogram their software and update their systems to generate the data that would allow their clients to comply with proposed rule 15c2–2. Some, if not all, of the cost for this

[167] Source: MSRB Registrants List (available on the Internet at *http://www.msrb.org/msrb1/PQweb/Registrants.xls*).

[168] This estimate is based on discussions with industry participants.

[169] MSRB rule G–15.

[170] The Commission staff understands that, because confirmation delivery systems already exist, new systems are not needed to generate the confirmations that would be required under proposed rule 15c2–2.

[171] Based on discussions with industry representatives, the Commission staff estimates that over 5,000 brokers, dealers and municipal securities dealers use vendors' confirmation data services.

reprogramming and systems upgrading would be allocated to the vendors' clients—the brokers, dealers and municipal securities dealers. The staff understands from discussions with vendors that the allocation of costs would coincide roughly with the volume of the client's transactions, so that a broker, dealer or municipal securities dealer that executes fewer transactions involving covered securities would be allocated less of its vendor's costs than a broker, dealer or municipal securities dealer that executes more transactions.

The Commission staff estimates from information provided by industry participants that the one-time burden to brokers, dealers and municipal securities dealers, and their vendors, for reprogramming software and otherwise updating systems to permit the confirmation delivery systems required under proposed rule 15c2–2 would be 15 million hours.[172]

• The Commission requests comment on the staff's estimates of the one-time reprogramming software and otherwise updating systems to permit the confirmation delivery systems required under proposed rule 15c2–2.

In addition to the one-time burden associated with reprogramming software and upgrading confirmation delivery systems, the Commission anticipates on-going burdens for complying with the requirements of proposed rule 15c2–2, including calculating revenue sharing and portfolio brokerage amounts required under rule 15c2–2. Based upon discussions with industry representatives, the Commission staff understands that, once completed, this reprogramming and systems updating would permit brokers, dealers, and municipal securities dealers to have automated access to the information that would be required to be disclosed in confirmations delivered pursuant to proposed rule 15c2–2. As a result, the burden associated with obtaining data to be included in confirmations would be *de minimis*. The Commission staff estimates from information provided by industry participants that the annual burden to brokers, dealers and municipal securities dealers, and their vendors, to comply with the requirements under proposed rule 15c2–2 to calculate revenue sharing and portfolio brokerage amounts and to maintain and further update the confirmation delivery systems, would be 2 million hours.[173]

• The Commission requests comment on the staff's estimates of the burdens associated with complying with the requirements of proposed rule 15c2–2, including calculating revenue sharing and portfolio brokerage amounts, as well as maintaining and updating confirmation delivery systems. The Commission specifically requests comment on the estimate that, after reprogramming, the burden associated with obtaining the data necessary to comply with the confirmation delivery requirements of proposed rule 15c2–2 would be *de minimis*. In particular, commenters are requested to address whether reprogramming software and updating systems would, in fact, permit the data to be automatically transmitted to brokers', dealers' and municipal securities dealers' systems or whether data would need to be manually entered into such systems. Commenters are further requested to provide quantitative data on the burdens associated with manually entering data into systems, if necessary.

Brokers, dealers and municipal securities dealers also would have a burden for generating and sending confirmations to investors. The Commission staff estimates from information provided by industry participants that it takes about one minute to generate and send a confirmation. Based on the estimate that there are 1 billion transactions annually in the covered securities, the Commission staff estimates that the annual burden to brokers, dealers and municipal securities dealers to generate and send confirmations to customers pursuant to proposed rule 15c2–2 would be 16.7 million hours.[174] It is important to note, however, that confirmations for transactions in covered securities are currently required to be delivered pursuant to rule 10b–10 or MSRB rule G–15, as applicable. As a result, the burden for generating and sending confirmations would not be entirely new, but would reflect a shift of burdens from rule 10b–10 to proposed rule 15c2–2. In addition, brokers, dealers and municipal securities dealers routinely send customers account statements pursuant to self-regulatory organizations' requirements and for reasons of prudent business practice. Nonetheless, the Commission staff estimates that the total annual burden for complying with the requirements of proposed rule 15c2–2 would be 18.7 million hours.[175] The number of confirmations sent and the cost of the confirmations vary from firm to firm. Smaller firms typically send fewer confirmations than larger firms because they effect fewer transactions.

Based upon discussions with industry participants, the Commission staff anticipates that there would be one-time external costs for upgrading and reprogramming printing systems for brokers, dealers municipal securities dealers who use out-sourced printing and other out-sourced services. The staff anticipates that these costs would be passed on to brokers, dealers and municipal securities dealers in the form of higher fees. While the staff is currently unable to determine the number of brokers, dealers and municipal securities dealers that utilize such outsourced services, based on discussions with industry representatives the staff estimates that the cost per broker, dealer or municipal securities would be approximately $18,500. Assuming that all of the approximately 5,400 brokers, dealers and municipal securities dealers subject to proposed rule 15c2–2 use such out-sourced services, the total one-time external cost would be about $100 million. We note that this assumption may result in a significant overstatement of these external costs.

[172] This estimate is based on the staff's understanding that 5,000 brokers, dealers and municipal securities dealers, including virtually all small entities, directly or indirectly through clearing brokers, use the services of 10 vendors. The staff estimates that the total one-time burden to the 10 vendors would be 1,580,000 hours, or 158,000 hours per vendor. Although the staff understands from discussions with vendors that this burden would be allocated to all of the vendors' clients in a manner that reflects the volume of transactions the broker, dealer or municipal securities dealer effects, the staff assumes for purposes of estimating the total burden that the burden would be allocated to each client on a pro rata basis (316 hours per broker, dealer or municipal security dealer that uses vendors' services). In addition, the staff estimates, based on discussions with industry representatives, that 400 brokers, dealers and municipal securities dealers use proprietary confirmation delivery systems that each of them, on average, would have a one-time burden of 33,550 hours. Thus, the total one-time burden is estimated to be 15 million hours ((5,000 × 316) + (400 × 33,550) = 15,000,000).

[173] The staff estimates that the burden to the 10 vendors to maintain their systems would be 500,000 million hours annually, or 50,000 hours per vendor. The staff estimates that the burden allocated to each client on a pro rata basis would be 100 hours annually per broker, dealer or municipal security dealer that uses vendors' services (500,000 hours/5,000 = 100 hours). The staff estimates, based on discussions with industry representatives, that the 400 brokers, dealers and municipal securities dealers that use proprietary confirmation delivery systems, on average, would have a burden of 3,750 hours annually for maintaining systems. Thus, the annual burden for maintaining systems is estimated to be 2 million hours ((5,000 × 100) + (400 × 3,750) = 2,000,000 hours).

[174] (1 billion confirmations at one minute per confirmation = 1 billion minutes; 1 billion minutes/60 minutes per hour = 16.7 million hours.)

[175] (16.7 million hours to generate and send confirmations to customers + 2 million hours to calculate revenue sharing and portfolio brokerage amounts and to maintain and further update the confirmation delivery systems = 18.7 million hours.)

As stated earlier, the Commission staff estimates that there are 1 billion securities transactions annually involving mutual fund shares, UIT interests and 529 plan securities. According to information provided by industry participants, the Commission staff estimates that the average cost, including postage and printing, for a two-page confirmation is about $1.05. As a result, the Commission staff estimates that the annual costs of complying with the requirements of proposed rule 15c2–2, including the printing and postal costs for generating and sending confirmations, would be $1.05 billion,[176] reflecting an increase of $160 million over the cost of the confirmations had they been delivered pursuant to rule 10b–10.[177]

In summary, the Commission staff estimates that there would be a one-time burden of 15 million hours associated with reprogramming software and upgrading systems to permit brokers, dealer and municipal securities dealers, and their vendors, to comply with the requirements of proposed rule 15c2–2. The staff further estimates that there would be an additional one-time cost of $100 million for fees of service providers. The staff estimates that the annual burden for complying with the requirements of proposed rule 15c2–2 would be 18.7 million and that the annual costs of complying with the requirements of proposed rule 15c2–2, including the printing and postal costs for generating and sending confirmations, would be $1.05 billion. We note that, as stated above, many of these costs and burdens, including the majority of the annual costs and burdens, would be shifted from rule 10b–10 to proposed rule 15c2–2. We also note that some of the assumptions the staff has made may result in the costs and burdens being overstated.

[176] (1 billion confirmations at $1.05 per confirmation = $1.05 billion.) As noted above, confirmations for transactions in covered securities are currently required to be delivered pursuant to rule 10b–10 or MSRB rule G–15, as applicable. As a result, this estimated cost is not entirely a new cost, but reflects a shift of costs from rule 10b–10 to proposed rule 15c2–2. This estimated cost also reflects an incremental increase in the cost of generating confirmations from 89 cents under rule 10b–10 to $1.05 under proposed rule 15c2–2. This incremental cost is associated with generating the two-page confirmation that would be required under proposed rule 15c2–2, as compared to a half-page or one-page confirmation that is currently permitted under rule 10b–10.

[177] (1 billion confirmations delivered pursuant to rule 10b–10 at $0.89 per confirmation = $890 million; $1.05 billion − $890 million = $160 million.)

5. Collection of Information Is Mandatory

This collection of information would be mandatory.

6. Confidentiality

The collection of information delivered pursuant to the proposed rule 15c2–2 would be provided by brokers, dealers and municipal securities dealers to customers, and also would be maintained by brokers, dealers and municipal securities dealers.

7. Record Retention Period

Exchange Act Rule 17a–4(b)(1)[178] requires broker-dealers to preserve confirmations for three years, the first two years in an accessible place. Similarly MSRB rule G–9 requires brokers, dealers and municipal securities dealers to preserve confirmations of transactions involving municipal securities for three years, the first two years in an accessible place.

B. Rule 15c2–3

1. Collection of Information at the Point of Sale in Connection With Certain Transactions Involving Open-End Management Investment Company Securities, Unit Investment Trust Interests, and Municipal Fund Securities Used for Education Savings

Proposed rule 15c2–3 under the Exchange Act would require brokers, dealers and municipal securities dealers to provide point of sale disclosure to investors prior to effecting transactions in mutual fund shares, UIT interests and 529 plan securities. The disclosure would provide investors with targeted material information about distribution-related costs and remuneration that lead to conflicts of interest for their brokers, dealers or municipal securities dealers. The collection of information under proposed rule 15c2–3 would require some of the disclosure that is also required under rule 15c2–2. However, in contrast to the confirmation disclosure required under proposed rule 15c2–2, which a customer will not receive in writing until after a transaction has been effected, the point of sale disclosure that would be required under rule 15c2–3 would specifically require that investors be provided with information that they can use at the time they determine whether to enter into a transaction to purchase one of the covered securities.

2. Proposed Use of Information

The purpose of proposed rule 15c2–3 is to provide information to investors at the time they make their investment decisions with respect to transactions in mutual fund shares, UIT interests and 529 plan securities. The rule specifically is intended to give investors timely access to information about sales loads and other distribution-related costs associated with transactions in those securities, as well as distribution arrangements that pose conflicts of interest for the brokers, dealers or municipal securities dealers, or their associated persons, that effect those transactions. In the absence of the new rule's requirements, investors in such transactions would lack, at the time they make their investment decision, important information about distribution costs that can reduce investment returns, and about conflicts of interest.

Records of the disclosure described above may be used by the Commission, the self-regulatory organizations, and other securities regulatory authorities in the course of examinations, investigations, and enforcement proceedings. No governmental agency regularly would receive any of the information described above.

3. Respondents

By its terms, proposed rule 15c2–3 potentially would apply to all of the approximately 5,338 brokers, dealers and municipal securities dealers that are registered with the Commission and that are members of NASD. It would also potentially apply to approximately 62 additional municipal securities dealers. It is important to note, however, that only those broker, dealers and municipal securities dealers that effect transactions in mutual fund shares, UIT interests and 529 plan securities would be affected by the provisions of proposed rule 15c2–3. Although as stated above, the staff believes some brokers, dealers and municipal securities dealers do not effect transactions in mutual fund shares, UIT interests and 529 plan securities, the staff is unable to estimate the number of such brokers, dealers and municipal securities dealers and has, therefore, assumed that all brokers, dealers and municipal securities dealers effect such transactions. This assumption may result in the paperwork burdens and costs of proposed rule 15c2–3 being overstated.

4. Reporting and Recordkeeping Burden

As noted above, the Commission staff estimates that there are 1 billion confirmations delivered annually in connection with securities transactions involving mutual fund shares, UIT interests and 529 plan securities.

[178] 17 CFR 240.17a–4(b)(1).

Proposed rule 15c2–3 would require brokers, dealers and municipal securities dealers to provide disclosure to customers about costs and conflicts at the point of sale for each of these transactions. The information that would be required to be delivered pursuant to proposed rule 15c2–3 would be derived from information that brokers, dealers and municipal securities dealers would otherwise prepare in order to fulfill their confirmation disclosure requirements under proposed rule 15c2–2. The Commission staff anticipates that one of the primary burdens to the industry of proposed rule 15c2–3 would be a one-time burden associated with reprogramming software and other such activities that will enable confirmation delivery systems to generate the information at the point of sale. Based on discussions with industry representatives, the Commission staff does not expect that brokers, dealers or municipal securities dealers would require new systems to be developed. Rather, the reprogramming and updating of current systems will enable brokers, dealers and municipal securities dealers to have access to such information at the point of sale, and to provide such information to investors at that time. Based on discussions with industry participants, the Commission staff estimates that the one-time burden to brokers, dealers and municipal securities dealers to reprogram software and conduct such other activities that will enable confirmation delivery systems to generate information required by proposed rule 15c2–3 to be delivered at the point of sale would be approximately 7 million hours.[179] We note that some, but not all of the burdens for complying with proposed rule 15c2–3 would be shared with burdens for complying with proposed rule 15c2–2. The estimates of burdens and costs in this section reflect this shared burden. However, if proposed rule 15c2–3 is adopted and proposed rule 15c2–2 is not, the burdens for complying with proposed rule 15c2–3 may increase.

Proposed rule 15c2–3(d) would require brokers, dealers and municipal securities dealers to make records of their disclosure sufficient to demonstrate compliance with the delivery requirements of paragraphs (a) and (b) of proposed rule 15c2–3. The brokers, dealers or municipal securities dealers would have to preserve those records for the period specified in Exchange Act rule 17a–4(b), or, in the case of records of oral communications or the disclosures, for the period specified in Exchange Act rule 17a–4(b) with regard to similar written communications and records. While this requirement often can be satisfied by maintaining a copy of the disclosure document that was provided to the customer, in the case of disclosure solely by means of oral communications, this provision would require the broker, dealer or municipal securities dealer to have compliance procedures in place that are adequate to demonstrate that it provided the required disclosure. Based on discussions with industry participants, the Commission staff estimates that the annual burden to brokers, dealers and municipal securities dealers to develop and implement such compliance procedures would be approximately 2 million hours.[180]

The Commission staff further estimates from information provided by industry participants that it will take, on average, about one minute to deliver to customers the point of sale disclosure required under proposed rule 15c2–3. The Commission staff also estimates from information provided by industry participants that the annual burden to brokers, dealers and municipal securities dealers to deliver at the point of sale the disclosure that would be required under proposed rule 15c2–3, and to maintaining systems that would permit such disclosure, would be 16.7 million hours.[181] As a result, the Commission staff estimates that the total annual burden to brokers, dealers and municipal securities dealers to comply with the requirements of proposed rule 15c2–3, would be 18.7 million hours.[182]

It is important to note that, under specified conditions, paragraph (e)(1) of proposed rule 15c2–3 would conditionally except transactions resulting from orders that a customer places via U.S. mail, messenger delivery or a similar third-party delivery service. The exception would be available to brokers, dealers or municipal securities dealers that, within the prior six months, have provided the customer with information about the maximum potential size of sales loads and asset-based sales charges and service fees associated with covered securities sold by that broker, dealer or municipal securities dealer, as well as statements about whether the broker, dealer or municipal securities dealer receives revenue sharing or portfolio brokerage commissions or pays differential compensation.[183] This exception would have the result of in a decrease in the burden to the industry of proposed rule 15c2–3.

Based upon discussions with industry participants, the Commission staff anticipates that there would be one-time external costs for out-sourced services, including call center services for brokers, dealers and municipal securities dealers that may use such services for delivery of point of sale information for transactions placed by telephone. The staff anticipates that these costs would be passed on to brokers, dealers and municipal securities dealers in the form of higher fees. While the staff is currently unable to determine the number of brokers, dealers and municipal securities dealers that utilize such outsourced services, based on discussions with industry representatives the staff estimates that the cost per broker, dealer or municipal securities dealer would be approximately $18,500. Assuming that all of the approximately 5,400 brokers, dealers and municipal securities dealers subject to proposed rule 15c2–3 use such out-sourced services, the total one-time external cost would be about $100 million. We note that this assumption may result in a significant overstatement of these external costs.

[179] The staff estimates that the total one-time burden to the 10 vendors would be 1,040,000 hours, or 104,000 hours per vendor. Although the staff understands from discussions with vendors that this burden would be allocated to all of the vendors' clients in a manner that reflects the volume of transactions the broker, dealer or municipal securities dealer effects, for purposes of this calculation, the staff assumes that the burden would be allocated to each client on a pro rata basis (208 hours per broker, dealer or municipal security dealer that uses vendors' services). In addition, the staff estimates, based on discussions with industry representatives, that 400 brokers dealers and municipal securities dealers use proprietary confirmation delivery systems that each of them, on average, would have a one-time burden of 22,400 hours. Thus, the total one-time burden is estimated to be 7 million hours ((5,000 × 208) + (400 × 14,900) = 7,000,000 hours).

[180] The staff estimates that the burden to the 10 vendors to maintain their systems would be 500,000 million hours annually, or 50,000 hours per vendor. The staff estimates that the burden allocated to each client on a pro rata basis would be 100 hours annually per broker, dealer or municipal security dealer that uses vendors' services (500,000 hours/5,000 = 100 hours). The staff estimates, based on discussions with industry representatives, that the 400 brokers dealers and municipal securities dealers that use proprietary confirmation delivery systems, on average, would have a burden of 3,750 hours annually for maintaining systems. Thus, the annual burden for maintaining systems is estimated to be 2 million hours ((5,000 × 100) + (400 × 3,750) = 2,000,000).

[181] (1 billion transactions at one minute per point of sale disclosure = 1 billion minutes; 1 billion minutes/60 minutes per hour = 16.7 million hours.)

[182] (16.7 million hours per point of sale disclosure + 2 million hours to develop and implement compliance procedures = 18.7 million hours.)

[183] *See supra* section V.G. for a detailed discussion of this exception.

Based on discussions with industry participants, the Commission staff estimates that the annual cost to brokers, dealers and municipal securities dealers for call center services and other service providers which would assist with development and implementation of procedures sufficient to demonstrate compliance with the delivery requirements of paragraphs (a) and (b) of proposed rule 15c2–3 would be approximately $40 million.[184]

In summary, the Commission staff estimates that there would be a one-time burden of 7 million hours associated with reprogramming software and upgrading systems to permit brokers, dealers and municipal securities dealers, and their vendors, to comply with the requirements of proposed rule 15c2–3. The staff further estimates that there would be an additional one-time cost of $100 million for fees of service providers. The staff estimates that the annual burden for complying with the requirements of proposed rule 15c2–3 would be 18.7 million hours and that the annual costs of complying with the requirements of proposed rule 15c2–3, including call center services, and recordkeeping and compliance costs, would be $40 million.

5. Collection of Information Is Mandatory

This collection of information would be mandatory.

6. Confidentiality

The collection of information delivered pursuant to the proposed rule 15c2–3 would be provided by brokers, dealers and municipal securities dealers to customers, and also would be maintained by brokers, dealers and municipal securities dealers.

7. Record Retention Period

Proposed rule 15c2–3 would require brokers, dealers and municipal securities dealers to preserve records for the period specified in Exchange Act rule 17a–4(b), or, in the case of records of oral communications and their disclosures, for the period specified in Exchange Act rule 17a–4(b) with regard to similar written communications and records. Exchange Act Rule 17a–4(b)(1)[185] requires the preservation of confirmations for three years, the first two years in an accessible place.

[184] Based on discussions with industry representatives, the staff estimates that the annual cost would be $7,400 per broker, dealer or municipal securities dealer. (5,400 brokers, dealers and municipal securities dealers × $7,400 = $39,996,000.)

[185] 17 CFR 240.17a–4(b)(1).

C. Proposed Amendments to Rule 10b–10

1. Collection of Information

For the reasons discussed above and consistent with proposed Rule 15c2–2, rule 10b–10 would be modified to exclude transactions in mutual fund shares and UIT interests (other than UIT interests that are traded in a secondary market). The purpose of the exclusion is to enhance disclosure efficiency and to avoid duplicative regulatory burdens. This exclusion from a regulatory burden would not impose recordkeeping or information collection requirements, or other collections of information under rule 10b–10 that require approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.* However, the proposed amendments to rule 10b–10 would also require brokers and dealers to disclose additional information in confirmations that would otherwise be delivered in connection with transactions involving callable preferred stock and callable debt. Specifically, the proposed amendments would require disclosure of the callable nature of preferred stock, if such is the case, and, in the case of callable debt that is effected on the basis of price to call, the date upon which the debt security may first be called. This information would be provided to customers in the form of written confirmations.

2. Proposed Use of Information

The purpose of the proposed amendments to rule 10b–10 is to provide to investors the information necessary to evaluate their transactions in callable preferred stock and redeemable debt. In the absence of the proposed amendments, investors in such transactions may not be fully informed of important information, such as whether the preferred stock is callable and the first date upon which callable debt securities may be called. In addition, the Commission, the self-regulatory organizations, and other securities regulatory authorities may use the confirmations described above in the course of examinations, investigations, and enforcement proceedings. No governmental agency would regularly receive any of the information described above.

3. Respondents

Rule 10b–10 applies to all of the 5,338 brokers and dealers that are registered with the Commission and that effect transactions for customers.

4. Reporting and Recordkeeping Burden

Based on information provided by registered broker-dealers to the Commission in FOCUS Reports[186], the Commission staff estimates that registered broker-dealers process approximately 295 million order tickets per month for transactions on behalf of customers. Each order ticket representing a transaction effected on behalf of a customer results in one confirmation. Therefore, the Commission staff estimates that approximately 3.54 billion confirmations[187] are sent to customers annually. As noted above, the staff estimates that approximately 1 billion confirmations are generated in connection with transactions in mutual funds, UIT interests and 529 plan securities and will be delivered pursuant to proposed rule 15c2–2, if adopted, and will accordingly decrease the number of confirmations delivered pursuant to rule 10b–10 by a like amount. As a result, the Commission staff estimates that approximately 2.54 billion confirmations will be sent to customers annually pursuant to rule 10b–10 if proposed rule 15c2–2 and the proposed amendments to rule 10b–10 are adopted.

The Commission staff estimates from information provided by industry participants that it takes about one minute to generate and send a confirmation. As a result, the Commission staff estimates that the annual burden to brokers, dealers and municipal securities dealers to comply with the confirmation delivery requirements of the proposed amendments to rule 10b–10 would be 42.3 million hours.[188] The number of confirmations sent and the cost of the confirmations vary from firm to firm as smaller firms send fewer confirmations than larger firms because they effect fewer transactions.

The Commission staff estimates that the one-time burden associated with reprogramming of software and other such activities to enable confirmation delivery systems to include the call information required under the proposed amendments to rule 10b–10 would be minimal. The Commission staff further estimates that the on-going

[186] FOCUS Reports are annual reports that broker-dealers are required to file with the Commission. They are contained in the broker-dealers' Form X–17A–5 (17 CFR 249.617).

[187] (295 million confirmations/month × 12 months/year = 3.54 billion confirmations.)

[188] (2.54 billion confirmations at one minute per confirmation = 2.54 billion minutes; 2.54 billion minutes/60 minutes per hour = 42.3 million hours.) We note that the estimates of this annual burden reflects a shift of confirmation delivery requirements with respect to open-end investment company securities and unit investment trust interests from rule 10b–10 to proposed rule 15c2–2.

burden for complying with the additional disclosure requirements of rule 10b–10 with respect to callable securities would be minimal. In addition, there would be no additional cost in connection with the deletion of the expired transition period related to the confirmation of transactions involving securities futures products.

According to information previously provided by industry participants, the Commission staff estimates that the average cost, including postage, for a one-page confirmation is 89 cents. Based upon discussions with industry participants, the Commission staff estimates that the total annual cost associated with generating and delivering to investors the information required under rule 10b–10, including the proposed amendments, would be $2.26 billion.[189] It is important to note, however, that the confirmation is a customary document used by the industry for business purposes.

5. Collection of Information Is Mandatory

This collection of information would be mandatory.

6. Confidentiality

The collection of information delivered pursuant to rule 10b–10 would be provided by broker-dealers to customers, and also would be maintained by broker-dealers.

7. Record Retention Period

Exchange Act Rule 17a–4(b)(1)[190] requires broker-dealers to preserve confirmations for three years, the first two years in an accessible place.

D. Proposed Amendments to Form N–1A

1. Collection of Information in Connection With Prospectus Disclosure

The Commission is proposing to amend the fee table of the mutual fund prospectus to require the maximum sales loads to be shown as a percentage of net asset value rather than as a percentage of offering price. The proposed amendments also would require a fund to provide disclosure in the fund prospectus to alert investors to the fact that sales loads shown in the prospectus as a percentage of net asset value 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, due to rounding. Finally, the proposed amendments would require that a mutual fund include brief disclosure in its prospectus regarding revenue sharing payments, in order to direct investors to the disclosure regarding revenue sharing that the Commission is proposing to require in the confirmation and point of sale disclosure.

2. Proposed Use of Information

The purpose of the proposed amendments is to provide investors in mutual funds with enhanced disclosure regarding sales loads, and to direct investors to disclosure regarding revenue sharing arrangements that a fund may have with an investor's financial intermediary.

3. Respondents

The likely respondents to this information collection are mutual funds registering or already registered with the Commission. We estimate that there are approximately 7,025 mutual fund portfolios that fit this description.

4. Reporting and Recordkeeping Burden

The current hour burden for preparing an initial Form N–1A filing is 812.5 hours per portfolio, and the current annual hour burden for preparing a post-effective amendment on Form N–1A is 104.5 hours per portfolio. The Commission staff estimates that, on an annual basis, registrants file initial registration statements on Form N–1A covering 483 portfolios, and file post-effective amendments on Form N–1A covering 6,542 portfolios. An additional burden of 33,250 hours is expected to result from the Commission's recent proposed rule relating to frequent purchases and redemptions of fund shares and selective disclosure of portfolio holdings, and the recent proposed rule relating to disclosure of sales load breakpoints.[191] Thus, the Commission staff estimates that the total annual hour burden for the preparation and filing of Form N–1A would be 1,109,330 hours.[192]

The Commission staff estimates that the proposed amendments regarding sales loads would increase the hour burden per portfolio per filing of an initial registration statement or a post-effective amendment on Form N–1A by 0.5 hours, and that 36% of mutual fund portfolios have sales loads and hence would be affected by the proposed amendments regarding sales load disclosure.[193] Thus, the additional incremental hour burden resulting from the proposed amendments relating to sales load disclosure would be 1265 hours ((0.5 hours for initial registration statements × 483 portfolios × 36%) + (0.5 hours for post-effective amendments × 6,542 portfolios × 36%)). The Commission staff estimates that the proposed amendments regarding revenue sharing arrangements would increase the hour burden per portfolio per filing of an initial registration statement or post-effective amendment on Form N–1A by 0.1 hours.[194] Thus, the staff estimates that the additional incremental hour burden resulting from the proposed amendments relating to disclosure of revenue sharing would be 703 hours ((0.1 hours for initial registration statements × 483 portfolios) + (0.1 hours for post-effective amendments × 6,542 portfolios)). If the proposed amendments to Form N–1A are adopted, the total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments to Form N–1A would be 1,111,298 hours (1265 hours + 703 hours + 1,109,330 hours).

5. Collection of Information Is Mandatory

This collection of information would be mandatory.

6. Confidentiality

Responses to the disclosure requirements are not confidential.

7. Record Retention Period

There is no mandatory record retention period associated with these amendments.

E. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

[189] (2.54 billion confirmations at $0.89 per confirmation = $2.26 billion.)

[190] 17 CFR 240.17a–4(b)(1).

[191] *See* Investment Company Act Release No. 26287 (Dec. 11, 2003) [68 FR 70402 (Dec. 17, 2003)]; Investment Company Act Release No. 26298 (Dec. 17, 2003) [68 FR 74732 (Dec. 24, 2003)].

[192] This estimate is based on the following calculation: (812.5 hours × 483 portfolios) + (104.5 hours × 6,542 portfolios) = 1,076,080 hours. An additional annual hour burden of 30,998 hours resulting from the proposed rule relating to frequent purchases and redemptions and selective disclosure, and an additional annual hour burden of 2,252 hours resulting from the proposed amendments relating to breakpoints disclosure, yield a total annual hour burden of 1,109,330 hours.

[193] This estimate is based on information regarding the number of mutual fund portfolios with front-end or deferred sales loads, derived by the staff from Commission filings and third-party information sources.

[194] The Commission estimates, for purposes of the Paperwork Reduction Act, that a significant majority of mutual fund portfolios either have revenue sharing arrangements or are part of a fund complex that has such an arrangement and thus would be affected by the proposed amendments regarding revenue sharing disclosure.

(ii) Evaluate the accuracy of the Commission staff's estimate of the burden of the proposed collection of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected; and

(iv) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609, and refer to File No. S7–06–04. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release in the **Federal Register**. Therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer File No. S7–06–04, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW, Washington, DC 20549.

IX. Costs and Benefits of the Proposed Rule and Rule Amendments

A. Introduction

Proposed rules 15c2–2 and 15c2–3 are intended to improve investor access to information about investments in mutual fund shares, UIT interests and 529 plan securities. The Commission is sensitive to the costs and benefits that result from its rules. In proposing new rules 15c2–2 and 15c2–3 and the amendments to rule 10b–10 and Form N–1A, the Commission has strived to minimize compliance costs while promoting investor protection.

In considering the potential costs and benefits of proposed rules 15c2–2 and 15c2–3, the Commission has considered the transaction confirmation practices of brokers, dealers and municipal securities dealers that effect transactions in mutual fund shares, UIT interests and 529 plan securities. The Commission has also considered the practices of mutual funds in disclosing sales loads. Similarly, in considering the potential costs and benefits of the proposed amendments to rule 10b–10, the Commission has considered the transaction confirmation practices of broker-dealers, including those that effect transactions in callable preferred securities and callable debt securities. The amendments to rule 10b–10 are intended to provide investors with information that is helpful in making an informed decision when investing in callable preferred stock and redeemable debt securities. The amendments to Form N–1A are intended to provide investors with a better understanding of the costs of investing in a fund with a sales load, and of revenue sharing received by financial intermediaries.

B. Rule 15c2–2

Proposed rule 15c2–2 responds to concerns that investors in mutual fund shares, UIT interests and 529 plan securities lack adequate information about certain distribution-related costs, as well as certain distribution arrangements, that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated persons. As noted above, those costs and other distribution arrangements have evolved substantially since 1977, when the Commission adopted its general confirmation rule, rule 10b–10.[195]

1. Benefits

The Commission believes that permitting investors to more readily obtain information about distribution-related costs that have the potential to reduce their investment returns and to give investors a better understanding of some of the distribution-related arrangements that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated persons.[196] The disclosure of information about these costs and arrangements can help investors make better informed investment decisions. Investors will also be in a better position to compare the costs of these investments, which we preliminarily believe will lead to a general increase in the transparency and efficiency of the market for mutual fund shares, UIT interests and 529 plan securities. Furthermore, as a result of the standardized disclosure that would be required under proposed rule 15c2–2, the Commission believes that the aggregate amount of the distribution-related costs associated with mutual fund shares, UIT interests and 529 plan securities may well decline over time. These benefits, while qualitatively important, are necessarily difficult to quantify. Therefore, the Commission is unable to provide a quantitative estimate of the benefits of proposed rule 15c2–2.

2. Costs

Proposed rule 15c2–2 would require brokers, dealers and municipal securities dealers to include additional information in confirmations that are currently sent to investors pursuant to rule 10b–10. The costs of adding this new information into confirmation disclosures may include both internal costs (for information technology specialists to re-program and update confirmation delivery systems, and for compliance officers and other staff to oversee and maintain confirmation delivery systems) and external costs (for printing and typesetting of the confirmation disclosure), all of which are included in the estimates of the Paperwork Reduction Act burden. For purposes of the Paperwork Reduction Act, the Commission staff has estimated that the one-time burden to brokers, dealers and municipal securities dealers, and their vendors, associated with reprogramming software and otherwise updating systems to permit the confirmation delivery systems required under proposed rule 15c2–2 would be 15 million hours. We estimate that this one-time burden would equal total internal costs of $750 million.[197] The staff further estimates that there would be an additional one-time cost of $100 million for fees of service providers[198], for a total cost of $850

[195] *See supra*, note 5.

[196] The Commission staff estimates that for the one-year period between September 2002 and August 2003, investors in open-end management investment company securities paid more than $6.7 billion in aggregate sales loads, consisting of approximately $4.9 billion in front-end loads and $1.8 billion in back-end loads.

[197] These figures are based on an estimated hourly wage rate of $50. The estimated wage figure is based on published compensation for compliance attorneys outside New York City ($39) and computer programmers ($34), and the estimate that attorneys and programmers would divide time equally on compliance with the proposed disclosure requirements, yielding a weighted wage rate of $36.50 ((39 × .50) + (34 × .50)) = $36.50). *See* Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2002* (Sept. 2002). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of about $50 ((36.50 × 1.35) = $49.28).

[198] As noted above, while the staff is currently unable to determine the number of brokers, dealers and municipal securities dealers that utilize outsourced services, based on discussions with

Continued

million, or approximately $157,407 per broker, dealer or municipal securities dealer. These figures will vary depending on whether a firm must update its own proprietary confirmation delivery system or whether it uses vendor services, in which case the cost will likely vary depending on the number of transactions the firm executes on an annual basis.[199]

In addition, for purposes of the Paperwork Reduction Act, the Commission staff has estimated that the annual burden to brokers, dealers and municipal securities dealers for complying with the requirements of proposed rule 15c2–2, including generating and sending confirmations to investors, calculating revenue sharing and portfolio brokerage amounts and maintaining and further updating the confirmation delivery systems, would be 18.7 million hours annually. As noted above, confirmations for transactions in covered securities are currently required to be delivered pursuant to rule 10b–10 or MSRB rule G–15, as applicable. As a result, the burden for generating and sending confirmations would not be entirely new, but would reflect a shift of an annual burden of 16.7 million hours from rule 10b–10 to proposed rule 15c2–2. Nonetheless, the Commission staff estimates that the annual burden for complying with the requirements of proposed rule 15c2–2 would equal total internal costs of $935 million annually, based on an estimated hourly wage of $50. The Commission staff further has estimated for purposes of the Paperwork Reduction Act that the external costs of complying with the requirements of proposed rule 15c2–2, including the printing and postal costs for generating and sending confirmations, would be $1.05 billion. The staff has estimated for purposes of the Paperwork Reduction Act that these external costs would reflect an increase of $160 million over the external cost of delivering the confirmations were they to be delivered pursuant to rule 10b–10. The Commission estimates that the annual costs for complying with proposed rule 15c2–2 would be $1.99 billion, or approximately $367,593 per broker, dealer or municipal securities dealer. It is important to note, however, no new confirmations will be required to be sent to investors under proposed rule 15c2–2; rather new information would be required to be included in confirmations that would otherwise be sent.

In addition to the foregoing costs, the Commission notes that other possible costs resulting from proposed rule 15c2–2 include the possibility that investors' ready access to information about the costs and conflicts associated with mutual fund shares, UIT interests and 529 plan securities may lead to a net reduction in the amount invested in those types of securities. Investors may pursue other types of investments that do not have, or do not appear to have, such costs and conflicts. In addition, the disclosure of distribution-related costs may result in a restructuring of the way funds compensate sellers of their securities.

3. Request for Comments

The Commission requests comment on the costs and benefits of proposed rule 15c2–2. Commenters are strongly encouraged to identify and supply any relevant data, analysis, and estimates concerning the costs and/or benefits of proposed rule 15c2–2, including any costs and benefits not described above. Commenters should address in particular the cost associated with adjusting operational systems to provide the disclosure required under proposed rule 15c2 and whether the proposed rule will generate the benefits described above. In addition, the Commission requests comment on whether a transitional period is necessary to make these adjustments. As always, commenters are specifically invited to share additional quantifiable costs and benefits that they believe may be imposed or generated by new rule 15c2–2.

C. Proposed Rule 15c2–3

Proposed rule 15c2–3 is intended to provide information to investors in mutual fund shares, UIT interests and 529 plan securities at the time they make their investment decisions.

1. Benefits

Proposed rule 15c2–3 would require brokers, dealers and municipal securities dealers to provide point of sale disclosure to customers prior to effecting transactions in those securities *i.e.*, at the time they make investment decisions. The Commission staff estimates that for the one-year period between September 2002 and August 2003, investors in open-end management investment company securities paid more than $6.7 billion in aggregate sales loads, consisting of approximately $4.9 billion in front-end loads and $1.8 billion in back-end loads. In addition, funds and their affiliates paid about $13 billion in marketing and distribution payments pursuant to 12b–1 plans. Absent proposed rule 15c2–3, investors in mutual fund shares, UIT interests, and municipal fund securities used for education savings would, at the time they make their investment decision, lack ready transaction-specific access to this information.

The proposed rule specifically would enable investors to see targeted, transaction-specific, information about these distribution-related costs, and about remuneration that lead to conflicts of interest for their brokers, dealers or municipal securities dealers. That would enable investors to better understand the costs and conflicts associated with each investment in those securities prior to entering into the transactions, which should promote better informed investment decision-making. In addition, as a result of the standardized disclosure that would be required under proposed rule 15c2–3, the Commission believes that the aggregate amount of the distribution-related costs associated with mutual fund shares, UIT interests and 529 plan securities may well decline over time. Furthermore, the record-retention requirements of proposed rule 15c2–3 would enable regulators to review the compliance of brokers, dealers and municipal securities dealers with the proposed rule as well as other legal obligations. These benefits, while qualitatively important, are necessarily difficult to quantify. Therefore, the Commission is unable to provide a quantitative estimate of the benefits of proposed rule 15c2–3.

2. Costs

Proposed rule 15c2–3 would require brokers, dealers and municipal securities dealers to provide point of sale disclosure to customers prior to effecting transactions in mutual fund shares, UIT interests and 529 plan securities. The costs of delivering this information to investors at the point of sale may include both internal costs (for information technology specialists to re-program and update confirmation delivery systems to allow point of sale disclosure, and for compliance officers and other staff to oversee and maintain point of sale disclosure systems) and external costs (for services related to point of sale disclosure, such as call center services and out-sourced services

industry representatives the staff estimates that the cost per broker, dealer or municipal securities dealer would be approximately $18,500. Assuming that all of the approximately 5,400 brokers, dealers and municipal securities dealers subject to proposed rule 15c2–2 use such out-sourced services, the total one-time external cost would be about $100 million. We note that this assumption may result in a significant overstatement of these external costs.

[199] As noted above, based on discussions with vendors, the Commission staff anticipates that vendors will allocate costs to brokers, dealers and municipal securities dealers roughly on the basis of the volume of transactions in the covered securities.

to assist firms with developing and implementing compliance procedures), all of which are included in the estimates of the Paperwork Reduction Act burden. For purposes of the Paperwork Reduction Act, the Commission staff has estimated that the one-time burden to brokers, dealers and municipal securities dealers, and their vendors, associated with reprogramming software and otherwise updating systems to permit the confirmation delivery systems to deliver point of sale disclosure required under proposed rule 15c2–3 would be 7 million hours and that the one-time external cost would be $100 million.[200] We estimate that these one-time burdens and costs would equal total internal costs of $450 million [201], or approximately $83,333 per broker, dealer or municipal securities dealer. These figures will vary depending on whether a firm must update its own proprietary confirmation delivery system or whether it uses vendor services, in which case the cost will likely vary depending on the number of transactions the firm executes on an annual basis.[202]

In addition, for purposes of the Paperwork Reduction Act, the Commission staff has estimated that the annual burden to brokers, dealers and municipal securities dealers for complying with the point of sale disclosure requirements of proposed rule 15c2–3, including delivering point of sale disclosure to investors and maintaining and further updating point of sale disclosure systems, would be 18.7 million hours. The Commission staff estimates that this burden would equal total internal costs of $935 million annually, based on an estimated hourly wage of $50. The Commission staff further estimated for purposes of the Paperwork Reduction Act that the additional external costs of complying with the requirements of proposed rule 15c2–3 would be $40 million per year.[203] Therefore, the Commission estimates that the costs annual costs for complying with proposed rule 15c2–3 would be $975 million, or approximately $180,556 per broker, dealer or municipal securities dealer.

In addition to the foregoing costs, as would be the case with proposed rule 15c2–2, the Commission notes that other possible costs resulting from proposed rule 15c2–3 include the possibility that investors' ready access to information about the costs and conflicts associated with mutual fund shares, UIT interests and 529 plan securities may lead to a net reduction in the amount invested in those types of securities. Investors may pursue other types of investments that do not have, or do not appear to have, such costs and conflicts. In addition, the disclosure of distribution-related costs may result in a restructuring of the way funds compensate sellers of their securities.

3. Request for Comments

The Commission requests comment on the costs associated with requiring brokers, dealers and municipal securities dealers to disclose part or all of the information proposed to be required under rule 15c2–3 prior to each customer purchase or sale of mutual fund shares, UIT interests and 529 plan securities. The Commission requests estimates of the costs and benefits described above, as well as any costs and benefits, not already defined, that may result from the adoption of these proposed amendments. The Commission specifically requests estimates of the one-time costs associated with reprogramming software to permit firms' systems to generate the information required under proposed rule 15c2–3 and estimates of the costs for complying with the record-keeping requirements of paragraph (d) of the proposed rule. In addition, the Commission requests comment on the benefits and costs of requiring brokers, dealers and municipal securities dealers to disclose all or parts of the information proposed to be required under new rule 15c2–2 prior to each customer purchase or sale of mutual fund shares and municipal fund securities.

D. Amendments to Rule 10b–10

The proposed amendments to rule 10b–10 would require a broker-dealer effecting transactions in shares of preferred stock to inform customers in writing, at or before the completion of the transaction, if the issuer of the stock has reserved the right to repurchase—or call—the shares. The proposed amendments would also require a broker-dealer effecting a transaction in a debt security on the basis of yield-to-call to disclose the first possible date on which the debt security may be called. Finally, the amendments would exclude transactions subject to rule 15c2–2 from the confirmation delivery requirements of rule 10b–10.

1. Benefits

The proposed amendments to rule 10b–10 are intended to avoid customer confusion by alerting customers to any misunderstandings about the rights associated with preferred stock and callable debt, and to promote the timely resolution of problems. This leads to better informed decision-making by investors.

2. Costs

For purposes of the Paperwork Reduction Act, the Commission staff has estimated that the annual burden to brokers, dealers and municipal securities dealers for complying with the confirmation delivery requirements of rule 10b–10, as modified by the proposed amendments, would be 42.3 million hours. The Commission staff estimates that this burden would equal total internal costs of $2.12 billion annually, based on an estimated hourly wage of $50. The Commission staff further estimated for purposes of the Paperwork Reduction Act that the additional external costs of complying with the requirements of proposed rule 10b–10, as amended, including postage costs to send confirmations, would be $2.26 billion.[204] Therefore, the Commission estimates that the annual costs for complying with proposed rule 10b–10, as amended, would be $4.38 billion, or approximately $811,111 per broker, dealer or municipal securities dealer. We note that this is a net reduction in the annual costs for complying with rule 10b–10, as transactions that would otherwise be required to be delivered pursuant to rule

[200] As noted above, while the staff is currently unable to determine the number of brokers, dealers and municipal securities dealers that utilize outsourced services, based on discussions with industry representatives the staff estimates that the cost per broker, dealer or municipal securities dealers would be approximately $18,500. Assuming that all of the approximately 5,400 brokers, dealers and municipal securities dealers subject to proposed rule 15c2–3 use such out-sourced services, the total one-time external cost would be about $100 million. We note that this assumption may result in a significant overstatement of these external costs.

[201] (7 million hours × $50 per hour = $350 million; $350 million + $100 million for other external costs = $450 million.)

[202] As noted above, based on discussions with vendors, the Commission staff anticipates that vendors will allocate costs to brokers, dealers and municipal securities dealers based roughly on the volume of transactions that require confirmations to be generated and sent.

[203] Based on discussions with industry participants, the Commission staff estimates that the annual cost to brokers, dealers and municipal securities dealers for call center services and other service providers which would assist with development and implementation of procedures sufficient to demonstrate compliance with the delivery requirements of paragraphs (a) and (b) of proposed rule 15c2–3 would be approximately $7,400 per broker, dealer or municipal securities dealer, for a total of $40 million. (5,400 brokers, dealers and municipal securities dealers × $7,400 = $39,996,000.)

[204] (2.54 billion confirmations at $0.89 per confirmation = $2.26 billion.)

to 10b–10 would be delivered pursuant to rule 15c2–2.

3. Request for Comments

The Commission requests comment on the costs and benefits of the proposed amendments to rule 10b–10, including the costs and benefits described above. As always, commenters are specifically invited to share additional quantifiable costs and benefits that they believe may be imposed or generated by the proposed amendments to rule 10b–10. The Commission is particularly interested in learning more about current industry practice regarding the disclosure of call and redemption information in connection with transactions involving preferred stock and debt securities and whether broker-dealers already disclose such information as a matter of prudent business practice on confirmations or in some other way highlight such information to their customers. The Commission also solicits comment on what additional costs the required disclosure of such information would impose on those broker-dealers not currently providing such information to customers. The Commission requests that commenters provide supporting empirical data for any positions advanced.

E. Amendments to Form N–1A

The proposed amendments to Form N–1A would require mutual funds to provide enhanced prospectus disclosure regarding sales loads and revenue sharing payments.

1. Benefits

The proposed amendments to Form N–1A are expected to benefit mutual fund investors by providing them with a better understanding of sales loads and revenue sharing arrangements. Specifically, we believe that the proposed amendments relating to disclosure of sales loads as a percentage of net asset value rather than as a percentage of offering price may benefit investors by requiring that information regarding sales loads be provided in a manner that would better help investors to understand the true costs of investing in a load fund. Further, investors would benefit because disclosure of sales loads as a percentage of net asset value would be consistent with the disclosure in the confirmation that would be required by proposed rule 15c2–2. In addition, the proposed requirement that mutual funds disclose in the fund prospectus the fact that sales loads shown in the prospectus as a percentage of the net asset value 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 may also assist investors in better understanding the sales load that they may pay. Finally, the proposed amendments relating to disclosure of revenue sharing payments may benefit investors by directing them to the disclosure regarding these arrangements that would be required in the confirmation and point of sale disclosure, and therefore may enhance investors' understanding of arrangements that may lead to conflicts of interest.

2. Costs

The proposals would impose new requirements on mutual funds to provide certain new prospectus disclosures regarding sales loads and revenue sharing arrangements. We estimate that complying with the proposed new disclosures would entail a relatively limited burden. The proposals to require fee table disclosure of sales loads on the basis of net asset value rather than offering price would impose a minimal burden, because mutual funds are already required to determine and disclose sales loads on this basis elsewhere in the prospectus. The additional disclosure that would be required regarding the effects of rounding in calculating sales loads would be limited, and the additional calculations regarding the range of variation resulting from rounding that would be required should be straightforward for funds to compute. Similarly, the additional disclosure that would be required regarding revenue sharing arrangements would be brief, and would only be required if any person within the fund complex that includes the fund makes revenue sharing payments.

The costs of adding these new prospectus disclosures may include both internal costs (for attorneys and other non-legal staff of a fund, such as computer programmers, to prepare and review the required disclosure) and external costs (for printing and typesetting of the disclosure). For purposes of the Paperwork Reduction Act, we have estimated that the proposed new disclosure requirements would add 1,968 hours to the total annual burden of completing Form N–1A.[205] We estimate that this additional burden would equal total internal costs of $98,400 annually, or approximately $14.01 per fund portfolio.[206] We expect the external costs of providing the new prospectus disclosure regarding sales loads and revenue sharing arrangements will be limited, because we do not expect that the proposed disclosure would add significant length to the prospectus.

3. Request for Comments

The Commission requests comment on the costs and benefits of the proposed amendments to Form N–1A. Commenters are strongly encouraged to identify and supply any relevant data, analysis, and estimates concerning the costs and/or benefits of the proposed amendments to Form N–1A, including any costs and benefits not described above.

X. Consideration of Burden on Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act,[207] Section 2(b) of the Securities Act of 1933,[208] and Section 2(c) of the Investment Company Act[209] require the Commission, whenever it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. In addition, section 23(a)(2) of the Exchange Act[210] requires the Commission, in making rules under the Exchange Act, to consider the impact that any such rule would have on competition. Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Proposed rules 15c2–2 and 15c2–3 are intended to improve investor access to material information about investments and contemplated investments in mutual fund shares, UIT interests and 529 plan securities. Similarly, the

[205] This estimate is based on the following calculation: (0.5 hours per initial registration statement for sales load disclosure × 483 portfolios × 36% of portfolios) + (0.5 hours per post-effective amendment for sales load disclosure × 6,542 portfolios × 36% of portfolios) + (0.1 hours per initial registration statement for revenue sharing disclosure × 483 portfolios) + (0.1 hours per post-effective amendment for revenue sharing disclosure × 6,542 portfolios) = 1,968 hours.

[206] These figures are based on a Commission estimate that initial registration statements for 483 portfolios and post-effective amendments for 6,542 portfolios are filed annually that would be subject to the proposed disclosure requirements, and an estimated hourly wage rate of $50. The estimate of the number of filings is based on data derived from the Commission's EDGAR filing system. For a discussion of the estimated hourly wage rate, *see supra* note 197.

[207] 15 U.S.C. 78c(f).

[208] 15 U.S.C. 77b(b).

[209] 15 U.S.C. 80a–2(c).

[210] 15 U.S.C. 78w(a)(2).

proposed amendments to rule 10b–10 are intended to eliminate duplicative requirements and to improve investor access to material information about investments in callable preferred stock and callable debt securities. The proposed amendments to Form N–1A are intended to provide investors in mutual funds with enhanced disclosure regarding sales loads, and to direct investors to disclosure regarding revenue sharing payments to an investor's financial intermediary.

The Commission preliminarily believes that mandating certain disclosure for transactions in mutual fund shares, UIT interests and 529 plan securities should serve as an efficient and cost-effective means for those entities to deliver information to consumers. The proposals should not hinder efficiency because firms should be able to use present confirmation delivery systems, after making appropriate adjustments, rather than having to build new information delivery systems. In addition, the Commission preliminarily believes that the new rules and the proposed amendments would improve investor confidence and, therefore, would promote capital formation. With respect to the proposed requirements for enhanced disclosure by mutual funds, although we believe that the proposed amendments would benefit investors, the magnitude of the effect of the proposed amendments on efficiency, competition, and capital formation, and the extent to which they would be offset by the costs of the proposals, are difficult to quantify.

The Commission also preliminarily believes that the proposals would enhance competition because investors would have access to information that would allow them to better understand and differentiate among various investments. Because investors would be in a better position to better compare the costs of these investments, market participants would be encouraged to compete on price, thereby increasing market efficiency.

- The Commission requests comment on whether the proposed amendments are expected to promote efficiency, competition, and capital formation.

XI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [211] we must advise the Office of Management and Budget as to whether the proposed regulation and disclosure requirements constitute ''major'' rules. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed regulation and disclosure requirements on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

XII. Initial Regulatory Flexibility Act Analysis

Congress enacted the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq,* to address concerns related to the effects of agency rules on small entities. The Commission is sensitive to the impact its rules may impose on small entities. This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603, and relates to the Commission's proposed rule 15c2–2, 15c2–3 and amendments to rule 10b–10 and Form N–1A.

A. Reasons for, and Objectives of, Proposed Rules 15c2–2 and 15c2–3 and Proposed Amendments to Rule 10b–10 and Form N–1A

The Commission is proposing rules 15c2–2 and 15c3–3 to address the concerns that investors in mutual fund shares, UIT interests and 529 plan securities be provided with adequate access to information regarding the costs of their investments, as well as the conflicts of interest their broker-dealers face. As noted above, those costs, and related distribution arrangements, have evolved substantially since 1977, when the Commission adopted its general confirmation rule—rule 10b–10.[212] We believe that disclosure of information about those costs and the arrangements that lead to conflicts of interest can help investors make better informed investment decisions.

Similarly, the Commission is proposing amendments to rule 10b–10 to eliminate duplicative requirements and to address concerns that certain material information has not been included in confirmations of transactions of callable preferred stock and redeemable debt. As described in detail above, the Commission proposes to amend rule 10b–10 to require broker-dealers to disclose whenever preferred stock could be called by the issuer. Rule 10b–10 requires similar disclosure for transactions in callable debt securities. The Commission further proposes to amend rule 10b–10 to require disclosure of the date of first call for transactions in callable debt securities. Finally, the Commission is proposing amendments to Form N–1A in order to provide investors with a better understanding of the costs of investing in a fund with a sales load, and of revenue sharing payments to an investor's financial intermediary.

B. Legal Basis

The Commission is proposing new rule 15c2–2, new rule 15c2–3 and amendments to rule 10b–10 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 10, 11, 15, 17, 23(a), and 36 [15 U.S.C. 78j, 78k, 78o, 78q, 78w(a), and 78mm] and Sections 12(b) and 38 of the Investment Company Act [15 U.S.C. 80a–12(b) and 80a–37]. The Commission is proposing amendments to Form N–1A pursuant to authority set forth in Sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)], and Sections 8, 12(b), 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a–8, 80a–12(b), 80a–24(a), 80a–29, and 80a–37].

C. Small Entities Subject to Proposed Rules 15c2–2 and 15c2–3 and Proposed Amendments to Rule 10b–10 and Form N–1A

Proposed rules 15c2–2 and 15c2–3 would apply to all brokers, dealers and municipal securities dealers, regardless of size, that effect transactions in mutual fund shares, UIT interests and 529 plan securities. The proposed amendments to rule 10b–10 would exclude from the general disclosure requirements of rule 10b–10 transactions in those securities. The proposed amendments to rule 10b–10 would also require all broker-dealers, regardless of size, to provide confirmation disclosure about the callable nature of preferred stock and, in the case of debt securities that are effected on the basis of yield-to-call, the date upon which the debt securities may first be called.

For purposes of the Regulatory Flexibility Act, a broker-dealer is a small business if it had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited

[211] Pub. L. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

[212] *See supra* note 5.

financial statements were prepared pursuant to rule 17a–5(d) of the Exchange Act or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter) and if it is not an affiliate of an entity that is not a small business.[213] The Commission staff estimates that approximately 885 brokers, dealers and municipal securities dealers meet this definition.[214]

The proposed amendments to Form N–1A would apply to all mutual funds. For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[215] Approximately 145 investment companies registered on Form N–1A meet this definition.[216]

D. Reporting, Recordkeeping and Other Compliance Requirements

As described above, proposed rule 15c2–2 and the amendments to rule 10b–10 would require additional information to be provided to investors in transaction confirmations. Proposed rule 15c2–3 would require information to be delivered to customers at the time they make investment decisions in connection with transactions involving mutual fund shares, UIT interests and 529 plan securities.

For purposes of the Paperwork Reduction Act, the Commission staff has estimated that the proposed disclosure requirements under proposed rule 15c2–2 would result in a one-time burden of 15 million hours and an annual burden of 18.7 million hours [217] to brokers, dealers and municipal securities dealers, and their vendors, in connection with delivering confirmations in for transactions in mutual fund shares and UIT interests. The Commission staff estimates that the one-time burden would result in total internal costs of $850 million, or approximately $157,407, on average, per broker, dealer and municipal securities dealer, and that the annual burden would result in total internal costs of $1.99 billion,[218] or approximately $367,593, on average, per broker, dealer and municipal securities dealer. As discussed above, as a general matter medium-sized and smaller firms, and also some larger firms, use third-party service providers, or vendors, to generate the data necessary to send confirmations. They may also use vendors to actually send confirmations to investors. Therefore, the firms' vendors would be required to reprogram their software and update their systems to generate the data that would allow their clients to comply with proposed rule 15c2–2. The staff understands from discussions with vendors that the allocation of costs would coincide roughly with the volume of the client's transactions, so that a broker, dealer or municipal securities dealer that executes fewer transactions involving covered securities would be allocated less of its vendor's costs than a broker, dealer or municipal securities dealer that executes more transactions.

The Commission staff has further estimated that the disclosure requirements of rule 15c2–3 would result in a one-time burden of 7 million hours and an annual burden of 18.7 million hours to brokers, dealers and municipal securities dealers, and their vendors, in connection with delivering point of sale disclosure for transactions in mutual fund shares and UIT interests. The Commission staff estimates that the one-time burden would result in total internal costs of $450 million, or approximately $83,333, on average, per broker, dealer and municipal securities dealer, and that the annual burden would result in total internal costs of $935 million, or approximately $173,148, on average, per broker, dealer and municipal securities dealer.

In addition, the Commission staff has further estimated that the disclosure requirements of rule 10b–10, including the proposed amendments, would result in an annual burden of 42.3 million hours to brokers, dealers and municipal securities dealers, and their vendors, in connection with delivering confirmations in connection with securities transactions. The Commission staff estimates that this burden would result in total internal costs of $1.91 billion annually, or approximately $773,000, on average, per affected entity. We note that this is a net reduction in the annual costs for complying with rule 10b–10, as transactions that would otherwise be required to be delivered pursuant to rule to 10b–10 would be delivered pursuant to rule 15c2–2.

Finally, the Commission staff has further estimated that the disclosure requirements of the proposed amendments to Form N–1A would increase the hour burden of prospectus disclosure by 1,968 hours. The Commission staff has estimated that this additional burden would increase total internal costs of filing an initial registration statement or post-effective amendment by $98,400 annually, or $14.01 per affected mutual fund portfolio.

- The Commission requests comment on the effect proposed new rules 15c2–2 and 15c2–3 and the proposed amendments to rule 10b–10 and Form N–1A would have on small entities. The Commission specifically requests data and analysis of the costs to implement and comply with the proposals, including expenditures of time and money for: any employee training; attorney, computer programmer or other professional time; preparing and processing relevant materials; and recordkeeping.

E. Duplicative, Overlapping or Conflicting Federal Rules

There are currently no rules that conflict with proposed new rules 15c2–2 and 15c2–3 or the amendments to rule 10b–10. The Commission notes, however, that MSRB rule G–15 is a separate confirmation rule that governs member transactions in municipal securities, including municipal fund securities. Furthermore, NASD Rule 2230 requires broker-dealers that are members of NASD to deliver a written notification containing certain information, including whether the member is acting as a broker for the customer or is working as a dealer for its own account. Brokers and dealers typically deliver this information in confirmations that fulfill the requirements of rule 10b–10. The Commission staff believes that, where required, brokers and dealers would incorporate such information into confirmations delivered pursuant to rule 15c2–2.

In addition, the Commission notes that information required for the point of sale disclosures pursuant to proposed rule 15c2–3 would also be required in confirmations delivered pursuant to

[213] 17 CFR 240.0–10.

[214] This estimate is based on information provided by registered broker-dealers to the Commission in FOCUS Reports.

[215] 17 CFR 270.0–10.

[216] This estimate is based on analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers, including Morningstar, Inc., and Lipper.

[217] It is important to note, however, that confirmations for transactions in covered securities are currently required to be delivered pursuant to rule 10b–10 or MSRB rule G–15, as applicable. As a result, the burden for generating and sending confirmations would not be entirely new, but would reflect a shift of a burden of 16.7 million hours from rule 10b–10 to proposed rule 15c2–2.

[218] The staff has estimated for purposes of the Paperwork Reduction Act that these external costs would reflect an increase of $160 million over the external cost of delivering the confirmations were they to be delivered pursuant to rule 10b–10.

proposed rule 15c2–2. The Commission believes that this overlap is appropriate because the information to be provided to investors at point of sale is helpful for the customer when making his or her investment decision. Confirmation disclosure of this information would serve to alert the customer to any misunderstandings about the rights associated with his or her investment in a security, promote the timely resolution of problems, and better enable the investor to evaluate potential future transactions involving that security.

Finally, there are no rules that duplicate, overlap, or conflict with the proposed amendments to Form N–1A.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small issuers. In connection with the proposed amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. Different disclosure requirements for brokers, dealers, or municipal securities dealers that are small entities may create the risk that the investors who effect securities transactions through such small entities would not be as able as investors who effect transactions through larger such entities to assess information, including the distribution-related costs or conflicts of interest. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small brokers, dealers or municipal securities dealers do not engage in the arrangements that are addressed by the proposals, while large such entities do. We believe, therefore, that it is important for the disclosure that would be required by the proposed amendments to be provided to shareholders by all brokers, dealers and municipal securities dealers, not just those that are not considered small entities.

We have endeavored through proposed new rules 15c2–2 and 15c2–3 and the amendments to rule 10b–10 and Form N–1A to minimize the regulatory burden on all brokers, dealers and municipal securities dealers, including small entities, while meeting our regulatory objectives. Small entities should benefit from the Commission's reasoned approach to the proposed new rules and proposed amendments to the same degree as other brokers, dealers and municipal securities dealers. Further consolidation or simplification of the proposals for brokers, dealers and municipal securities dealers that are small entities would be inconsistent with the Commission's goals for fostering investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. Solicitation of Comments

The Commission encourages the submission of written comments with respect to any aspect of this analysis. Comment is specifically requested on the number of small entities that would be affected by proposed new rules 15c2–2 and 15c2–3 and the proposed amendments to rule 10b–10 and Form N–1A and the likely impact of the proposals on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposals themselves. Commenters should provide empirical data to support their views. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–06–04; this file number should be included on the subject line if E-mail is used. Comment letters will be available for inspection and copying in the Commission's Public Reference Room at the same address. Electronically submitted comment letters will be posted on the Commission's Internet Web site (*http://www.sec.gov*).[219]

XIII. Statutory Authority

The Commission is proposing new rule 15c2–2, new rule 15c2–3 and amendments to rule 10b–10 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 10, 11, 15, 17, 23(a), and 36 [15 U.S.C. 78j, 78k, 78o, 78q, 78w(a), and 78mm] and Sections 12(b) and 38 of the Investment Company Act [15 U.S.C. 80a–12(b) and 80a–37]. The Commission is proposing amendments to Form N–1A pursuant to authority set forth in Sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)], and Sections 8, 12(b), 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a–8, 80a–12(b), 80a–24(a), 80a–29, and 80a–37].

Text of Proposed Rules

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 240

Broker-dealers, Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

1. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 80a–8, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

2. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j,

[219] We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

78j–l, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

3. Section 240.10b–10 is amended by:

a. Revising the Preliminary Note;

b. Revising the introductory text of paragraph (a) and paragraphs (a)(4), (a)(6), (a)(9) and (b);

c. Removing paragraph (d)(6);

d. Redesignating paragraphs (d)(7), (d)(8), (d)(9) and (d)(10) as paragraphs (d)(6), (d)(7), (d)(8) and (d)(9);

e. Revising paragraph (e); and

f. Adding paragraph (g).

The additions and revisions read as follows:

§ 240.10b–10 Confirmation of transactions.

Preliminary Note. This section requires broker-dealers to disclose specified information in writing to customers at or before completion of a transaction. Section 240.15c2–2 sets forth the confirmation requirements that apply to broker-dealer transactions in certain investment company securities or municipal fund securities. The requirements under this section that particular information be disclosed at or before completion of a transaction are not determinative of, and do not exhaust, a broker's, dealer's or municipal securities dealer's obligations under the general antifraud provisions of the federal securities laws, or under any other legal requirements, to disclose additional information to a customer at the time of the customer's investment decision.

(a) *Disclosure requirement.* It shall be unlawful for any broker or dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security (other than securities exempted by paragraph (g) of this section) unless such broker or dealer, at or before completion of such transaction, gives or sends to such customer written notification disclosing:

* * * * *

(4) (i) In the case of any transaction in a debt security subject to redemption before maturity, a statement to the effect that such debt security may be redeemed in whole or in part before maturity, that such a redemption could affect the yield represented and the fact that additional information is available upon request;

(ii) In the case of any transaction in preferred stock that is subject to repurchase by the issuer at a specified price, a statement to the effect that such preferred stock may be repurchased at the election of the issuer at any time; and

* * * * *

(6) In the case of a transaction in a debt security effected on the basis of yield:

(i) The yield at which the transaction was effected, including the percentage amount and its characterization (*e.g.,* current yield, yield to maturity, or yield to call) and if effected at yield to call, the type of call, the call date and, if different, the first date upon which the security may be called, and call price; and

(ii) The dollar price calculated from the yield at which the transaction was effected; and

(iii) If effected on a basis other than yield to maturity and the yield to maturity is lower than the represented yield, the yield to maturity as well as the represented yield; *provided, however,* that this paragraph (a)(6)(iii) shall not apply to a transaction in a debt security that either:

(A) Has a maturity date that may be extended by the issuer thereof, with a variable interest rate payable thereon; or

(B) Is an asset-backed security, that represents an interest in or is secured by a pool of receivables or other financial assets that are subject continuously to prepayment; and

* * * * *

(9) That the broker or dealer is not a member of the Securities Investor Protection Corporation (SIPC), or that the broker or dealer clearing or carrying the customer account is not a member of SIPC, if such is the case.

(b) *Alternative periodic reporting.* A broker or dealer may effect transactions for or with the account of a customer without giving or sending to such customer the written notification described in paragraph (a) of this section if:

(1) Such transactions are effected pursuant to a periodic plan; and

(2) Such broker or dealer gives or sends to such customer within five business days after the end of each quarterly period, a written statement disclosing 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 month; the date of such transaction; the identity, number, and price of any securities purchased or redeemed by such customer in each such transaction; the total number of shares of such securities in such customer's account; any remuneration received or to be received by the broker or dealer in connection therewith; and that any other information required by paragraph (a) of this section will be furnished upon written request; *provided, however,* that the written statement may be delivered to some other person designated by the customer for distribution to the customer; and

(3) Such customer is provided with prior notification in writing disclosing the intention to send the written information referred to in paragraph (b)(1) of this section in lieu of an immediate confirmation.

* * * * *

(e) *Security futures products.* The provisions of paragraphs (a) and (b) of this section shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) to the extent that it effects transactions for customers in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)) and a broker or dealer registered pursuant to section 15(b)(1) of the Act (15 U.S.C. 78*o*(b)(1)) that is also a futures commission merchant registered pursuant to section 4f(a)(1) of the Commodity Exchange Act (7 U.S.C. 6f(a)(1)), to the extent that it effects transactions for customers in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)); *provided that* the broker or dealer that effects any transaction for a customer in security futures products in a futures account gives or sends to the customer no later than the next business day after execution of any futures securities product transaction, written notification disclosing:

(1) The date the transaction was executed, the identity of the single security or narrow-based security index underlying the contract for the security futures product, the number of contracts of such security futures product purchased or sold, the price, and the delivery month;

(2) The source and amount of any remuneration received or to be received by the broker or dealer in connection with the transaction, including, but not limited to, markups, commissions, costs, fees, and other charges incurred in connection with the transaction; *provided that* if no remuneration is to be paid for an initiating transaction until the occurrence of the corresponding liquidating transaction, that the broker or dealer shall disclose the amount of remuneration only on the confirmation for the liquidating transaction;

(3) The fact that information about the time of the execution of the transaction, the identity of the other party to the contract, and whether the broker or dealer is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for its own account, and if the broker or

dealer is acting as principal, whether it is engaging in a block transaction or an exchange of security futures products for physical securities, will be available upon written request of the customer; and

(4) Whether payment for order flow is received by the broker or dealer for such transactions, the amount of this payment and the fact that the source and nature of the compensation received in connection with the particular transaction will be furnished upon written request of the customer; *provided that* brokers or dealers that do not receive payment for order flow have no disclosure obligation under this paragraph.

* * * * *

(g) This section does not apply to transactions in any of the following securities:

(1) U.S. Savings Bonds;

(2) Municipal securities; and

(3) Any other security that is a ''covered security'' as provided in § 240.15c2–2.

4. Section 240.15c2–2 is added to read as follows:

§ 240.15c2–2 Confirmation of transactions in open-end management investment company shares, unit investment trust interests, and municipal fund securities used for education savings.

Preliminary Note. This section requires brokers (including municipal securities brokers), dealers and municipal securities dealers to disclose specified information in writing to customers at or before completion of a transaction in certain investment company securities or municipal fund securities, while § 240.10b–10 sets forth the confirmation requirements that apply to other transactions. The requirements under this section that particular information be disclosed at or before completion of a transaction are not determinative of, and do not exhaust, a broker's, dealer's or municipal securities dealer's obligations under the general antifraud provisions of the federal securities laws, or under any other legal requirements, to disclose additional information to a customer at the time of the customer's investment decision.

(a) *Disclosure requirement.* It shall be unlawful for any broker, dealer or municipal securities dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, any covered security unless the broker, dealer or municipal securities dealer complies with the requirements set forth in paragraphs (b), (c), (d) and (e) of this section. All disclosures made pursuant to paragraphs (b) and (c) of this section shall be made in a manner consistent with Schedule 15C (§ 240.15c–100).

(b) *General disclosure requirement.* At or before the completion of a transaction in any covered security, the broker, dealer or municipal securities dealer shall give or send to such customer written notification disclosing:

(1) The date of the transaction;

(2) The issuer and class of the covered security;

(3) The net asset value of the shares or units and, if different, the public offering price of the shares or units;

(4) The number of shares or units of the 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 (equal to the number of shares or units bought or sold multiplied by the net asset value of those shares or units);

(5) Any commission, markup or other remuneration received or to be received by the broker, dealer or municipal securities dealer from the customer in connection with the transaction;

(6) In the case of transactions in which a customer sells shares or units of a covered security, the amount of any deferred sales load that the customer has incurred or will incur in connection with the transaction; and

(7) That the broker, dealer or municipal securities dealer (other than a municipal securities dealer that is a bank) is not a member of the Securities Investor Protection Corporation (SIPC), or that the broker, dealer or municipal securities dealer clearing or carrying the customer account is not a member of SIPC, if such is the case; *provided, however, that* this paragraph (b)(7) shall not apply in the case of a transaction in shares or units of a covered security if:

(i) The customer sends funds or securities directly to, or receives funds or securities directly from, the issuer of the covered security, its transfer agent, its custodian, or other designated agent, and such person is not an associated person of the broker or dealer required by paragraph (a) of this section to send written notification to the customer; and

(ii) The written notification required by paragraph (a) of this section is sent on behalf of the broker or dealer to the customer by a person described in paragraph (b)(7)(i) of this section.

(c) *Additional disclosure requirement for purchases.* At or before the completion of any transaction in which a customer purchases a covered security, the broker, dealer or municipal securities dealer also shall give or send to such customer written notification that discloses the following information:

(1) 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:

(i) If the customer will incur a sales load at the time of sale, information about the availability of breakpoints as reflected in Schedule 15C (§ 240.15c–100). with regard to the covered security, including a statement of the applicable sales load as set forth in the prospectus, reflecting any breakpoint discount and the value of the securities position (based on net asset value, public offering price, or other applicable value) to which the sales load is applied; or

(ii) If the customer will not incur a sales load at the time of sale, information about the availability of breakpoints as reflected in Schedule 15C (§ 240.15c–100) 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.

(2) An explanation of the potential amount of any deferred sales load that the customer may incur in connection with any subsequent sale of the shares or units purchased in the transaction (other than deferred sales loads of no more than one percent that expire no later than one year after purchase, when no other sales load would be incurred on that transaction), including, for each year that the deferred sales load may be in effect:

(i) The maximum amount of the deferred sales load that would be associated with the sale of those shares or units, expressed in dollars; and

(ii) The maximum amount of the deferred sales load that would be associated with the sale of those shares or units, expressed as a percentage of the net asset value at the time of purchase or at the time of sale, as applicable.

(3) An explanation of any asset-based sales charges and asset-based service fees incurred, or to be incurred, by the issuer of the covered security in connection with the customer's purchase of the shares or units. Based on the issuer's policies at the time of the purchase, this explanation shall state:

(i) The annual amount of asset-based sales charges and asset-based service fees incurred in connection with the shares or units purchased, as a percentage of net asset value; and

(ii) The total annual dollar amount of asset-based sales charges and asset-based service fees incurred in connection with the shares or units purchased in the transaction, if the net asset value does not change.

(4) The amount of any dealer concession that the broker, dealer or municipal securities dealer will earn in

connection with the transaction, expressed in dollars and as a percentage of the net amount invested.

(5)(i) The amount directly or indirectly earned from the fund complex by:

(A) The broker, dealer or municipal securities dealer; and

(B) Any associated person that is a broker, dealer or municipal securities dealer; and

(C) If the covered security is not a proprietary covered security, any other associated person of the broker, dealer or municipal securities dealer.

(ii) The broker, dealer or municipal securities dealer may disclose the information required to be disclosed pursuant to paragraphs (c)(5)(i)(A), (B) and (C) of this section as a percentage of the total cumulative net asset value of the covered securities issued by the fund complex that are sold by such broker, dealer or municipal securities dealer over the four most recent calendar quarters (or over the four calendar quarters preceding the most recent calendar quarter if the date of the transaction is less than 30 days after the end of the most recent calendar quarter), in connection with the following types of arrangements:

(A) Revenue sharing payments from persons within the fund complex; or

(B) Commissions associated with portfolio securities transactions, including markups or other remuneration associated with transactions effected on a riskless principal basis, on behalf of the issuer of the covered security, or issuers of other covered securities within the fund complex.

(iii) For each of the types of arrangements described in paragraph (c)(5)(ii) of this section, the broker, dealer or municipal securities dealer shall disclose the percentage required pursuant to that paragraph and the total dollar amount of remuneration it may expect to receive in connection with the transaction, calculated by multiplying that percentage by the net amount invested in the transaction. In addition, to the extent that the broker, dealer or municipal securities dealer has entered into a revenue sharing arrangement or understanding that would result in a specific amount of remuneration in connection with purchases of the covered security, the broker, dealer or municipal securities dealer shall also disclose that remuneration as a percentage of the net amount invested and the total dollar amount of remuneration it may expect to receive in connection with the transaction.

(6) If applicable, that the broker, dealer or municipal securities dealer engages in the following types of differential compensation practices related to the covered security purchased:

(i) Payment of differential compensation to any associated persons in connection with the sale of a class of covered securities that charges a deferred sales load (other than deferred sales loads of no more than one percent that expire no later than one year after purchase, when no other sales load would be incurred on that transaction), if the customer purchased a covered security that charges that type of sales load; and

(ii) Payment of differential compensation to any associated persons in connection with the sale of a proprietary covered security, if the customer purchased a proprietary covered security; and

(iii) For each of the types of differential compensation described in paragraphs (c)(6)(i) and (ii) of this section, the broker, dealer or municipal securities dealer shall disclose whether it provides differential compensation by means of a series of three checkboxes, associated with a yes, no or ''not applicable'' response.

(d) *Alternative periodic reporting.* A broker, dealer or municipal securities dealer may effect transactions for or with the account of a customer without giving or sending to such customer the written notification described in paragraphs (b) and (c) of this section if:

(1) The broker, dealer or municipal securities dealer:

(i) Effects such transactions pursuant to a covered securities plan, or

(ii) Effects such transactions in shares of any open-end management investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a) (the ''Investment Company Act'') that holds itself out as a money market fund and attempts to maintain a stable net asset value per share if no sales load is deducted upon the purchase or redemption of shares in the money market fund; and

(2) The broker, dealer or municipal securities dealer gives or sends to the customer within five business days after the end of each quarterly period, for transactions involving covered securities plans, and after the end of each monthly period for other transactions described in paragraph (d)(1) of this section, a written statement disclosing:

(i) 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;

(ii) The total number of shares or units of the covered security in the customer's account;

(iii) The information required by paragraph (b) of this section and, to the extent applicable, paragraphs (c)(1) and (c)(4) of this section, related to each purchase, redemption, credit or reinvestment;

(iv) The information required by paragraphs (c)(5) and (c)(6) of this section, as of the date of the final purchase or reinvestment during the period;

(v) The information required by paragraph (c)(2) of this section, based on the total value of the purchases or reinvestments during the period; and

(vi) The information required by paragraph (c)(3) of this section, based on the total purchases or reinvestments during the period and on the net asset value of the covered security at the end of the period; and

(3) The broker, dealer or municipal securities dealer provides prior notification to the customer, in writing, disclosing the intention to send the written information referred to in paragraph (d)(1) of this section in lieu of an immediate confirmation, and provides to the customer at least one written disclosure document consistent with paragraphs (b) and (c) of this section prior to relying on this paragraph (d) for any transaction in which the customer purchases a covered security.

(e) *Comparison ranges.* (1) For the following disclosures required by paragraphs (b), (c) and (d) of this section, the broker, dealer or municipal securities dealer also shall disclose the median information and comparison ranges for the following:

(i) Front-end sales loads (paragraph (c)(1) of this section)—the median and 95th percentile range of front-end sales loads involving the same category of covered security (*i.e.,* mutual fund, unit investment trust or municipal fund security);

(ii) Deferred sales loads (paragraph (c)(2) of this section)—the median and 95th percentile range of deferred sales loads involving the same category of covered security, for each year in which the sales load may be in effect;

(iii) Annual asset-based sales charges and service fees (paragraph (c)(3)(iv) of this section)—the median and 95th percentile range of asset-based distribution and service fees involving the same category of covered security;

(iv) Dealer concession or other sales fees (paragraph (c)(4) of this section)—the median and 95th percentile range of dealer concessions or other sales fees

involving the same category of covered security;

(v) Revenue sharing (paragraph (c)(5)(i) of this section)—the median and 95th percentile range of revenue sharing involving transactions by all brokers, dealers or municipal securities dealers that distribute that category of covered security; and

(vi) Portfolio brokerage commissions (paragraph (c)(5)(ii) of this section)—the median and 95th percentile range of portfolio brokerage commissions involving transactions by all brokers, dealers or municipal securities dealers that distribute that category of covered security.

(2) The median information and comparison ranges will be published from time to time by the Commission as percentages; *provided, however, that* this paragraph (e) will not be effective until 90 days after the Commission publishes the initial schedule of comparison ranges in the **Federal Register**. The Commission will publish revised ranges in the **Federal Register**. When a range is revised, all disclosures pursuant to this section that are provided to customers more than 90 days following the publication of the revised ranges shall conform to the revised ranges.

(f) *Definitions.* For purposes of this section:

(1) Asset-based sales charges means all asset-based charges incurred in connection with the distribution of a covered security, paid by the issuer or paid out of the assets of covered securities owned by the issuer.

(2) *Asset-based service fee* means all asset-based amounts for personal service and/or the maintenance of shareholder accounts, paid by the issuer or paid out of the assets of covered securities owned by the issuer.

(3) *Completion of the transaction* has the meaning provided in § 240.15c1–1.

(4) *Consistent with Schedule 15C* means using Schedule 15C (§ 240.15c–100), or using a similar layout of disclosure so long as:

(i) All information specified in Schedule 15C is set forth in the confirmation;

(ii) Information specified in Sections B through F of Schedule 15C are included with no change, including the use of bold print for data items printed in bold in Schedule 15C, and in the order set forth in Schedule 15C; and

(iii) Information specified in Section A of Schedule 15C is displayed prominently.

(5) *Covered securities plan* means any plan under which covered securities are purchased by a customer (the payments being made directly to, or made payable to, the issuer of the securities, or the principal underwriter, custodian, trustee, or other designated agent of the registered investment company), or sold by a customer pursuant to:

(i) An individual retirement or individual pension plan qualified under the Internal Revenue Code (26 U.S.C. *et seq.* (1986));

(ii) A contractual or systematic agreement under which the customer purchases at the applicable public offering price, or redeems at the applicable redemption price, such securities in specified amounts (calculated in security units or dollars or by reference to dividends or other distributions paid by the issuer) at specified time intervals, or at the time dividends or other distributions are paid by the issuer, and setting forth the commissions or charges to be paid by such customer in connection therewith (or the manner of calculating them); or

(iii) Any other arrangement involving a group of two or more customers and contemplating periodic purchases of such securities by each customer through a person designated by the group; *provided that* such arrangement requires the issuer of the covered security or its agent:

(A) To give or send to the designated person, at or before the completion of the transaction for the purchase of such securities, a written notification of the receipt of the total amount paid by the group;

(B) To send to anyone in the group who was a customer in the prior quarter and on whose behalf payment has not been received in the current quarter a quarterly written statement reflecting that a payment was not received on his behalf; and

(C) To advise each customer in the group if a payment is not received from the designated person on behalf of the group within 10 days of a date certain specified in the arrangement for delivery of that payment by the designated person and thereafter to send to each such customer the written notification described in paragraph (a) of this section for the next three succeeding payments.

(6) *Covered security* means:

(i) Any security issued by an *open-end company,* as defined by section 5(a)(1) of the Investment Company Act (15 U.S.C. 80a–5(a)(1)), that is not traded on a national securities exchange or a facility of a national securities association;

(ii) Any security issued by a *unit investment trust* as that term is defined by section 4(2) of the Investment Company Act (15 U.S.C. 80a–4(2)), but is not an exchange-traded fund that is traded on a national securities exchange; *provided, however, that* an interest in a unit investment trust that is the subject of a secondary market transaction is not a covered security for purposes of this section; and

(iii) Any municipal fund security.

(7) *Customer* shall not include a broker, dealer or municipal securities dealer.

(8) *Dealer concession* means any fees that the broker, dealer or municipal securities dealer will earn at the time of the sale, in connection with the transaction, from the issuer of the covered security, an agent of the issuer, the primary distributor, or any other broker, dealer or municipal securities dealer.

(9) *Differential compensation* means:

(i) In the case of transactions involving the purchase of a class of covered security that is associated with a deferred sales load (other than classes associated with a deferred sales load of no more than one percent that expires no later than one year after purchase for certain transactions, when no other sales load would be incurred on that transaction), any form of higher compensation (including total commissions, reimbursement of charges or expenses, avoidance of charges or expenses, other cash compensation, or non-cash compensation) that a broker, dealer or municipal securities dealer can be expected to pay to any of its associated persons over the next year (assuming no change in net asset value if applicable) in connection with the sale of a stated dollar amount of that class of covered security, compared with the compensation that would have been paid to the associated person over the next year in connection with the sale of the same dollar amount of another class of the same covered security that is associated with a sales load at the time of purchase; and

(ii) In the case of transactions involving the purchase of a proprietary covered security:

(A) Any practice by which a broker, dealer or municipal securities dealer pays an associated person a higher percentage of the firm's gross dealer concession in connection with the sale of a proprietary covered security than the percentage of the gross dealer concession that firm would pay in connection with the sale of the same dollar amount of any non-proprietary covered security offered by the firm; and

(B) Other practices of a broker, dealer or municipal securities dealer that cause an associated person to earn a higher rate of compensation in connection with the sale of a proprietary covered security, including but not limited to

additional cash compensation or the imposition, allocation or waiver of expenses, overhead costs or ticket charges.

(10) *Fund complex* shall include the issuer of the covered security (including the sponsor, depositor or trustee of a unit investment trust, and any insurance company issuing a variable annuity contract or variable life insurance policy), the issuer of any other covered security that holds itself out to investors as a related company for purposes of investment or investor services, any agent of any such issuer, any investment adviser for any such issuer, and any affiliated person (as defined by section 2(a)(3) of the Investment Company Act (15 U.S.C. 80a–2(a)(3))) of any such issuer or any such investment adviser.

(11) *Gross dealer concession* means the total amount of any discounts, concessions, fees, service fees, commissions or asset-based sales charges provided by the issuer of a covered security to the broker, dealer or municipal securities dealer in connection with the sale and distribution of the covered security; but does not include any commissions associated with portfolio securities transactions on behalf of the issuer.

(12) *Municipal fund security* means any municipal security that is issued pursuant to a qualified State tuition program as defined by section 529 of the Internal Revenue Code (26 U.S.C. 529), and that is issued by an issuer that, but for the application of section 2(b) of the Investment Company Act (15 U.S.C. 80a–2(b)), would constitute an investment company within the meaning of section 3 of the Investment Company Act (15 U.S.C. 80a–3).

(13) *Net amount invested* means the price paid to purchase the covered securities less any applicable sales load.

(14) *Portfolio securities transaction* means any transaction involving securities owned by the issuer of a covered security, or owned by any other issuer within the same fund complex.

(15) *Proprietary covered security* means any covered security as to which the broker, dealer or municipal securities dealer is an affiliated person (as defined by section 2(a)(3) of the Investment Company Act (15 U.S.C. 80a–2(a)(3))) of the issuer, or is an associated person of the issuer's investment adviser or principal underwriter, or, in the case of a covered security that is an interest in a unit investment trust, is an associated person of a sponsor, depositor or trustee of the covered security.

(16) *Revenue sharing* means any arrangement or understanding by which a person within a fund complex, other than the issuer of the covered security, makes payments to a broker, dealer or municipal securities dealer, or any associated person of the broker, dealer or municipal securities dealer, excluding amounts earned at the time of the sale that constitute a dealer concession or other sales fee and that are disclosed pursuant to paragraph (b)(4) of this section.

(17) *Sales load* has the meaning set forth in section 2(a)(35) of the Investment Company Act (15 U.S.C. 80a–2(a)(35)).

(18) *Securities position* means the value of the purchase of covered securities; the value of securities that are subject to rights of accumulation under the terms of the prospectus with respect to the covered security or a related class of the covered security, to the extent known by the broker, dealer or municipal securities dealer, including the value of such securities purchased in other accounts or by other persons; and the value of any such securities that are the subject of letters of intent that may be considered in computing a breakpoint with respect to the covered security or a related class of the covered security.

(g) *Exemptions.* The Commission may exempt any broker, dealer or municipal securities dealer from the requirements of paragraphs (b), (c) (d) and (e) of this section with regard to specific transactions or specific classes of transactions for which the broker, dealer or municipal securities dealer will provide alternative procedures to effect the purposes of this section; any such exemption may be granted subject to compliance with such alternative procedures and upon such other stated terms and conditions as the Commission may impose.

5. Section 240.15c2–3 is added to read as follows:

§ 240.15c2–3 Point-of-sale disclosure for purchase transactions in open-end management investment company shares, unit investment trust interests, and municipal fund securities used for education savings.

Preliminary Note. This section requires brokers (including municipal securities brokers), dealers and municipal securities dealers to disclose specified information in writing to customers prior to transactions in certain investment company securities or municipal fund securities. The requirements under this section that particular information be disclosed at the point of sale are not determinative of, and do not exhaust, a broker's, dealer's or municipal securities dealer's obligations under the general antifraud provisions of the federal securities laws, or under any other legal requirements, to disclose additional information to a customer at the time of the customer's investment decision.

(a) *Requirement.* Except as provided in paragraph (e) of this section, it shall be unlawful for any broker, dealer or municipal securities dealer to effect a purchase of a covered security for a customer without disclosing information consistent with this paragraph at the point of sale.

(1) The broker, dealer or municipal securities dealer shall separately disclose each of the following categories of information by reference to the value of the purchase, or, if that value is not reasonably estimable at the time of disclosure, by reference to a model investment of $10,000:

(i) 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 of the covered security in connection with the shares or units purchased over the next year if net asset value does not change;

(iii) An estimate of the maximum amount of any deferred sales load that would be associated with the shares or units purchased if those shares or units are sold within one year (other than deferred sales loads of no more than one percent that expire no later than one year after purchase, when no other sales load would be incurred on that transaction), along with a statement informing the customer about 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; and

(2) The broker, dealer or municipal securities dealer also shall disclose:

(i) Whether the broker, dealer or municipal securities dealer, or any affiliate, receives revenue sharing from the fund complex;

(ii) Whether the broker, dealer or municipal securities dealer, or any affiliate, receives portfolio brokerage commissions from the fund complex; and

(iii) If applicable, whether the broker, dealer or municipal securities dealer engages in the following types of differential compensation practices related to the covered security purchased:

(A) Payment of differential compensation to any associated persons in connection with the sale of a class of covered securities that charges a

deferred sales load (other than deferred sales loads of no more than one percent that expire no later than one year after purchase, when no other sales load would be incurred on that transaction), if the customer purchased a covered security that charges that type of sales load; and

(B) Payment of differential compensation to any associated persons in connection with the sale of a proprietary covered security, if the customer purchased a proprietary covered security.

(b) *Customers' right to terminate orders made prior to disclosure.* An order received by the broker, dealer or municipal securities dealer prior to the disclosure required by this section shall be treated as an indication of interest until after the information required by paragraph (a) of this section is disclosed to the customer, and, following disclosure, the customer has had an opportunity to determine whether to place an order. The broker, dealer or municipal securities dealer shall disclose this right to the customer at the time it discloses the information required by this paragraph (b).

(c) *Manner of disclosure*—(1) *Generally.* The information required to be disclosed pursuant to paragraph (a) or (b) of this section shall be given or sent to the customer in writing using Schedule 15D (§ 240.15c–101); *provided, however, that* if the point of sale occurs at an in-person meeting, the information shall also be disclosed orally to the customer at the in-person meeting.

(2) *Exception for oral communication.* Notwithstanding paragraph (c)(1) of this section, if the point of sale occurs through means of oral communication other than at an in-person meeting, the information shall be disclosed orally to the customer at the point of sale.

(d) *Recordkeeping.* A broker, dealer or municipal securities dealer, at the time of disclosing information pursuant to this section, shall make records of communications and records of such disclosure sufficient to demonstrate compliance with the requirements of paragraphs (a) and (b) of this section. The broker, dealer or municipal securities dealer shall preserve such records for the period specified in § 240.17a–4(b). Records of oral communications and records of disclosure of oral communications shall be kept in accordance with § 240.17a–4(f) and for the period specified in § 240.17a–4(b) with regard to similar written communications and records.

(e) *Exceptions.* This section shall not apply to the following transactions in a covered security, or participants in a transaction:

(1) Transactions resulting from orders received from the customer via U.S. mail, messenger delivery or similar third-party delivery service if:

(i) The broker, dealer or municipal securities dealer meets the requirements of paragraph (e)(1)(ii) of this section and, within the previous six months, has provided the following information to the customer:

(A) A statement of the maximum front-end and deferred sales loads that may be associated with investments in covered securities offered by the broker, dealer or municipal securities dealer, expressed as a percentage of net asset value, along with an explanation of how sales loads can reduce investment returns;

(B) A statement of the maximum asset-based sales charge or asset-based service fees that may directly or indirectly be paid out of the assets of issuers of covered securities offered by the broker, dealer or municipal securities dealer, expressed as a percentage of net asset value, along with an explanation of how asset-based charges can reduce investment returns;

(C) A statement about whether the broker, dealer or municipal securities dealer receives revenue sharing or portfolio brokerage commissions from any fund complex, along with an explanation of how those arrangements pose conflicts of interest; and

(D) A statement about whether the broker, dealer or municipal securities dealer pays differential compensation in connection with transactions in covered securities, along with an explanation of how differential compensation pose conflicts of interest; and

(ii) The broker, dealer or municipal securities dealer is not compensated for effecting transactions for customers that do not have accounts with that broker, dealer or municipal securities dealer;

(2) 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:

(i) The broker, dealer or municipal securities dealer did not communicate with the customer about the transaction other than to accept the customer's order; and

(ii) The broker, dealer or municipal securities dealer reasonably believes that another broker, dealer or municipal securities dealer has delivered the information to the customer as required by this section;

(3) Transactions as part of a covered securities plan; *provided, however, that* the broker, dealer or municipal securities dealer provides disclosure consistent with this section prior to the first transaction in any covered security that is purchased as part of a covered securities plan;

(4) Reinvestments of dividends earned; or

(5) Transactions in which the broker, dealer or municipal securities dealer is exercising investment discretion.

(f) *Definitions.*

(1) *Point of sale* shall mean:

(i) Except as provided by paragraph (f)(1)(ii) of this section, immediately prior to the time that the broker, dealer or municipal securities dealer accepts the order from the customer.

(ii) As to transactions for customers who have not opened an account with the broker, dealer or municipal securities dealer, and transactions in which the broker, dealer or municipal securities dealer does not accept the order from the customer, the time that the broker, dealer or municipal securities dealer first communicates with the customer about the covered security, specifically or in conjunction with other potential investments.

(2) The terms *asset-based sales charges, asset-based service fee, covered securities plan, covered security, customer, dealer concession, differential compensation, fund complex, portfolio securities transaction, revenue sharing* and *sales load* shall have the meanings provided in § 240.15c2–2.

6. Section 240.15c–100 is added to read as follows:

§ 240.15c–100 Schedule 15C.

Securities and Exchange Commission, Washington, DC 20549.

Schedule 15C

BILLING CODE 8010–01–P

SCHEDULE 15C - FRONT PAGE

<Name of broker, dealer or municipal securities dealer >

Fees and Payments Associated with Your Investment

A. General information

Customer:	_____	Symbol:	_____
Account Number:	_____	CUSIP number:	_____
Date of transaction:	_____	Type of security:	_____
Type of transaction:	_____	Net Asset Value (NAV):	_____
No. shares bought/sold:	_____	Price (NAV plus load):	_____
Security issuer:	_____	Amount paid/received:	_____
Class (if applicable):	_____	Amount of your investment/sale:	_____

Commission/other compensation: _____
Other charges: _____

<If applicable> *Note: even if there is no commission or other charge, you may be paying for distribution through loads or asset-based fees, as described below.*

B. What you pay (directly or indirectly) for purchases

Front-end sales load — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Back-end sales load

<if applicable> *If you sell these shares in ___ year[s], you will pay* — **<amount>** <if applicable> *or _ % of your investment, whichever is less*
<or if applicable> *(which equals __% of your investment)*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

<repeated as necessary>

Estimated first-year asset-based sales charges — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Estimated first-year asset-based service fees — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

C. Amounts that your broker, <broker, dealer or municipal securities dealer>, will receive from the fund or its affiliates

Sales fee <broker, dealer or municipal securities dealer> received for your purchase: — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Revenue sharing <broker, dealer or municipal securities dealer> may receive in connection with your purchase: — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Portfolio brokerage commissions <broker, dealer or municipal securities dealer> may receive in connection with your purchase: — **<amount>** <if applicable> *which is equivalent to ___% of your investment*
<if applicable> *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Additional disclosures:

D. Payment of special compensation to personnel of your broker, <broker, dealer or municipal securities dealer>

	Yes	No	NA
If you bought a security of an fund affiliated with <broker, dealer or municipal securities dealer>: Does <broker, dealer or municipal securities dealer> pay its personnel more to sell securities of affiliated funds?	☐	☐	☐
If you bought a share class with a back-end sales load: Does <broker, dealer or municipal securities dealer> pay its personnel more to sell this class than to sell front-end sales load share classes of the same fund?	☐	☐	☐

E. Breakpoint discount information

<If applicable because a front-end sales load was paid> Many mutual fund companies offer sales load discounts to customers that have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) entitles you to a sales load of ____%. You were charged a sales load of ____%, which may vary from the sales load disclosed in the prospectus due to rounding to the nearest penny in the transaction.

<if applicable because no front-end sales load was paid> Many mutual fund companies offer sales load discounts to customers that have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) would have entitled you to a sales load of ___% of NAV had you bought a share class that is subject to a front-end sales load. Instead, you bought a share class that is not subject to a front-end sales load, but is subject to annual asset-based sales charges of ___ percent of net asset value for a period of ___ years.

SCHEDULE 15C - CONTINUED

F. Explanations and Definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Amount of your investment - when you buy a share class that has a front-end sales lead, the "net amount invested" equals what you paid for the shares minus the sales load. That is the value of the shares.*
- *Dollar and percentage values - This document provides information about what you pay and what your broker-dealer will receive. Some of that information is set forth in dollar amounts and as percentages of "your investment." In general, those percentages are based on the net amount of your investment (which is the current value of the shares you are purchasing). Information about back-end sales loads and first year sales charges and service fees may be based on the value of your investment at some point in the future.*
- *Timing of sales loads - If you buy shares with a front-end sales loads, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If these shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that otherwise would be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often will have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *Disclosure of revenue sharing and portfolio brokerage commissions - This disclosure document provides information about revenue sharing that the broker-dealer has received from the fund or its affiliates, and portfolio brokerage commissions that the broker-dealer has received from the fund or its affiliates. Those amounts are stated as a percentage of the broker-dealer's sales on behalf of the fund complex - consisting of the fund or its affiliates - over a recent 12 month period. For example, if a broker-dealer received $1 million in revenue sharing from a fund complex over that period, and the broker-dealer sold $50 million worth of shares for the fund complex over that period, then revenue sharing represents 2 percent of total sales. Based on that percentage, this confirmation also states the amount of that compensation that may be associated with this transaction. These are estimates only, and your broker-dealer can provide you with more specific information.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to the fund, or another affiliate of the fund, makes payments to a broker-dealer. In some cases, the investment advisor may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments - regardless if they are labeled as reimbursements - may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation for proprietary sales - This document states whether your broker-dealer pays its salespersons or other associated persons a higher compensation rate for selling securities of affiliated funds (proprietary sales) than the rate that the broker-dealer pays for selling securities of non-affiliated funds. In some cases, a broker-dealer pays its personnel a higher percentage of the broker-dealer's own compensation for the sale of securities of affiliated funds than it pays for the sale of securities of non-affiliated funds. This may give your broker a greater incentive to sell the shares of affiliated funds than non-affiliated funds.*
- *Special compensation for shares with a back-end sales load - This document states whether your broker-dealer pays its salespersons or other associated persons higher compensation, in actual dollars, for selling a security with a back-end sales load than your broker-dealer pays its personnel for the sale of the same dollar amount of shares in a share classes with a front-end sales load. Some share classes without front-end sales loads (such as class B shares) may require you to pay higher asset-based fees than share classes with front-end sales loads (typically class A shares). Broker-dealer personnel may earn more when they sell classes with a back-end sales load, and therefore your broker may have a greater incentive to sell shares with a back-end sales load.*
- *Comparison ranges - The "comparison ranges" provide additional information about your purchase. These are expressed as a percentage of NAV. In the case of sales loads, asset-based fees and sales fees received by the broker-dealer, those comparison ranges represent the range of charges and fees associated with 95 percent of comparable securities. For example, a comparison range of "0-4%" means that 95 percent of comparable securities would charge between zero and 4 percent of NAV for a sale of that size. In the case of revenue sharing and portfolio brokerage commissions earned by the broker-dealer, the comparison range represents the range associated with the activity of 95 percent of other firms that distribute comparable securities.*

7. Section 240.15c–101 is added to read as follows:

§ 240.15c–101 Schedule 15D.

Securities and Exchange Commission, Washington, DC 20549.

Schedule 15D

SCHEDULE 15D - FRONT PAGE

<Name of broker, dealer or municipal securities dealer>

Name _____
Account number _____
Date _____
Security under consideration _____
Class _____
Amount of contemplated transaction _____

Sales load and what we will be paid up front

Front-end sales load	_____
Back-end sales load	_____
Amount of sales load we will receive from the fund	_____
Estimated first year asset-based distribution or service fees that we will receive from the fund	_____

Potential conflicts of interest

Do the fund or its affiliates pay us brokerage commissions for buying or selling fund assets, such as stocks and bonds?	_____
Do the fund's affiliates make additional payments to us, such as revenue sharing?	_____

Special compensation for our personnel - potential conflicts of interest

If this is a "proprietary" security issued by an affiliate, would we pay more to our personnel for selling it to you?	_____
If this security carries a back-end sales load, would we pay more to our personnel for selling it to you?	_____

ASK BEFORE YOU BUY! This document contains information that your broker-dealer is required to provide you about potential transactions in certain investments, such as mutual funds, variable annuities or "529 plans." It tells you about the investment's sales-related costs, and about the incentives your broker-dealer and its personnel have to sell you this investment. YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT.

SOME THINGS TO KNOW ABOUT LOADS: Sometimes shares that do not have a front-end load have high fees -- which makes them more expensive for the long-term investor. Also, many mutual fund companies offer sales load discounts to investors over a certain level. Sometimes family or household holdings can count toward these discounts. To find out more, talk with your broker or financial adviser, or check the fund's prospectus or website.

SCHEDULE 15D - CONTINUED

Explanations and Definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If the shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that would otherwise be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees generally is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to a fund, or another affiliate of a fund, makes payments to a broker-dealer. In some cases, the investment advisor may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments -- regardless if they are labeled as reimbursements -- may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation - This document states whether your broker-dealer would pay its salespersons or other associated persons higher compensation if you decide to buy the security you are considering. Some broker-dealers pay their personnel higher compensation, as a percentage of the broker-dealer's own compensation, for selling their affiliates' securities. In addition, some broker-dealers pay their personnel higher compensation, in actual dollars, for selling a security that has a back-end sales load, because broker-dealers themselves may earn more when they sell those share classes.*

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

* * * * *

9. Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by:

a. In the table entitled ''Fees and expenses of the Fund'' in Item 3, revising the caption ''Maximum Sales Charge (Load) Imposed on Purchases (as a percentage of offering price)'' to read ''Maximum Sales Charge (Load)

Imposed on Purchases (as a percentage of net asset value)'';

b. In Item 3, revising the first sentence of Instruction 2(a)(i);

c. In Item 3, revising Instruction 2(a)(ii);

d. In Item 3, adding a new Instruction 2(a)(iv);

e. In Item 8, adding new Instruction 4 to paragraph (a)(1);

f. In Item 8, redesignating paragraph (c) as paragraph (d); and

g. In Item 8, adding new paragraph (c).

These additions and revisions read as follows:

Note: The text of Form N–1A does not, and these amendments will not, appear in the Code of Federal Regulations.

Form N–1A

* * * * *

Item 3. Risk/Return Summary: Fee Table

* * * * *

Instructions.

* * * * *

2. *Shareholder Fees.*

(a)(i) ''Maximum Deferred Sales Charge (Load)'' includes the maximum total deferred sales charge (load) payable upon redemption, in installments, or both, expressed as a percentage of the amount or amounts stated in response to Item 8(a), except that, for a sales charge (load) based on offering price at the time of purchase, show the sales charge (load) as a percentage of the *net asset value* at the time of purchase. * * *

(ii) If more than one type of sales charge (load) is imposed (*e.g.*, a deferred sales charge (load) and a front-end sales charge (load)), the first caption in the table should read ''Maximum Sales Charge (Load) (as a percentage of net asset value)'' and show the maximum cumulative percentage of net asset value. Show the percentage amounts and the terms of each sales charge (load) comprising that figure on separate lines below.

* * * * *

(iv) If applicable, disclose in a footnote that the maximum sales charge (load) that may be paid by an investor as a percentage of the net amount invested may be higher than the maximum sales charge (load) shown as a percentage of net asset value in the fee table, and briefly explain the reason for this variation. The footnote, if applicable, should disclose the maximum sales charge (load) that may be paid by an investor as a percentage of the net amount invested. This footnote requirement applies to all types of sales charges (loads) (*e.g.*, front-end and deferred), as well as cumulative sales charges (loads) disclosed pursuant to Instruction 2(a)(ii).

* * * * *

Item 8. Distribution Arrangements

(a)(1) * * *

Instructions.

* * * * *

4. If applicable, disclose in a footnote that the actual front-end sales load that may be paid by an investor as a percentage of the gross or net amount invested at any breakpoint may be higher or lower than the applicable sales load in the table of front-end sales loads, and briefly explain the reason for this variation. The footnote, if applicable, should disclose the range of the actual front-end sales loads that may be paid by an investor at each sales load breakpoint, as a percentage of the gross and net amount invested.

* * * * *

(c) *Revenue Sharing Arrangements.* If any person within the fund complex that includes the Fund makes revenue sharing payments, disclose that fact and disclose that specific information about revenue sharing payments to an investor's financial intermediary, if any, is included in the written notification or periodic statement required under rule 15c2–2 under the Securities Exchange Act and in the disclosure provided at the point of sale required under rule 15c2–3 under the Securities Exchange Act. For purposes of this Item 8(c), ''fund complex'' and ''revenue sharing'' have the meanings set forth in rule 15c2–2(f)(10) and (15) under the Securities Exchange Act.

* * * * *

Dated: January 29, 2004.

By the Commission.

J. Lynn Taylor,

Assistant Secretary.

Note: Attachments 1–5 to the preamble will not appear in the Code of Federal Regulations.

BILLING CODE 8010–01–P

Attachment 1 - Confirmation example for hypothetical class A share purchase

Acme Clearing, Inc.

Fees and Payments Associated with Your Investment

A. General information

Customer:	John Doe	Symbol:	
Account Number:	1234-5678	CUSIP number:	
Date of transaction:	1/1/05	Type of security:	Mutual fund
Type of transaction:	You bought	Net Asset Value (NAV):	$18.17
No. shares bought/sold:	422.610	Price (NAV plus load):	$18.93
Security issuer:	BBB Equity Fund	Amount paid/received:	$8,000.00
Class (if applicable):	A	Amount of your investment/sale:	$7,678.82

Commission/other compensation: $0.00
Other charges: $0.00

Note: even if there is no commission or other charge, you may be paying for distribution through loads or asset-based fees, as described below.

B. What you pay (directly and indirectly) for purchases

Front-end sales load	**$321.18**	*which is equivalent to* 4.18% *of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Back-end sales load	NA	
Estimated first-year asset-based sales charges	NA	
Estimated first-year asset-based service fees	**$19.20**	*which is equivalent to* 0.25% *of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

C. Amounts that your broker, AAA Introducing, Inc., will receive from the fund or its affiliates

Sales fee AAA Introducing received for your purchase:	**$300.00**	*which is equivalent to* 3.91% *of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Revenue sharing AAA Introducing may receive in connection with your purchase:	**$30.72**	*which is equivalent to* 0.40% *of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Portfolio brokerage commissions AAA Introducing may receive in connection with your purchase:	**$15.36**	*which is equivalent to* 0.20% *of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Additional disclosures:

D. Payment of special compensation to personnel of your broker, AAA Introducing, Inc.

	Yes	No	NA
If you bought a security of a fund affiliated with AAA Introducing: Does AAA Introducing pay its personnel more to sell securities of affiliated funds?		X	
If you bought a share class with a back-end sales load: Does AAA Introducing pay its personnel more to sell this class than to sell front-end sales load share classes of the same fund?			X

E. Breakpoint discount information

Many mutual fund companies offer sales load discounts to customers that have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) entitles you to a sales load of 4.17%. You were charged a sales load of 4.18%, which may vary from the sales load disclosed in the prospectus due to rounding to the nearest penny in the transaction.

F. Explanations and definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Amount of your investment - When you buy a share class that has a front-end sales load, the "net amount invested" equals what you paid for the shares minus the sales load. That is the value of the shares.*
- *Dollar and percentage values - This document provides information about what you pay and what your broker-dealer will receive. Some of that information is set forth in dollar amounts and as percentages of "your investment." In general, those percentages are based on the net amount of your investment (which is the current value of the shares you are purchasing). Information about back-end sales loads and first year sales charges and service fees may be based on the value of your investment at some point in the future.*
- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If these shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that otherwise would be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often will have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *Disclosure of revenue sharing and portfolio brokerage commissions - This document provides information about revenue sharing that the broker-dealer has received from affiliates of the fund, and portfolio brokerage commissions that the broker-dealer has received from the fund or its affiliates. Those amounts are stated as a percentage of the broker-dealer's sales on behalf of the fund complex - consisting of the fund or its affiliates - over a recent 12 month period. For example, if a broker-dealer received $1 million in revenue sharing from a fund complex over that period, and the broker-dealer sold $50 million worth of shares for the fund complex over that period, then revenue sharing represents 2 percent of total sales. Based on that percentage, this confirmation also states the amount of that compensation that may be associated with this transaction. These are estimates only, and your broker-dealer can provide you with more specific information.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to the fund, or another affiliate of the fund, makes payments to a broker-dealer. In some cases, the investment adviser may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments - regardless if they are labeled as reimbursements - may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation for proprietary sales - This document states whether your broker-dealer pays its salespersons or other associated persons a higher compensation rate for selling securities of affiliated funds (proprietary sales) than the rate that the broker-dealer pays for selling securities of non-affiliated funds. In some cases, a broker-dealer pays its personnel a higher percentage of the broker-dealer's own compensation for the sale of securities of affiliated funds than it pays for the sale of securities of non-affiliated funds. This may give your broker a greater incentive to sell the shares of affiliated funds than non-affiliated funds.*
- *Special compensation for shares with a back-end sales load - This document states whether your broker-dealer pays its salespersons or other associated persons higher compensation, in actual dollars, for selling a security with a back-end sales load than your broker-dealer pays its personnel for the sale of the same dollar amount of shares in a share class with a front-end sales load. Some share classes without front-end sales loads (such as class B shares) may require you to pay higher asset-based fees than share classes with front-end sales loads (typically class A shares). Broker-dealer personnel may earn more when they sell classes with a back-end sales load, and therefore your broker may have a greater incentive to sell shares with a back-end sales load.*
- *Comparison ranges - The "comparison ranges" provide additional information about your purchase. These are expressed as a percentage of NAV. In the case of sales loads, asset-based fees and sales fees received by the broker-dealer, those comparison ranges represent the range of charges and fees associated with 95 percent of comparable securities. For example, a comparison range of "0-4%" means that 95 percent of comparable securities would charge between zero and 4 percent of NAV for a sale of that size. In the case of revenue sharing and portfolio brokerage commissions earned by the broker-dealer, the comparison range represents the range associated with the activity of 95 percent of other firms that distribute comparable securities.*

Attachment 2 - Confirmation example for hypothetical class B share purchase (back-end load as minimum of present or future NAV)

Acme Clearing, Inc.

Fees and Payments Associated with Your Investment

A. General information

Customer:	John Doe	Symbol:	
Account Number:	1234-5678	CUSIP number:	
Date of transaction:	1/1/05	Type of security:	Mutual fund
Type of transaction:	You bought	Net Asset Value (NAV):	$18.17
No. shares bought/sold:	440.286	Price (NAV plus load):	$18.17
Security issuer:	BBB Equity Fund	Amount paid/received:	$8,000.00
Class (if applicable):	B	Amount of your investment/sale:	$8,000.00

Commission/other compensation: $0.00
Other charges: $0.00

Note: even if there is no commission or other charge, you may be paying for distribution through loads or asset-based fees, as described below.

B. What you pay (directly and indirectly) for purchases

Front-end sales load	NA	
Back-end sales load		
If you sell these shares in one year, you will pay	**$400.00**	*or 5% of your investment, whichever is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in two years, you will pay	**$320.00**	*or 4% of your investment, whichever Is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in three years, you will pay	**$240.00**	*or 3% of your investment, whichever is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in four years, you will pay	**$240.00**	*or 3% of your investment, whichever is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in five years, you will pay	**$160.00**	*or 2% of your investment, whichever is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in six years, you will pay	**$80.00**	*or 1% of your investment, whichever is less* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Estimated first-year asset-based sales charges	**$60.00**	*which is equivalent to 0.75% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Estimated first-year asset-based service fees	**$20.00**	*which is equivalent to 0.25% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

C. Amounts that your broker, AAA Introducing, Inc., will receive from the fund or its affiliates

Sales fee AAA Introducing received for your purchase:	**$320.00**	*which is equivalent to 4.00% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Revenue sharing AAA Introducing may receive in connection with your purchase:	**$32.00**	*which is equivalent to 0.40% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Portfolio brokerage commissions AAA Introducing may receive in connection with your purchase:	**$16.00**	*which is equivalent to 0.20% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Additional disclosures:

D. Payment of special compensation to personnel of your broker, AAA Introducing, Inc.

	Yes	No	NA
If you bought a security of a fund affiliated with AAA Introducing: Does AAA Introducing pay its personnel more to sell securities of affiliated funds?		X	
If you bought a share class with a back-end sales load: Does AAA Introducing pay its personnel more to sell this class than to sell front-end sales load share classes of the same fund?	X		

E. Breakpoint discount information

Many mutual fund companies offer sales load discounts to customers that have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) would have entitled you to a sales load of 4.17% of NAV had you bought a share class that is subject to a front-end sales load. Instead, you bought a share class that is not subject to a front-end sales load, but is subject to annual asset-based sales charges of 0.75% of net asset value for a period of 6 years.

F. Explanations and definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Amount of your investment - When you buy a share class that has a front-end sales load, the "net amount invested" equals what you paid for the shares minus the sales load. That is the value of the shares.*
- *Dollar and percentage values - This document provides information about what you pay and what your broker-dealer will receive. Some of that information is set forth in dollar amounts and as percentages of "your investment." In general, those percentages are based on the net amount of your investment (which is the current value of the shares you are purchasing). Information about back-end sales loads and first year sales charges and service fees may be based on the value of your investment at some point in the future.*
- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If these shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that otherwise would be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often will have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *Disclosure of revenue sharing and portfolio brokerage commissions - This document provides information about revenue sharing that the broker-dealer has received from affiliates of the fund, and portfolio brokerage commissions that the broker-dealer has received from the fund or its affiliates. Those amounts are stated as a percentage of the broker-dealer's sales on behalf of the fund complex - consisting of the fund or its affiliates - over a recent 12 month period. For example, if a broker-dealer received $1 million in revenue sharing from a fund complex over that period, and the broker-dealer sold $50 million worth of shares for the fund complex over that period, then revenue sharing represents 2 percent of total sales. Based on that percentage, this confirmation also states the amount of that compensation that may be associated with this transaction. These are estimates only, and your broker-dealer can provide you with more specific information.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to the fund, or another affiliate of the fund, makes payments to a broker-dealer. In some cases, the investment adviser may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments - regardless if they are labeled as reimbursements - may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation for proprietary sales - This document states whether your broker-dealer pays its salespersons or other associated persons a higher compensation rate for selling securities of affiliated funds (proprietary sales) than the rate that the broker-dealer pays for selling securities of non-affiliated funds. In some cases, a broker-dealer pays its personnel a higher percentage of the broker-dealer's own compensation for the sale of securities of affiliated funds than it pays for the sale of securities of non-affiliated funds. This may give your broker a greater incentive to sell the shares of affiliated funds than non-affiliated funds.*
- *Special compensation for shares with a back-end sales load - This document states whether your broker-dealer pays its salespersons or other associated persons higher compensation, in actual dollars, for selling a security with a back-end sales load than your broker-dealer pays its personnel for the sale of the same dollar amount of shares in a share class with a front-end sales load. Some share classes without front-end sales loads (such as class B shares) may require you to pay higher asset-based fees than share classes with front-end sales loads (typically class A shares). Broker-dealer personnel may earn more when they sell classes with a back-end sales load, and therefore your broker may have a greater incentive to sell shares with a back-end sales load.*
- *Comparison ranges - The "comparison ranges" provide additional information about your purchase. These are expressed as a percentage of NAV. In the case of sales loads, asset-based fees and sales fees received by the broker-dealer, those comparison ranges represent the range of charges and fees associated with 95 percent of comparable securities. For example, a comparison range of "0-4%" means that 95 percent of comparable securities would charge between zero and 4 percent of NAV for a sale of that size. In the case of revenue sharing and portfolio brokerage commissions earned by the broker-dealer, the comparison range represents the range associated with the activity of 95 percent of other firms that distribute comparable securities.*

Attachment 3 - Confirmation example for hypothetical class B share purchase (back-end load as a function of present NAV)

Acme Clearing, Inc.

Fees and Payments Associated with Your Investment

A. General information

Customer:	John Doe	Symbol:	
Account Number:	1234-5678	CUSIP number:	
Date of transaction:	1/1/05	Type of security:	Mutual fund
Type of transaction:	You bought	Net Asset Value (NAV):	$18.17
No. shares bought/sold:	440.286	Price (NAV plus load):	$18.17
Security issuer:	BBB Equity Fund	Amount paid/received:	$8,000.00
Class (if applicable):	B	Amount of your investment/sale:	$8,000.00

Commission/other compensation: $0.00
Other charges: $0.00

Note: even if there is no commission or other charge, you may be paying for distribution through loads or asset-based fees, as described below.

B. What you pay (directly and indirectly) for purchases

Front-end sales load	NA	
Back-end sales load		
If you sell these shares in one year, you will pay	**$400.00**	*(which equals 5% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in two years, you will pay	**$320.00**	*(which equals 4% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in three years, you will pay	**$240.00**	*(which equals 3% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in four years, you will pay	**$240.00**	*(which equals 3% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in five years, you will pay	**$160.00**	*(which equals 2% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
If you sell these shares in six years, you will pay	**$80.00**	*(which equals 1% of your investment)* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Estimated first-year asset-based sales charges	**$60.00**	*which is equivalent to 0.75% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Estimated first-year asset-based service fees	**$20.00**	*which is equivalent to 0.25% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

C. Amounts that your broker, AAA Introducing, Inc., will receive from the fund or its affiliates

Sales fee AAA Introducing received for your purchase:	**$320.00**	*which is equivalent to 4.00% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Revenue sharing AAA Introducing may receive in connection with your purchase:	**$32.00**	*which is equivalent to 0.40% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*
Portfolio brokerage commissions AAA Introducing may receive in connection with your purchase:	**$16.00**	*which is equivalent to 0.20% of your investment* *Industry norms: Range x.xx - x.xx%; median x.xx%.*

Additional disclosures:

D. Payment of special compensation to personnel of your broker, AAA Introducing, Inc.

	Yes	No	NA
If you bought a security of a fund affiliated with AAA Introducing: Does AAA Introducing pay its personnel more to sell securities of affiliated funds?		X	
If you bought a share class with a back-end sales load: Does AAA Introducing pay its personnel more to sell this class than to sell front-end sales load share classes of the same fund?	X		

E. Breakpoint discount information

Many mutual fund companies offer sales load discounts to customers that have invested over a certain dollar amount. These discounts may be calculated based on your current purchase or on your aggregate holdings, and may also include the holdings of your family or household members. To ensure that you are obtaining all available discounts, you should talk with your broker or financial advisor, or check the fund's prospectus or website. According to the fund's prospectus, the amount you invested (together with any holdings of which we are aware) would have entitled you to a sales load of 4.17% of NAV had you bought a share class that is subject to a front-end sales load. Instead, you bought a share class that is not subject to a front-end sales load, but is subject to annual asset-based sales charges of 0.75% of net asset value for a period of 6 years.

F. Explanations and definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Amount of your investment - When you buy a share class that has a front-end sales load, the "net amount invested" equals what you paid for the shares minus the sales load. That is the value of the shares.*
- *Dollar and percentage values - This document provides information about what you pay and what your broker-dealer will receive. Some of that information is set forth in dollar amounts and as percentages of "your investment." In general, those percentages are based on the net amount of your investment (which is the current value of the shares you are purchasing). Information about back-end sales loads and first year sales charges and service fees may be based on the value of your investment at some point in the future.*
- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If these shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that otherwise would be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often will have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *Disclosure of revenue sharing and portfolio brokerage commissions - This document provides information about revenue sharing that the broker-dealer has received from affiliates of the fund, and portfolio brokerage commissions that the broker-dealer has received from the fund or its affiliates. Those amounts are stated as a percentage of the broker-dealer's sales on behalf of the fund complex - consisting of the fund or its affiliates - over a recent 12 month period. For example, if a broker-dealer received $1 million in revenue sharing from a fund complex over that period, and the broker-dealer sold $50 million worth of shares for the fund complex over that period, then revenue sharing represents 2 percent of total sales. Based on that percentage, this confirmation also states the amount of that compensation that may be associated with this transaction. These are estimates only, and your broker-dealer can provide you with more specific information.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to the fund, or another affiliate of the fund, makes payments to a broker-dealer. In some cases, the investment adviser may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments - regardless if they are labeled as reimbursements - may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation for proprietary sales - This document states whether your broker-dealer pays its salespersons or other associated persons a higher compensation rate for selling securities of affiliated funds (proprietary sales) than the rate that the broker-dealer pays for selling securities of non-affiliated funds. In some cases, a broker-dealer pays its personnel a higher percentage of the broker-dealer's own compensation for the sale of securities of affiliated funds than it pays for the sale of securities of non-affiliated funds. This may give your broker a greater incentive to sell the shares of affiliated funds than non-affiliated funds.*
- *Special compensation for shares with a back-end sales load - This document states whether your broker-dealer pays its salespersons or other associated persons higher compensation, in actual dollars, for selling a security with a back-end sales load than your broker-dealer pays its personnel for the sale of the same dollar amount of shares in a share class with a front-end sales load. Some share classes without front-end sales loads (such as class B shares) may require you to pay higher asset-based fees than share classes with front-end sales loads (typically class A shares). Broker-dealer personnel may earn more when they sell classes with a back-end sales load, and therefore your broker may have a greater incentive to sell shares with a back-end sales load.*
- *Comparison ranges - The "comparison ranges" provide additional information about your purchase. These are expressed as a percentage of NAV. In the case of sales loads, asset-based fees and sales fees received by the broker-dealer, those comparison ranges represent the range of charges and fees associated with 95 percent of comparable securities. For example, a comparison range of "0-4%" means that 95 percent of comparable securities would charge between zero and 4 percent of NAV for a sale of that size. In the case of revenue sharing and portfolio brokerage commissions earned by the broker-dealer, the comparison range represents the range associated with the activity of 95 percent of other firms that distribute comparable securities.*

Attachment 4 - Point of sale example for hypothetical class A share purchase

AAA Introducing, Inc.

Name	John Doe
Account number	1234-5678
Date	1/1/05
Security under consideration	BBB Equity Fund
Class	A
Amount of contemplated transaction	$8,000.00

Sales load and what we will be paid up front

Front-end sales load	$321.18
Back-end sales load - maximum first year	NA
Amount of sales fee we will receive from the fund	$300.00
Estimated first year asset-based distribution or service fees that we will receive from the fund	$19.20

Potential conflicts of interest

Do the fund or its affiliates pay us brokerage commissions for buying or selling fund assets, such as stocks and bonds?	Yes
Do the fund's affiliates make additional payments to us, such as revenue sharing?	Yes

Special compensation for our personnel - potential conflicts of interest

If this is a "proprietary" security issued by an affiliate, would we pay more to our personnel for selling it to you?	No
If this security carries a back-end sales load, would we pay more to our personnel for selling it to you?	NA

ASK BEFORE YOU BUY! This document contains information that your broker-dealer is required to provide you about potential transactions in certain investments, such as mutual funds, variable annuities or "529 plans." It tells you about the investment's sales-related costs, and about the incentives your broker-dealer and its personnel have to sell you this investment. YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT.

SOME THINGS TO KNOW ABOUT LOADS: Sometimes shares that do not have a front-end load have high fees -- which makes them more expensive for the long-term investor. Also, many mutual fund companies offer sales load discounts to investors over a certain level. Sometimes family or household holdings can count toward these discounts. To find out more, talk with your broker or financial adviser, or check the fund's prospectus or website.

Explanations and Definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*

- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*

- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If the shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*

- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that would otherwise be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees generally is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*

- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to a fund, or another affiliate of a fund, makes payments to a broker-dealer. In some cases, the investment adviser may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments -- regardless if they are labeled as reimbursements -- may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*

- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a higher incentive to sell the shares of that fund or affiliated funds.*

- *Special compensation - This document states whether your broker-dealer would pay its salespersons or other associated persons higher compensation if you decide to buy the security you are considering. Some broker-dealers pay their personnel higher compensation, as a percentage of the broker-dealers' own compensation, for selling their affiliates' securities. In addition, some broker-dealers pay their personnel higher compensation, in actual dollars, for selling a security that has a back-end sales load, because broker-dealers themselves may earn more when they sell those share classes.*

Attachment 5 - Point of sale example for hypothetical class B share purchase

AAA Introducing, Inc.

Name	John Doe
Account number	1234-5678
Date	1/1/05
Security under consideration	BBB Equity Fund
Class	B
Amount of contemplated transaction	$8,000.00

Sales load and what we will be paid up front

Front-end sales load	NA
Back-end sales load - maximum first year *- back-end sales loads terminate after six years*	$400.00
Amount of sales fee we will receive from the fund	$320.00
Estimated first year asset-based distribution or service fees that we will receive from the fund	$80.00

Potential conflicts of interest

Do the fund or its affiliates pay us brokerage commissions for buying or selling fund assets, such as stocks and bonds?	Yes
Do the fund's affiliates make additional payments to us, such as revenue sharing?	Yes

Special compensation for our personnel - potential conflicts of interest

If this is a "proprietary" security issued by an affiliate, would we pay more to our personnel for selling it to you?	No
If this security carries a back-end sales load, would we pay more to our personnel for selling it to you?	Yes

ASK BEFORE YOU BUY! This document contains information that your broker-dealer is required to provide you about potential transactions in certain investments, such as mutual funds, variable annuities or "529 plans." It tells you about the investment's sales-related costs, and about the incentives your broker-dealer and its personnel have to sell you this investment. YOU HAVE A RIGHT TO CONSIDER THE COSTS OF THE INVESTMENT AND YOUR BROKER-DEALER'S INCENTIVES BEFORE YOU DECIDE WHETHER TO MAKE THE INVESTMENT.

SOME THINGS TO KNOW ABOUT LOADS: Sometimes shares that do not have a front-end load have high fees -- which makes them more expensive for the long-term investor. Also, many mutual fund companies offer sales load discounts to investors over a certain level. Sometimes family or household holdings can count toward these discounts. To find out more, talk with your broker or financial adviser, or check the fund's prospectus or website.

Explanations and Definitions

- *Net asset value (NAV) - Net asset value is the approximate value of one share of a fund, and is determined by dividing the fund's net assets by the number of shares outstanding. When you sell your shares, their NAV may differ from the price you paid for the shares.*
- *Price and NAV - Securities that have front-end sales loads are sold at the public offering price. That price includes the sales load and therefore is higher than the NAV.*
- *Timing of sales loads - If you buy shares with a front-end sales load, you pay a fee at the time of purchase. If you buy shares with a back-end sales load (sometimes called a deferred sales load), you may pay a fee when you sell your shares, depending on how long you hold them. If the shares have a back-end sales load, the amount of the fee you pay will depend on when you sell the shares and their NAV at the time.*
- *Asset-based fees - Asset-based sales charges and service fees (such as 12b-1 fees) are annual fees that the fund pays out of its assets to market its shares to potential investors or to compensate brokers for maintaining the accounts of current shareholders. By reducing the amount of a fund's assets (that would otherwise be available for investment), the fees may reduce the return on your investment. The amount of future asset-based fees generally is not predictable because these fees are a percentage of NAV, which can fluctuate over time. Share classes that have a back-end sales load often have higher asset-based fees than comparable share classes with a front-end sales load. However, share classes with a back-end sales load may, in some later year, convert to a share class with lower asset-based fees.*
- *What is revenue sharing? - Revenue sharing occurs when the investment adviser to a fund, or another affiliate of a fund, makes payments to a broker-dealer. In some cases, the investment adviser may describe those payments as reimbursing the broker-dealer for expenses it incurs in selling the shares. Those payments -- regardless if they are labeled as reimbursements -- may give the broker-dealer a greater incentive to sell the shares of that fund or affiliated funds.*
- *What are portfolio brokerage commissions? - Portfolio brokerage commissions are payments that a fund makes to broker-dealers for helping the fund buy or sell securities in the fund's portfolio. Portfolio brokerage commissions may give the broker-dealer a higher incentive to sell the shares of that fund or affiliated funds.*
- *Special compensation - This document states whether your broker-dealer would pay its salespersons or other associated persons higher compensation if you decide to buy the security you are considering. Some broker-dealers pay their personnel higher compensation, as a percentage of the broker-dealers' own compensation, for selling their affiliates' securities. In addition, some broker-dealers pay their personnel higher compensation, in actual dollars, for selling a security that has a back-end sales load, because broker-dealers themselves may earn more when they sell those share classes.*

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