

**What Is the Unsafe Condition Presented in This AD?**

(d) This AD is the result of several reports of failed shuttle control valves of the SVS and one report of an airplane crash with a

fatality in which improper use of the SVS was a factor. The actions specified in this AD are intended to correct problems with the SVS before failure or malfunction during instrument flight rules (IFR) flight that can

lead to pilot disorientation and loss of control of the aircraft.

**What Must I Do To Address This Problem?**

(e) To address this problem, you must do the following:

Actions	Compliance	Procedures
(1) Incorporate the airplane flight manual supplement (AFMS) in the airplane flight manual with the appropriate revision in the FAA-approved airplane flight manual (AFM). (i) The owner/operator holding at least a private pilot certificate as authorized by section 43.7 of the Federal Aviation Regulations (14 CFR 43.7) may do the flight manual changes requirement of this AD. (ii) Make an entry in the aircraft records showing compliance with this portion of the AD following section 43.9 of the Federal Aviation Regulations (14 CFR 43.9).	Within 30 days after the effective date of this AD, unless already done.	Not Applicable.
(2) Install placards described in the AFMS .....	Before further flight after incorporating the AFMS in the FAA-approved airplane flight manual (AFM) required by paragraph (e)(1) of this AD.	Follow the Standby Vacuum System AFM SUPPLEMENT, dated February 4, 2000.
(3) Upgrade the Model SVS I or SVS IA SVS to the Model SVS VISVS, install the appropriate placards, and add the installation report including the instructions for continued airworthiness (ICA) to the maintenance schedule for the aircraft.	Within 1 year after the effective date of this AD, unless already done.	Follow Precise Flight, Inc. Installation Report No. 08080, Standby Vacuum System Model VI—Shuttle Valve S/N 10243 & Subsequent (Manual Valve), Revision A, dated February 21, 2001.
(4) Do not install any Model SVS I or SVS IA SVS without also doing the actions required by paragraphs (e)(1), (e)(2) and (e)(3) of AD.	As of the effective date of this this AD .....	Not applicable.

**May I Request an Alternative Method of Compliance?**

(f) You may request a different method of compliance or a different compliance time for this AD by following the procedures in 14 CFR 39.19. Unless FAA authorizes otherwise, send your request to your principal inspector. The principal inspector may add comments and will send your request to the Manager, Seattle Aircraft Certification Office (ACO), FAA. For information on any already approved alternative methods of compliance, contact Ms. Marcia Smith, Aerospace Engineer, FAA, Seattle Aircraft Certification Office, 1601 Lind Avenue, SW, Renton, Washington 98055-4065; telephone: (425) 917-6484; facsimile: (425) 917-6590.

**May I Get Copies of the Documents Referenced in This AD?**

(g) To get copies of the documents referenced in this AD, contact Precise Flight, Inc., 63120 Powell Butte Road, Bend Oregon 97701, telephone: (800) 547-2558; facsimile: (541) 388-1105; electronic mail: [preciseflight@preciseflight.com](mailto:preciseflight@preciseflight.com); Internet: <http://www.preciseflight.com/>. To view the AD docket, go to the Docket Management Facility; U.S. Department of Transportation, 400 Seventh Street, S.W., Nassif Building, Room PL-401, Washington, DC, or on the Internet at <http://dms.dot.gov>. The docket number is FAA-2004-19354.

Issued in Kansas City, Missouri, on February 23, 2005.

**David R. Showers,**  
*Acting Manager, Small Airplane Directorate, Aircraft Certification Service.*

[FR Doc. 05-4239 Filed 3-3-05; 8:45 am]

**BILLING CODE 4910-13-P**

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 239, 240 and 274**

[Release Nos. 33-8544; 34-51274; IC-26778; File No. S7-06-04]

**RIN 3235-AJ11; 3235-AJ12; 3235-AJ13; 3235-AJ14**

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

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule; reopening of comment period and supplemental request for comment.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is reopening the comment period on

proposed rules, published in January 2004, that would require broker-dealers to provide their customers with information regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, 529 college savings plan interests, and variable insurance products. The Commission also is supplementing its request for comments on the proposed rules to reflect issues raised by commenters, including feedback received from investors in in-depth interviews about revised forms for disclosing information at the point of sale. The Commission is publishing this supplemental request for comment and reopening the comment period to assure that the public has a full opportunity to address such issues in their comments.

**DATES:** Comments should be submitted on or before April 4, 2005.

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-06-04 on the subject line; or

• Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

• Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. All submissions should refer to File Number S7-06-04. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### 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, Branch Chief, David W. Blass, Branch Chief, or John J. Fahey, 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 Deborah Skeens, Senior Counsel, at (202) 942-0721, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0506.

#### SUPPLEMENTARY INFORMATION:

##### I. Introduction

On January 29, 2004, the Commission issued, and requested comment on, two proposed new rules, as well as rule amendments under the Securities Exchange Act of 1934 designed to enhance the information broker-dealers provide to their customers in connection with transactions in certain types of securities.<sup>1</sup> Proposed rules 15c2-2 and 15c2-3 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, 529 college savings plan interests<sup>2</sup>, and variable insurance products (collectively, "covered securities"). The Commission also proposed conforming amendments to rule 10b-10, 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 proposed amendments to Form N-1A, the registration form for mutual funds, to improve disclosure of sales loads and revenue sharing payments.<sup>3</sup>

We received over one thousand separate comments on the proposed rules and rule amendments, as well as over four thousand comments from individuals and entities using a variety of standard letter types.<sup>4</sup> Because proposed rules 15c2-2 and 15c2-3 were intended to provide clear and useful disclosure to investors, we actively encouraged comments from individual investors and investor groups. We also met with numerous investor groups, and engaged a consultant to assist in investor testing of possible forms for confirmation and point of sale disclosures.

The comments and other feedback we received suggest a number of areas where the proposed point of sale and confirmation disclosure requirements may need to be revised to more effectively communicate information to investors, while more efficiently balancing the benefits of disclosure against the costs of compliance. In addition, some feedback suggests that we should consider taking a more layered approach to disclosure by requiring broker-dealers to use the Internet as a disclosure medium to supplement point of sale and confirmation disclosure.

Section II of this release discusses possible improvements to the proposed point of sale disclosure rule for transactions in covered securities.

<sup>2</sup> College savings plans are often referred to as "529 savings plans."

<sup>3</sup> In the Proposing Release, and on the forms attached to the Proposing Release, we used the term "revenue sharing" to refer to payments to broker-dealers for promoting certain covered securities over others. However, investor feedback indicated that the term "revenue sharing" is not easily understandable. While we continue to refer to the term "revenue sharing payment" in this release, we have removed references to "revenue sharing" from the forms attached to this release and instead refer to payments broker-dealers receive for promoting certain covered securities over others. See *infra* part II.A.3.

<sup>4</sup> The full text of comments to the proposal, including the text of standard letter types, is publicly available at: <http://www.sec.gov/rules/proposed/s70604.shtml>.

Section III discusses possible improvements to the proposed confirmation disclosure rule for transactions in covered securities. Section IV discusses the possible requirement for broker-dealers to disclose detailed information about revenue sharing payments and other broker compensation practices on the Internet. Section V discusses possible changes to the prospectus disclosure of revenue sharing. Section VI contains a general request for comments on this release and also renews our request for comments on the proposals in the Proposing Release.<sup>5</sup>

##### II. Point of Sale Proposal

Proposed rule 15c2-3 was intended to improve investment decisionmaking by providing investors at the point of sale with information about costs and conflicts of interest associated with purchases of covered securities. Comments and investor feedback indicated, however, that while point of sale disclosure may be quite useful to investors, there are a number of areas that could be enhanced to make the proposed rule more effective. These include: (a) The content and format of the disclosure that would be required under the proposed rule, including the disclosure of "management fees" and "other expenses" of the covered security; (b) the manner in which oral point of sale disclosures would be made; (c) the timing of delivery of point of sale disclosures; (d) exceptions to the requirement to deliver point of sale disclosures; and (e) special issues related to variable insurance products. We seek additional comment about these key areas, as detailed below.

##### A. Content and Format of Proposed Point of Sale Disclosure for Covered Securities

###### 1. Brief Summary of Select Comments to the Proposing Release Relating to Point of Sale Disclosure

We received substantial feedback on the point of sale forms that would be required under proposed rule 15c2-3. Some investors were confused by the use of industry jargon, such as "sales loads" and "revenue sharing," in the forms attached to the Proposing Release.

<sup>5</sup> In the Proposing Release, we proposed rule language to require confirmation disclosure of comparative information about certain costs and conflicts. This release does not address those proposed requirements, given that the content of comparison information and the form of disclosure (e.g., at the point of sale versus in confirmations) in large part will depend upon any final point of sale and confirmation requirements. At a later date and in a separate release, we plan to request further comments about comparison range disclosure requirements.

<sup>1</sup> See Securities Exchange Act Release No. 49148 (January 29, 2004), 69 FR 6438 (February 10, 2004) ("Proposing Release").

Some stated that the definitions and explanatory materials were not as useful as they would have liked. Others stated that the forms did not adequately differentiate one-time costs from ongoing costs.<sup>6</sup> Also, many investors wanted point of sale disclosure to provide comprehensive information about all the costs of owning covered securities, not just distribution-related costs. They sought comprehensive information about ownership costs, in percentage terms and in dollar terms, to better inform them about the total costs associated with purchasing and owning these securities.<sup>7</sup>

Some securities industry commenters urged the Commission to revisit the proposed requirement that point of sale disclosure be specific to the anticipated amount of the customer's transaction, stating that such quantified disclosure would be difficult and costly to provide. Some saw standardized point of sale disclosure as preferable to transaction-specific disclosure and some viewed point of sale disclosure as overly time-consuming for broker-dealers to deliver, particularly over the telephone.

Some commenters suggested specific changes to the wording and layout of the proposed point of sale forms, and provided alternative forms for us to consider.<sup>8</sup> In addition, we received

<sup>6</sup> AARP conducted its own investor testing, which further indicated that the proposed disclosure form was not effective in communicating information to many investors.

<sup>7</sup> While many investors recognized that dollar-based disclosure of future annual costs is hypothetical in nature, in that these costs would vary over time, they nonetheless concluded that such dollar-based disclosure would help them make better investment decisions. Consumer advocates also supported this change, stating that point of sale disclosure that failed to include information about fund management fees and other non-distribution costs could cause some investors to mistakenly believe that those additional costs of ownership are not present.

<sup>8</sup> See Letter from Mary L. Shapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, NASD, to Jonathan G. Katz, Secretary, Commission, dated May 4, 2004; Letter from Mary L. Shapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, NASD, to Jonathan G. Katz, Secretary, Commission, dated August 20, 2004; Letter from Mike Scafati, Senior Vice President, A.G. Edwards & Sons, Inc., dated April 12, 2004; Letter from William Lutz, Professor of English, Rutgers University, to Jonathan G. Katz, Secretary, Commission, dated April 12, 2004; Letter from Nancy M. Smith to Jonathan G. Katz, Secretary, Commission, dated April 12, 2004; Letter from Nancy M. Smith to Jonathan G. Katz, Secretary, Commission, dated April 22, 2004; Letter from Amy B.R. Lancellotta, Acting General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission, dated April 12, 2004; Memorandum from the Division of Market Regulation regarding a meeting with representatives of the Investment Company Institute, dated October 26, 2004; and Memorandum from the Division of Market Regulation regarding a meeting with representatives of the Securities Industry Association, dated October 26, 2004.

several comments about the proposed "yes or no" point of sale disclosure of whether a broker-dealer or its affiliates receive revenue sharing from a person within a fund complex. The disclosure requirement, including proposed definitions of "revenue sharing" and "fund complex," in general would have required a broker-dealer to disclose whether it receives certain payments from affiliates of the issuer of the covered security, but not from the issuer itself. Disclosure about special compensation arrangements was intended to alert customers to those conflicts of interest and promote further inquiry.

One commenter suggested that the disclosure requirement relating to revenue sharing should be more focused, stating that the proposal would encompass payments unrelated to the distribution of covered securities purchased by a customer.<sup>9</sup> Commenters also expressed concern that the provisions of the proposed rules relating to revenue sharing would lead to inconsistent disclosure depending upon how payments are depicted by a fund complex, particularly in light of the proposed exclusion for payments by issuers.<sup>10</sup> Some commenters also suggested that such payments merely constitute "cost sharing" by which fund families compensate broker-dealers for services that the fund families otherwise would incur.<sup>11</sup>

## 2. Revised Point of Sale Disclosure Forms

In response to the comments we received to the Proposing Release, we sought feedback from investors and have developed revised forms that we are considering adopting.<sup>12</sup> Broker-

<sup>9</sup> Some commenters also stated that the proposed disclosure requirement should not encompass payments that a broker-dealer receives for underwriting state bonds, or payments received by banks that are affiliated with broker-dealers, or certain payments that broker-dealers receive from affiliated fund complexes.

<sup>10</sup> That particularly may be an issue with regard to payments received by fund "supermarkets" operated by certain broker-dealers.

<sup>11</sup> Regardless of the characterization, a broker-dealer's receipt of special payments from some fund complexes but not others gives the broker-dealer monetary incentives to promote the sale of securities of the fund complexes that make those payments. That is true even if the payments solely reimburse the broker-dealer for sales and servicing costs it incurs.

<sup>12</sup> The Commission retained Siegel & Gale, LLC and Gelb Consulting Group, Inc. to help develop and test model disclosure forms that would effectively convey information to investors. See Siegel & Gale, LLC/Gelb Consulting Group, Inc., "Results of In-Depth Investor Interviews Regarding Proposed Mutual Fund Sales Fee and Conflict of Interest Disclosure Forms: Report to the Securities and Exchange Commission," (November 4, 2004) and "Supplemental Report to the Securities and

dealers would be required to deliver these proposed new forms at the point of sale before a customer purchases a covered security. Consistent with investors' views that disclosure should be targeted and should exclude irrelevant information, broker-dealers would not use a "one size fits all" form to provide written point of sale disclosure to customers. Instead, while broker-dealers would have to disclose specific categories of information in a required format to the extent those categories are applicable, the written point of sale forms would omit categories of information that are not applicable to a particular purchase.<sup>13</sup> This targeted approach would limit "information overload"—which can undercut the effectiveness of highly detailed disclosure—and also would facilitate disclosure of special costs associated with particular securities.<sup>14</sup> It therefore should lead to disclosure that is as standardized as possible, while targeted enough to be useful to a wide range of investors. We would hope that investors would request, and broker-dealers would provide, forms for different share classes where applicable and where consistent with suitability obligations, in order to help investors make informed investment decisions.

Consistent with those principles, the forms in Attachments 1–6 reflect feedback we have received through investor outreach about how to improve the clarity and readability of the forms, as well as additional analysis about how to improve their cost-effectiveness.<sup>15</sup> Attachments 1–3 show proposed new "models" of required point of sale disclosure forms filled in for a hypothetical mutual fund,<sup>16</sup> with the

Exchange Commission" (November 29, 2004) (together, the "Siegel & Gale/Gelb Consulting Report"). The report is available at <http://www.sec.gov/rules/proposed/s70604/rep110404.pdf> and the supplemental report is available at <http://www.sec.gov/rules/proposed/s70604/sup-rep010705.pdf>.

<sup>13</sup> Thus, for example, a customer contemplating buying class A mutual fund shares with an upfront sales fee would receive a form that would reflect that upfront fee in a standardized format, but a broker-dealer would not be required to include information about deferred sales fees, which are not applicable to class A shares.

<sup>14</sup> As discussed below, those special costs may include, among others, account opening fees imposed by the issuers of college savings plans, or purchase or redemption fees imposed by funds.

<sup>15</sup> This section discusses generally the proposed new point of sale disclosure forms for all covered securities. We recognize, however, that variable insurance products have special disclosure issues. We discuss additional forms more appropriate to those products in part II.E.

<sup>16</sup> The proposed new "model" forms in Attachments 1–3 and 4–6 depict how the required forms would be filled in for hypothetical mutual funds or 529 savings plans, respectively.

differences among the forms reflecting differences in share classes and other pricing attributes. Attachments 4–6 show proposed new “models” for the required point of sale disclosure forms filled in for a hypothetical 529 savings plan, again reflecting differences in pricing. Following is a summary of some of the key aspects of these forms:

a. *Clarity of the forms.* We believe that the forms in Attachments 1–6 are clearer and easier to understand than the point of sale forms attached to the Proposing Release. Where possible, we have used plain English in the forms, rather than using industry jargon. In addition, broker-dealers would be required to deliver forms in the same format, including font size and layout, as that of Attachments 1–6.

b. *Identification of security subject to disclosure.* Broker-dealers would be required to more clearly identify the security subject to disclosure in the forms. For example, in the case of mutual funds, this would include the disclosure of the fund’s ticker symbol (if applicable). In the case of 529 savings plans, this would include disclosure of the specific age-based or other portfolio within the plan, if applicable, and the name of the state that sponsors the plan, if that name otherwise would not be identified. Disclosure of point of sale information for 529 savings plan interests also would include brief text reminding customers to consider the potential tax benefits of investing in the plan of their home state.

c. *Combined use of standardized and transaction-specific cost disclosure.* Costs associated with investments in covered securities would be shown using standardized \$1,000, \$50,000 and \$100,000 payment or investment amounts. In addition, if a customer requests at the point of sale, broker-dealers would be required to use “fill in the blank” boxes to disclose cost information reflecting the customer’s anticipated payment amount.<sup>17</sup>

<sup>17</sup> There are potential disclosure efficiencies associated with standardized disclosure, such as the use of preprinted forms. At the same time, however, our testing has shown that many investors want information at the point of sale that is specific to the anticipated amount of their purchase. The proposed new forms are intended to strike a balance between the use of standardized disclosure and the ability for interested investors to receive more personalized information.

In developing these new proposed forms, we considered disclosing information based on a \$10,000 hypothetical investment. However, our investor testing indicated that disclosure based on a \$1,000 hypothetical investment should permit customers to more easily estimate the costs for their actual purchase amount than disclosures based on a \$10,000 hypothetical investment. Furthermore, disclosure of information based on hypothetical \$50,000 and \$100,000 investments provide

d. *Presentation of sales fee disclosure.* Based on the standardized payment amounts (for securities with an upfront sales fee)<sup>18</sup> or investment amounts (for other securities), broker-dealers would be required to disclose on the forms sales fees in dollars and as a percentage of the amount invested.<sup>19</sup> For securities with an upfront sales fee, the forms would contain an additional column for the net amount invested. Broker-dealers would be required to disclose the back end sales fee on the form as a “maximum”, reflecting the highest back end fee a customer could expect to pay if the investment did not appreciate or depreciate.<sup>20</sup> Broker-dealers would also be required to disclose on the forms a brief statement about the possible availability of breakpoint discounts, referred to on the forms as “volume discounts.”

e. *Comprehensive annual cost disclosure.* In the Proposing Release, we proposed to require broker-dealers to disclose only distribution-related costs. However, in response to the comments and investor testing described above, we now propose to require broker-dealers to disclose on the proposed new forms comprehensive information about all the costs of owning the securities subject to disclosure, including investment company costs such as “management fees” and “other expenses” that are disclosed in the prospectus. The disclosure of those costs would be made in both dollar terms and as a percentage of investment value. Because our investor testing showed that disclosure of costs appears to be most effective when all the components of the costs are identified, broker-dealers would be required to show the breakdown of annual costs by category. In addition, they would be required to disclose any flat annual fees, such as the account fee illustrated on Attachment 1.

f. *Disclosures tailored to share class and pricing structure.* Broker-dealers would be required to tailor point of sale disclosures to reflect particular share classes or other pricing structures that are applicable to a contemplated

additional context and also illustrate the effect of breakpoint discounts on upfront sales loads (referred to on the forms and in this release as “sales fees” for mutual funds).

<sup>18</sup> Whenever an upfront sales fee is charged, the amount of the investment is less than what the customer pays.

<sup>19</sup> The “investment amount” could be defined to equal the customer’s total payment less the upfront sales fee.

<sup>20</sup> The amount of any back end sales fee depends on the time an investor sells the covered security and the net asset value of the covered security at that time, the actual amount of the fee would not be known at the point of sale.

purchase. Accordingly, point of sale disclosure would be required for all share classes and pricing structures, not just the front-end, back-end, and “level load” structures set forth in the attachments (commonly referred to as A, B, and C share classes). Broker-dealers selling any other share classes or pricing structures would be required to provide the applicable disclosures from the attached forms.

g. *Disclosure of all share classes under consideration.* A broker-dealer would have to provide point of sale information with regard to all share classes that are under consideration at the point of sale, including share classes other than the typical A, B, and C share classes.

h. *Disclosure of revenue sharing arrangements.* Broker-dealers would be required to disclose the existence of revenue sharing payments they receive for promoting covered securities as a conflict of interest. Consistent with the proposed Internet disclosure requirements discussed below, broker-dealers would also be required to disclose on the point of sale forms an Internet Web site and a toll-free telephone number customers can use to find more detailed information about disclosures of those payments, including the amounts of, and sources of, the payments.<sup>21</sup>

i. *Disclosure of special incentives to broker-dealer sales personnel.* Broker-dealers would be required to disclose the fact, if true, that they pay their personnel proportionately more for selling the covered security than for others (*i.e.*, whether they pay differential compensation) or for selling certain share classes over others.<sup>22</sup> The

<sup>21</sup> Broker-dealers would not be required to include the amounts of revenue sharing payments on the point of sale disclosure forms, or on transaction confirmations. This differs from the proposed rules described in the Proposing Release. Some investors expressed more interest in information about the existence of the conflict of interest created by the revenue sharing payments than the amounts paid under revenue sharing arrangements. While descriptive information about the conflicts posed by revenue sharing arrangements is necessary to inform customers about the conflicts of interest facing their agents, as discussed below in part IV, Internet-based disclosure may be a preferable means for giving investors detailed and more thorough information about revenue sharing payments their broker-dealer receives and the conflicts of interest those payments create.

<sup>22</sup> As proposed, point of sale disclosure of differential compensation practices would not cover situations in which an associated person has a financial incentive to sell securities that pay a relatively high dealer concession or commission to the broker-dealer, even though that could translate into a relatively high payment to the associated person. That type of compensation incentive was not proposed to be captured at the point of sale due to the need to keep point of sale disclosure simple

forms would inform investors of where to find out more detailed disclosures of broker compensation and the special incentives paid to sales personnel for selling certain funds over others.<sup>23</sup>

j. *Reference to the fund prospectus as the primary source of information about the fund.* Broker-dealers would be required to include a statement that customers should consider all costs, goals and risks before purchasing a covered security, direct customers to the security's prospectus or official statement for more information, and inform customers that the broker-dealer can provide those documents, including the disclosure regarding special incentives.

k. *Permissive omission of categories where no information is applicable.* Broker-dealers would be able to omit any categories of information that are not applicable. For example, if the disclosure on the forms about a conflicts of interest is "NO," broker-dealers could, but are not required to, omit that disclosure.

### 3. Request for Additional Comments

Would the proposed new point of sale disclosure forms outlined above and attached improve decisionmaking by providing investors with the right information about covered securities prior to purchasing those securities? Commenters are invited to discuss the effectiveness of the proposed point of sale disclosure forms in Attachments 1–6 and to suggest alternatives and modifications. Commenters specifically are invited to discuss:

Q. *Clarity of the forms.* Do the proposed new forms in Attachments 1–6 strike an appropriate balance between

and the risk that such disclosure either would invariably lead to a "yes" answer or else would be too unwieldy at the point of sale. See Proposing Release n. 105.

<sup>23</sup> As with disclosure of revenue sharing payments, investors in general expressed more interest in information about costs they would pay than in information about how broker-dealers were compensated. Accordingly, the forms would not require disclosure of the standard dealer concession that broker-dealers receive to sell the covered security. As discussed below in part IV, Internet-based disclosure may be a preferable means for giving customers quantified information about how their brokers are being compensated.

Because we prohibited the use of brokerage to promote distribution in September 2004, point of sale disclosure of information about portfolio brokerage commissions no longer would be necessary. See Investment Company Act Release No. 26591 (Sept. 2, 2004), 69 FR 54728 (Sept. 9, 2004). The NASD has adopted a corresponding amendment to its rules governing broker-dealers, and NASD rules for several years have prohibited member broker-dealers from favoring or disfavoring any fund based on expected brokerage commissions. See Securities Exchange Act Release No. 50883 (Dec. 20, 2004), 69 FR 77286 (Dec. 27, 2004).

the use of plain English and the need for specific disclosure of information about the costs and conflicts associated with purchases of covered securities? Is the terminology used in the forms easily understandable? If not, how should it be modified? For example, should the disclosure of annual fees on the forms include the term "12b–1 fee" to refer to annual distribution and service fees paid to broker-dealers for selling a covered security? Should the disclosure of conflicts of interest on the forms include the term "revenue sharing," so that investors may connect the information on the forms with information they receive through other disclosure documents or the media? Would the use of the terms "12b–1 fee" and "revenue sharing" be confusing? If so, what other terms are appropriate substitutes? Also, are there other terms that should be included on the forms?

• Is it appropriate for the Commission to mandate the format of the forms, including font size and layout? If the format of the forms is not mandated, is it likely, either intentionally or unintentionally, that broker-dealers would obscure the information being disclosed?

• Should the forms contain a "date line" where the broker-dealer would be required to fill in the date when the point of sale disclosures were communicated to the investor? Would such a requirement aid in assuring compliance with the rule? For point of sale information delivered orally, should broker-dealers be required to notify the customer that the information is current as of the date of disclosure?

• Should the forms contain a "signature line" which customers would be required to sign to evidence receipt of the point of sale disclosures? Would such a requirement aid in assuring compliance with the rule? Could it cause broker-dealers to make point of sale disclosures later in the selling process in order to avoid having customers sign multiple disclosure forms? How would such a "signature line" requirement be implemented for oral point of sale disclosures?

Q. *Identification of security subject to disclosure.* Do the attached proposed forms appropriately set forth the covered security's issuer and class or pricing structure, ticker symbol (if applicable), and other portfolio or fund designations as necessary to identify the security and differentiate it from the issuer's other securities?

• In a transaction involving a 529 savings plan interest or variable insurance product, point of sale disclosure would be required to encompass costs related to a number of

underlying securities (such as 12b–1 fees imposed at the level of the underlying security), and conflicts related to underlying securities (such as revenue sharing paid for distribution of those securities). Should broker-dealers be required to inform investors that the information being disclosed reflects costs and conflicts arising from securities underlying the covered security that is being directly purchased, as well as the costs and conflicts directly applicable to the covered security? Should broker-dealers also be required to disclose the identity of the securities underlying the covered security that is being directly purchased? Are there certain circumstances where such disclosure should be required, such as when that information is not otherwise available?

• For interests in a 529 savings plan, should broker-dealers be required to identify a specific age-based portfolio or other portfolio within the plan, to the extent a specific portfolio has been identified at the point of sale?

Alternatively, if the underlying portfolio has not been identified at the point of sale, should the broker-dealer be able to provide a disclosure document setting forth maximum costs (*i.e.*, maximum sales fee and maximum annual ownership costs) associated with all portfolios underlying the plan? To what extent do investors purchase interests in 529 plans without already having identified the underlying portfolio for the investment? If the state sponsoring a plan is not otherwise identified, should the broker also be required to disclose the name of the state in order to help customers determine whether they may be entitled to state tax deductions or other benefits for investing in that state's plan?

• Some states offer state tax benefits for investments in the 529 savings plans they sponsor. If residents of those states invest in a different state's 529 savings plan, they generally would not be eligible to receive the state tax benefits. Attachments 4–6 include a brief text reminding customers to consider the potential tax benefits of investing in a plan sponsored by their home state. Is this disclosure appropriate? Should it be modified, narrowed, or expanded?

Q. *Combined use of standardized and transaction-specific cost disclosure.* The proposed new forms would combine disclosure of standardized information with disclosure of transaction-specific information upon customer request, or in accordance with a broker-dealer's standard practice. Does this approach appropriately balance the cost savings of standardized disclosure with the effectiveness of transaction-specific

disclosure? Should the Commission require that the brokers disclose transaction-specific information in all situations, and not just upon request? Alternatively, are there certain situations or products for which transaction-specific information should always be required?

**Q. *Presentation of sales fee disclosure.*** Would the disclosure of upfront sales fees in the forms in Attachments 1–6—with separate columns for payment amount, fee in dollars, investment and fee as a percentage of net investment—effectively communicate information about the amount of those fees and their immediate impact on investment? If not, how should the forms be modified? Would it be appropriate to exclude the impact of letters of intent, rights of accumulation, purchases by related parties, or other customer-specific discounts, in light of the additional costs and complexity that could be associated with their inclusion?

- For disclosure of upfront sales fees, should the “investment amount” equal the customer’s payment less the amount of the sales fee? Should other fees, such as broker-imposed commissions or purchase fees, be deducted to determine the “investment amount”?

- Would the proposed disclosure of deferred sales fees in the forms—with separate columns for investment amount, maximum fee in dollars and fee as a percentage of investment amount—effectively communicate information about the potential amount of those fees? Would focusing on maximum amounts of those fees, rather than providing year-by-year breakdowns, effectively convey information about those fees’ potential impact?

**Q. *Comprehensive annual cost disclosure.*** Would the proposed method of disclosing comprehensive annual costs in the forms in Attachments 1–6—with separate columns for investment amount and fees in dollars and fee as a percentage of investment amount—effectively communicate illustrative information about the potential amount of, and likely variations in, those costs? Would the proposed new point of sale disclosure forms adequately put investors on notice that the disclosed amount of the annual costs are illustrative, and that actual amounts are likely to vary? Should the forms include a statement that such annual costs would not be directly taken out of the investor’s accounts—and would not be subject to separate disclosure as they are incurred—but rather would continuously be paid out of the assets of the funds the investor has purchased (including underlying funds in two-

tiered 529 savings plan interests and variable insurance products)?

- Should point of sale disclosure include all the costs to the investor associated with owning covered securities (including mutual fund management and other costs), and not only distribution costs? If not, what costs should be included? Commenters are also invited to discuss whether investors perceive the economic impact of costs differently based on whether costs are charged directly or indirectly (*i.e.*, fees that are deducted from fund assets).

- Should we require each category of annual fee to be separately quantified in percentage terms, as set forth in the proposed new forms? Should we require the aggregate of those annual ownership fees also to be quantified in dollar terms (based on the potential quantification standards discussed above)? Are there better ways to inform investors about the scope of those costs in dollar terms and to help investors understand the economic consequences of annual fees on an investment?

- Should point of sale disclosure set forth information about account fees that issuers may charge to typical investors in the covered security (other than fees that apply only in limited circumstances, such as returned check fees)? Should such account fees be expressed as a fixed dollar amount and/or as a percentage of assets (whichever is applicable)? If fees are applied only on accounts that are valued below a specified amount, should this threshold amount be disclosed? Commenters are also invited to discuss how disclosure of such fees could be expected to influence customers’ decisions to purchase covered securities. Commenters also are invited to identify other fees that should be disclosed at point of sale, and discuss how disclosure could be done effectively.

- We also invite comment on the costs associated with providing dollar quantification of comprehensive fees, including the extent to which disclosure of transaction-specific information upon a customer’s request would increase compliance costs.

- We note that the approach discussed here would require broker-dealers to make certain disclosures based on estimates, such as estimates of future first year ownership costs calculated with a total annual fee percentage that is derived from expense ratios reported in the current prospectus. The dollar estimates of those future first year costs also would be based on the assumption that the net asset value of an investment would not change during the first year following

the investment. Broker-dealers would be required by rule to deliver those estimates, even though future outcomes may well differ from the estimates. Should the Commission address concerns about exposure to unfair private actions, for example, by requiring additional disclosures or providing a safe harbor? We would not expect private rights of action to result from non-fraudulent disclosures under the rule even if, for example, a broker-dealer erred by negligently transposing numbers between information in the prospectus and information reported at the point of sale.

**Q.** In addition to disclosing cost information category-by-category (*e.g.*, sales fees and annual ownership costs), should point of sale disclosure also depict ownership costs on an aggregate basis? Alternatively, should aggregate information be disclosed in lieu of category-by-category disclosure? Mutual fund prospectuses are required to estimate the total expenses associated with a \$10,000 investment over one, three, five and ten year time horizons, based on an assumed five percent return and other assumptions. Those estimates help investors quantify the combined impact of disparate ownership costs such as sales fees and ongoing ownership costs. Those estimates also facilitate comparisons among share classes and funds. Would point of sale disclosure of information that similarly quantifies the aggregate impact of multiple cost categories provide a useful supplement to, or replacement for, category-by-category disclosure of ownership costs? If so, should disclosures of aggregate information reflect a range of investment amounts (such as \$1,000, \$50,000 and \$100,000), consistent with other cost disclosures on the written point of sale form? On the other hand, would disclosure of aggregate cost information as a supplement to category-by-category information potentially confuse some investors by leading them to believe that those aggregate costs would be incurred in addition to other disclosed costs, rather than being an alternative way of expressing those costs? Would disclosure of aggregate information as a supplement to category-by-category information threaten to pose “information overload” that would reduce some investors’ use of point of sale disclosure? Would aggregate information be suitable as a replacement for disclosure of category-by-category information? Alternatively, would aggregate information be inadequate as a replacement for category-by-category information? For example, would

aggregate information fail to explicitly inform investors about the types and timing of ownership costs that they would incur if they purchase a covered security? Further, would aggregate information be inadequate because its accuracy depends on the accuracy of underlying assumptions? Commenters are invited to suggest models by which aggregate cost information could be disclosed clearly on written point of sale forms as a supplement to, or a replacement for, category-by-category information.<sup>24</sup>

Q. *Disclosures tailored to share class and pricing structure.* Should the Commission adopt separate forms for all share classes and pricing structures?<sup>25</sup> In the alternative, should the Commission adopt an additional form that would permit disclosure of all potential costs for all share classes and pricing structures of mutual fund and 529 savings plan investments, including purchase and redemption fees that are paid into fund assets?<sup>26</sup> How could disclosure of the costs of owning classes of covered securities that are not illustrated by one of the forms attached as Attachments 1–6 (or funds with different pricing structures than those illustrated) be efficiently implemented?

- Do the proposed new forms appropriately require disclosure of information about fees customers must pay upon purchase or redemption that are retained in fund assets (as distinct from sales loads and commissions that are paid to broker-dealers)? Should the required disclosure of redemption fees reflect the duration of such redemption fees? Should this type of disclosure be required to be quantitative or narrative, depending on the fee being disclosed? For example, should redemption fees imposed on short-term holdings (such as holdings of 180 days or less) be disclosed in narrative terms, with other redemption fees disclosed the same way that back-end sales loads would be disclosed (consistent with the

quantification standards discussed above)? Should it include other information about other costs of owning covered securities not otherwise required to be disclosed in our proposed rules and forms, such as the one-time application fees that some states charge upon initial investments in their 529 savings plan interests? Is the placement of the disclosure of the application fee on the B and C class disclosures for 529 plans appropriate?

Q. *Disclosure of all share classes under consideration.* Would it be appropriate to require a broker-dealer to provide point of sale information with regard to all share classes that are under consideration at the point of sale?

Q. *Disclosure of revenue sharing payments.* Do the point of sale disclosure forms in Attachments 1–6 provide sufficient information about revenue sharing arrangements, including where to find more detail about those arrangements, to inform customer's investment decisions? In light of concerns expressed by commenters, including investors, that complex disclosures potentially could distract investors from other important information, is it appropriate to omit the sources and amounts of revenue sharing payments received by the broker-dealer from point of sale disclosures and require them instead to be disclosed on the Internet and made available to customers upon request through a toll-free number? On the other hand, investors may find this information useful at the point of sale. Should we require the disclosure of the source and amount of revenue sharing payments at the point of sale? Commenters are invited to discuss how revenue sharing information can be disclosed simply and efficiently.

- Should the requirement to disclose the existence of revenue sharing payments focus on payments, either to a broker-dealer or its affiliate, that are directly or indirectly funded by some or all of the following: an investment adviser; a principal underwriter; and an administrator or transfer agent of the issuer of the covered security (and of issuers of underlying securities with regard to two-tiered products)?<sup>27</sup> Should the disclosure requirement extend to payments from issuers and/or from other parties not specifically identified above?<sup>28</sup> Would such a

requirement be adequate to prevent evasion of the proposed disclosure obligation? The revenue sharing disclosure obligation set forth in the Proposing Release focused on payments received from persons "within the fund complex." Under this targeted approach to disclosure of revenue sharing payments, would it be appropriate to eliminate the definition of "fund complex"?

- Should the proposed definition of "revenue sharing" be replaced by a definition of "promotional payment" to more accurately reflect the nature of such payments? If the required disclosure were to be targeted, as discussed above, to payments received from investment advisers, principal underwriters, administrators or transfer agents, should the definition of either "revenue sharing" generally encompass payments from an investment adviser, principal underwriter, administrator or transfer agent to a broker-dealer or associated person? Should payments that constitute dealer concessions be excluded from the definition because dealer concessions do not raise the same conflicts as special compensation arrangements, which warrant special disclosure?<sup>29</sup> Should payments funded by asset-based distribution fees (such as rule 12b–1 fees) be excluded because they would be included elsewhere in the point of sale disclosure? Should payments that represent compensation for providing services as a principal underwriter of a covered security be included or do those payments not pose the same conflicts of interest?<sup>30</sup>

Should payments to an issuing insurance company from funds underlying variable insurance products be included? What conflicts do these payments pose? Would other inclusions or exclusions be appropriate?

- If the revenue sharing disclosure were targeted, as discussed above, should the required disclosure exclude payments made "solely in connection"

distribution of covered securities, such an approach may inject too great an element of subjectivity into the disclosure requirement, by permitting a broker-dealer to characterize a particular payment as not distribution-related, and claim no need to disclose it. It may be more effective to implement an approach that requires disclosure of the types of payments that can be expected to compensate broker-dealers for distribution, and that does not reach to other payments.

<sup>29</sup> As defined in the Proposing Release, the dealer concession consists of fees earned by the broker-dealer at the time of sale from the issuer or its agent, the distributor or another broker-dealer.

<sup>30</sup> The point of sale rules propose an exception for underwriters. Even if a targeted underwriter exclusion were adopted, however, such a carve-out might be inappropriate at times, such as when an underwriter is broker of record on an "orphan" account originated by another broker-dealer.

<sup>24</sup> Disclosure of aggregate cost information also may facilitate the disclosure and use of comparative information at the point of sale. That is because it may be easier for many investors to weigh a single aggregate cost amount against the benchmark posed by the aggregate cost average and range for alternative funds, than it would be to separately weigh the comparative context of upfront sales fees, deferred sales fees and annual ownership costs. As discussed above, we expect to address possible requirements for disclosure of comparative information in a later release.

<sup>25</sup> Other pricing structures would include purchase and redemption fees some funds charge and which are paid into fund assets rather than for distribution.

<sup>26</sup> For example, in the Proposing Release the Commission set forth a generic point of sale form that was not specific to any particular share class or pricing structure.

<sup>27</sup> Such an approach would be an alternative to the proposed requirement that the broker-dealer identify payments received from persons within a "fund complex", including affiliates of the fund but not the fund issuer.

<sup>28</sup> While a commenter has suggested that the revenue sharing disclosure requirement be limited to payments "in connection with" the sale or

with securities issued by a person that is not a “related issuer” of the issuer of the covered security? If so, would a definition of “related issuer” appropriately encompass the issuer of the covered security (and underlying securities in the case of two-tiered products), and the issuers of other covered securities that hold themselves out as related companies for purposes of investment or investor services, as well as other affiliated issuers?<sup>31</sup> Would there be better ways of excluding payments that are intended to promote the sale of a covered security other than the security that the customer is considering purchasing?

- If the required revenue sharing disclosures were targeted in such a way, should the disclosure requirement further exclude payments received by an associated person if the broker-dealer making the disclosure reasonably determined that the associated person received those payments solely in connection with the distribution of covered securities by a different broker-dealer or by a bank?<sup>32</sup> Are there other ways of excluding payments to affiliates that would not pose conflicts of interest for the broker-dealer and would pose fewer compliance challenges? Would such an exclusion for payments received by affiliates that are linked solely to a second broker-dealer’s distribution activities be justified in part by the expectation that the second broker-dealer would be required to provide point of sale disclosures to put its own customers on notice of those payments? Should such an exclusion apply if payments received by an affiliate are not solely linked to the

distribution activities of a second broker-dealer or a bank?

- If payments received by an affiliate of a broker-dealer would not have to be disclosed if they are “solely connected” with the distribution activities of another broker-dealer or a bank, what facts and circumstances should a broker-dealer have to consider to determine whether revenue sharing received by an affiliate are in fact “solely connected” with the distribution activities of another broker-dealer or a bank?<sup>33</sup> In the case of payments that do not represent transaction-based or asset-based payment streams, such as payments that are designated as compensation for seminar sponsorship, should the broker-dealer be permitted to avoid having to disclose payments received by an affiliated broker-dealer if the payments that it receives and the payments that the affiliated broker-dealer receives are reasonably proportional to the relative size of the two broker-dealers’ distribution activities?<sup>34</sup>

- Would such a comprehensive alternative to revenue sharing disclosure, including the possible elimination of the definition of “fund complex,” adequately exclude payments that a broker-dealer receives in connection with underwriting municipal bonds?

- Is the description in the attached forms of the conflict that arises as a result of revenue sharing arrangements readily understandable? If not, how should it be modified? Should the term “revenue sharing” be explicitly stated in the description of the conflict or would this term be confusing?

*Q. Disclosure of special incentives to broker-dealer sales personnel.* Broker-

dealers would be required to disclose on the proposed new forms, if true, that sales personnel are paid more for selling the covered security over other securities. Is this disclosure appropriate? Is it useful to investors? Is the language used to describe this conflict of interest appropriate? Should point of sale disclosure of differential compensation practices cover situations in which securities pay a relatively high dealer concession or commission to the broker-dealer, rather than only the situation where a broker-dealer provides an extra financial incentive to its sales personnel for selling a covered security?

- In light of concerns expressed by commenters that overly complex disclosures could distract investors from other important information, is it appropriate and helpful to omit quantified information about dealer concessions from point of sale disclosures and require it instead to be disclosed on the Internet, as discussed below?

- In addition, the attached forms for class B and class C shares would require disclosure of the fact, if true, that sales personnel are paid more for selling those classes of securities than class A shares. Is this disclosure appropriate? Is it helpful to investors? Should it appear on the forms for other classes of shares?

- Do the references pointing investors to the broker-dealer’s Web site for more information about “special incentives” adequately inform investors of where they can find more details about revenue sharing payments? Should other terms be used, such as “extra incentives” or “conflicts of interest”?

*Q. References to the fund prospectus as the primary source of information about the fund.* Would the approach for disclosure of other information on the forms in Attachments 1–6 (apart from ownership costs and conflicts of interest), such as the fact that investors should take other factors into account when making investment decisions, strike a reasonable balance between disclosure that is easy to understand and disclosure that is appropriately comprehensive?

*Q. Permissive omission of categories where no information is applicable.* Would it be appropriate to permit broker-dealers to omit categories of information that are not applicable, or should disclosure of such categories be required to promote comparability? Should conflict of interest information be presented in all situations to provide investors with full conflict information about all funds they are considering? Should some sections be required to be omitted if inapplicable, such as sections on upfront fees for forms for variable

<sup>31</sup> Such a definition would be consistent with other securities laws provisions that identify investment company affiliates in part depending on whether two companies hold themselves out as related companies. See, e.g., Exchange Act rule 15a-6 (defining term “family of investment companies” in part based on whether registered investment companies that share the same investment adviser or principal underwriter “hold themselves out to investors as related companies for purposes of investment and investor services”); Investment Company Act rule 11a-3 (defining term “group of investment companies” in part based on whether registered open-end investment companies hold themselves out to investors as related companies for purposes of investment and investor services).

<sup>32</sup> Securities activities by banks are subject to a different regulatory regime, so long as the banks meet applicable exceptions and exemptions from the definitions of “broker” and “dealer” set forth in Sections 3(a)(4)(B) and 3(a)(5)(B) of the Exchange Act and the rules thereunder. See also Securities Exchange Act Release No. 50618 (Nov. 1, 2004) (order extending temporary exemption of banks, savings associations, and savings banks from the definition of “broker” under Section 3(a)(4) of the Exchange Act).

<sup>33</sup> For example, would it be reasonable to conclude that payments received by an associated person (including a second broker-dealer or a bank) are solely in connection with the distribution activities of a second broker-dealer or a bank—and hence to fall within such an exclusion—if the payments are comprised of transaction-based streams that are linked solely to transactions effected by that other broker-dealer or bank, or if the payments are comprised of asset-based streams that are linked solely to assets held by customers of that other broker-dealer or bank?

<sup>34</sup> For instance, if the disclosing broker-dealer and the affiliated broker-dealer each have sold roughly the same amount of covered securities on behalf of the fund complex in the past year, and the two broker-dealers each received roughly the same amount of such miscellaneous payments, then would it be reasonable for the disclosing broker-dealer to conclude that the miscellaneous payments received by the affiliated broker-dealer were solely in connection with the affiliated broker-dealer’s distribution activities? If, in contrast, the affiliated broker-dealer received materially more of those miscellaneous revenue sharing payments than the disclosing broker-dealer, while relative sales still were roughly the same, then would the disclosing broker-dealer reasonably have to inform the customer about those payments?

annuities that do not charge them? Would disclosure of some inapplicable information (for example, the fact, if true, that a broker-dealer is not paid extra for promoting one fund over others) serve to educate investors, or enhance their understanding of the remaining disclosure?

- In addition, would it be appropriate to permit broker-dealers to omit all point of sale information, thereby eliminating all point of sale disclosures, in circumstances where there are no distribution-related expenses or conflicts of interest required to be disclosed at the point of sale? Would such an approach create a competitive advantage for funds that take advantage of such an exception? Would any such advantage be appropriate?

#### B. Oral Disclosure of Point of Sale Information

Commenters expressed a variety of views about the proposed requirement for point of sale information to be disclosed orally when the point of sale occurs through means of oral communication other than at an in-person meeting (such as through a telephone conversation). Some consumer advocates questioned whether oral disclosure ever would be appropriate in light of difficulties associated with monitoring compliance and the need to give investors the opportunity to consider the point of sale information when making investment decisions. Some securities industry commenters suggested replacing oral disclosure with Internet-based alternatives or after-the-fact disclosure. Others stated that a verbatim reading of the point of sale form would not be practical and that disclosure of summary information should be sufficient. Commenters also stated that customers should be able to opt out of disclosure in certain circumstances, such as when orders are placed through automated telephone systems.

As the comments indicate, oral point of sale disclosure poses special challenges given the difficulty that could be associated with hearing complex information without simultaneously seeing it. However, we are concerned that Web site disclosure or after-the-fact disclosure could be ineffective at providing investors with key information about costs and conflicts contemporaneous with investment decisions as point of sale disclosure. Moreover, we are concerned that requiring broker-dealers to provide all point of sale disclosures in writing prior to accepting an order might preclude investors from purchasing

mutual funds and related securities over the telephone without undue delay.<sup>35</sup>

In light of these concerns, we believe that one possible way to make oral point of sale disclosure more effective could be to require broker-dealers to provide oral point of sale information that is either: (A) Quantified to reflect the anticipated amount of the purchase; or (b) quantified to reflect a standardized purchase amount—\$1,000, \$50,000 or \$100,000—that would be appropriate based on the customer's anticipated payment and the fee schedule of the covered security (or \$1,000 if that amount is not readily estimable), supplemented by transaction-specific quantification upon the investor's request.<sup>36</sup>

A second possibility could be to clarify that oral disclosure would not require a verbatim reading of the written disclosure form. Instead, in addition to the quantitative information discussed above, broker-dealers would be required to provide summary qualitative information about whether they receive revenue sharing payments or engage in differential compensation practices, as well as to disclose other information useful to investors (some of which are suggested in the questions below). This could include requiring disclosure that they are required to provide transaction-specific quantified information upon the customer's request (if such transaction-specific information has not been provided as a matter of course). Under such an approach, broker-dealers would be able to omit categories of costs that are not applicable to a contemplated purchase.

A third possibility could be to permit a broker-dealer using an automated telephone system to receive customer purchase orders to program the system to convey the required point of sale information about sales fees and then allow customers to elect not to listen to information, other than about sales fees, that otherwise would have to be disclosed in a written disclosure document. Such an exception could

<sup>35</sup> As discussed more fully below, we are considering ways to combine written and oral point of sale disclosure. We would expect any written disclosure supplementing oral point of sale disclosure to be provided contemporaneously.

<sup>36</sup> Under the latter type of arrangement, the broker-dealer would not be able to "round up" the standardized disclosure amount to reduce the apparent percentage sales fee communicated through oral disclosure. For example, if the anticipated amount of the payment is \$85,000, standardized information with regard to a \$50,000 model payment may be more appropriate for disclosure of upfront sales fees than standardized information with regard to a \$100,000 model payment, if the \$50,000 model more accurately depicts the percentage sales fee associated with the customer's anticipated payment.

accommodate the preference of some investors not to hear point of sale information, while helping to ensure that investors at a minimum are provided with information about sales fees. This alternative would not appear appropriate when a customer communicates with a natural person associated with a broker-dealer as part of the process of placing an order because, in these circumstances, the natural person would be well positioned to provide disclosure and respond to investor questions.<sup>37</sup>

*Request for comment.* The Commission generally seeks comment on oral point of sale disclosure. To make oral point of sale disclosure more effective, should the Commission adopt one of the alternatives outlined above, or some combination of the alternatives? Would any of the alternatives be more effective than others? Would some combination of the alternatives be effective? Should the Commission require the broker-dealer to provide an investor a written copy of the disclosure form following each oral conversation? Should that disclosure be limited to an oral conversation that results in the customer placing an order? Are there other alternatives not discussed above that would make oral point of sale disclosure more effective? Commenters specifically are invited to address:

Q. Would the proposed revised quantification standards for oral disclosure better permit investors to obtain sufficient information about the costs of owning covered securities than our original proposal? Would this approach provide investors with a reasonable amount of specificity without "information overload"? If not, what other approaches should the Commission consider? Are disclosures based on standardized \$1,000, \$50,000 or \$100,000 amounts appropriate? Would different or additional standardized amounts be appropriate (e.g. \$10,000)? Should we adopt additional requirements to inform customers that the costs they may incur may be different than those disclosed at the point of sale due to the effects of rounding?<sup>38</sup>

Q. When point of sale disclosure is made orally, would it be practical to require broker-dealers to disclose that they are required to provide transaction-specific quantified information upon the customer's request (if such transaction-specific information has not been

<sup>37</sup> Such an alternative would not permit a broker-dealer to require a customer to "opt into" point of sale disclosure, but simply would allow a customer to affirmatively "opt out" of such disclosure.

<sup>38</sup> See Proposing Release, n. 155 (discussing the impact of rounding).

provided as a matter of course)? Would it lead to practical and effective disclosure if we were to require broker-dealers to disclose that investors should consider all costs, goals and risks associated with potential investments before making purchases, and that related information is available in the applicable prospectus or official statement which the broker-dealer can provide to the customer? Would it lead to practical and effective disclosure if we were to require a broker-dealer to inform customers that they can inquire about special incentives that the broker-dealer may receive to sell the covered security? If not, how should we require that a broker-dealer provide an investor with adequate disclosure about these special incentives?

Q. If a customer is contemplating buying a security with an upfront sales fee, would it be appropriate and useful for the customer to receive disclosure that he or she may qualify for fee discounts if the customer or members of the customer's family holds other shares from the fund family, or if the investor agrees to make additional purchases? Should broker-dealers have to disclose additional types of qualitative information? If so, what sort of information? For any such category of information, should the rules permit the broker-dealer to omit any disclosure conditioned on the broker-dealer's providing the customer with additional information in writing at a later time? Should there be any other conditions a broker-dealer would have to meet before being able to do so?

Q. Would it be useful to investors to require broker-dealers to disclose that investors should consider all costs, goals and risks associated with potential investments before making purchases, and that related information is available in the applicable prospectus or official statement which the broker-dealer can provide to the customer? Would it be useful to investors to require a broker-dealer to inform customers that they can inquire about special incentives that the broker-dealer may receive to sell the covered security? If not, how should we require that a broker-dealer provide an investor with sufficient disclosure about these special incentives?

Q. Would it be useful to investors if the Commission were to clarify that when providing oral disclosure a broker-dealer must provide summary qualitative information about whether a broker-dealer receives revenue sharing payments or engages in differential compensation practices? What other information would be useful to investors to receive if broker-dealers were permitted to summarize qualitative

information? Are there compliance procedures that would help ensure that permitting broker-dealers to summarize qualitative information would not lead to situations where brokers obscure the information being disclosed?

Q. Would it be appropriate to allow investors using automated telephone order systems to "opt out" of receiving certain oral point of sale disclosures? If so, what categories of information should be mandated and what categories subject to the opt-out right? If investors could opt out, would they still receive sufficiently helpful information to make an investment decision? Could an exception permitting customers to "opt out" of oral point of sale disclosure for orders taken via automated telephone systems be subject to manipulation intended to deter delivery of point of sale disclosure? What limitations could minimize or eliminate this potential? Should we require broker-dealers to send written point of sale disclosures to customers who opt out of oral point of sale disclosures for orders taken via automated telephone systems?

Q. Would it be helpful to investors who receive oral point of sale disclosure to receive both the quantitative information discussed above, as well as summary qualitative information about whether their broker-dealer receives revenue sharing payments or engages in differential compensation practices? Is there a minimum amount and/or type of information that should be mandated for oral point of sale disclosure? What should be the required key items to help investors make informed investment decisions?

Q. Would it be appropriate to permit broker-dealers to make Internet-based disclosures or e-mail disclosures to those customers who consent to electronic delivery? Should Internet-based or e-mail disclosures be made in the same format as that of the proposed point of sale disclosure forms? On what basis should the Commission permit a broker-dealer to do this? What limitations or procedures should apply to help ensure that customers actually receive written disclosures at the point of sale?

### C. Timing of Point of Sale Disclosure

The proposed definition of "point of sale" would have determined the timing of disclosure through a two-tiered approach. In general, the proposed rule would have required disclosure "immediately prior" to acceptance of the order. In circumstances in which a broker-dealer could solicit transactions and receive compensation without opening customer accounts or handling

customer orders, however, disclosure would have to have been received upon initial communication with a customer.

Consumer advocates stated that investors should receive disclosure earlier in the sales process to have adequate time to consider the information when making investment decisions. They suggested adding a time-of-recommendation component to trigger the disclosure. Some securities industry commenters suggested that point of sale disclosure could be provided most efficiently at the time of account opening. Some also indicated that the proposed communication-based standard would be difficult to implement and would lead to duplicative disclosure.

The timing of point of sale disclosure is critically important, as investors should receive information early enough in the sales process to give them adequate time to consider the information, but not so early that they receive multiple disclosures for securities they may not be interested in purchasing. The timing of the point of sale trigger also should reflect the various ways in which customers may convey orders.<sup>39</sup>

*Request for comment.* The Commission solicits comment on the timing of point of sale disclosure. Should the Commission adopt a revised "point of sale" definition that would allow investors to receive disclosure earlier in the sales process than they would have in the initial proposal? If so, how should the Commission define the "point of sale" to promote timely disclosure while minimizing implementation and compliance difficulties? Commenters are also requested to discuss the following issues relating to the "point of sale" definition:

Q. How could the general point of sale trigger be moved earlier in the sales process while remaining meaningful? For example, should it be based on the earlier of the time that a customer expresses a "preliminary intent" to purchase the covered security or the time that a broker-dealer recommends a covered security?<sup>40</sup> If so, should the

<sup>39</sup>For example, an order-based trigger would not appear practical when a broker-dealer can solicit transactions and receive compensation without executing customer orders (such as may be present in so-called "check and application" arrangements), because in these circumstances the purchase may be completed before the soliciting broker-dealer is even aware of the order.

<sup>40</sup>Some commenters have suggested that point of sale information should be disclosed only when a broker-dealer recommends a transaction, not when a customer places an unsolicited order. However, when a broker-dealer does not specifically recommend the securities it is selling, investors

standard for disclosure “immediately prior” to receipt of the order be retained as a backstop if disclosure otherwise is not provided earlier? What regulatory requirements or compliance procedures could help ensure that such an option would be treated as a backstop, rather than the primary option for timing the delivery of point of sale information?<sup>41</sup>

Q. How could the point of sale trigger avoid disclosure gaps when a broker-dealer solicits and is compensated for an order, but does not execute the order? In these circumstances, should the point of sale be the later of the time the broker-dealer “first communicates” with the customer about the covered security, or the time the customer expresses a “potential interest” in purchasing the covered security? Would other standards for the definition of “point of sale” better provide timely disclosure, while reflecting the fact that there may be an ongoing dialogue between the broker-dealer and the customer? If so, what would those standards be?

#### *D. Exceptions to Point of Sale Disclosure Requirements*

##### 1. Exception for Subsequent Purchases of a Particular Covered Security and Class

Some commenters urged the Commission to implement a point of sale exception that encompasses an investor’s non-periodic purchases of a covered security following his or her initial purchase.<sup>42</sup> In their view, the critical decision related to an

may wish to scrutinize whether the fees they are paying to the broker-dealer, and the resulting reduction in net investment and in return on their money, are justified by the relatively limited services they receive. Moreover, even absent an explicit recommendation, a broker-dealer can influence a customer’s investment decision through the way it presents investment options. Allowing disclosure to vary depending on whether a recommendation has occurred also may give some broker-dealers the incentive to inappropriately assert that they are not making recommendations when in fact they are.

<sup>41</sup> We recognize that requiring earlier point of sale disclosure also may impact other proposed rule requirements. For example, one proposed provision of the point of sale rule states that orders would only be “indications of interest” prior to point of sale disclosure being provided. Some commenters criticized that provision as facilitating rescission based on “buyer’s remorse,” and as potentially promoting market timing. Some commenters also raised operational questions related to that provision, such as how trades would be unwound (including whether the issuer would have to enter into an offsetting trade or whether the broker-dealer would simply bear a monetary loss). An earlier point of sale trigger, in combination with other investor remedies for broker-dealer violations of securities regulations, may influence our consideration of whether explicit “indication of interest” language would be appropriate.

<sup>42</sup> The proposed point of sale rule included an exception for periodic purchases.

investment in a covered security is made prior to the investor’s first purchase of that security, and requiring point of sale disclosure for subsequent purchases would be duplicative and unlikely to promote informed investment decisionmaking.

*Request for comment.* We solicit comments on the appropriateness and necessity of point of sale disclosure for subsequent non-periodic purchases of a covered security. Would a subsequent purchase exception appropriately balance the goal of enhancing investment decisionmaking with reducing potentially duplicative disclosures? Commenters specifically are invited to discuss:

Q. How could a point of sale exception for subsequent purchases of a covered security be crafted to reduce disclosures that otherwise would be redundant? Should such an exception be absolute, or should it require occasional redundant disclosure to accommodate investors who might have been distracted at the time of the initial point of sale disclosure, or might have forgotten about it because substantial time has passed since receiving the disclosure?

Q. To address the possibility that prior point of sale information becomes outdated, should the exception be limited by how much time separates the original transaction and the subsequent transaction, such as six months, 12 months, or some other time period? Should such an exception require the broker-dealer periodically to provide the customer with some or all of the information that otherwise would be provided at the point of sale? Should broker-dealers be permitted to satisfy such a requirement by providing standardized point of sale forms periodically to the customer? Should a subsequent purchase exception be conditioned on the broker-dealer providing transaction-specific point of sale disclosures upon the customer’s request? Should an investor be able to request point of sale disclosure and thus override an exception? What other conditions or limitations would be appropriate for such an exception?

Q. Should such an exception apply to purchases of money market funds? If so, how? Should broker-dealers be required to make disclosure about money market funds at the time the customer funds a brokerage account?<sup>43</sup>

Q. To what extent could an exception for subsequent purchases be subject to

<sup>43</sup> Money market funds, including funds that may be purchased through brokerage “sweep” accounts, may bear asset-based distribution fees and may be associated with revenue sharing payments.

abuse by unscrupulous salespersons who seek to obscure the impact of distribution costs by following a relatively modest initial sale that bears small distribution costs with a much larger subsequent sale, without disclosure at the latter time?<sup>44</sup> Are there ways, such as limiting the subsequent sale exception to purchases in amounts equal or less than the initial purchase, that would help prevent such abuse? How would such a limitation affect broker-dealer system costs?

Q. How narrowly should an exception for subsequent purchases be drafted? Would it be enough to limit such an exception to purchases of a covered security having the issuer, program series (or portfolio in the case of 529 savings plans), and share class (or pricing structure in the case of variable insurance products) for which the customer previously received point of sale disclosure from the broker-dealer? In the case of 529 savings plans and variable insurance products, should such an exception be further limited to subsequent purchases of the same portfolio or directed to the same subaccounts?

Q. Would the use of Internet web sites help customers receive point of sale information when making subsequent purchases? For example, would making standardized point of sale information available on the Internet be a useful means by which broker-dealers would be required to provide point of sale information upon subsequent purchases, to customers who want additional information but are willing to accept Internet-based disclosure?

Q. Commenters are invited to estimate the total number of transactions that would be subject to any such exception, as well as the potential cost savings to broker-dealers.

##### 2. Exception for Purchases by Institutional Investors

In proposing rule 15c2-3, we requested comment about whether to include an exception for purchases by institutional investors. Several commenters supported such an exception, and one recommended that we refer to NASD rules to define “institutional investor.”<sup>45</sup>

<sup>44</sup> Does the inclusion of disclosure based on standardized purchase amounts help to address that potential problem?

<sup>45</sup> NASD rules 2211(a)(3) and 3110(c)(4), in conjunction, designate the following persons as “institutional investors”: (i) A bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered with the Commission or with a state securities commission (or any agency or office performing like functions); (iii) any other entity

Continued

*Request for comment.* We request additional comment regarding the advisability, scope and limitations of such an exception. In particular, if the Commission were to adopt an exception for purchases by institutional investors, how could we define “institutional investor” to limit the exception to transactions with persons who may be expected to have sufficient financial sophistication to make point of sale disclosure unnecessary? Commenters are specifically invited to discuss:

Q. Should a definition of “institutional investor” include banks, savings associations, insurance companies, or registered investment companies?

Q. Should it include other entities, including corporations, partnerships and trusts, with total assets of at least \$50 million?<sup>46</sup> Should a \$50 million threshold also apply to government or political subdivisions, or other government agencies or instrumentalities?<sup>47</sup>

Q. Should natural persons with assets of at least \$50 million be included within the definition of “institutional investor”?<sup>48</sup> Commenters may also wish to discuss the extent to which including natural persons would not be necessary if a point of sale exemption for transactions subject to investment adviser discretion, discussed below, were adopted.

Q. Should a definition of “institutional investor” include persons acting solely on behalf of any other person who meets that definition? Should a definition of “institutional investor” be extended to other persons? Should it instead be based on the definition of “qualified investor” set forth in Section 3(a)(54) of the Exchange Act?<sup>49</sup> Alternatively, should the

(whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million; (iv) a governmental entity or subdivision thereof; (v) an employee benefit plan that meets the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and has at least 100 participants (but not including any participant of such a plan); (vi) a qualified plan, as defined in Section 3(a)(12)(C) of the Act, that has at least 100 participants (but not including any participant of such a plan); (vii) an NASD member or registered associated person of such a member; and (viii) a person acting solely on behalf of any such institutional investor.

<sup>46</sup> The \$50 million threshold is consistent with NASD rules.

<sup>47</sup> That \$50 million threshold would be consistent with the “qualified investor” definition set forth in Section 3(a)(54) of the Exchange Act.

<sup>48</sup> Such natural persons may be institutional investors under NASD rules.

<sup>49</sup> The definition of “qualified investor” in general encompasses: (i) investment companies registered with the Commission; (ii) issuers eligible for an exclusion from the definition of investment company pursuant to section 3(c)(7) of the

definition be based on the related definitions set forth in NASD rules?<sup>50</sup>

Q. Should any exception for purchases by institutional investors be conditioned on the broker-dealer providing point of sale disclosure upon an institutional investors’ request? Would other conditions be appropriate for such an exception?

Q. Commenters are also invited to estimate the cost savings to broker-dealers if a point of sale exception for purchases by institutional investors is adopted. Commenters are invited to include an estimate of the total number of transactions that would be subject to any such exception, and to discuss whether broker-dealer compliance systems would be readily able to identify transactions with such persons.

### 3. Exception for Transactions Subject to Investment Adviser Discretion

Proposed rule 15c2–3 included an exception to point of sale disclosure for transactions in which the broker-dealer exercises investment discretion. Commenters generally supported this exception. Some commenters recommended extending the exception to transactions in which an investment adviser exercises investment discretion for the customer. Absent such an exception, the rule would require broker-dealers to provide or to send information to the investment adviser acting on behalf of the customer.

*Request for comment.* If the Commission were to adopt an exception to point of sale disclosure for transactions in which an investment adviser exercises investment discretion, should it be limited to investment advisers that are registered either with the Commission under Section 203 of the Investment Advisers Act of 1940, or with a state securities commission or agency or office performing like functions? Should the broker-dealer be required to provide point of sale

Investment Company Act; (iii) banks, savings associations, brokers, dealers, insurance companies, or business development companies; (iv) certain small business investment companies licensed by the U.S. Small Business Administration; (v) certain benefit plans; (vi) certain trusts; (vii) market intermediaries exempt under section 3(c)(2) of the Investment Company Act; (viii) associated persons of a broker-dealer other than a natural person; (ix) foreign banks; (x) foreign governments; (xi) corporations, companies, or partnerships that own and invest not less than \$25 million on a discretionary basis; (xii) any natural person who owns and invests not less than \$25 million on a discretionary basis; (xiii) any government or political subdivision, agency, or instrumentality of a government who owns and invests not less than \$50 million on a discretionary basis; and (xiv) multinational or supranational entities or related agencies or instrumentalities. See Section 3(a)(54) of the Exchange Act.

<sup>50</sup> See *supra* n. 44.

information upon the request of the investment adviser? If so, should we require that the information be delivered in the same time frame as other required point of sale disclosures?

### 4. Potential Changes to Exception for Mailed Orders

Proposed rule 15c2–3 included a limited exception for transactions received from a customer via U.S. mail, messenger delivery or similar third-party delivery services.<sup>51</sup> The purpose of an exception for mailed-in orders is to promote effective disclosure while avoiding the need to delay the execution of orders received via mail or similar services. It was intended to recognize that it may not be possible to quickly locate those customers and provide the required disclosure. One commenter criticized the proposed exception as overly broad, indicating that it could allow broker-dealers to evade disclosure by recommending a fund and then having customers mail in orders. That commenter suggested narrowing the exception to apply only when there has been “no prior contact” about the transaction at which disclosure could have occurred.

*Request for comment.* The Commission solicits comments on the appropriateness and necessity of the mailed order exception. Could the potential for abuse be minimized if the Commission were to make the exception unavailable to a broker-dealer that prompts a customer to use the mail, messenger delivery or similar third-party delivery service to submit an order? Commenters are specifically invited to address:

Q. Would a “no prior contact” standard for mailed-in orders, discussed above, be practical?

Q. Should the exception require a broker-dealer relying on it to provide to its customers, every six months, standardized information about distribution costs and compensation associated with covered securities sold by the broker-dealer?

Q. What are other possible ways to appropriately tailor the exception for orders received via the mail, messenger

<sup>51</sup> As set forth in the Proposing Release, this exception would have been available only to broker-dealers that receive no compensation for effecting transactions for customers that have no accounts with them. Moreover, the exception would have been conditioned on the broker-dealer providing, within the prior six months, 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.

delivery or similar third-party delivery service?

*E. Special Issues Relating to Point of Sale Disclosure for Variable Insurance Products*

When we proposed rule 15c2-3, we drafted a single set of disclosure requirements to apply to variable insurance products as well as other covered securities. Commenters, however, stated that the proposed point of sale forms were not well suited to illustrating the costs associated with variable insurance products and did not reflect the products' particular terminology, features, and pricing structure.<sup>52</sup>

To be effective, required point of sale disclosures for purchases of variable insurance products should take into account the unique characteristics of those products. This could be done through disclosure forms that are tailored to address the costs and conflicts particularly associated with variable annuities and variable life insurance products. Attachment 7 sets forth a point of sale disclosure form for variable annuities.<sup>53</sup> While this form is based on the point of sale forms for mutual funds and 529 savings plan interests discussed above, it is tailored to reflect the unique features of variable annuities. For example, it would require disclosure of insurance-related costs associated with variable annuities, and would alert investors to the existence of the "free look" right available to them under state law.

*Request for comment.* The Commission solicits comment generally on the appropriateness and necessity of written point of sale disclosure for variable annuity and variable life insurance products. If the Commission were to adopt written point of sale disclosure requirements for variable annuities and variable life insurance products based on the attached form, would the form enhance investor understanding of those products? Does the attached form provide appropriate disclosure of the costs and conflicts

<sup>52</sup> For example, the concept of "share class" generally is not applicable to variable annuities. In addition, variable annuities impose charges for available insurance features, which were not addressed in the original proposal.

<sup>53</sup> Like the other point of sale forms discussed above, the proposed new form in Attachment 7 depicts how the required form would be filled in for a hypothetical variable annuity. The form is designed to disclose standardized information, plus transaction-specific information upon the customer's request or as part of the broker-dealer's standard practice. Similarly, the form would include quantified information about upfront sales fees and investment amount, deferred sales fees, and ongoing fees and expenses, as well as narrative information regarding potential conflicts of interest.

associated with variable annuities?<sup>54</sup> Does it provide appropriate disclosure for variable life insurance products? Commenters are also invited to suggest alternative models and submit alternative forms for both variable annuities and variable life insurance products. In addition, commenters specifically are invited to discuss the following:

Q. How could disclosure of comprehensive information about the costs of owning variable insurance products, such as mortality and expense risk fees, insurance costs, and fees associated with underlying funds, be accomplished?<sup>55</sup> Should each fee category be listed separately, or would disclosure of aggregate fees associated with a particular type of expense, such as insurance or fund costs, be preferable? Would disclosure of aggregate underlying fund fees, rather than discrete disclosure of each element of the fees' composition, be sufficient?

Q. Should broker-dealers be required in point of sale disclosure to inform investors about how variable insurance product fees and expenses are charged? Should it explain that insurance and underlying fund costs may be deducted daily from contract value, while other charges may be imposed quarterly or annually?

Q. Does the proposed disclosure of annual percentage ranges accommodate the different ways in which variable insurance product fees are calculated? If not, how might this be accomplished?<sup>56</sup>

Q. Would point of sale disclosure of the maximum surrender charge percentage, and the general basis for its calculation, be sufficient to alert investors to these costs, particularly in light of the potential complexity of the surrender charge calculation?<sup>57</sup> Should broker-dealers be required in the point of sale disclosure to disclose the potential recapture of bonus credits? Commenters are invited to provide specific suggestions for making this disclosure.

<sup>54</sup> Broker-dealers would be required to disclose upfront sales fees on the proposed new form for variable annuities. Although front-end sales fees typically have not been charged on variable insurance products in recent years, we understand that a number of issuers are considering that pricing option. See *Annuity Market News* (October 2004).

<sup>55</sup> Mortality and expense risk fees are imposed, in part, to compensate the insurance company for insurance risks it assumes under the contract.

<sup>56</sup> For example, mortality and expense risk charges for some variable life insurance products are calculated based on underwriting characteristics of the contract owner or the insured.

<sup>57</sup> A surrender charge may be imposed if an investor withdraws money from the annuity before a specified time period, often from seven to nine years.

Q. Should we require the inclusion in point of sale disclosure of costs associated with assets directed to the insurance company's fixed account?<sup>58</sup> If so, would quantitative disclosure be necessary or would narrative disclosure suffice?

Q. Commenters also are invited to specifically address what terminology should be used in the point of sale disclosure for variable annuities. Should terms used in the point of sale disclosure be consistent with language commonly used in variable insurance product disclosure documents, including prospectuses, and sales materials? If not, commenters are invited to suggest "plain English" substitutes.

Q. Should broker-dealers be required in point of sale disclosure to enumerate any non-recurring costs of owning variable insurance products, such as fees associated with excessive underlying fund transfers, or loan processing fees?

Q. Because variable annuities typically do not impose both upfront and deferred sales fees, should the rule require broker-dealers to exclude the inapplicable section?

Q. Should we require that the point of sale disclosure for variable insurance products describe the features and risks particular to these products, such as their insurance aspects, tax treatment and penalties for early withdrawal?

Q. Although variable annuities and variable life insurance share many characteristics, the products differ in a number of ways.<sup>59</sup> Comment is requested on how to tailor point of sale disclosure for variable life insurance. How should the insurance costs associated with variable life insurance be disclosed? Many broker-dealers use personalized illustrations to provide information to prospective variable life insurance purchasers. Personalized illustrations are tables that demonstrate how the cash value, cash surrender value, and death benefit under a policy change over time based on (i) assumed gross rates of return on the underlying mutual funds, and (ii) deduction of applicable fees and expenses. These

<sup>58</sup> The term "fixed account" refers to an account supported by an insurance company's general account. Variable insurance product investors who direct funds to the fixed account are credited a predetermined interest rate, which is typically reset from time to time.

<sup>59</sup> For example, while both products offer insurance features, variable life insurance typically has a more significant life insurance component, while a variable annuity typically may be utilized as a retirement investment vehicle. In addition, a variable life insurance purchase is typically subject to an insurance underwriting process, while a variable annuity purchase is not.

illustrations are based on the investor's particular circumstances, such as age, gender, risk classification, and premium payment pattern, and they reflect the effect of costs on death benefits and cash values. As an alternative to requiring point of sale cost disclosure for variable life insurance, should we instead mandate uniformity among personalized illustrations or otherwise regulate their content?

Q. Finally, commenters are invited to address any issues raised above regarding mutual funds and 529 savings plan interests that they believe are relevant to variable insurance product disclosure.

### III. Confirmation Proposal

Commenters raised a number of issues about the proposed rule 15c2-2 confirmation requirements. Some were similar to issues discussed above with regard to point of sale disclosure, while others were specific to confirmation disclosure. In light of those issues and further analysis of the proposal, we seek additional comment on the confirmation disclosure in a number of particular areas.

#### A. Format of Confirmation Disclosure

Proposed rule 15c2-2 would require broker-dealers to deliver confirmation disclosures to customers "in a manner consistent with Schedule 15C," subject to an exception for a periodic reporting alternative. The proposed Schedule 15C confirmation disclosure form includes general transaction information (e.g., price and net asset value) plus purchase-specific information about distribution costs, broker-dealer compensation, differential compensation and breakpoint discounts, as well as extensive definitions and explanations.

Several commenters stated that the proposed disclosure form was inadequate in that it would omit important information, would not permit adequate operational flexibility, and would not permit disclosure of additional information that may be needed to prevent the confirmation from being misleading. Commenters also highlighted the industry-wide cost of upgrading confirmation generation and delivery systems to produce two-page confirmations consistent with Schedule 15C. Conversely, one commenter suggested that the proposal would not adequately ensure standardized and transparent disclosure. Our own investor outreach and AARP's testing indicated that Schedule 15C was less effective than intended.

*Request for comment.* If the Commission were to adopt revisions to

the confirmation requirements in connection with transactions in covered securities, should it allow broker-dealers to use their own format for presentation of information in the confirmation (in contrast to our proposal to mandate the format of point of sale disclosures) in order to avoid costs for upgrading existing confirmation generation and delivery systems? Would this approach still appropriately convey the necessary information to investors? Alternatively, should the Commission prescribe a format for confirmation disclosures, such as the format used to produce the proposed new confirmations set forth in Attachments 8-13? Attachments 8-10 show possible confirmations for mutual fund purchases and Attachments 11-13 show possible confirmations for 529 savings plans. Commenters particularly are invited to discuss the following:

Q. Would it be appropriate to permit broker-dealers to deliver confirmations in varying formats so long as required information is disclosed? If no specific format is required, should the Commission require broker-dealers to follow specific disclosure criteria?<sup>60</sup>

Q. If a specific confirmation disclosure form is not prescribed, should broker-dealers be precluded from using different terminology (e.g., terms such as "sales load" or "12b-1 fee") on confirmations than on point of sale disclosure forms?

Q. Will investors be more likely to be confused or unable to elicit relevant information if the format is not specified by the Commission? Commenters are also invited to estimate the cost savings that might be realized if broker-dealers were not required to deliver confirmations in a particular format.

#### B. Confirmation Disclosure of Comprehensive Ownership Cost Information

Proposed rule 15c2-2 would require confirmation disclosure of the potential amount of any asset-based sales charges and service fees that would be incurred by the issuer of the covered security in connection with the shares or units purchased. That was consistent with the rule's proposed focus on distribution costs rather than total ownership costs. As with point of sale disclosure, many investors favored confirmation disclosure of comprehensive

<sup>60</sup> For example, such criteria could require broker-dealers to provide confirmations in a format readily communicated to investors, using layout and presentation that is reasonably calculated to draw attention to the information required under the confirmation disclosure rule, and using terminology that is intended to clearly convey required information to the investor.

information about ownership costs, beyond distribution costs, including disclosure of non-distribution costs such as fund management fees and other expenses.<sup>61</sup>

*Request for comment.* Should the Commission require confirmations to include information about all ongoing costs of owning covered securities, such as "management fees" and "other expenses", and not merely distribution costs? Commenters also may wish to address the forms in Attachments 8-13, which illustrate how such fees could be set forth on confirmations. Commenters particularly are invited to discuss:

Q. Would comprehensive confirmation disclosure of all the asset-based distribution charges, management fees and other expenses that constitute the annual asset-based costs of owning covered securities be particularly appropriate in light of the possibility that point of sale disclosures could be given orally, or that no point of sale disclosure could be given at all if a subsequent purchase exception is adopted? Would disclosure in a specified format and/or using specific terminology be particularly appropriate for the same reasons?

Q. Should information about comprehensive asset-based fees and costs be disclosed separately by category and in the aggregate, or only in the aggregate? Should the fees be expressed as a percentage of asset value and in dollars?

Q. In the case of two-tiered products, such as 529 savings plan interests and variable insurance products, should the disclosure requirement encompass fees associated with underlying securities as well as fees incurred by the issuers of covered securities? If disclosing the ownership fees associated with each fund underlying an insurance separate account or other covered security would not be useful, should confirmations instead set forth information about the fees associated with the underlying funds that are involved in a particular transaction, or about the range of possible fees? In such circumstances, should percentage disclosure be based on either the net asset value of the underlying securities purchased using money invested in the covered security or on the asset value of the covered security, itself?

Q. What operational issues would be related to the inclusion of comprehensive disclosure of the asset-based charges on transaction confirmations? Commenters are invited to estimate the cost of including this information.

<sup>61</sup> See Siegel & Gale/Gelb Consulting Report.

### C. Confirmation Disclosure of Broker-Dealer Compensation

As described in the Proposing Release, proposed rule 15c2-2 would have required confirmation disclosure of the amount of dealer concessions earned by the broker-dealer in connection with the transaction, as well as estimates about the amounts of revenue sharing and portfolio brokerage commissions that a broker-dealer or its affiliates receives from persons within the fund complex. It also would require "yes" or "no" disclosure about whether the broker-dealer engaged in certain differential compensation practices.

While many investors supported the concept of confirmation disclosure about broker-dealer compensation, the results of our in-depth investor interviews and focus group testing suggested that investors are more interested in seeing the total amounts they pay for investments in covered securities than in seeing the broker-dealer's precise compensation. Some securities industry commenters discussed the difficulty of placing quantitative information about compensation on confirmations, and emphasized the cost required to convey compensation information from selling brokers to firms that issue confirmations or to other entities that prepare confirmations on behalf of selling broker (as well as the fact that investors ultimately may be expected to bear the bulk of those costs). A number of commenters stated that confirmation disclosure of broker-dealer compensation and conflicts of interest would be duplicative of the point of sale disclosure, and that disclosure of compensation and conflicts could be done more effectively through broker-dealer Internet web sites. Some securities industry commenters also stated that the proposed method of quantifying revenue sharing payments would be misleading, and that the disclosure of differential compensation was unclear and not well tailored to those payments.

As discussed in more detail below, we are asking for comments about the possible use of Internet-based disclosure as a supplement to, but not a replacement for, point of sale and confirmation disclosure. Under such an alternative, broker-dealers would be permitted to show the quantified details of their compensation practices to interested investors via a web site, while continuing to disclose the existence of the conflict of interest arising from such practices on point of sale and confirmation disclosure documents.

*Request for comment.* The Commission solicits comment on all aspects of the proposed disclosure of broker-dealer compensation. Should the Commission require broker-dealers to show quantified details of their compensation practices via a web site, and disclose only the existence of the conflict of interest arising from such practices on point of sale and confirmation disclosure documents? Commenters specifically are invited to discuss the following:

Q. Would supplementary Internet-based disclosure of the type discussed below serve as an appropriate and useful alternative to the confirmation disclosure proposed in the Proposing Release about how much and how broker-dealers and their personnel are compensated, particularly in light of concerns about "information overload"?

Q. If confirmation disclosure about compensation is appropriate to assist investors, should information about revenue sharing payments be quantified on confirmations? If so, how could that accurately be done? Should we require, in addition to amount, the sources of revenue sharing payments received by the broker-dealer on the confirmation (e.g., "Last year, fund manager AAA or its affiliates paid us \$XX to promote the sale of their funds")?

Q. What are the potential cost savings associated with requiring disclosure of the existence of the conflict of interest arising from broker compensation practices on the confirmation and point of sale documents and more detailed, quantified information about those practices on the Internet?

Q. If a transaction confirmation is issued by a clearing broker-dealer, but the sale also was effected by an introducing broker-dealer, should confirmation disclosure identify conflicts of interest separately for each broker-dealer?

### D. Confirmations for Transactions Involving 529 Savings Plan Interests

As described in the Proposing Release, proposed rule 15c2-2 would require confirmation disclosure of the net asset value of the covered security, and, if different, the public offering price. One commenter noted that in the context of 529 savings plan interests there may not be an issuer-calculated net asset value available, and suggested that broker-dealers, issuers and other industry participants will need to work toward making net asset value, or information necessary to calculate net asset value, available on a daily basis.

Because 529 savings plan interests are two-tiered products, and their underlying portfolios may be purchased

at a different time than the investment in some plans, the proposed rule may require multiple confirmations.

*Request for comment.* Commenters are invited to discuss generally confirmation disclosure in connection with transactions in 529 savings plan interests, as well as the following issues:

Q. In the event that a 529 savings plan issuer does not make information about net asset value and price available daily, how should a broker-dealer effecting a transaction in an interest in that plan report the net asset value and public offering price on the confirmation? Should the initial confirmation report that amount as "unknown"? Should the broker-dealer be required to subsequently send the customer complete information as soon as it becomes available, through a supplementary confirmation? Are there other mechanisms that the Commission should permit broker-dealers to use to provide the required disclosure?

Q. To what extent do existing 529 savings plans hold investor money for one or more days before placing that investment into an underlying security? In such circumstances, should broker-dealers be required to provide separate confirmations (the first at the time of the customer's investment, and the second when the state issuer places that money into the underlying security)? In these circumstances, would the broker-dealer be sufficiently apprised of the state's practices to enable it to comply? For each such confirmation, what price or net asset value should be conveyed? Commenters are invited to suggest alternatives to this approach that would be consistent with investor protection.

### E. Confirmations for Transactions Involving Variable Insurance Products

Attachment 14 sets forth a confirmation related to a transaction in a variable annuity. This confirmation form seeks to reflect the special characteristics and terminology associated with those products. For example, the form uses the term "unit value" rather than "net asset value," and sets forth the unit value and number of units for each subaccount involved in a transaction. When appropriate, as shown on Attachment 14, the confirmation would set forth dollar amounts for each subaccount when accumulation units are not used.

*Request for comment.* The Commission solicits comment on all aspects of variable insurance product confirmation disclosure. If the Commission were to adopt confirmation disclosure requirements for variable insurance products similar to those on this form, would investors be

adequately informed about transactions in those products? Is the confirmation in Attachment 14 appropriate for transactions in variable life insurance products? Commenters specifically are invited to discuss:

Q. Would the confirmation form appropriately inform customers about the particulars of the investment, including information about the value and price of the investment (including amounts allocated to particular subaccounts and the insurance company fixed account) and the costs associated with owning underlying securities?

Q. What would be the implementation and cost issues associated with applying such confirmation requirements to variable insurance products?

Q. How should we tailor the confirmation disclosure requirement to variable life insurance products? How should the insurance costs associated with variable life insurance be disclosed? Should the forms include any explanation or definitions of the insurance terms that are used, such as "mortality and expense risk fees," "cost of insurance," "death benefit," and "fixed account"? Are there other insurance terms which should be used on the disclosures? Are there terms for which explanatory definitions would be useful to investors?<sup>62</sup> If so, what definitions should be used? Alternatively, would including definitions of insurance terms on the forms lead to "information overload" or otherwise not be useful to investors?

#### IV. Supplemental Internet-based Disclosure of Detailed Information About Revenue Sharing Payments and Other Broker Compensation Practices

Some commenters recommended permitting the proposed point-of-sale disclosures to be made on a broker-dealers' web site. We do not believe that Internet-based disclosure would be an adequate substitute for point of sale disclosure and improved confirmation disclosure.<sup>63</sup> We also do not believe that requiring investors to use the Internet as the sole means to obtain key information about their own costs of owning covered securities and about special compensation arrangements that lead to conflicts of interest will

<sup>62</sup> For example, the Commission explains terms in its publication "Variable Annuities: What You Should Know" (available at <http://www.sec.gov/investor/pubs/varannty.htm>). Would these terms be appropriate to use in the context of variable life products?

<sup>63</sup> However, in part II.B above we requested comment about whether it would be appropriate to permit broker-dealers to deliver point of sale disclosures over the Internet or by e-mail to those customers who have opted to receive such disclosures electronically.

adequately serve investors' interests, or adequately address broker-dealers' obligations.

At the same time, a number of factors suggest that Internet-based disclosure could supplement point of sale and confirmation disclosures, and could adequately serve as a primary means of providing some types of information to customers. As noted above, investors generally expressed more interest in information about the costs of owning covered securities than about broker-dealer compensation.<sup>64</sup> Moreover, point of sale and confirmation disclosure of quantified compensation information also may lead to "information overload." This may distract investor attention from information about distribution costs. Also, it would be difficult to accurately depict some compensation arrangements on simple disclosure documents given that any such approach may inaccurately cause investors to think their particular purchase would lead their broker-dealer to receive precisely the disclosed amount of revenue sharing, when in reality there would be no such causal link.<sup>65</sup>

Internet-based disclosure that provides customers with quantified information about broker-dealer compensation arrangements (not merely generic descriptive information) and identifies the sources of payments made under those arrangements could help customers evaluate how those arrangements can impact broker-dealers' recommendations and presentation of investment options. Necessarily, Internet-based disclosure must be supplemented with other means for investors to obtain the disclosure if they have no access to the Internet or desire to receive the disclosure by other means. Accordingly, we are considering requiring broker-dealers to maintain a toll-free telephone number which investors could call to request that a

<sup>64</sup> See Siegel & Gale/Gelb Consulting Report.

<sup>65</sup> As set forth in the Proposing Release, rule 15c2-2 would have required broker-dealers to quantify revenue sharing and portfolio brokerage commissions on confirmations using a *pro rata* estimate approach that considered: (i) the amount of the customer's transaction, (ii) the broker-dealer's prior receipt of compensation from the fund complex, and (iii) the broker-dealer's prior distribution of shares on behalf of the fund complex. Some securities industry commenters objected to the proposed quantification of revenue sharing associated with particular transactions.

Securities industry commenters also emphasized that providing transaction-specific quantified information about compensation could be particularly costly on confirmations, as that could require selling broker-dealers to develop linkages to convey relevant data to clearing firms or others that issue confirmations.

copy of the Internet-based disclosure be mailed to them.

Some broker-dealers currently disclose on their web sites quantified information about potential amounts of revenue sharing or other payments from fund families, including information about payments the broker-dealers receives from mutual funds for recordkeeping activities. While those web sites that have quantitative information represent steps in the right direction, customers should be able to see more information about how their sales personnel are compensated.<sup>66</sup> Moreover, customers should have ready access to quantified information rather than having to search for the information in the midst of extensive explanations. Customers also should be able to see compensation information that is labeled clearly and consistently, and not referred to by vague or generic terms such as "administrative service" or "support fees" or "expense reimbursement."

If the Commission were to require Internet-based disclosure of compensation arrangements—as a supplement to proposed disclosure of the existence of the conflict of interest arising from such practices on point of sale and confirmation disclosure documents—such Internet-based disclosure could include information about:

- Revenue sharing payments;
- Certain other payments out of issuer assets that may provide incentives for broker-dealers to distribute covered securities;
- Special compensation-related conditions that broker-dealers place on fund distribution;
- Broker compensation; and
- Brokers' differential compensation practices.

Attachment 15 illustrates how such Internet-based disclosure could appear in practice, if we were to adopt a rule requiring Internet-based disclosure of broker-dealer compensation arrangements.<sup>67</sup>

<sup>66</sup> For example, an investor should be able to see not only what is the maximum possible fee a broker-dealer may receive, but also what a broker-dealer actually has received or can expect to receive for selling a particular covered security. That is because a customer would be better able to scrutinize a broker-dealer's sales efforts if, for example, the customer can see that one potential investment is associated with a 0.25 percent transaction-based fee, but another is associated with a 0.15 percent transaction-based fee.

<sup>67</sup> As noted in the Proposing Release, in 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

Finally, for those customers who have no access to the Internet or who prefer other means of receiving the proposed Internet-based disclosures, we would also require broker-dealers to maintain toll-free telephone numbers by which investors can request a mailed copy of the disclosure information. As discussed in previous sections, the toll-free number would be disclosed on point of sale disclosures and on transaction confirmations.

#### A. Detailed Disclosure of Revenue Sharing Payments

A critically important component of any Internet-based disclosure of broker-dealer compensation arrangements would be detailed disclosures of revenue sharing payments that selling broker-dealers or their affiliates may receive for distributing fund shares from a fund's investment adviser or others.<sup>68</sup>

company. The proposal also would require broker-dealers to use the Internet or a toll-free telephone number to provide updated information, or else to send updated information to customers semi-annually. Among other features, that NASD proposal would require broker-dealers to rank fund families that make revenue sharing payments in descending order of amounts paid to the broker-dealer (without having to identify the actual amount of compensation received). It also would require broker-dealers to state whether they pay differential compensation in the form of heightened payout ratios, and to identify the investment companies favored by those arrangements. See NASD Notice to Members 03-54 (Sept. 2003).

The approach to Internet-based disclosure we are considering here would focus on quantifying compensation resulting from a customer's purchase of a specific covered security. Thus, the approach described here would appear to complement the approach described by NASD (which has yet to be submitted as a proposed rule change).

<sup>68</sup> Those payments provide sales incentives that create conflicts between broker-dealers' financial interests and their agency duties to customers. Revenue sharing payments may lead a broker-dealer to use "preferred lists" that explicitly favor the distribution of certain funds. Revenue sharing payments also may lead to favoritism that is less explicit but just as real, such as through broker-dealer practices allowing funds that make revenue sharing payments to have special access to broker-dealer sales personnel, and through other incentives or instructions that a broker-dealer may provide to managers or salespersons. See, e.g., *In the matter of Edward D. Jones & Co.*, Securities Act Release No. 8520 (Dec. 22, 2004) (broker-dealer violated antifraud provisions of Securities Act and Exchange Act by failing to disclose conflicts of interest arising from receipt of revenue sharing, directed brokerage payments and other payments from "preferred" families that were exclusively promoted by broker-dealer); *In the Matter of Morgan Stanley DW Inc.*, Securities Act Release No. 8339 (Nov. 17, 2003) (broker-dealer violated antifraud provisions of Securities Act by failing to disclose special promotion of funds from families that paid revenue sharing and portfolio brokerage).

Revenue sharing payments also can play a role in compensating broker-dealers that distribute no-load funds through mutual fund "supermarkets." Those broker-dealers may charge commissions for some fund purchases, but provide commission-free purchases of funds from fund complexes that make revenue sharing payments. Funds that make

As with qualitative point of sale disclosure, we are proposing to require quantitative Internet-based disclosure of revenue sharing payments, regardless of how they are labeled. Even if a particular payment from a fund complex fairly can be depicted as offsetting broker-dealer expenses connected with fund distribution, the payments still can constitute direct financial incentives for a broker-dealer to favor that fund complex over fund complexes that do not make such payments. The proposed disclosure requirement would be targeted toward payments that are most likely to impact the broker-dealer's distribution of the covered security, by excluding payments from certain sources and certain payments to affiliates.<sup>69</sup> On the Internet, the compensation that is required to be disclosed could be broken down by payment stream (with separate disclosure of transaction-based payments), asset-based payments, and miscellaneous payments.<sup>70</sup> The source of payments would also be disclosed.

Attachment 15 illustrates how those separate types of payment streams could be disclosed under such a requirement. For example, disclosure of transaction-based revenue sharing payments that the broker-dealer or associated person receives from certain affiliates of a fund would be required to be expressed in dollars received per \$1,000 of covered securities sold, reflecting benchmarks that may lead to stepped-up compensation when the broker-dealer sells more shares of a particular mutual fund or fund family. Similarly, disclosure of asset-based revenue sharing payments would be required to be expressed in dollars received per \$1,000 dollars sold, again reflecting benchmarks that may impact the compensation. Such disclosures would encompass revenue sharing payments received, whether by a broker-dealer or by an affiliate, in connection with securities that underlie a covered

revenue sharing payments also may be placed on lists of mutual funds that a broker-dealer suggests or otherwise highlights to customers.

<sup>69</sup> In asking above about revenue sharing disclosure requirements at the point of sale, we discuss potential definitions and exclusions that may appropriately focus the disclosure requirement in that way.

<sup>70</sup> Payments linked to a broker-dealer's recent sales of shares issued by a fund complex give the broker-dealer an incentive to sell more shares of that fund complex. Payments linked to the asset-based fees that the adviser earns in connection with shares of a fund complex held by broker-dealer customers give the broker-dealer an incentive to sell more shares of, and keep its customers invested in, that fund complex. Miscellaneous payments such as sponsorships of broker-dealer training programs further promote the sale of shares on behalf of the fund complex.

security, including revenue sharing payments received from underlying funds in connection with sales of 529 savings plans and variable insurance products.

This type of approach to disclosure also would require broker-dealers to summarize other revenue sharing payments that do not reflect transaction-based, and asset-based, income streams. Such amounts would be depicted retrospectively in terms of total dollars received in the prior fiscal year, along with a statement of the value of the covered securities that the broker-dealer or associated person sold on behalf of that group of issuers (or "related issuers") during that period. Such amounts also would be depicted prospectively as a reasonable estimate of such revenue sharing payments expected to be received in the current fiscal year based on present arrangements or understandings, along with a statement of the amount of revenue sharing payments received in the prior fiscal quarter.<sup>71</sup>

*Request for comment.* Commenters are invited to discuss the possible contours of an Internet-based disclosure requirement for revenue sharing payments as an alternative to disclosure in point of sale or confirmation documents, including the adequacy of the disclosure set forth in Attachment 15. Commenters particularly are invited to discuss the following:

Q. Would such disclosure adequately set forth information about the various possible payment streams? Would more particularized disclosure better alert customers to the resulting conflicts of interest? If so, how should we tailor the required disclosure to do so? Should we require broker-dealers to state the total amounts of revenue sharing payments received by source? Should the Commission instead require disclosure of the source and amounts of payments at the point of sale or on transaction confirmations?

Q. How should customers be informed about revenue sharing payments and other payments that are not subject to formal agreements, but

<sup>71</sup> Retrospective information would have the benefit of being comprehensive, while prospective information would have the benefit of being more timely. Such prospective information alone may be incomplete given that broker-dealers and fund families may adjust revenue sharing payments to reflect prior sales efforts, and due to the informal nature of some of these arrangements. There may be special disclosure challenges because certain promotional payment arrangements are not reduced to written agreements. Under such an approach, broker-dealers would have to fairly and accurately depict their understandings, together with any ambiguities in compensation that may exist. Investors would then have to weigh the significance of those ambiguities.

instead take the form of ad hoc payment arrangements?

Q. How should customers be informed about prospective revenue sharing payments that a broker-dealer expects to receive in the future but that have not been paid or accrued?

Q. How should investors be informed of payments received by the insurance company issuing a variable product from the investment advisers of underlying funds? What types of conflicts do these payments raise?

#### *B. Disclosure of Certain Payments Out of Issuer Assets*

Internet-based disclosure also might be appropriate for certain payments that broker-dealers receive out of fund assets. These payments may not pose the same conflicts of interest as certain payments received from investment advisers and other non-issuers but they may provide incentives for broker-dealers to distribute covered securities. For example, payments out of issuer assets may represent compensation for the broker-dealer's own recordkeeping activities. Even when payments out of fund assets could be justified as *bona fide* compensation for non-distribution services, they may constitute a direct financial incentive for a broker-dealer to favor fund complexes that make such payments.<sup>72</sup>

Attachment 15 illustrates how such payments might be depicted in a way that would allow customers to evaluate the significance of the incentives they provide. As shown in this illustration, the broker-dealer would be required to disclose a summary of all payments it receives from the issuer of the covered security (or from the issuer of an underlying covered security in the case of two-tiered products). Such amounts would be disclosed retrospectively (as a statement of the total dollars of such payments that the broker-dealer received from such issuer in the prior fiscal year) and prospectively (as a reasonable estimate of such payments that the broker-dealer can expect to

<sup>72</sup> Other payments out of issuer assets would not appear to pose a significant influence on broker-dealer distribution. For example, payments from issuers to compensate broker-dealers for mailing certain documents (other than the prospectus) to customers are subject to cost limits imposed by NASD rules, and as such may not be expected to provide compensation for distribution services. See NASD rule IM-2260 (approved rates of reimbursement).

Also, as noted above, payments from funds for brokerage services are barred from being used to finance distribution. In September 2004, we amended rule 12b-1 under the Investment Company Act to prohibit the use of fund brokerage to compensate broker-dealers for selling fund shares. See Investment Company Act Release No. 26591 (Sept. 2, 2004), 69 FR 54728 (Sept. 9, 2004).

receive from such issuer in the current fiscal year, based on present arrangements or understandings).

*Request for comment.* Would requiring a broker-dealer to disclose certain payments received from issuers discussed above be useful to investors? Commenters particularly are invited to discuss the following:

Q. Would disclosure of amounts received from issuers, with specific exclusions for brokerage commissions, mailing fees and other payments disclosed elsewhere, appropriately provide customers with information about issuer payments that can pose conflicts of interest? Should such a disclosure requirement be more specific, perhaps by focusing on payments for transfer agent-related activities or other recordkeeping-related activities?

Q. Should such a disclosure requirement encompass payments received by certain affiliates of broker-dealers? To what extent do broker-dealer affiliates receive such payments in connection with securities distributed by broker-dealers? How could required disclosure of those issuer payments be implemented for payments received by associated persons of a broker-dealer?

Q. Are there other payments or economic benefits that broker-dealers receive from issuers or their affiliates that we should require broker-dealers to disclose?

Q. Broker-dealers particularly are invited to discuss how the amounts they receive via such payments compare to the costs they would incur to provide such services (particularly costs they would not otherwise incur as part of their normal course of business).

#### *C. Disclosure of Other Distribution-Related Factors That Influence Broker-Dealer Sales of Covered Securities*

Internet-based disclosure also may be appropriate for informing customers about factors in addition to those disclosed at point of sale that influence broker-dealer sales of covered securities. For example, as noted above, some broker-dealers give fund complexes that make revenue sharing payments special marketing access to broker-dealer sales personnel that is not available to other fund complexes. Some broker-dealers may have a practice of restricting recommendations of securities to the funds of complexes that make revenue sharing payments, or of restricting placement of securities on a highlighted list to only those funds of complexes that make revenue sharing payments. We understand that some broker-dealers may require that a fund complex pay asset-based distribution fees under a

rule 12b-1 plan with regard to other mutual funds of that complex, including mutual funds that are closed to new investors, as a condition of selling one or more other funds of that fund complex.

Additional information about these practices may help customers evaluate broker-dealer sales incentives. Attachment 15 illustrates the types of disclosure that could result if broker-dealers were required to use the Internet to set forth any explicit or implicit arrangement by which they condition any distribution-related benefit to a fund or fund complex upon the receipt of certain compensation or other economic benefits. In fulfilling their disclosure obligations under such a provision, a broker-dealer would need to comprehensively inform customers about all arrangements by which distribution is conditioned on special compensation or benefits. Under this form, required disclosures would include, if applicable, statements: (i) That the broker-dealer does not sell no-load funds; (ii) that the broker-dealer provides preferred salesperson access to fund complexes or other issuers that make revenue sharing payments; (iii) that the broker-dealer only distributes covered securities whose issuer pays a certain threshold of recordkeeping-related fees; (iv) that all covered securities on the broker-dealer's "preferred" or "select" list of securities make revenue sharing payments to the broker-dealer; or (v) that the broker-dealer conditions distribution of any covered security of the fund complex or other issuer to the receipt of rule 12b-1 fees in connection with other covered securities of that fund complex or other issuer.

*Request for comment.* Should the Commission adopt a requirement for broker-dealers to disclose additional distribution-related conditions? If adopted, should this disclosure be on the Internet? Would such disclosures assist customers in understanding broker-dealer financial incentives?

Q. To what extent do broker-dealers currently have a practice of conditioning recommendations and placement on preferred lists to fund families that make revenue sharing payments? To what extent do broker-dealers currently condition distribution of funds on receipt of rule 12b-1 fees from all funds in the complex?

Q. Should any rules explicitly identify certain arrangements that would have to be disclosed under this type of provision, such as those in statements (i) through (v) above? If so, which arrangements should be identified with particularity in a rule?

Should such conditions also have to be disclosed at the point of sale?

*D. Disclosure of Compensation That Broker-Dealers Receive in Connection With Distributing Covered Securities*

An Internet-based disclosure requirement could encompass disclosure of the concessions that broker-dealers earn in connection with a transaction, and annual asset-based payments that broker-dealers would expect to receive for selling the covered security or for providing services to the customer's account (including payments denoted as compensation for providing shareholder services, as well as other distribution-related compensation). Such disclosures would include payments in connection with underlying securities purchased via two-tiered products, such as 529 savings plans and variable insurance products. As depicted in Attachment 15, such payments would be quantified based on model purchases to allow investors to see how much of a dealer concession the broker-dealer would receive in connection with various transaction sizes or asset amounts.

*Request for comment.* Should the Commission adopt an Internet-based disclosure requirement of broker-dealer compensation arrangements, including dealer concessions and annual asset-based payments that broker-dealers would expect to receive for selling the covered security or for providing services to the customer's account? Commenters specifically are invited to discuss whether the Commission should require such Internet-based disclosure as a supplement to point of sale and confirmation disclosure. In addition, commenters are requested to discuss the following:

Q. Would disclosure about dealer concessions and annual asset-based fees earned by each broker-dealer effecting a transaction appropriately encompass all standard types of compensation?

Q. How should disclosure of such amounts be quantified? Would requiring thresholds of \$1,000, \$50,000 and \$100,000 be appropriate? Should disclosure of compensation related to front-end sales fees reflect a model purchase of \$1,000 and any breakpoint threshold?

Q. How should such disclosure requirements be applied to broker-dealer underwriters for mutual funds and other covered securities?<sup>73</sup> Would

<sup>73</sup> The amounts earned by an underwriter may be difficult to quantify in a fee schedule because an underwriter may retain the residual between sales fees paid by investors and dealer concessions paid to selling brokers, rather than a preset amount. That

investors benefit from disclosure of underwriter compensation in the same way they would benefit from disclosure of the compensation received by selling broker-dealers? Would that benefit depend on the types of compensation received or an underwriter's direct versus indirect interaction with a customer, such as instances in which an underwriter is also broker of record for the customer (so-called "orphan accounts")?

Q. How should such disclosure requirements be applied to broker-dealers that clear purchase transactions on behalf of other broker-dealers? Would it be adequate for a clearing firm to satisfy its disclosure requirements by setting forth its fee schedule for clearing covered securities, and disclosing the source of its compensation (e.g., selling broker-dealer or mutual fund complex)?<sup>74</sup> How would customers be informed about the conflicts of interest posed by promotional arrangements between clearing broker-dealers and fund complexes, such as arrangements by which a fund complex agrees to pay ticket charges imposed by a clearing broker-dealer, so the charges are not passed on to selling broker-dealers and their sales personnel?

*E. Disclosure of Differential Compensation*

The Internet, supplemented with investors' ability to call toll-free numbers to request mailed copies of required disclosures made on the Internet, also may provide a useful medium for broker-dealers to provide customers with quantitative information about differential compensation practices. As noted in the Proposing Release, conflicts of interest may result from practices by which an associated person is paid a heightened 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 makes revenue sharing payments to the broker-dealer), and practices by which an associated person earns more for selling "class B" shares with deferred sales fees than other share classes because of the higher sales compensation received by the broker-dealer firm for selling class B shares. Point of sale disclosure of differential compensation practices as proposed,

particularly would be an issue in the case of share classes with a deferred sales load.

<sup>74</sup> Disclosure of the source of clearing firm compensation would appear appropriate because some clearing broker-dealers enter into promotional arrangements through which clearing fees are paid by a fund complex rather than by selling broker-dealers.

however, would not cover situations in which an associated person has a financial incentive to sell securities that pay a relatively high dealer concession or commission to the broker-dealer, even though that would translate into a relatively high payment to the associated person.<sup>75</sup>

Requiring Internet-based disclosure of a broker-dealer's compensation practices, however, may provide an appropriate forum for disclosure of additional compensation incentives to sales personnel and other associated persons. Attachment 15 depicts how, under such a requirement, a broker-dealer could use the Internet to illustrate the compensation incentives associated with relatively high dealer concessions, compared to comparable covered securities.<sup>76</sup> Under such an approach, multiple covered securities may be "comparable" if they are not materially different with respect to their investment objectives and goals, its principal investment strategies, and the principal risks that would result from investing in such a covered security. That disclosure also illustrates how the Internet could be used to illustrate and quantify differential compensation in connection with the sale of a class of covered securities that charges a deferred sales fee, and information about the payment of any other form of differential compensation to any associated persons in connection with the purchase of the covered security.

*Request for comment.* Should the Commission require broker-dealers to make enhanced disclosure of differential compensation on the Internet? Should the Commission also require broker-dealers to permit customers the ability to request the Internet-based disclosures be mailed to them by calling a toll-free telephone

<sup>75</sup> That type of compensation incentive was not proposed to be captured at the point of sale due to the need to keep point of sale disclosure simple and the risk that such disclosure either would invariably lead to a "yes" answer or else would be too unwieldy at the point of sale.

<sup>76</sup> A broker-dealer might determine that a particular set of funds are "comparable" if they fall within the same grouping or categorizations provided by major vendors of mutual fund data. Such groupings may focus on particular investment styles as "mid cap value" or industry sector funds, as well as distinguishing between index funds and actively managed funds. Such a type of highly focused categorization appears appropriate for disclosure of differential compensation, because that focus would appear consistent with differences in broker-dealer compensation. Such a type of "comparable" categorization standard is intended to avoid comparisons that would invariably lead to "yes" answers, such as comparisons of load funds with no-load funds. Broker-dealers would have to determine whether or not the compensation associated with a particular mutual fund is above the average compensation associated with the applicable category.

number? Commenters particularly are invited to discuss the following:

Q. Should we require broker-dealers to identify any payment practice by which the issuer or underwriter of a covered security pays the broker-dealer a higher dealer concession than the average dealer concession paid in connection with the distribution of comparable covered securities, when that would lead an associated person of the broker-dealer to receive more in connection with the sale of the covered security than would be received in connection with the sale of the same dollar amount of a comparable covered security that pays an average dealer concession? For those purposes, should we state that the term "comparable" means another covered security that is not materially different with respect to its investment objectives and goals, its principal investment strategies, and the principal risks that would result from investing in such a covered security?

Q. Would such a requirement be feasible to implement? Would the resulting information be useful to investors? Commenters may wish to suggest criteria for identifying "comparable" funds, or suggest existing databases or assessments that would be useful in identifying practical fund categories. For example, would it be appropriate for groupings of "comparable" funds to be based on particular investment styles such as "mid cap value" or industry sector funds? Would it be appropriate for such groupings to distinguish between index funds and actively managed funds? Would it be appropriate for broker-dealer to determine that a particular set of funds are "comparable" if they fall within the same grouping set forth by a nationally recognized categorization of mutual funds, such as categorizations provided by major vendors of mutual fund data? Should the Commission seek to develop and publish lists of "comparable" covered securities for these purposes? Alternatively, even if a focus on relatively narrow categories of funds would accurately reflect differences in broker-dealer compensation among categories, should the groupings of funds be broader to more fully inform investors about the differences in incentives facing broker-dealer personnel?<sup>77</sup>

<sup>77</sup> An analogous issue arise in the distinct context of calculating comparative information. Comparative information should provide investors with context about whether a particular fund has relatively high or low ownership costs. In calculating comparative information, using groupings of securities that are overly narrow would not lead to data that adequately informs investors about the ownership costs associated with

Q. Should Internet disclosure of differential compensation related to share classes sold reflect higher payments for selling class C shares as well as for selling class B shares?

#### F. Format of Disclosure

The format of disclosure would be critical to any Internet disclosure requirements, as well as disclosure through any other media. Information may be presented on the Internet in a way that is intended to obscure, rather than to provide effective disclosure. Moreover, many investors may not have Internet access or choose to use the Internet. Accordingly, we would require that broker-dealers maintain a toll-free telephone number which investors could call to request that a copy of the Internet-based disclosure be mailed to them.

To promote clear disclosure, we propose to require information to be highly visible, and depicted in a tabular format that is readily communicated to investors, using layout and presentation that is reasonably calculated to draw attention to the required information, and using terminology that is intended to clearly convey required information to the investor.<sup>78</sup> Other requirements that we could adopt as appropriate could include: (i) That the web site not (1) have password protection, (2) require entry of identifying information or e-mail addresses, or (3) otherwise restrict access (including the use of "cookies");<sup>79</sup> (ii) that disclosure be assessed through a prominent link on the principal Internet homepage of the broker-dealer;<sup>80</sup> and (iii) that the web site have a Uniform Resource Locator (URL) that is disclosed in conjunction with all point of sale and confirmation disclosures that the broker-dealer is required to make. We also could require broker-dealers to maintain toll-free telephone numbers by which investors

alternative investment. When identifying the presence or absence of differential compensation, however, groupings of securities that are overly broad (such as including no-load funds with load funds) may invariably lead to "yes" answers, which would not appear useful to investors.

<sup>78</sup> Such a requirement would prevent broker-dealers from providing responsive information that is obscured with excess verbiage. Such a requirement would mean that the information must be disclosed in tabular form in a highly visible location within a disclosure document, possible using easily navigable links within a particular webpage.

<sup>79</sup> Such a requirement that the web site not be restricted in access does not preclude the broker-dealer from taking down the web sit on occasion as necessary to perform technical maintenance.

<sup>80</sup> Such a requirement would not apply to a broker-dealer that does not maintain a principal Internet homepage.

can request a mailed copy of the disclosure information.<sup>81</sup>

Any Internet disclosure requirement should require broker-dealers to depict information that is specific to share classes, as applicable.<sup>82</sup> We would anticipate that multiple broker-dealers may opt to maintain disclosure on a single webpage, with each recipient of a payment clearly identified.<sup>83</sup>

*Request for comment.* How could an Internet disclosure rule be crafted to ensure that investors have clear and timely access to information? Commenters particularly are invited to discuss the following:

Q. Should an Internet-based disclosure requirement mandate the use of a standardized template or form, or the use of certain terminology, perhaps as defined by the Commission? Commenters are invited to suggest models.

Q. Should broker-dealers be permitted to establish links to third-party web sites where definitions or explanatory information would be available? Would this help investors better understand the meaning of particular terms without providing information that potentially is biased or otherwise misleading? Alternatively, would such a linkage to third-party web sites have the effect of seeming to endorse that information? Commenters may wish to refer to existing Internet web sites that contain glossaries or other models of terminology or explanatory materials that could effectively improve investor understanding of this information. Should the Commission instead adopt standardized definitions to be used in this context?

Q. What are the costs to broker-dealers of making the kinds of Internet-based disclosures discussed in this section? In addition, what are the cost savings to broker-dealers of making such Internet-based disclosures in lieu of making such disclosures at the point-of-sale or on transactions confirmations?

<sup>81</sup> Moreover, we could require that broker-dealers update Internet-disclosed information promptly to maintain accuracy, and that information about payments received in the prior fiscal year be updated within 30 days of the end of that fiscal year.

<sup>82</sup> Some relevant disclosures, such as dealer concessions and trailing commissions, may vary by the share class of the covered security. Other disclosures, such as revenue sharing payments, would appear less likely to differ according to share class.

<sup>83</sup> More than one broker-dealer may receive compensation in connection with a customer's purchase of a covered security. For example, a selling broker may receive the bulk of a sales fee, while the fund distributor retains a small portion of that fee. Also, introducing firms and clearing firms both may receive revenue sharing payments from a fund complex.

Would there be cost savings or other efficiencies from maintaining disclosures for multiple broker-dealers on a single web page?

Q. Is it appropriate and useful for the Commission to require that broker-dealers update Internet-disclosed information promptly to maintain accuracy? Should the Commission also require that broker-dealers update information about payments received in the prior fiscal year within 30 days of the end of that fiscal year?

Q. Would it be useful to investors if we require broker-dealers to maintain a toll-free number investors can call to request copies of the Internet-based disclosure be mailed to them? What procedures would be necessary to ensure compliance with this requirement? Commenters may wish to discuss the cost to broker-dealers of implementing such a requirement.

#### V. Prospectus Disclosure of Revenue Sharing Payments

Along with the amendments discussed above, the Commission proposed to amend Form N-1A in order to improve disclosure in fund prospectuses of revenue sharing payments.<sup>84</sup> If any person within a fund complex makes revenue sharing payments, the proposed amendment would have required a fund to disclose that fact in its prospectus and also to disclose that specific information about revenue sharing payments is included in the confirmation and point of sale disclosure as originally proposed.<sup>85</sup> We are considering whether to adopt modified or additional Form N-1A requirements to complement the disclosure by broker-dealers on which we are requesting comment in this release. Specifically, we are considering whether it may be helpful to investors to receive additional information in a fund's prospectus regarding revenue sharing payments.<sup>86</sup>

<sup>84</sup> See Proposing Release, Section VI. The Commission also proposed amendments to Form N-1A that would enhance disclosure of sales loads in the fund prospectus.

<sup>85</sup> Proposed subparagraph (c) to Item 8 (now Item 7) of Form N-1A.

<sup>86</sup> We recently brought enforcement cases against fund advisers concerning their failure to adequately disclose arrangements for increased "shelf space" with various broker-dealer. See *In the Matter of Franklin Advisers, Inc. and Franklin/Templeton Distributors, Inc.*, Investment Advisers Act Release No. 2337 (December 13, 2004); *In the Matter of PA*

*Request for comment.* Are prospectus disclosure requirements regarding revenue sharing payments, beyond those we originally proposed, appropriate or necessary? Specifically, we seek comment on whether a brief description of such revenue sharing payments should be required in a mutual fund's prospectus.

Q. If any person within a fund complex makes revenue sharing payments, should a fund be required to disclose this fact in its prospectus? Should a fund be required to include information relating to these payments, such as the services provided in return for the payments; the factors considered in determining the payments to be made (including the number of fund shares sold by a financial intermediary, the amount of fund assets held through that intermediary, the redemption rate of fund shares held through that intermediary, and the quality of the intermediary's relationship with the fund's principal underwriters); and the basis on which such payments are made (e.g., percentage of total sales of fund shares by a financial intermediary, percentage of total fund assets attributable to that financial intermediary)? Should a fund also be required to disclose the maximum amount of revenue sharing payments to a single financial intermediary annually? If so, how should this disclosure be stated (e.g., as a dollar amount, a percentage of net assets, or otherwise), and what period of time should it cover (e.g., the most recent fiscal year, the projected total for the current fiscal year, or some other period)? Should any other information be required?

Q. Should we also require disclosure of the aggregate amounts of revenue sharing payments that a fund makes to all financial intermediaries? If so, how should this disclosure be stated (e.g., as a dollar amount, a percentage of net assets, or otherwise), and what period of time should it cover (e.g., the most recent fiscal year, the projected total for the current fiscal year, or some other period)? Should any other information be required?

*Fund Management LLC, et al.*, Investment Advisers Act Release No. 2295 (September 15, 2004); *In the Matter of Massachusetts Financial Services Company*, Investment Advisers Act Release No. 2224 (March 31, 2004).

Q. We also invite comment on the costs associated with providing enhanced disclosure in the prospectus relating to revenue sharing payments, including quantification of such payments. To what extent would the disclosure of specific information relating to such payments increase compliance costs?

Q. If specific information about revenue sharing payments is available through a broker-dealer's Web site or toll-free telephone number, should a fund be required to disclose that fact in its prospectus, either in addition or as an alternative to other disclosure?

Q. For purposes of enhanced prospectus disclosure of revenue sharing payments, what definition of "revenue sharing" should the Commission use? Should it be consistent with that used in connection with the proposed broker-dealer disclosure rules? Commenters are asked to address, among other things, the questions about the definition of "revenue sharing" that are raised above in the context of the proposed broker-dealer disclosure requirements.<sup>87</sup>

Q. Commenters are also asked to address what, if any, disclosure requirements should be added to Forms N-3, N-4, and N-6 with respect to revenue sharing payments? In this context, we invite commenters to address the same questions raised above relating to disclosure of revenue sharing payments by mutual funds, as well as any other relevant matters.

#### VI. General Request for Comment

In addition to the supplemental requests for comment set forth above, the Commission renews its requests for comment on the proposals that were published in the Proposing Release. In its evaluation of further rulemaking action, the Commission will consider, in addition to the comments received in response to this release, all comments received in response to the Proposing Release.

By the Commission.

Dated: February 28, 2005.

**Margaret H. McFarland,**  
*Deputy Secretary.*

**BILLING CODE 8010-01-P**

<sup>87</sup> See the request for additional comment relating to the proposed definition of "revenue sharing" *supra*, part II.A.3.

**[B-D Name]**

Date: \_\_\_\_\_

**Fees you pay and our conflicts of interest  
for purchases of AAA Equity Fund – Class A shares (AAAEA)****Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this fund. Ask us to fill in the blanks below for details about the fees you must pay.

**Volume discount**

You may qualify for fee discounts if you or members of your family hold other shares from this fund family, or if you agree to make additional purchases. Ask us for more information about these discounts.

**Fees****You pay when you buy**

You pay a sales fee for Class A shares when you purchase them — up front. The amount of the up front fee you pay is based on your total payment amount.

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request.

Total payment amount	Estimated up front fee you pay	Your investment amount	Up front fee as % of your investment amount
\$	\$	\$	%
\$1,000.00	\$57.50	\$942.50	6.10%
\$50,000.00	\$2,250.00	\$47,750.00	4.71%
\$100,000.00	\$3,500.00	\$96,500.00	3.63%

**You also pay each year**

In addition to the up front sales fee, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	0.25%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>1.92%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st year annual fees you pay	Annual fee %
\$	\$	1.92%
\$1,000.00	\$19.20	1.92%
\$50,000.00	\$960.00	1.92%
\$100,000.00	\$1,920.00	1.92%

In addition, you pay each year:

**Account fee: \$100.00**

**Conflicts of Interest**

Does the fund or its affiliates pay us extra to promote this fund over other funds? **YES**

Do we pay our personnel more for selling this fund than for selling other funds we offer? **NO**

**Find out more****Fund prospectus**

You should consider all the costs, goals and risks associated with any fund before you buy. Read about this information in the fund prospectus. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/equityfund/prospectus](http://www.aaafunds.com/equityfund/prospectus).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this fund. This information is not available in the fund prospectus. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**Attachment 1****Mutual Fund Class A – Point of Sale**

**[B-D Name]**

Date: \_\_\_\_\_

## Fees you pay and our conflicts of interest for purchases of AAA Equity Fund – Class B shares (AAAEB)

**Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this fund. Ask us to fill in the blanks below for details about the fees you must pay.

### Fees

**You pay when you sell**

You pay a sales fee for Class B shares when you sell them—at the back end. This fee varies with both the value of the shares you sell and the length of time you hold them.

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment amount	Estimated maximum back end sales fee	Maximum back end fee %
\$	\$	6.10%
\$1,000.00	\$61.00	6.10%
\$50,000.00	\$3,050.00	6.10%
\$100,000.00	\$6,100.00	6.10%

**You also pay each year**

In addition to the back-end sales fee, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>2.67%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st year fees	Annual fee %
\$	\$	2.67%
\$1,000.00	\$26.70	2.67%
\$50,000.00	\$1,335.00	2.67%
\$100,000.00	\$2,670.00	2.67%

### Conflicts of interest

Does the fund or its affiliates pay us extra to promote this fund over other funds? **YES**

Do we pay our personnel more for selling Class B shares than for selling other share classes of the same fund? **YES**

Do we pay our personnel more for selling this fund than for selling other funds we offer? **NO**

### Find out more

**Fund prospectus**

You should consider all the costs, goals and risks associated with any fund before you buy. Read about this information in the fund prospectus. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/equityfund/prospectus](http://www.aaafunds.com/equityfund/prospectus).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this fund. This information is not available in the fund prospectus. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**Attachment 2**

**Mutual Fund Class B – Point of Sale**

**[B-D Name]**

Date: \_\_\_\_\_

## Fees you pay and our conflicts of interest for purchases of AAA Equity Fund – Class C shares (AAEC)

**Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this fund. Ask us to fill in the blanks below for details about the fees you must pay.

### Fees

**You will pay each year**

For Class C shares, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>2.67%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st-year fees	Annual fee %
\$ <input style="width: 100px;" type="text"/>	\$ <input style="width: 100px;" type="text"/>	<b>2.67%</b>
\$1,000.00	<b>\$26.70</b>	<b>2.67%</b>
\$50,000.00	<b>\$1,335.00</b>	<b>2.67%</b>
\$100,000.00	<b>\$2,670.00</b>	<b>2.67%</b>

### Conflicts of interest

Does the fund or its affiliates pay us extra to promote this fund over other funds? **YES**

Do we pay our personnel more for selling this fund than for selling other funds we offer? **NO**

Do we pay our personnel more for selling Class C shares than for selling other share classes of the same fund? **YES**

### Find out more

**Fund prospectus**

You should consider all the costs, goals and risks associated with any fund before you buy. Read about this information in the fund prospectus. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/equityfund/prospectus](http://www.aaafunds.com/equityfund/prospectus).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this fund. This information is not available in the fund prospectus. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**[B-D Name]**

Date: \_\_\_\_\_

## Fees you pay and our conflicts of interest for purchases of [STATE] 529 Savings Plan Growth Portfolio – Class A

**Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this portfolio. Ask us to fill in the blanks below for details about the fees you must pay.

**Your state's tax incentives**

Many states offer their residents tax deductions and other benefits for investing in their 529 college savings plans, but not for investing in other states' plans. If you live in a state that offers these tax deductions or other benefits, you should consider whether investing in a college savings plan sponsored by your state is best for you.

**Fees****You pay when you buy**

You pay a sales fee when you purchase Class A shares of this 529 college savings plan – up front. The amount of the up front fee you pay is based on your total payment amount.

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request.

Total payment amount	Estimated up front fee you pay	Your investment amount	Up front fee as % of your investment amount
\$	\$	\$	%
\$1,000.00	\$57.50	\$942.50	6.10%
\$50,000.00	\$2,250.00	\$47,750.00	4.71%
\$100,000.00	\$3,500.00	\$96,500.00	3.63%

In addition when you open your account, you will pay:

**Application fee:**      **\$75.00** ([State] residents)  
   **\$95.00** (non-residents)

**You also pay each year**

In addition to the up front sales fee, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	0.25%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>2.38%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st year annual fees you pay	Annual fee %
\$	\$	2.38%
\$1,000.00	\$23.80	2.38%
\$50,000.00	\$1,190.00	2.38%
\$100,000.00	\$2,380.00	2.38%

**Conflicts of interest**

Are we paid extra to promote this college savings plan over others?      **YES**

Do we pay our personnel more for selling this college savings plan than for selling other plans we offer?      **NO**

**Find out more****Plan offering document**

You should consider all the costs, goals and risks associated with any college savings plan before you buy. Read about this information in the college savings plan's offering document. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/state529plan/offeringdocument](http://www.aaafunds.com/state529plan/offeringdocument).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this college savings plan. This information is not available in the plan offering document. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

[B-D Name]

Date: \_\_\_\_\_

**Fees you pay and our conflicts of interest  
for purchases of [STATE] 529 Savings Plan Growth Portfolio – Class B**

**Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this portfolio. Ask us to fill in the blanks below for details about the fees you must pay.

**Your state's tax incentives**

Many states offer their residents tax deductions and other benefits for investing in their 529 college savings plans, but not for investing in other states' plans. If you live in a state that offers these tax deductions or other benefits, you should consider whether investing in a college savings plan sponsored by your state is best for you.

**Fees**

**You pay when you sell**

You pay a sales fee for Class B shares of this 529 college savings plan when you sell them—at the back end. This fee varies with both the value of the shares you sell and the length of time you hold them.

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your shares does not change.

Investment amount	Estimated maximum back end sales fee	Maximum back end fee %
\$	\$	6.10%
\$1,000.00	\$61.00	6.10%
\$50,000.00	\$3,050.00	6.10%
\$100,000.00	\$6,100.00	6.10%

In addition when you open your account, you will pay:

**Application fee:** \$75.00 ([State] residents)  
\$95.00 (non-residents)

**You also pay each year**

In addition to the back end sales fee, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>3.13%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st year annual fees you pay	Annual fee %
\$	\$	3.13%
\$1,000.00	\$31.03	3.13%
\$50,000.00	\$1,565.00	3.13%
\$100,000.00	\$3,130.00	3.13%

**Conflicts of interest**

Are we paid extra to promote this college savings plan over others? **YES**

Do we pay our personnel more for selling this college savings plan than for selling other plans we offer? **NO**

Do we pay our personnel more for selling Class B shares than for selling other share classes of the same 529 college savings plan? **YES**

**Find out more**

**Plan offering document**

You should consider all the costs, goals and risks associated with any college savings plan before you buy. Read about this information in the college savings plan's offering document. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/state529plan/offeringdocument](http://www.aaafunds.com/state529plan/offeringdocument).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this college savings plan. This information is not available in the plan offering document. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**[B-D Name]**

Date: \_\_\_\_\_

**Fees you pay and our conflicts of interest****for purchases of [STATE] 529 Savings Plan Growth Portfolio – Class C****Ask before you buy**

We are required to tell you about fees and conflicts of interest that may affect your decision to buy shares of this portfolio. Ask us to fill in the blanks below for details about the fees you must pay.

**Your state's tax incentives**

Many states offer their residents tax deductions and other benefits for investing in their 529 college savings plans, but not for investing in other states' plans. If you live in a state that offers these tax deductions or other benefits, you should consider whether investing in a college savings plan sponsored by your state is best for you.

**Fees****You pay each year**

For Class C shares, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your portfolio, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>3.13%</b>

**Do you want us to fill in the blanks for you?**

We must write in amounts for your investment at your request. This estimate assumes the value of your investment does not change.

Investment value	Estimated 1st year annual fees you pay	Annual fee %
\$	\$	3.13%
\$1,000.00	\$31.03	3.13%
\$50,000.00	\$1,565.00	3.13%
\$100,000.00	\$3,130.00	3.13%

In addition when you open your account, you will pay:

**Application fee:**      **\$75.00** ([State] residents)  
   **\$95.00** (non-residents)

**Conflicts of interest**

Are we paid extra to promote this college savings plan over others?      **YES**

Do we pay our personnel more for selling this college savings plan than for selling other plans we offer?      **NO**

Do we pay our personnel more for selling Class C shares than for selling other share classes of the same 529 college savings plan?      **YES**

**Find out more****Plan offering document**

You should consider all the costs, goals and risks associated with any college savings plan before you buy. Read about this information in the college savings plan's offering document. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaafunds.com/state529plan/offeringdocument](http://www.aaafunds.com/state529plan/offeringdocument).

**Summary of special incentives**

Ask us for a summary of the special incentives we receive to sell this college savings plan. This information is not available in the fund prospectus. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**Attachment 6**

529 Savings Plan Class C – Point of Sale

Date: \_\_\_\_\_

# [B-D Name]

## Fees and our conflicts of interest for purchases of AAA Variable Annuity

### Ask before you buy

We are required to tell you about fees and the conflicts of interest that may affect your decision to buy this variable annuity. Ask us to fill in the blanks below for details about the fees you must pay.

### Free look right

You may be able to terminate your contract within the "free look" period and receive a refund of your payments or your contract value, which may be less. Ask us for details.

## Fees

### You pay when you buy

You pay a sales fee up front when you make a payment. The fee you pay is based on the amount of your payment.

### Do you want us to fill in the blanks for you?

We must write in amounts for your payment at your request.

Total payment amount	Estimated up front fee you pay	Your investment amount	Up front fee as % of your investment amount
\$	\$	\$	%
\$1,000.00	\$63.50	\$936.50	6.79%
\$50,000.00	\$3,175.00	\$46,825.00	6.79%
\$100,000.00	\$6,350.00	\$93,650.00	6.79%

### You pay when you sell

You pay a surrender charge if you withdraw money from your contract within a certain period of time. The charge is based on the amount you withdraw, and when you make the withdrawal. If you received a bonus credit, part of it will also be taken away. The surrender charge % will decline over time.

Amount withdrawn	Estimated maximum surrender charge including bonus repayment	Maximum surrender charge %
\$	\$	9.00%
\$1,000.00	\$90.00	9.00%
\$50,000.00	\$4,500.00	9.00%
\$100,000.00	\$9,000.00	9.00%

### You also pay each year

In addition to the surrender charge, you will pay ongoing fees every year you hold the contract. These fees will vary with the value of your contract, and may not be charged on assets held in the fixed account. You may also pay an annual contract charge of \$45. Ask us for details.

For Each \$1,000 of Contract Value, You Pay Each Year

Type of Fee	Minimum You Would Pay	Maximum You Would Pay
Investment Option Fees	\$5.50 (0.55%)	\$22.50 (2.25%)
Insurance Charges	\$18.00 (1.80%)	\$25.00 (2.50%)
<b>Total Fees for \$1,000</b>	<b>\$23.50 (2.35%)</b>	<b>\$47.50 (4.75%)</b>
\$1,000.00	\$23.50	\$47.50
\$50,000.00	\$1,175.00	\$2,375.00
\$100,000.00	\$2,350.00	\$4,750.00

## Conflicts of interest

Does the insurance company or its affiliates pay us extra to promote this product over other variable annuities? **YES**

Do we pay our personnel more for selling this product than for selling other variable annuities we offer? **NO**

## Find out more

### Prospectuses

You should consider all the costs, goals and risks associated with any variable annuity before you buy. Read about this information in the prospectus. We can provide you with a copy today, or you may obtain one by calling (800) 999-9999 or on line at [www.aaaannuities.com/variable-annuity/prospectus](http://www.aaaannuities.com/variable-annuity/prospectus).

### Summary of special incentives

Ask us for a summary of the special incentives we receive to sell this product. This information is not available in the prospectus. You can request this information by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives)

## Confirmation of your transaction AAA Equity Fund – Class A shares

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

### Details of your transaction

Your total payment to purchase the fund:	\$12,500.00
Up front sales fee you paid:	\$722.50
Amount you invested in the fund:	<b>\$11,777.50</b>
Amount invested per share (Net Asset Value):	\$23.11
Number of shares bought:	509.6279

### Fees

#### You paid when you bought

You paid a sales fee for your Class A shares up front when you purchased your shares. This fee pay was based on your total payment amount.

Your total payment	Up front sales fee you paid	Your investment amount	Up front fee as % of your investment amount
\$12,500.00	<b>\$722.50</b>	<b>\$11,777.50</b>	<b>6.13%</b>

The up front fee % you paid differs from the up front fee % in the prospectus due to rounding. The up front fee % stated in the prospectus is 6.10%.

#### You also pay each year

In addition to the up front sales fee, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	0.25%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>1.92%</b>

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$11,777.50	<b>\$226.13</b>	<b>1.92%</b>

### Conflicts of interest

Does the fund or its affiliates pay us extra to promote this fund over other funds?	<b>YES</b>
Do we pay our personnel more for selling this fund than for selling other funds we offer?	<b>NO</b>

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

## Confirmation of your transaction AAA Equity Fund – Class B shares

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

### Details of your transaction

Your total payment to purchase this fund: **\$12,500.00**  
 Amount invested per share (Net Asset Value): **\$23.11**  
 Number of shares bought: **540.8914**

### Fees

#### You will pay when you sell

You pay a sales fee for your Class B shares when you sell them—at the back end. This fee varies with both the value of the shares you sell and the length of time you hold them.

These estimates assume no change in the value of your investment. Your actual fee will depend on the value of the shares that you sell.

Your investment	If you hold these shares	Back-end sales fee you pay	Back-end fee%
\$12,500.00	less than 1 year	<b>\$762.50</b>	<b>6.10%</b>
	from 1 to 2 years	<b>\$588.75</b>	<b>4.71%</b>
	from 2 to 3 years	<b>\$453.75</b>	<b>3.63%</b>
	from 3 to 4 years	<b>\$331.25</b>	<b>2.65%</b>
	from 4 to 5 years	<b>\$218.75</b>	<b>1.75%</b>
	from 5 to 6 years	<b>\$93.75</b>	<b>0.75%</b>
	more than 6 years	<b>\$0.00</b>	<b>0.00%</b>

#### You also pay each year

In addition to the back end sales fee, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>2.67%</b>

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$12,500.00	<b>\$333.75</b>	<b>2.67%</b>

### Conflicts of interest

Does the fund or its affiliates pay us extra to promote this fund over other funds? **YES**

Do we pay our personnel more for selling this fund than for selling other funds we offer? **NO**

Do we pay our personnel more for selling class B shares than for selling other share classes of this same fund? **NO**

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

## Confirmation of your transaction AAA Equity Fund – Class C shares

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

### Details of your transaction

Your total payment to purchase the fund: **\$12,500.00**  
 Amount invested per share (Net Asset Value): **\$23.11**  
 Number of shares bought: **540.8914**

### Fees

#### You will pay each year

For Class C shares, you will pay ongoing fees every year you hold shares in the fund. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	0.92%
<b>Total annual fee %</b>	<b>2.67%</b>

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$12,500.00	\$333.75	2.67%

### Conflicts of interest

Does the fund or its affiliates pay us extra to promote this fund over other funds? **YES**

Do we pay our personnel more for selling this fund than for selling other funds we offer? **NO**

Do we pay our personnel more for selling class C shares than for selling other share classes of this same fund? **NO**

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**Confirmation of your transaction**  
**[STATE] 529 Savings Plan Growth Portfolio – Class A**

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

**Details of your transaction**

Your total payment to purchase this college savings plan: **\$12,500.00**  
 Up front sales fee you paid: **\$722.50**  
 Application fee you paid: **\$75.00**  
 Amount you invested in the fund: **\$11,702.50**  
 Amount invested per share (Net Asset Value): **\$23.11**  
 Number of shares bought: **506.3825**

**Fees**

**You paid when you bought**

You paid a sales fee for your Class A shares up front when you purchased shares of this 529 college savings plan. This fee pay was based on your total payment amount.

Your total payment	Up front sales fee you paid	Your investment amount	Up front fee as % of your investment amount
\$12,500.00	\$722.50	\$11,777.50	6.13%

The up front fee % you paid differs from the up front fee % in this college savings plan's offering document due to rounding. The up front fee % stated in the offering document is 6.10%.

**You also paid an application fee: \$75.00** ([State] residents)

**You also pay each year**

In addition to the up front sales fee, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	0.25%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>2.38%</b>

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$11,777.50	\$280.30	2.38%

**Conflicts of interest**

Are we paid extra to promote this college savings plan over others? **YES**  
 Do we pay our personnel more for selling this college savings plan than for selling other plans we offer? **NO**

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

## Confirmation of your transaction

### [STATE] 529 Savings Plan Growth Portfolio – Class B

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

#### Details of your transaction

Your total payment to purchase this college savings plan: **\$12,575.00**  
 Application fee you paid: **\$75.00**  
 Amount you invested in the fund: **\$12,500.00**  
 Amount invested per share (Net Asset Value): **\$23.11**  
 Number of shares bought: **540.8914**

#### Fees

##### You will pay when you sell

You pay a sales fee for your Class B shares when you sell them—at the back end. This fee varies with both the value of the shares you sell and the length of time you hold them.

These estimates assume no change in the value of your investment. Your actual fee will depend on the value of your shares at the time you sell.

Your investment	If you hold these shares	Back-end sales fee you pay	Back-end fee%
\$12,500.00	less than 1 year	<b>\$762.50</b>	<b>6.10%</b>
	from 1 to 2 years	<b>\$588.75</b>	<b>4.71%</b>
	from 2 to 3 years	<b>\$453.75</b>	<b>3.63%</b>
	from 3 to 4 years	<b>\$331.25</b>	<b>2.65%</b>
	from 4 to 5 years	<b>\$218.75</b>	<b>1.75%</b>
	from 5 to 6 years	<b>\$93.75</b>	<b>0.75%</b>
	more than 6 years	<b>\$0.00</b>	<b>0.00%</b>

##### You also pay each year

In addition to the back end sales fee, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>3.13%</b>

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$12,500.00	<b>\$391.25</b>	<b>3.13%</b>

#### Conflicts of interest

Are we paid extra to promote this college savings plan over others? **YES**

Do we pay our personnel more for selling this college savings plan than for selling other plans we offer? **NO**

Do we pay our personnel more for selling Class B shares than for selling other share classes of the same 529 college savings plan? **YES**

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

#### Attachment 12

529 Savings Plan Class B – Confirmation

## Confirmation of your transaction

### [STATE] 529 Savings Plan Growth Portfolio – Class C

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

#### Details of your transaction

Your total payment to purchase this college savings plan:	<b>\$12,575.00</b>
Application fee you paid:	\$75.00
Amount you invested in the fund:	<b>\$12,500.00</b>
Amount invested per share (Net Asset Value):	\$23.11
Number of shares bought:	540.8914

#### Fees

#### You will pay each year

For Class C shares, you will pay ongoing fees every year you hold this portfolio. These fees are based on the value of your investment, and include:

Distribution fees <i>(we receive all or almost all of the distribution fees)</i>	1.00%
Management fees	0.75%
Other expenses	1.18%
State administrative fees	0.20%
<b>Total annual fee %</b>	<b>3.13%</b>

This estimate assumes the value of your investment stays the same. Your actual annual fees will depend on the value of your investment at the time the fee is calculated.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$12,500.00	<b>\$391.25</b>	<b>3.13%</b>

#### Conflicts of interest

Are we paid extra to promote this college savings plan over others? **YES**

Do we pay our personnel more for selling this college savings plan than for selling other plans we offer? **NO**

Do we pay our personnel more for selling Class C shares than for selling other share classes of the same 529 college savings plan? **YES**

You can request a summary of the special incentives we receive to sell this fund by calling (800) 888-8888 or review it on-line at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

## Confirmation of your transaction

### AAA Variable Annuity

Name: **David Smith**  
 Account no: **2345-9911**  
 Order date: **October 28, 2004**  
 Settlement date: **October 28, 2004**

### Details of your transaction

Your payment: \$12,000.00  
 Less up front sales fee you paid (6.35% of payment): <762.50>  
 Equals investment amount before bonus **\$11,237.50**  
 Plus bonus credit \$500.00  
 Equals investment amount: **\$11,737.50**

This amount was allocated as follows:

Name of Fund	Accumulation Unit Value	Number of Units	Dollar Value
Equity Fund	\$24.50	346.939	\$8,500.00
Bond Fund	\$42.85	46.383	\$1,987.50
AAA Insurance Fixed Account			\$1,250.00
<b>Total</b>			<b>\$11,737.50</b>

### Fees

#### You paid when you bought

You paid a sales fee for your variable annuity up front when you purchased your contract.

Your payment	Up front sales fee you paid	Investment amount before bonus	Up front fee as % of investment amount before bonus
\$12,000.00	<b>\$762.50</b>	\$11,237.50	<b>6.79%</b>

#### You also pay each year

You will pay ongoing fees every year you hold the contract. These fees will vary with the value of your contract, and may not be charged on assets held in the fixed account. Ask us for details.

Investment value	Estimated 1 <sup>st</sup> year annual fees you will pay	Annual fee %
\$11,737.50	Investment Option Fees <b>\$134.98</b>	<b>1.15%</b>
	Insurance Charges <b>\$234.75</b>	<b>2.00%</b>
	Annual Contract Charge <b>\$45.00</b>	
	<b>Total \$414.73</b>	

#### You will pay when you sell

You pay a surrender charge if you withdraw money from your contract within a certain period of time. The charge is based on the amount you withdraw, and when you make the withdrawal. If you received a bonus credit, part of it will also be taken away.

**You may be able to make a partial surrender of your contract without incurring a surrender charge; see the prospectus for details.**

This estimate assumes the value of your contract stays the same during the year. Your actual fees will vary based on the value of your contract at the time you surrender your contract.

Investment value	If you surrender within	Back-end sales	
		fee including bonus repayment	Back-end fee%
\$11,737.50	less than 1 years	<b>\$1056.33</b>	<b>9.00%</b>
	from 1 to 2 years	<b>\$939.00</b>	<b>8.00%</b>
	from 2 to 3 years	<b>\$821.63</b>	<b>7.00%</b>
	from 3 to 4 years	<b>\$704.25</b>	<b>6.00%</b>
	from 4 to 5 years	<b>\$586.88</b>	<b>5.00%</b>
	from 5 to 6 years	<b>\$469.50</b>	<b>4.00%</b>
	from 6 to 7 years	<b>\$352.13</b>	<b>3.00%</b>
	from 7 to 8 years	<b>\$234.75</b>	<b>2.00%</b>
	from 8 to 9 years	<b>\$117.38</b>	<b>1.00%</b>
more than 9 years	<b>\$0.00</b>	<b>0.00%</b>	

### Conflicts of interest

Does the insurance company or its affiliates pay us extra to promote this product over other variable annuities? **YES**

Do we pay our personnel more for selling this product than for selling other variable annuities we offer? **NO**

You can request a summary of the special incentives we receive to sell this variable annuity by calling (800) 888-8888 or review it online at [www.brokerwebsite.com/specialincentives](http://www.brokerwebsite.com/specialincentives).

**Our compensation for selling AAA Equity Fund****Compensation that all broker-dealers receive for selling this fund**

We receive the following compensation in connection with selling this fund. These amounts may be funded by sales fees or other distribution charges. For most investors, those amounts will have been disclosed prior to purchase.

**Class A shares ("front-end" sales fees)**

<b>Up-front compensation</b>	Payment amount	What we receive	Our payment as %
	\$1,000.00	\$50.00	5.00%
We receive the following up-front compensation for selling Class A shares of this fund.	\$50,000.00	\$2,000.00	4.00%
	\$100,000.00	\$3,250.00	3.25%
<b>Additional annual compensation</b>	Investment value	What we receive	Our payment as %
	\$1,000.00	\$2.50	0.25%
Each year we also receive the following compensation based on the value of Class A shares owned by our customers.	\$50,000.00	\$125.00	0.25%
	\$100,000.00	\$250.00	0.25%

**Class B shares ("back-end" sales fees)**

<b>Up-front compensation</b>	Payment amount	What we receive	Our payment as %
	\$1,000.00	\$45.00	4.50%
We receive the following upfront compensation for selling Class B shares of this fund.	\$50,000.00	\$2,250.00	4.50%
	\$100,000.00	\$4,500.00	4.50%
<b>Additional annual compensation</b>	Investment value	What we receive	Our payment as %
	\$1,000.00	\$10.00	1.00%
Each year for the first seven years you own this fund, we also receive the following compensation based on the value of Class B shares owned by our customers. After seven years, this amount will reduce to 0.25%.	\$50,000.00	\$500.00	1.00%
	\$100,000.00	\$1,000.00	1.00%

**Class C shares ("level sales fees")**

<b>Up-front compensation</b>	Payment amount	What we receive	Our payment as %
	\$1,000.00	\$10.00	1.00%
We receive the following upfront compensation for selling Class C shares of this fund.	\$50,000.00	\$500.00	1.00%
	\$100,000.00	\$1,000.00	1.00%
<b>Additional annual compensation</b>	Investment value	What we receive	Our payment as %
	\$1,000.00	\$10.00	1.00%
Each year we also receive the following compensation based on the value of Class C shares owned by our customers.	\$50,000.00	\$500.00	1.00%
	\$100,000.00	\$1,000.00	1.00%

**Special revenue sharing and other promotional payments we receive from the AAA fund family**

We or our affiliates also receive other payments from AAA fund family. These promotional payments, which create conflicts of interest, are described below.

Type of payment	What we receive
Sales-based payments	We receive \$2 for every \$1000 of AAA Equity Fund shares we sell after we sell \$10 million of AAA Equity Fund in a calendar year.
Payments for fund shares held by our customers	We annually receive 50 cents for every \$1000 of AAA fund family shares that our customers maintain in their accounts for more than one year.
Other payments	In addition to the promotional compensation discussed above, in our most recent fiscal year we received \$50,000 from the AAA family, on \$40 million of total sales of AAA fund family shares. We expect to receive at least \$25,000 of these types of promotional compensation from the AAA fund family in the current fiscal year, and we received \$7500 of this type of compensation in the most recent fiscal quarter.

**Additional payments we receive from the AAA fund family**

In addition to the compensation described above, we or our affiliates further receive some payments from the AAA fund family for "transfer agent" or recordkeeping services that we perform in connection with fund shares held by our customers. In the most recent fiscal year, we received \$40,000 from the AAA family. We expect to receive at least \$20,000 of this type of compensation in the current fiscal year, and we received \$6000 of this type of compensation in the most recent fiscal quarter.

**Compensation-related conditions to our sale of mutual funds**

- We only sell mutual funds that charge sales fees. We do not sell no-load funds, which charge no sales fees.
- We only sell mutual funds from fund families that pay us asset-based distribution fees ("rule 12b1 fees") of at least 0.25% of assets. If a fund family does not pay us those fees for all funds (including funds that are closed to new investors), we do not sell that family's mutual funds.
- We only sell mutual funds that pay us sub-transfer agent fees of \$12 per customer account.
- Funds that pay revenue sharing to us receive special access to our sales personnel.

**Special incentives we pay to our personnel for selling this fund or particular share classes****Our personnel are paid more for selling AAA fund shares***[Illustrative disclosure - higher payout to representative]*

We pay our personnel more for selling fund shares issued by AAA fund family than for selling shares issued by some other fund families. For example, a salesperson who typically receives 42% of the sales fees we earn on mutual fund sales receive 45% of the sales fees we receive for the sale of AAA fund shares. Also, when our personnel sell AAA fund shares, they do not have to pay \$8 per-transaction "ticket charges" that we otherwise would take out of their compensation.

*[Alternative illustration - sale of fund that provides above average compensation]*

Moreover, this fund's distributor pays all broker-dealers more for selling shares of this fund than the average we receive for selling comparable funds. Because we pay our personnel a standard percentage of our revenues, our personnel may earn more for selling this fund than they earn for selling comparable funds.

**Our personnel may be paid more for selling class [B/C] shares**

We can expect to earn more for selling class [B/C] shares of this fund than class A shares, particularly for larger sales, than we earn for selling other share classes. As a result, our personnel also may earn more when they sell class [B/C] shares.