Dechert LLP

Financial Services

FEBRUARY 20, 2004 / NUMBER 6

SEC Proposes New Confirmation and Point of Sale Disclosures

On January 29, 2004, the Securities and Exchange Commission ("SEC" or "Commission") proposed new rules ("Proposed Rules") under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that would substantially change the disclosure obligations of broker-dealers selling mutual funds and similar products.[1] The proposal would require an extensive new confirmation statement for transactions involving securities issued by open-end management investment companies ("mutual funds"), interests issued by unit investment trusts ("UITs") and securities issued by education savings plans ("529 plans"). In a significant change from existing practice, the Proposed Rules also would create new point of sale disclosure for transactions in these securities. The SEC also proposed rule amendments to Rule 10b-10 and Form N-1A. The SEC believes the Proposed Rules will improve investors' ability to obtain information about costs and conflicts arising from transactions in covered securities and address concerns about the inadequacy of the current disclosure regime. This proposal would impose significant new costs[2] and in many circumstances would require broker-dealers to adopt new procedures when selling these products.

This Financial Services Update summarizes the proposed confirmation and point of sale disclosure requirements and related proposed amendments to Form N-1A.

Current Confirmation Disclosure Requirements--Exchange Act Rule 10b-10

The SEC adopted its current confirmation rule, Exchange Act Rule 10b-10, in 1977. Under Rule 10b-10, broker-dealers are required to disclose, among other things, the identity of the security, the number of shares purchased or sold and the price at which a transaction

---

1 *Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds*, Rel. Nos. 33-8358, 34-49148, IC-26341, 69 Fed. Reg. 6438 (Jan. 29, 2004) ("Proposing Release").

2 For example, the Proposing Release states that for the new confirmation requirement, Proposed Rule 15c2-2, the SEC staff estimates that the burden initial implementation would cost of $750 million. The staff further estimates that there would be an additional one-time cost of $100 million for fees of service providers, for a total cost of $850 million, or approximately $157,407 per broker-dealer. The estimate is based on an hourly wage rate of $50. Proposing Release, *supra* note 1, 69 Fed. Reg. 6438, 3471.

was effected. A broker-dealer also must disclose any remuneration it receives from the customer when it acts as the customer's agent, as well as the source and amount of remuneration received from third parties for agency transactions in which it participates in the distribution of the securities.

In the past, with respect to mutual fund transactions, the SEC and its staff had taken the position that a broker-dealer may satisfy its obligation under Rule 10b-10 without providing a customer transaction-specific disclosure about sales loads or third-party remuneration, so long as the customer is provided with a mutual fund prospectus that discloses that information.[3] The SEC staff also had stated it would not recommend enforcement action against a broker-dealer where the customer received a mutual fund prospectus that "disclosed the precise amount of the sales load or other charges or a formula that would enable the customer to calculate the precise amount of those fees."[4] More recently, in an *amicus* brief filed with the Second Circuit, the SEC staff interpreted the Rule 10b-10 Adopting Release as establishing the general principal that "delivery of a prospectus containing sufficient disclosure can satisfy a broker-dealer's obligations under Rule 10b-10."[5]

Confirmation Disclosure--Proposed Exchange Act Rule 15c2-2

The Proposing Release notes that distribution-related costs and distribution arrangements for mutual funds, unit investment trusts ("UITs") and 529 plans have evolved substantially since the adoption of Rule 10b-10 in 1977, leading some to question whether current disclosure practices are adequate to protect investors. The SEC believes Proposed Exchange Act Rule 15c2-2 ("Proposed Rule 15c2-2") will "provide investors with adequate access to information regarding the costs of their investments as well as the conflicts of interest their broker-dealers face."[6]

The new confirmation statement requirements of Proposed Rule 15c2-2 would apply to transactions in mutual funds shares, UIT interests,[7] and 529 plans

---

[3] *Securities Confirmations*, Rel. No. 34-13508 (May 5, 1977) ("Rule 10b-10 Adopting Release"), at n.41 (stating "[I]n the case of offerings registered under the Securities Act of 1933, the final prospectus delivered to the customer should generally set forth the information required by the proviso with respect to source and amount of remuneration. . . . In such situations the information specified in the proviso need not be separately set forth on the confirmation.").

[4] *Investment Company Institute,* SEC No-Action Letter (pub. avail. Apr. 18, 1979). According to the Proposing Release, the Division of Market Regulation intends to withdraw the ICI no-action letter as part of the current rulemaking initiative. Such action was one of the recommendations of the Joint NASD/Industry Taskforce on Breakpoints.

[5] *See* Commission brief, *Cohen v. Donaldson, Lufkin & Jenrette Securities Corp.*, reported as *Press v. Quick & Reilly, Inc.*, 218 F.3d 121 (2d Cir. 2000). The SEC did not address whether compliance with Rule 10b-10 also constituted compliance with Rule 10b-5, the general anti-fraud rule under the Exchange Act. The court noted that:

> because the SEC has decided precisely what type of disclosure is necessary to reveal a conflict of interest arising from third-party payments to broker-dealers in the context of Rule 10b-10, we will not undermine the SEC's interpretation of its regulation by requiring even greater disclosure about that conflict of interest under the general antifraud provisions of Rule 10b-5. Accordingly, we are compelled to conclude that additional disclosure beyond what the fund prospectuses and SAIs reveal is not, as a matter of law, material. For the foregoing reasons, we hold that defendants' compliance with Rule 10b-10 renders the allegedly omitted information immaterial as a matter of law. Although we are not ourselves certain that the disclosure requirements under Rule 10b-10 fulfil [sic] its stated purpose, we defer to the SEC's interpretation of its rule and leave it to the governmental entity best suited to sort out any inadequacies of the current disclosure regime.

As discussed below, the Proposing Release subsequently reiterates the Commission's view that compliance with a confirmation requirement does not necessarily constitute compliance with the general anti-fraud provisions of the securities laws.

[6] Proposing Release, *supra* note 1, 69 Fed. Reg. 6438, 6445.

[7] Securities issued by a UIT that is an exchange traded fund that is traded on a national securities exchange or facility of a

(collectively "covered securities") by brokers, dealers, and municipal securities dealers[8] (collectively "broker-dealers") on behalf of customers.[9] The Commission is requesting comment on whether the definition of "covered security" is sufficient. The Commission also is specifically requesting comment on whether the Proposed Rule should apply to all UIT interests and ETF shares and whether it should apply to closed-end investment companies generally or to particular closed-end companies, such as interval funds that make regular repurchase offers.

The proposed preliminary note accompanying Proposed Rule 15c2-2 explains that broker-dealers would be required to provide specified information to customers in writing at or before completion of a transaction in certain securities and cautions that the disclosure provided pursuant to Proposed Rule 15c2-2 would not be determinative of and would not exhaust any of the broker-dealer's other disclosure or legal obligations to customers under the federal securities laws. Moreover, a broker-dealer that misstates information in a confirmation delivered under Proposed Rule 15c2-2 with an intent to mislead may be subject to liability under Exchange Act Section 10(b) and Rule 10b-5. The Proposing Release characterizes Proposed Rule 15c2-2 as providing a "minimal benchmark" and states that while the SEC "believe[s] the information required to be disclosed under the proposed rule is material to investors, there may be other information that is material for purposes of alerting investors about the costs of these transactions and the conflicts raised by them."[10]

national securities association or a UIT that is the subject of a secondary market transaction are not covered by Proposed Rule 15c2-2.

8 The Proposed Rules would apply to banks that act as municipal securities dealers in transactions involving mutual fund securities.

9 As a consequence of Proposed Rule 15c2-2, the Proposing Release also includes proposed changes to current Rule 10b-10 to exclude transactions in covered securities.

10 Proposing Release, *supra* note 1, 69 Fed. Reg. 6438, 6445.

Proposed Schedule 15C would establish the format for disclosing the information required by Proposed Rule 15c2-2.[11] The proposed form has six main parts: (A) general information; (B) distribution-cost information; (C) broker-dealer compensation information; (D) differential compensation information; (E) breakpoint discount information; and (F) explanations and definitions. The information required by Proposed Rule 15c2-2 would have to be disclosed in a manner that is "consistent with Schedule 15C" under the Exchange Act.[12]

General Disclosure Requirements

The general disclosure required under Proposed Rule 15c2-2(b), would require the broker-dealer to provide the customer with written disclosure of the following information:

- the date of the transaction;
- the issuer and class of the covered security;
- the net asset value ("NAV") of the shares and units and, if different, their public offering price;[13]
- the number of shares of a covered security purchased or sold by the customer as well as the total dollar amount paid or received in the

11 The Commission has attached examples of completed confirmations based on hypothetical share purchases that conform with Schedule 15C to the Proposing Release. *See* Proposing Release, *supra* note 1, Attachments 1-3.

12 Under Proposed Rule 15c2-2(f)(4), "consistent with Schedule 15C" means using proposed "Schedule 15C, or using a similar layout of disclosure so long as: (i) all information specified in Schedule 15C is set forth in the confirmation; (ii) information specified in Sections B through F of Schedule 15C are included with no change, including the use of bold print for data items printed in bold in Schedule 15C, and in the order set forth in Schedule 15C; and (iii) information specified in Section A of Schedule 15C is displayed prominently."

13 Rule 10b-10 only requires disclosure of price.

transactions and the net amount of the investment bought or sold in the transactions;[14]

- any commission, mark up or other payment the broker-dealer will receive from the customer in connection with the transaction;[15]
- any deferred sales load incurred by the customer;[16] and
- when applicable, the fact that the broker-dealer effecting the transaction or clearing or carrying the customer's account is not a member of SIPC.[17]

The Commission is requesting comment on the adequacy of these disclosures and, in particular, whether these disclosures are appropriate for securities transactions that have an insurance component, such as variable insurance products. In this regard, the Commission also is requesting comment on whether to use a single confirmation for both the insurance contract or policy and the underlying funds.

Additional Disclosure Requirements

Proposed Rule 15c2-2(c) would require disclosure of what the customer pays, directly or indirectly, for purchases, as follows:

- *Sales Loads.* Broker-dealers would be required to disclose any sales loads the customer has incurred or will incur at the time of purchase, expressed in dollars and as a percentage of net amount invested.[18]
- *Breakpoints.* For transactions where the customer incurs a sales load at the time of purchase, the broker-dealer would be required to disclose information about the availability of breakpoint discounts for the covered security. For transactions where the customer does not incur a sales load at the time of purchase, the broker-dealer would be required to disclose information about the availability of breakpoint discounts for another class of the covered security and the amount of any sales load the customer would have incurred had the customer

---

14 Rule 10b-10 requires disclosure of the number of shares or units purchased or sold.

15 These commissions are distinct from any dealer concession or sales fee the broker-dealer may receive from the fund or its primary distributor and also are distinct from any sales loads the customer may pay in connection with the transaction. These commissions would include, for example, a service fee or ticket charge assessed by the broker-dealer for purchasing a fund.

16 Rule 10b-10 does not explicitly require this disclosure.

17 SIPC is the Securities Investor Protection Corporation. Proposed Rule 15c2-2 creates an exemption from this disclosure. Proposed Rule 15c2-2(b)(7) provides an exception if:

> (i) The customer sends funds or securities directly to, or receives funds or securities directly from, the issuer of the covered security, its transfer agent, its custodian, or other designated agent, and such person is not an associated person of the broker or dealer required by paragraph (a) of this section [*i.e.,* this disclosure requirement] to send written notification to the customer; and
>
> (ii) The written notification required by paragraph (a) of this section is sent on behalf of the broker or dealer to the customer by a person described in paragraph (b)(7)(i) of this section.

This requirement is consistent with current Rule 10b-10(a)(9).

18 For example, the confirmation would show the following for a hypothetical purchase:

NAV	$ 18.18
Price (NAV Plus load)	$ 18.93
Amount paid/received	$8,000.00
Amount of your investment	$7,678.82
Front-end sales load	$ 321.18

As discussed below, the confirm would have to show additional information.

purchased that other class of the covered security.

- *Deferred Sales Loads.* Broker-dealers would be required to disclose, on a year-by-year basis for as long as the sales loads may be in effect, the maximum deferred sales load each year expressed in dollars and as a percentage of NAV at the time of purchase or sale. This disclosure would only need to be made at the time of sending the confirmation (not on an annual basis).

  With respect to this requirement, the Proposing Release states that:

  > We recognize that broker-dealers would rarely, if ever, know in advance when an investor may redeem those shares, and therefore would generally not be able to disclose the specific amount of a deferred sales load. Investors nonetheless have an interest in seeing transaction-specific information about the potential cost of deferred sales loads. . . . Accordingly, proposed paragraph (c)(2) would require the [broker-dealer] to disclose, on a year-by-year basis for as long as the deferred load may be in effect, information about the maximum amount of the load expressed in dollars. Proposed paragraph (c)(2) also would require disclosure of the maximum deferred sales load as a percentage of net asset value at the time of purchase or sale, as applicable.[19]

- *Asset-based sales charges and asset-based service fees.* Broker-dealers would be required to disclose any asset-based sales charges and/or service fees as a percentage of NAV. Additionally, asset-based sales charges and service fees would be disclosed as an estimate of the total annual dollar amount of asset-based sales charges and service fees associated with the shares purchased if NAV were to remain unchanged. This disclosure would capture Rule 12b-1 fees.

  The Commission is requesting comment on whether these requirements would provide investors with an appropriate amount of information about the amount of distribution-related costs they or the issuer may incur in connection with purchases. Specifically, the Commission has asked whether the disclosure related to deferred sales loads would be sufficiently clear to customers. Additionally, the Commission is seeking comment on whether certain disclosure requirements should be eliminated for some types of transactions. For example, the Commission is requesting comment on how disclosure of front-end sales loads as a percentage of net amount invested would apply to securities with a life insurance components and whether alternative disclosure requirements would be preferable for these products.

- *Dealer concessions and other sales fees.* Broker-dealers would be required to disclose dealer concessions or other sales fees that they will earn in connection with the transaction, expressed in dollars and as a percentage of the net amount invested. The Commission is requesting comment on whether this requirement is adequate to inform customers about the incentives associated with sales fees and, if it is not adequate, suggestions for how

---

[19] Proposing Release, *supra* note 1, 69 Fed. Reg. 6438, 6449.

the requirement could be modified.

- *Revenue sharing*[20] *and portfolio securities transaction*[21] *commissions.* For both revenue sharing and portfolio securities transaction ("portfolio brokerage") commissions, broker-dealers would be required to disclose information about payments received directly or indirectly from the fund complex[22] by the broker-dealer, any associated person that is a broker-dealer and, where the security is not a proprietary covered security, any other associated persons. These amounts would be disclosed as a percentage of total NAV represented by the broker-dealer's total sales of covered securities on behalf of the fund complex over the four most recent calendar quarters, updated each quarter.[23] The required disclosure would also include the total dollar amount of revenue sharing or portfolio brokerage commissions the broker-dealer expects to receive in connection with the transaction.[24]

  The Commission is requesting comment on whether the proposed definition of revenue sharing encompasses all distribution arrangements that pose potential conflicts of interest to broker-dealers. The Commission also invites commenters to discuss whether the rule should use a term other than "revenue sharing" and whether the definition of revenue sharing under the proposed rule appropriately excludes payments made by the issuer. The Commission is requesting comment on whether the proposed disclosure of revenue sharing and portfolio brokerage arrangements provide sufficient information to investors. In particular, the Commission invites comment on whether firms should be required to disclose revenue sharing and portfolio commissions in absolute dollar amounts and whether the arrangements should be disclosed on a different basis than 12-month periods, updated quarterly.

- *Differential compensation.* Broker-dealers are required to disclose on the confirmation whether they engage in the payment of differential compensation for two types of transactions: (1) transactions involving covered securities with a deferred sales load and (2) transactions involving proprietary covered securities. Disclosure is made using a series of check boxes labeled "yes," "no" or "not applicable."

  With respect to differential compensation, the Proposing Release notes that:

---

20 "Revenue sharing" would be defined as "any arrangement or understanding by which a person within a fund complex, other than the issuer of a covered security, makes payments to a [broker-dealer] or any associated person of a [broker-dealer], excluding amounts earned at the time of sale that constitute a dealer concession or other sales fee." The Proposing Release contemplates that this definition would encompass payments that would be characterized as having purposes other than paying a broker-dealer for "shelf space."

21 "Portfolio securities transaction" would be defined as "any transaction involving securities owned by the issuer of a covered security, or owned by any other issuer within the same fund complex."

22 "Fund complex" would be defined to include "the issuer of a covered security . . . , the issuer of any other covered security that holds itself out to investors as a related company for the purposes of investment or investor services, any agent of such issuer, any investment adviser for such issuer, and any affiliated person of such issuer or such investment adviser."

23 The Proposing Release suggests that disclosure on the basis of the fund complex is appropriate because the arrangements in question are usually established on a fund complex basis, rather than by individual funds within a complex.

24 It should be noted that Proposed Rule 15c2-2 is not intended to preempt other provisions of law that may apply to revenue sharing and/or portfolio brokerage commissions, such as NASD Rule 2830(k)(1), which bars broker-dealers from favoring the distribution of funds that pay portfolio brokerage commissions.

> The proposed rule would not require [brokers-dealers] to identify all instances in which an associated person has a higher financial stake to sell the shares of one fund than another. Rather, the proposed rule is targeted toward transactions in securities without front-end sales loads and proprietary securities because other aspects of the proposed rule 15c2-2 should provide customers with information about other conflicts of interest facing the [broker-dealer].

The Commission is requesting comment on whether the proposed disclosure would adequately inform customers about the conflicts associated with differential compensation. For example, the Commission requests comment on whether broker-dealers should be required to disclose payment of differential compensation in other contexts. The Commission also requests comment on whether the proposed definition of "proprietary security" is sufficiently broad.

Alternative Periodic Reporting

In certain limited instances, Proposed Rule 15c2-2(d) would permit broker-dealers to disclose the information required in the confirmation statement periodically, rather than on a transaction-by-transaction basis. Periodic reporting would only be available for transactions in a plan for the direct purchase or sale of a covered security pursuant to certain retirement plans, pension plans, or other arrangements (a "covered securities plan") or for transactions in no-load open-end money market funds. The definition of "covered securities plan" would largely be analogous to the rule 10b-10 definition of "investment company plan;" however, it would specifically encompass arrangements for automatic reinvestment of dividends or other distributions paid by the issuer of a covered security.

Comparison Ranges

Proposed Rule 15c2-2(e) would require disclosure of "median information and comparison ranges" for the types of disclosure required by Proposed Rule 15c-2-2(b) and (c). The Proposing Release characterizes such disclosure as "a mechanism to give investors additional context for evaluating the significance of certain required disclosures." Proposed Rule 15c2-2(e) would require, in the case of loads, asset-based sales charges and service fees and dealer concessions, disclosure based on the median of, and the ranges associated with, 95 percent of the transactions involved the same type of covered security (*i.e.*, mutual fund, UIT or 529 plan). In the case of revenue sharing and portfolio brokerage commission, the Proposed Rule would require disclosure based on the medians and ranges associated with 95 percent of the broker-dealers that distribute the same type of covered security. The medians and comparative ranges would be published by the SEC annually in percentage form in the Federal Register.

If the Proposed Rule is adopted, the Commission would have to undertake additional rulemaking to implement reporting requirements to allow the SEC (or a vendor) to collect this type of information to calculate appropriate medians and ranges, since regulated entities are not currently required to disclose information that does not directly relate to them. If the SEC were to determine that publication of median and comparative range information is not feasible, broker-dealers would not be required to disclose such information.

The Commission is requesting comment on whether the disclosure of median and comparison range information is useful. For example, the Commission is asking for comment on whether issuers of covered securities should be able to select the comparison category applicable to their securities, or whether the Commission should

assign comparison categories. The Commission also is requesting comment on whether it should be responsible for analyzing the information used to calculate medians and comparative ranges or whether it should have a vendor or third-party source analyze and publish the information. Finally, the Commission is seeking comment on the appropriate entity to disclose the information necessary for calculating comparative ranges, *i.e.*, whether the investment company or the broker-dealer should provide information to the Commission.

Transactions Effected by Multiple Firms

The requirements of Proposed Rule 15c2-2 would apply to every broker-dealer that effects a transaction in a covered security, including transactions effected by more than one broker-dealer. Under the Proposed Rule, customers could receive a single confirmation for a transaction effected as part of an introducing-clearing arrangement; however, Proposed Rule 15c2-2 would require separate disclosure of sales fees, revenue sharing and portfolio brokerage commissions earned by each firm. Proposed Rule 15c2-2 would also require disclosure of payments made to a broker-dealer who solicits a transaction, even if that other broker-dealer will not carry the account, such as in the case where a broker-dealer solicits persons as part of an employee-sponsored marketing arrangement, but does not carry the accounts. The Proposing Release notes that requiring this disclosure may require enhancement of existing flows of information between various broker-dealers who may be effecting a transaction. The Commission has asked for comment on whether the Proposed Rule will result in adequate disclosure of distribution-related costs and conflicts as well as any operational challenges for introducing or clearing brokers associated with implementing the Proposed Rule.

Point of Sale Disclosure--Proposed Exchange Act Rule 15c2-3

As previously noted, the Commission is proposing a significant departure from existing practice by proposing a new point of sale disclosure requirement. Proposed Exchange Act Rule 15c2-3 ("Proposed Rule 15c2-3") would require broker-dealers to provide investors with information regarding costs and conflicts of interest prior to purchasing covered securities.[25] As with Proposed Rule 15c2-2, any broker-dealer that misstates information in point of sale disclosure with an intent to mislead an investor may be subject to liability under the anti-fraud provisions of Section 10(b) and Rule 10b-5. As such, Proposed Rule 15c2-3 includes a preliminary note similar to that of Proposed Rule 15c2-2 stating that the disclosure requirements are not determinative of, and do not exhaust, a broker-dealer's disclosure obligations under the anti-fraud provisions of the federal securities laws.

The Commission is requesting comment on whether the point of sale disclosures should apply to other securities, such as variable insurance products. The Commission also requests comment on whether other persons participating in the distribution of covered securities, such as banks, should be subject to the disclosure requirements.

Under Proposed Rule 15c2-3, broker-dealers would be required to deliver information at the point of sale. The definition of "point of sale" would differ depending on the relationship between a broker-dealer and the customers it solicits. As a general rule, point of sale would be defined as the time immediately prior to the broker-dealer accepting the order from the customer. However, in the case where a customer has not yet

---

[25] According to the Proposing Release, Proposed Rule 15c2-3 would not apply to **sales** of covered securities, because "those transactions do not raise the same special cost and conflict concerns." Proposing Release, *supra* note 1, 69 Fed. Reg. 6438, 6457.

opened an account with the broker-dealer, point of sale would be defined as the time when the broker-dealer first communicates with the customer about the covered security.[26]

The Commission has requested comment on the proposed timing of the required provision of the point of sale disclosure, whether the confirmation disclosure is duplicative of the point of sale disclosure, and how to harmonize the NASD's current proposal to require point of sale revenue sharing and differential compensation disclosure.[27]

Proposed Rule 15c2-3 would require both quantitative and qualitative disclosure about the costs and conflicts of interests that may arise from the transaction. Proposed Rule 15c2-3(a)(1)would require the broker-dealer to disclose the following costs: (1) the amount of sales loads that would be incurred at the time of purchase; (2) estimated asset-based sales charges and service fees in the year following purchase if NAV does not change; (3) the maximum amount of any deferred sales loads if the shares to be purchased were sold within one year and a statement of how many years the deferred sales load will be in effect; (4) and any dealer concession or sales fees the broker-dealer expects to received in connection with the transaction. These disclosures would be made with reference to the value of the purchase, or if the purchase amount cannot be reasonably estimated at the time of disclosure, with reference to a model investment of $10,000.

Proposed Rule 15c2-3(a)(2) would require the broker-dealer to disclose whether it receives revenue sharing or portfolio brokerage commissions from the fund complex.[28] Additionally, if the transaction involves a covered security with a deferred sales load or proprietary covered security, the broker-dealer would have to disclose whether it pays differential compensation in connection with such a transaction. The Commission is requesting comment on the form and specificity of the disclosure, whether other types of cost information should be disclosed, whether breakpoint disclosure should be included and whether particular disclosure related to switching should be disclosed.

Pursuant to Proposed Rule 15c2-3, any order made prior to the required point of sale disclosure would be treated as indication of interest until after the point of sale disclosure is made and the customer would have an opportunity to terminate the order following disclosure of the information. The broker-dealer would be required to disclose this right to terminate at the time it discloses the point of sale information.

The Proposing Release outlines how broker-dealers would need to make the point of sale disclosure. The Commission is proposing that broker-dealers make disclosure in a medium related to the form of contact with the customer. The point of sale information would be provided to the customer in writing using proposed

---

[26] The Proposing Release notes:

> For most transactions, the time of disclosure is based on the time that the [broker-dealer] receives the order from the customer — a standard that should allow customers to consider material information when they make their investment decisions. That standard would not work, however, in the case of [brokers-dealers] that solicit transactions in covered securities — and receive compensation in connection with those transactions — without opening accounts for or handling orders from the investors who make those purchases. Because the investors solicited by those firms instead would contact another [broker-dealer] or the issuer to complete those transactions, it would not be feasible to trigger the disclosure obligations of those soliciting [brokers-dealers] on the time that an order is accepted. Those soliciting firms therefore would disclose the required information at the time they recommend the security or otherwise discuss the investment. 69 Fed. Reg. 6438, 6458-9.

[27] *See* NASD Notice to Members 03-54 (Sept. 2003).

[28] The definitions of "revenue sharing," "portfolio brokerage commissions" and "fund complex" are the same as the definitions used under Proposed Rule 15c2-2, discussed above.

Schedule 15D and supplemented by oral disclosure if the point of sale occurs at an in-person meeting. For example, if the broker-dealer took the customer's order over the telephone, then oral disclosure over the telephone would be required. If the broker-dealer takes the order over the Internet, it could use the Internet to provide the information to the customer.

Attachments 4 and 5 to the Proposing Release provide examples of disclosure based on hypothetical share purchases that are consistent with proposed Schedule 15D. In the case of oral communications, broker-dealers would be required to have adequate compliance procedures in place to demonstrate that required disclosure was made. Broker-dealers would, at the time of point of sale disclosure, be required to make records of their communications and disclosure sufficient to demonstrate compliance with the delivery requirements of Proposed Rule 15c2-3. These records would be subject to the retention requirements of Exchange Act Rule 17a-4(b).

Proposed Rule 15c2-3 also includes a number of exceptions. For example, Proposed Rule 15c2-3 would include alternative provisions for providing disclosure to customers who mail in their purchase, provided that the customer did not have an account with that broker-dealer and the broker-dealer is not compensated for effecting transactions for new customers. Other provisions would address arrangements with clearing firms and transactions in a "covered securities plan," such as for reinvestment of dividends.

Proposed Amendments to Form N-1A

The SEC also proposed amendments to Form N-1A, including revisions to the fee table and additional disclosure regarding revenue sharing payments. Under the proposed amendments to Form N-1A, the fee table would be revised to require: (1) the maximum front-end sales load to be shown as a percentage of NAV, rather than a percentage of current offering price;[29] (2) any deferred sales load to be shown as a percentage of NAV at the time of purchase, rather than the offering price at the time of purchase; and (3) the aggregate load to be shown as a percentage of NAV, if the fund imposes more than one type of sales load. Additionally, revised Form N-1A would require, in the form of a footnote to the fee table, prospectus disclosure to the effect that as a result of rounding, sales loads shown in the prospectus as a percentage of NAV or offering price may be higher or lower than the actual sales load that an investor would pay as a percentage of the net or gross amount invested.

The proposed amendments to Form N-1A would also address revenue sharing payments. If any person within the fund complex makes revenue sharing payments, the fund would be required to disclose that fact in its prospectus. If such payments are made, the fund would have disclose in its prospectus that specific information concerning revenue sharing payments to an investor's financial intermediary is available in the confirmation statement provided under Proposed Rule 15c2-2 and the point of sale disclosure provided under Proposed Rule 15c2-3.

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

■ ■ ■ ■

---

[29] The Proposing Release notes:

> For example, if an investor started with $10,000 and paid a 5% front-end load on the gross amount, the load would be $500. The net amount invested would be $9,500 ($10,000 — $500), and the load as a percentage of the net amount invested would be 5.26% ($500/$9500 x 100%). The fee table currently requires the load to be disclosed as 5%. Our proposed amendment would require the load to be disclosed as 5.26%.
> 69 FR 6438, 6462.

Dechert LLP continues to monitor these and other developments and will issue Financial Services Updates when warranted. If you have questions concerning this Update, please contact one of the attorneys listed below or the Dechert LLP attorney with whom you are in regular contact.

Stuart J. Kaswell
+1.202.261.3314 ..... stuart.kaswell@dechert.com

Jack W. Murphy
+1.202.261.3303 ..... jack.murphy@dechert.com

Paul Schott Stevens
+1.202.261.3348 .....paul.stevens@dechert.com

Ethan D. Corey
+1.202.261.3304 .....ethan.corey@dechert.com

Elliott R. Curzon
+1.202.261.3341 ..... elliott.curzon@dechert.com

Robert J. Smith
+1.202.261.3488 .....robert.smith@dechert.com

Margaret Riley
+1.202.261.3432 .....margaret.riley@dechert.com

Megan C. Johnson*
+1.202.261.3395 ..... megan.johnson@dechert.com

*Admitted in Maryland only; practice supervised by member of the District of Columbia Bar.

Please visit us at www.dechert.com/financialservices.