

May 21, 2004

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

**Re: Confirmation Requirements and Point of Sale Disclosure
Requirements for Transactions in Certain Mutual and Other
Securities, File No. S7-06-04**

Dear Mr. Katz:

AARP appreciates this opportunity to comment on the U.S. Securities and Exchange Commission's (SEC, or the Commission) two new proposed rules and rule amendments, described in Release Nos. 33-8358 and 34-49148, to the Securities Exchange Act of 1934. We commend the Commission for its effort to develop clear, meaningful investment disclosure documents. In particular, we commend the Commission for its efforts to reach out to individual investors for their assessments and recommendations.

These proposals are designed to enhance the information broker-dealers provide to their mutual fund customers. The primary objective of the proposed new rules is to improve investor access to additional material information about investments in open-end management investment companies (also known as mutual funds), unit investment trusts (including insurance company separate accounts that offer variable annuity contracts and variable life insurance policies) and securities issued by education savings plans. Our comments will focus the application of the proposed disclosures to mutual funds.

The substantive requirements of the proposed rules mandate that brokers and dealers provide enhanced cost and conflict of interest information to consumers and that information be made available at the point of sale (i.e., made available to the customer prior to a sale as an aid to decision-making) as well as being made available as part of post-transaction confirmation (received in written form by the investor validating the provisions and costs of the sale). Whether the point of sale disclosure is made available in written form, and/or orally, is an issue that the Commission seeks comment on.

Two sets of forms are presented for evaluation based on the timing of the sales loads (fees). Class "A" share point of sale and confirmation forms are for mutual fund investments where the sales fees are to be paid at the time of purchase. Class "B" share point of sales and confirmation forms are for mutual fund investments where the sales fees typically are paid when the mutual fund shares are sold – or at least deferred from the date of sale.

The Scope, Context and Integration of the Proposed Mutual Fund Disclosures

As a general rule, we believe effective investment disclosures should require that:

- Appropriate information is readily available to potential investors that facilitate instrument comparison through standardization (optimally across different types of securities investments as well as more specifically between mutual funds); and
- The information is presented to users in a fashion that promotes improved decision-making by ordinary consumers without diminishing its accuracy, reliability or accountability.¹

We believe that the rules proposed by the SEC represent a promising step forward within the marketplace for mutual funds. The new rules:

- introduce a confirmation disclosure previously lacking, that
- requires information on distribution costs be presented on a comparable basis, and
- provides some information on conflicts of interest prior to the sale.

However, even within the confines of the mutual fund market, more needs to be done to:

- capture operating costs,
- disclose more conflicts of interest, and
- link the disclosed information to the investors' decision-making processes.²

¹ As a supplement to the investor Point of Sale Disclosures, we believe either a full fund prospectus or a fund profile should be attached.

² For a thoughtful examination of the relationship of disclosed information to investor decision-making processes, see: Troy A. Paredes, "Blinded by the Light: Information Overload and Its Consequences for Securities Regulation," Washington University Law Quarterly, forthcoming. It is available as a Faculty Working Paper, No. 03-02-02.

However, we do recognize that there are limits to what any discrete investment disclosure reform can accomplish, particularly when the reform is constrained to one type of financial instrument (mutual fund shares) that must compete for investors in a highly diversified, liquid and dynamic securities market. One concern is whether our time-worn and much weakened Investment Advisors Act (of 1940) might frustrate, distort or otherwise disadvantage mutual funds as a result of the proposed investment disclosure reforms.³

Nevertheless, we believe the Commission has made progress with mutual fund disclosure by requiring that qualitative information be provided at the point of sale about directed brokerage, revenue-sharing payments, and the existence of higher payments for sale of proprietary funds - as well as funds that carry a back-end sales load. However, we remain concerned that the proposed regulatory reforms do not do enough to identify all the pertinent types of compensation that a broker might receive – and therefore be potentially relevant to a discriminating investor - for selling a particular mutual fund. To the extent that other sales incentives exist, such as sales contests to promote a particular mutual fund family, that fact should also be disclosed as part of the point of sale form. Similarly, on the issue of breakpoint disclosure, the point of sale document should indicate the dollar amount at which the next breakpoint discount is available.

Further, we believe that it is not helpful to give investors the material information they need to make an informed investment decision if you do not also require that they receive the information in time to be incorporated in their investment decision. Potential investors need adequate time to process this information before they can rationally act on it. For example, investors need to be able to assess, not just the amount of the commission that they are likely to pay and that the broker is likely to receive, but how that amount compares to those of other funds. This is a key reason why we believe it is so important to move comparative cost information from the confirmation statement to the point of sale disclosure and to expand the information that is provided.

The Commission has requested comment on whether point of sale disclosure might have the effect of directing investors away from mutual funds and related securities. To the contrary, more complete disclosure may help customers understand the costs associated with purchasing fund share classes that carry

³ The accounting and reporting misdeeds of publicly-traded corporations and the recent allegations of misconduct within the mutual fund industry reveal how vulnerable individual investors have become under a much weakened Investment Advisors Act (IAA). In a letter dated November 27, 2003, regarding the long-proposed rule 202(a)(11)-1, that would amend the IAA, we urged the Commission to revise 202(a)(11)-1 to provide clear guidance to broker-dealers, investment advisers and, most importantly, to investors regarding the types of services (and their related bases for compensation) that should distinguish between brokerage and advisory services.

deferred sales loads, as well as the potential conflicts of interest that broker-dealers and their firms have in connection with the sale of those share classes. We encourage the SEC to expand the disclosure strategy articulated in these proposed rules to the broader securities market. We believe the proposed mutual fund disclosures will demonstrate the need for similar standardization in disclosure design across the market.

We believe that the Commission should not limit the reach of the proposed point of sale disclosure by requiring only that information about distribution-related costs and associated conflicts be disclosed. Distribution-related costs are relevant and important. But for the saver-investor, fund operating costs may also be a differentiating, pre-sale factor to consider. We support expanding the scope of the comparative cost information provided and making it comparable to industry norms. Further, we believe that the usefulness of the point of sale disclosure will be markedly improved if the cost information were made available to potential investors prior to the sale. Furthermore, we believe the point of sale disclosure is the document that should carry the most complete explanation of conflicts of interest that are relevant to the particular recommended fund.

Generally, the comments we have made above about the appropriate content and format of point of sale disclosures apply equally to confirmation disclosures. We believe it is essential that presentation of distribution expenses in the confirmation (and point of sale) disclosure be standardized so as to ensure that this information is easy to understand and use.

We also believe that confirmation disclosures should clearly characterize the nature of the disclosed information. For example, we support dividing the information on costs into two sections. One should be clearly labeled as payments that the investor pays directly or indirectly in connection with the transaction. We believe this should include both distribution-related costs and operating expenses of the fund. The other section should be clearly marked as the payments the broker receives directly or indirectly in connection with the transaction.

The brokerage industry has raised a serious objection to the proposed point of sale disclosure rule - in particular - on the basis that it will lead to substantial costs that will not be justified by the benefits. An increase in cost is unavoidable. Clearly, provided the complexity of the distribution payment system and the pervasiveness of the conflicts of interest it creates, effective disclosure cannot be accomplished without some added cost. However, we believe that much of this expense may be recovered through better investment choices and returns.

An Approach for Field-Testing Proposed Investment Disclosure Forms

In support of our recommendation that the point of sale and confirmation disclosure forms be standardized, we recommend that they be designed by experts in the field.⁴ We also call for the forms to be field-tested to assess their effectiveness in conveying information to ordinary investors before the final rule is promulgated.

To illustrate how this type of analysis might be accomplished, AARP conducted a study in March, 2004, to evaluate the mutual fund Point of Sale and Confirmation Disclosure Forms designed by the SEC.⁵ The data for this study were collected from two national samples of adults age 35 and older.⁶ One sample of respondents was selected to evaluate the Class "A" share version of the Point of Sale and the Confirmation forms. The second sample of respondents was selected to evaluate the Class "B" share set of forms. Both sets of disclosure forms had been filled in by the SEC with mock fund names, figures, and information. We used these sample forms and two national samples of potential investors to approximate a real purchase of shares in a mutual fund. The two surveys were fielded simultaneously.⁷

Respondents were able to view the SEC disclosure forms in their original design (all of the forms were copied directly from the Commission's website without change). They were encouraged to review their respective set of forms as often as they wished while completing the questionnaires. Of the 2,034 surveys completed, 1,011 were for the purchase of mutual fund class "A" shares and 1,023 were for the purchase of mutual fund class "B" shares. For this study, a confidence interval of 95% was used. The sampling error is ± 3 .⁸

⁴ The SEC has long been aware of the challenge of promulgating its rules in plain English. See its "A Plain English Handbook: How to create clear SEC disclosure documents (August 1998).

⁵ We understand that the SEC has convened a series of focus groups to assess its proposals for disclosing information to investment customers. However, among the advantages of the methodology implemented in the attached AARP study are its ability to generalize findings to broader market of investors, the ability to segment the respondents and findings for more detailed analysis, the capability to emulate market conditions and its applications for comparative use for other investment instruments.

⁶ Mutual fund ownership is most prevalent among heads of households age 35-64. *Fundamentals*, Investment Company Institute, Vol. 12/ No. 4, October 2003.

⁷ See Appendix A of the attached copy of our full report for an extensive explanation of the WebTV methodology used to survey study participants.

⁸ For this study, a confidence interval of 95% was used. The sampling error is ± 3 , which means that values presented in the report may be within a range of ± 3 . Also, the values presented can be expected to be correct 95% of the time. For presentation purposes, percentage points have been rounded off to the nearest whole number. As a result, percentages in a given table column may total slightly higher or lower than 100%. For questions that permit multiple responses, columns may total to significantly more than 100%, depending on the number of different responses offered by each respondent. Similarly, when only selected responses are shown, percentages may total to less than 100%.

An Overview of Investor Assessments

This study asked respondents to rate the mutual fund forms based on how well they were able to interpret information in the forms. Respondents were also asked to offer suggestions to improve the utility of the forms. Generally, respondents were able to correctly identify key features of both the Point of Sale form and Confirmation form. There are also aspects of the proposed disclosures that need to be re-thought.

Survey findings are highlighted below by class of shares and type of disclosure:

- Sales Loads and Fees,
- Broker Commissions and Other Payments,
- Form Rating, and
- Share Information.⁹

Point of Sale Disclosure Form for Class "A" Shares

Sales Loads and Fees:

- Slightly more than 8 in 10 respondents (84%) were able to correctly ascertain that there was a front-end sales load listed on the Point of Sale Form for Class "A" Shares and 81% of these respondents were able to correctly identify the exact dollar amount of the front-end sales load.
- A total of 69% of respondents correctly reported that there was no back-end sales load listed on the Point of Sale Form for Class "A" Shares.
- Slightly more than 8 in 10 respondents (82%) answered correctly that the broker would receive a fee from the fund for the sale presented in the sample Point of Sales Form for Class "A" Shares. Of these respondents 72% correctly identified the exact dollar amount of the broker sales fee.

⁹ See the attached full study report for a more detailed examination of the survey findings. In the full report, responses have been cross-tabulated by age, race, income, education, investor status (investor, non-investor) and mutual fund investor (yes, no).

Broker Commissions and Other Payments:

- Nearly 8 in 10 respondents (79%) correctly, reported that the broker would receive commissions for buying or selling fund assets, such as stocks or bonds. Seventy-three percent of respondents answered correctly that the broker would be paid additional payments from the fund's affiliates.
- Slightly less than two-thirds of respondents (65%) correctly answered that, according to the information presented in the sample Point of Sales Form for Class "A" Shares, they would pay asset-based distribution or service fees in the first year.
- Slightly more than half the respondents (52%) were able to correctly determine that fees would be deducted from the account annually from the mock account presented in the Point of Sales Form for Class A Shares.
- More than half of all respondents (55%) reported correctly that the broker of the mock purchase of shares presented in the Point of Sales Form for Class "A" Shares would not receive a higher payment for service if he or she were to sell a proprietary security issued by an affiliate.
- Nearly two-thirds of the respondents (63%) were unable to locate or correctly report the total purchase price of the "A" shares.

Form Rating:

- About half of all respondents (49%) reported they would feel somewhat confident (42%) or very confident (7%) in making a decision to purchase or not to purchase mutual fund shares if they had all of the information found in the Point of Sales Form for Class "A" Shares.
- Half of all respondents reported they would prefer to receive the information found in this form (Point of Sales Form for Class "A" Shares) in written form. More than one-third of respondents (36%) would like to have the option to choose to receive the information orally or in writing at the time of the transaction and 8% prefer to receive the information orally.
- When considering the entire Point of Sales Form for Class "A" Shares, nearly 6 in 10 respondents (57%) reported that the form was not too difficult (46%) or not at all difficult (10%).

Confirmation Form for Class "A" Shares

Share Information:

- Two-thirds of respondents (66%) were able to locate the correct total price of each share.
- Only 36% of respondents were able to locate the correct amount of money reported to be invested on the mock Confirmation Form for Class "A" Shares.
- More than 6 in 10 respondents (67%) reported correctly that fund affiliates were sharing revenue with the broker in connection with the purchase presented on the Confirmation Form.
- Nearly 7 in 10 respondents (68%) correctly reported that the broker does receive portfolio brokerage commissions from the fund or its affiliates.
- Slightly more than 6 in 10 respondents (62%) reported the correct amount of the front-end sales load listed on the Confirmation Form for Class "A" Shares.
- Only one-third of respondents (33%) were unable to locate or correctly report the amount of shares purchased on the mock Confirmation Form.

Form Rating:

- When asked how helpful the explanations and definitions were in helping respondents understand the Confirmation Form for Class "A" Shares, 67% reported the form was somewhat helpful (45%) or very helpful (22%).
- More than half of all respondents (55%) reported they had some difficulty understanding the explanations of the terms.
- Nearly 8 in 10 respondents (79%) reported that it was very important (48%) or somewhat important (31%) to know that a broker may be paid more depending on which fund he/she were to sell to them. A total of 62% of respondents reported that they would change their mind about the purchase if they knew this information.
- Slightly more than eighty percent of respondents (81%) reported that it was very important (47%) or somewhat important (34%) to know that a

broker may receive more compensation (money) if he or she sells you shares of a fund that includes a back-end sales load.

Point of Sale Disclosure Form for Class "B" Shares

Sales Loads and Fees:

- More than 6 in 10 respondents (65%) were able to correctly determine that there was not a front-end sales load listed on the Point of Sale Form for Class "B" Shares.
- Nearly eight in ten of respondents (79%) correctly reported that there was a back-end sales load listed on the Point of Sale Form for Class "B" Shares. Of these respondents, 84% were able to correctly identify the exact dollar amount of the back-end sales load.
- More than 8 in 10 respondents (85%) answered correctly that the broker would receive a fee from the fund for this purchase presented in the sample Point of Sale Form for Class "B" Shares.

Broker Commissions and Other Payments:

- Slightly more than 8 in 10 respondents (83%) answered correctly that the broker would receive commissions for buying or selling fund assets, such as stocks or bonds.
- Nearly seventy percent of respondents (69%) correctly answered that, according to the information presented in the sample Point of Sale Form for Class "B" Shares, they would pay asset-based distribution or service fees in the first year; of these respondents, 75% were able to locate and correctly identify the amount of the asset-based distribution or service fees for the first year
- More than half of the respondents (57%) were able to correctly determine that fees would be deducted annually from the account.
- Over one-third of the respondents (36%) were able to correctly locate from the sample form the total cost of "B" shares purchased. Nearly two-thirds (64%) were unable to locate or correctly report the total purchase price of the "B" shares.

Form Rating:

- Slightly over one-half of the respondents (51%) of respondents reported they would feel not too (25%) or not at all (26%) confident in making a decision to purchase or not purchase mutual fund shares if they had all of the information found in the Point of Sale Form for Class "B" Shares.
- Slightly less than one-half of the respondents (48%) reported they would prefer to receive the information found in this form (Point of Sale Form for Class "B" Shares) in written form. More than one-third of respondents (36%) would like to have the option to choose to receive the information orally or in written form at the time of the transaction and 10% prefer to receive the information orally.
- When considering the entire Point of Sale Form for Class "B" Shares, slightly over one-half of all respondents (52%) reported that the form was not too difficult (44%) or not at all difficult (7%).

Confirmation Form for Class "B" Shares

Share Information:

- Nearly two-thirds of respondents (64%) were able to locate the correct total price of each share.
- More than 7 in 10 respondents (72%) were able to locate the correct amount of money reported to be invested on the mock Confirmation Form for Class "B" Shares.
- Nearly 7 in 10 respondents (68%) correctly reported that the broker does receive portfolio brokerage commissions from the fund or its affiliates.
- Slightly more than two-thirds of respondents (67%) reported the correct amount of the back-end sales load listed on the Confirmation Form for Class "B" Shares.

Form Rating:

- Nearly two-thirds of respondents (65%) reported the explanations and definitions found on the form were either somewhat helpful (46%) or very helpful (19%). However, more than half of all respondents (56%) reported they had some difficulty understanding the explanations of the terms.
- Eight in ten respondents (80%) reported that it was very important (50%) or somewhat important (30%) to know that a broker may be paid more depending on which fund he/she were to sell to them. Over six in ten of respondents (63%) reported that they would change their mind if they knew this information.
- Eight in ten respondents (80%) reported that it was very important (44%) or somewhat important (36%) to know that a broker may receive more compensation (money) if he or she sells you shares of a fund that includes a back-end sales load.
- A total of 47% of respondents reported little difficulty finding information in the Confirmation Form for Class "B" Shares. A similar percentage of respondents (45%) reported they had at least some difficulty finding information in the Confirmation Form for Class "B" Shares.

Study Summary

The findings from this study reveal that there are variations regarding respondent comprehension of the mutual fund disclosure forms that warrant more detailed examination. For example, some of the variation in respondent comprehension is associated with demographic and experiential differences. Respondents who were less educated, earned less income, were non-white and older were more likely to respond incorrectly to questions throughout the survey than their counterparts. Respondents who had more experience investing in mutual funds and other forms of financial investments were more likely to answer form content questions correctly. Other variations appear associated with content and design, exemplified by respondent difficulty in finding information on forms they had ready access to.

Conclusions

Our conclusion is that the SEC is on the right track in its proposed rule-making as far as 'by whom, why and when' investment disclosures should be made to potential investors of mutual funds. It is on the issues of 'what and how' investment disclosures should be made available - to meet the practical as well as contractual necessities for protecting the ordinary investor - that requires more attention in the proposed forms. The results from our study suggest that the field-testing methodology used here can provide some additional insight and guidance to the SEC for finding the most effective balance.

In general, more needs to be done to standardize the principles of investment disclosure across the securities markets. These improvements are necessary to assure that when making disclosure a more effective utility for ordinary investors in one market, it does not prove also to be an investment handicap because of lax disclosure in another.

We would welcome the opportunity to meet and discuss these issues, or the findings of our study. Please feel free to contact me or have your staff call Roy Green in our Federal Affairs Department at (202) 434-3800.

Sincerely,

David Certner
Director
Federal Affairs