



VIA ELECTRONIC MAIL

April 12, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549-0609

RE: Point of Sale and Confirmation Disclosure Requirements
Release Nos. 33-8358; 34-49148; IC-26341; File No. S7-06-04

Dear Mr. Katz:

The Vanguard Group, Inc. (“Vanguard”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s recent proposal to require broker-dealers to provide their customers with information, at the point of sale and in transaction confirmations, regarding the costs and potential conflicts of interest that may arise from the distribution of mutual fund shares. We strongly agree with the Commission that broker-dealers should be required to publicly disclose these distribution-related costs and conflicts. And we believe this information should be available to investors continuously, not just at the point of sale. However, we have two critical concerns that we urge the Commission to address in adopting final rules:

- *First*, the principal underwriter of directly sold, no-load funds should be exempt from the point of sale disclosure requirement if it has none of the conflicts of interest which justify point of sale disclosure. Investors in these funds will not benefit from an additional document that is *blank* except for its duplication of the prospectus fee table, which in the direct market is typically delivered *before* the point of sale.
- *Second*, the Commission should embrace the Internet as the preferred medium for point of sale disclosure. Otherwise, the proposal will introduce *several days of delay* to the execution of a significant portion of the purchase orders transmitted each year, to the detriment of mutual fund investors.

¹ Headquartered in Malvern, Pennsylvania, Vanguard is the nation’s second largest mutual fund company. Vanguard serves 18 million shareholders accounts, and manages more than \$815 billion in U.S. mutual fund assets. Vanguard offers 129 funds to U.S. investors and 40 additional funds in foreign markets.

As discussed below, Vanguard believes the Commission's welcome idea of disclosing distribution-related costs and conflicts of interest at the point of sale can be achieved at a price and in a format that is vastly less expensive, and far more useful to investors, than currently proposed.

I. Directly Sold, No-Load Funds Should Be Exempt

If adopted in its current form, the Commission's proposal would impose a highly disruptive and unreasonably expensive document production and delivery obligation on firms, like Vanguard, that distribute low-cost, no-load funds directly to investors with no middleman and, therefore, no hidden costs or conflicts. In Vanguard's direct distribution business, most investors receive a prospectus *before* they decide to invest. Our typical investor begins the decision-making process by visiting our website or calling our phone representatives. The investor will research different funds and then request a prospectus/application kit, or review the information online and submit the application electronically.

We believe the principal underwriter of a directly sold, no-load fund should be exempt from the point of sale disclosure requirement if it has none of the conflicts of interest which justify point of sale disclosure. The additional expenses of generating, printing and mailing a point of sale document that discloses no costs or conflicts (aside from repeating the fee table that is already contained in the prospectus) will significantly increase the distribution costs of no-load funds, to the detriment of the millions of self-directed investors who favor this channel.²

Accordingly, Vanguard supports the recommendation of the Investment Company Institute ("ICI") that the Commission exempt the principal underwriter of a fund from making point of sale and confirmation disclosure if (1) the fund is "no load" within the meaning of NASD rules and (2) the principal underwriter has none of the conflicts of interest which justify point of sale disclosure.³ For example, there are no "heightened financial incentives" or "hidden conflicts" between the Vanguard funds and their internalized distributor, Vanguard Marketing Corporation, to be disclosed. This arrangement does not involve revenue sharing, payment for shelf space, differential compensation or any other conflicts that warrant special point of sale disclosure. Under the circumstances, it would be a terrible result if the Commission's new rules required firms and their shareholders in the direct, no-load market to bear the additional expenses

² As recently revised by the Commission, the point of sale disclosure document may omit all categories of information that do not apply to a particular purchase. See *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*, Release Nos. 33-8544; 34-51274; IC-26778 (Feb. 28, 2005) at 4. Therefore, when no-load funds are distributed directly by their principal underwriter (*i.e.*, without the involvement of a third-party broker-dealer), the only substantive information that would appear in the disclosure document would be fees and expenses that are already disclosed in the prospectus.

³ See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission, dated April 4, 2005 at 7 [hereinafter, "ICI Comment Letter"].

of generating, printing and mailing a point of sale document that provides investors with no additional useful information.⁴

II. The Commission Should Designate the Internet as the Preferred Medium for Point of Sale Disclosure

Vanguard encourages the Commission to embrace the Internet as the preferred medium for point of sale disclosure. Investors would benefit by having immediate and continuous access to every broker-dealer's distribution-related costs and conflicts of interest before, during and after the point of sale. We agree with the ICI, the NASD Mutual Fund Task Force and the NASD staff that Internet disclosure is the *only* reasonably practical way to deliver this information to *all* investors *when* they need it.⁵

Significantly, the point of sale disclosure requirement, as currently proposed by the Commission, will introduce *several days of delay* to the execution of a purchase order that arrives by mail (thereby postponing the customer's investment).⁶ The point of sale disclosure requirement will add a *several minute or longer delay* to the execution of a purchase order that is received by phone (thereby postponing late-day orders to the next business day).⁷ Even if a customer consents to electronic delivery of the point of sale document,⁸ we believe broker-

⁴ Of course, to the extent that Vanguard funds are distributed through a *third-party* broker-dealer, we believe the selling broker-dealer should make point of sale and confirmation disclosures, to the extent applicable.

⁵ See ICI Comment Letter at 4 ("In our view, the best way to achieve [the Commission's] objective is to designate the Internet as the primary medium for point of sale disclosure."); *Report of the Mutual Fund Task Force: Mutual Fund Distribution*, NASD (March 2005) at 11 [hereinafter, "Mutual Fund Task Force Report"] ("Web site disclosure would, for most investors, be the simplest and most straightforward way to deliver information to investors quickly and in a format that allows them to easily review as much or as little detail as may be desired."); Letter from Robert R. Glauber, Chairman and CEO, NASD, dated March 31, 2005 at 2 ("Internet disclosure is the only effective way to assure that investors receive the information they desire at the point of sale. The Commission should mandate Internet delivery of the point of sale disclosure document.").

⁶ A broker-dealer will not be able to mail the point of sale disclosure document to any customer who submits a purchase order by mail until the order is received. The firm would then deliver the document to the customer, probably by First-Class Mail, which takes 1 to 3 days. See *A Customer's Guide to Mailing*, United States Postal Service (<http://www.usps.com/customersguide/dmm100.htm>). After receiving the disclosure, the customer would then need an opportunity to consider whether to terminate or resubmit the order, and would have to act on that decision by contacting the firm a second time.

⁷ We handle millions of telephone calls from investors each year (over 6.9 million in 2004) and believe it will take considerably longer than the *single minute* the Commission estimates will be required to orally recite the point of sale document. However, we cannot provide a realistic estimate of total call time because the Commission has not specified how much time must pass after delivery of the point of sale document before a broker-dealer may reliably conclude that a customer has "had an opportunity to determine whether to place an order" within the meaning of proposed Rule 15c2-3(b).

⁸ See generally *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*, Release Nos. 33-8358; 34-49148; IC-26341 (Jan. 29, 2004) at 39 [hereinafter, the "Proposing Release"] ("If the broker, dealer or municipal securities dealer took the customer's order over the Internet, then the Internet could be used to provide the required disclosure.") (footnote omitted); *Use of Electronic Media*, Release Nos. 33-7856; 34-42728; IC-24426 (Apr. 28, 2000) (providing guidance on the use of electronic media to deliver documents under the federal securities laws).

dealers will not be able to deliver the document on a same-day basis in many cases unless the Commission modifies its proposal.⁹ That is because under the proposed rules, a broker-dealer must treat every customer's purchase order as an "indication of interest" until (1) the point of sale information is disclosed in writing or orally and (2) the customer has been given an opportunity to determine whether to terminate or resubmit the order. Consequently, the proposal is likely to delay most of the 1 billion customer purchase orders that are transmitted each year.¹⁰

Vanguard urges the Commission to use the Internet to disclose distribution-related costs and conflicts, consistent with Chairman Donaldson's recent statements to the mutual fund industry that:

[I]nvestors . . . need information that is timely. In this regard, we need to examine ways that we can make better use of technology, including the Internet, in our disclosure regime. No good idea will be off the table – and we welcome and encourage your input. You possess an understanding of the industry's intricacies, and you will surely have ideas about needed reforms – especially how to improve disclosure.¹¹

According to the Commission, 75% of all Americans have access to the Internet in their homes.¹² We believe this percentage is even higher among mutual fund investors. Our shareholders and prospective shareholders are avid users of the Internet. Since Vanguard introduced its website in 1995, usage has increased at a very rapid pace to the point where now over 80% of our client interactions occur over the Internet. Website disclosure has the benefits of low cost, instant accessibility and continuous availability. Use of the Internet would enable broker-dealers to establish hyperlinks between the point of sale document and the relevant pages of a fund's prospectus. This would make the document easier to read and understand. Website disclosure also permits investors to easily compare one firm's costs and conflicts in distributing a fund with those of another firm. In short, use of the Internet would lead to more informed decision-making by investors. Finally, online disclosure can be quickly updated as facts change, without the unnecessary cost of maintaining and updating a physical inventory.

⁹ For example, a broker-dealer cannot satisfy the requirement in the point of sale document to "write in amounts for your investment at your request" for a customer if the customer cannot specify a purchase amount in dollars. This would occur if the customer's purchase of shares in one fund is effected through an exchange from another fund, in which case the dollar amount will not be known until the net asset value per share is determined. Removing the "write in" sections from the point of sale document would allow broker-dealers to automatically generate point of sale disclosure for customers who consent to electronic delivery.

¹⁰ "The Commission staff estimates that there are 1 billion confirmations delivered annually to customers in connection with securities transactions involving mutual fund shares, UIT interests and 529 plan securities." See Proposing Release at 49 (footnote omitted).

¹¹ *Remarks Before the Mutual Fund and Investment Management Conference*, Chairman William H. Donaldson (Mar. 14, 2005) at 3; see also *Testimony Concerning The State of the Securities Industry Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, Chairman William H. Donaldson (Mar. 9, 2005) at 11; *Remarks Before the Mutual Fund Directors Forum*, Chairman William H. Donaldson (Feb. 16, 2004) at 4.

¹² See *Securities Offering Reform*, SEC Release Nos. 33-8501; 34-50624; IC-26649 (Nov. 3, 2004) at 86 [hereinafter, the "Prospectus Delivery Release"].

Of course, Vanguard would support a requirement that the broker-dealer mail a hard copy of the point of sale disclosure document free of charge to any customer who requests it. Moreover, a broker-dealer representative should be prepared to discuss these issues with a customer who raises them over the phone or in person. However, requiring a representative to read the disclosure document, even in the face a customer's objections, would not serve the interests of investors.

We believe the Commission is well positioned to select the Internet as the appropriate source for point of sale disclosure because the Commission has already proposed an "access equals delivery" disclosure approach for publicly traded securities. Under this model, investors are presumed to have access to the Internet, and issuers and intermediaries can satisfy their prospectus delivery requirements if the filings or documents are posted on a web site.¹³ The Commission has stated that its "proposed 'access equals delivery' model would continue to satisfy the principal statutory purposes of prospectus delivery while recognizing the need to modernize the obligations in view of technological and market structure developments."¹⁴

Vanguard believes the access equals delivery model is just as appropriate when a broker-dealer sells mutual fund shares to a customer as when the broker-dealer sells the same customer common stock in a corporation. The Commission excluded investment companies from its access equals delivery proposal because "[t]hese entities are subject to a separate framework governing communications with investors, and we believe that it would be more appropriate to consider any changes to our prospectus delivery requirements as they apply to registered investment companies and business development companies in the context of a broader reconsideration of this framework."¹⁵ We agree with the Commission that a full reconsideration of mutual fund disclosure is warranted, but we strongly urge the Commission to acknowledge the "technological and market structure developments" within the mutual fund industry by extending the access equals delivery model to investment companies.

Vanguard believes the Commission can take a critical step toward modernizing mutual fund disclosure by mandating web-based disclosure of key fund characteristics, such as the "Profile Plus" recommendation made by the NASD Mutual Fund Task Force.¹⁶ If the Commission decides to adopt the Profile Plus (or a similar method of online disclosure), it should take care to structure the rules in a manner that ensures that the broker-dealer's disclosure document precisely incorporates applicable information and disclosure from a fund's prospectus.¹⁷

¹³ See Prospectus Delivery Release at 86.

¹⁴ *Id.* at 87.

¹⁵ *Id.* at 87 to 88.

¹⁶ See Mutual Fund Task Force Report.

¹⁷ A prospectus may be supplemented or amended from time to time without advance notice to a fund's third-party distributors.

III. Other Comments

While Vanguard generally supports the views expressed by the ICI in response to the Commission's recent supplemental request for comment, we believe several points deserve emphasis.

- ***Unsolicited Orders Should Be Exempted.*** The point of sale disclosure proposal should exempt unsolicited orders from self-directed investors where the broker-dealer has not made a recommendation. These investors, by definition, have exercised their own independent judgment, completely free of the influence of a broker-dealer. Point of sale disclosure, and the resulting delay in order execution, would be unhelpful in those circumstances. If a broker-dealer does recommend a particular investment, however, NASD rules require the firm to make a suitability determination, which in turn should immediately trigger point of sale disclosure by the firm.
- ***Subsequent Orders Should Be Exempted.*** Investors who want to add to their holdings in a fund should not be forced to delay their investment just to receive duplicative point of sale disclosure. The proposal should exempt subsequent purchases in the same fund through the same broker-dealer from repetitive point of sale disclosure.
- ***Institutional Orders Should Be Exempted.*** We support an exemption for purchase orders from institutional investors.¹⁸ These investors are sophisticated, can conduct better-than-average due diligence of brokerage firms, and can protect their own interests. We note that if the Commission adopts the Internet as the preferred means of providing this information to the marketplace, *all* investors will have ready access to the information.
- ***Confirmations Should Not Duplicate Point of Sale Disclosures.*** We believe the Commission should modify its proposed revisions to confirmations to eliminate duplicative disclosure about conflicts which already appears in the point of sale document. Transaction confirmations are costly and difficult to modify. Any advantage in duplicating the information does not justify the imposition of these new costs and complexities, and does not serve the public interest.

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¹⁸ We would support using either the definition of "institutional investor" that appears in NASD Conduct Rule 2110(a)(3) or the definition of "qualified investor" that appears in Section 3(a)(54) of the Securities Exchange Act of 1934.

Mr. Jonathan G. Katz

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Vanguard appreciates the opportunity to provide these comments on the Commission's proposal to require broker-dealers to disclose distribution-related costs and conflicts of interest to their mutual fund customers at the point of sale and in transaction confirmations. Vanguard would be happy to discuss these comments in greater detail with the Commission staff or to provide additional information that would assist the Commission in considering the proposed rules.

Please do not hesitate to call me, or Edward C. Delk, Principal, in our Legal Department, if you have any questions or would like additional information.

Sincerely,

/s/ Heidi Stam

Heidi Stam
Principal
Securities Regulation

cc: The Honorable William H. Donaldson, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel S. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner

Annette L. Nazareth, Director
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