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April 4, 2005

VIA EMAIL TRANSMISSION

United States Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549
Attn: Jonathan G. Katz
Secretary

Re: 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 (File No. S7-06-04)

Dear Mr. Katz:

USAA Investment Management Company (IMCO) appreciates the opportunity to comment on the Securities and Exchange Commission's (Commission) proposed rulemaking regarding point of sale (POS) and confirmation disclosure requirements for transactions in mutual funds, college savings plans, and certain other securities (covered securities). While IMCO supports the Commission's stated objectives for its proposed rulemaking, it is concerned, however, about the significant costs to be incurred by the breadth and types of disclosure proposed, and the fact that the current proposal does not except from the POS requirements those transactions in covered securities that do not pose conflicts of interest.

I. Summary

IMCO supports investor access to important information regarding the costs of investing in covered securities and the potential conflicts of interest faced by brokers in selling those securities. We believe that investors would benefit from the additional knowledge of those conflicts of interest present with the transactions in which they are to engage. Unfortunately, the Commission's latest proposal extends far beyond this objective to include disclosure that presently resides elsewhere, such that investors will receive certain information multiple times in the transaction process. Moreover, categories of transactions for which no conflicts exist remain subject to the requirements under the current proposal. We are concerned that in its present state the proposal will dramatically increase systems costs with, in certain cases, little or no marginal benefit to investors. This is particularly troubling as a sponsor of a direct-marketed fund complex focused on keeping expenses low.

The current proposal would effectively require that investors receive duplicative information in a fund's prospectus, the POS and confirmation, and impose overlapping

duties on fund companies and broker/dealers to monitor and update certain fund information in order to transmit such information.¹ IMCO believes that POS and confirmation disclosure should be focused on illuminating the distribution-related costs and resulting conflicts of interest associated with investments in covered securities, and the mutual fund prospectus should remain the primary integrated document that provides investors with all material information about the fund, including its ongoing fees and expenses.²

In summary, we believe any final rules in this area should reflect the following points:

- Exempt transactions in covered securities from POS disclosure when the covered securities do not have the distribution-related expenses described in the form, and none of the potential conflicts of interest are implicated (Directly Sold Securities).
- Exempt unsolicited transactions from POS disclosure given these transactions are initiated by the customer, and could result in delays in executing customer initiated transactions.
- Exempt transactions in covered securities in discretionary accounts managed by the broker/dealer or an affiliated investment adviser.
- Adopt Internet disclosure as the primary medium to deliver POS information to ensure that client-initiated transactions are timely executed.
- Delineate clearly the different disclosure requirements for transactions initiated through in-person meetings, the telephone or the Internet.
- Exclude investor-specific expense information in required POS disclosure. Those new fields would substantially increase operating and compliance costs and delay the execution of customer transactions.

¹ Chairman Donaldson has stated that the Commission would be undertaking a comprehensive review of the mutual fund disclosure regime. IMCO supports such a review and amendments to enhance the prospectus as the primary disclosure document for material fund information. We also would support amendments designed to streamline the information contained in fund prospectuses to improve usability to investors.

² The NASD Task Force recently issued a report recommending that broker/dealers make available on their websites a "Profile Plus" document to provide enhanced point of sale disclosure that will include investment information about a fund's investment objectives and policies and fee and performance information. *See* Report of the Mutual Fund Task Force: Mutual Fund Distribution (March 24, 2005) (NASD Report). Although we agree that the Internet should be the primary delivery medium for any required POS document, we believe that the fund's prospectus should remain the primary disclosure document for material information about a fund and not impose duplicative requirements on fund companies and broker/dealers.

- Exclude the fund's annual operating expense ratios and estimates of first year expenses from the POS and confirmation. IMCO believes that such information should properly remain within the fund's prospectus or other fund document with other material information about the fund.
 - If the Commission decides to require that the POS and confirmation include a fund's annual operating expense ratio, then it should ensure that all relevant fund information can be collected, maintained and updated in a centralized database, and mandate that fund companies populate and update fields required to be disclosed by Commission rules to ensure accuracy, consistency and reduce the costs associated with compliance.
- Establish a unified compliance date for all the final and pending Commission rules and initiatives that will impact the contractual relationship, and information flow, between funds and broker/dealers and other intermediaries (e.g. redemption fee rule implementation). A unified compliance date with a long transition period will ensure that necessary contractual amendments and systems changes to implement all these initiatives may be effected efficiently once.

We discuss these comments in greater detail below.

II. Background

IMCO is an indirect, wholly-owned subsidiary of United Services Automobile Association (USAA), a member-owned association. USAA seeks to facilitate the financial security of its members and their families by providing a full range of highly competitive financial products and services, including insurance, banking and investment products. USAA members are the American military community, and include present and former commissioned and noncommissioned officers, enlisted personnel, and their families. Although many of USAA's products and services, including its mutual funds, may be purchased by non-members, USAA does not actively market beyond its eligible member base.

IMCO is a registered investment adviser and broker/dealer. IMCO serves as the investment adviser and distributor of the funds in the USAA family of funds, including thirty-nine (39) no-load, no 12b-1 fee retail funds (the USAA Funds).³ Telephone orders are taken by salaried member service representatives of IMCO (MSRs). Orders for shares in the USAA Funds come to IMCO via the mail, Internet and telephone only. IMCO MSRs do not meet in person with customers. Finally, the MSRs do not earn transaction-based compensation on sales of covered securities purchased by customers.

³ IMCO also serves as the investment adviser and distributor of five (5) funds used as investment options for variable insurance products issued by an affiliated life insurance company.

IMCO also is a registered broker/dealer that provides discount brokerage services to its customers, including access to a fund supermarket that permits investors to purchase, among other securities, non-USAA mutual funds. IMCO MSRs do not solicit or recommend transactions in non-USAA mutual funds. IMCO also is the sponsor and investment adviser to two discretionary advisory wrap programs – a mutual fund wrap program and a private account program. Both of these programs purchase mutual fund securities but the funds purchased for those accounts are no-load, no 12b-1 fee funds, or the shares are purchased at net asset value with the sales load waived to the customer.

Finally, USAA offers a college savings plan (the Plan) sponsored by the State of Nevada that includes certain of the USAA retail funds as underlying funds for the investment choices in the Plan. The Plan does not charge any distribution fees or sales-based charges although it does include certain account fees. Interests in the Plan are sold directly to customers through IMCO. Once a customer has made the decision to invest in the Plan, rather than through a Coverdell or other savings vehicle, IMCO MSRs could assist the customer in choosing the investment portfolio (age-based or investment style) that best suits the customer's investment objectives and risk tolerance.

III. Point of Sale Disclosure Requirements

IMCO remains primarily concerned with the proposed POS disclosure requirements and the effect it could have on delays in executing customer transactions and the operating costs for a no-load fund distributor and discount broker/dealer. The proposals appear to assume that the majority of transactions occur in face-to-face meetings, and does not adequately provide alternative disclosure for the predominant mediums by which customers contact discount broker/dealers – the telephone and the Internet. Although IMCO supports the Commission's efforts to ensure that investors receive POS disclosure about conflicts of interest faced by their brokers when selling covered securities, IMCO believes that further changes are necessary to ensure that transactions not raising potential conflicts of interest will not be delayed by the POS disclosure requirements. Finally, IMCO questions the utility of providing duplicative disclosure to investors in, at times, three separate documents.

A. Point-of-Sale Exemption for Directly Sold Securities

In its original proposal, the Commission stated in the summary that “[t]he two new rules would require broker-dealers to provide their customers with targeted information, at the point of sale and in transaction confirmations, regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, unit investment trust interests (including insurance securities), and municipal fund securities used for education savings.”⁴ IMCO agrees that investors should receive some targeted disclosure regarding

⁴ See Proposed Rule: 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, Exchange Act Rel. No. 49148 (Jan. 29, 2004) (Original Proposal).

the distribution fees and expenses that would be earned, and the resulting potential conflicts of interest faced, by broker-dealers in selling covered securities to investors. IMCO, however, believes that the final rules should provide an exemption for transactions in covered securities where no such conflicts exist.

In seeking to achieve its mission, IMCO offers the USAA Funds with no load or distribution fees. Almost all shares of the USAA Funds are sold directly to investors with no intermediary or through IMCO's salaried MSRs.⁵ We refer to these securities as Directly Sold Securities. Thus, under the first POS form proposed by the Commission, IMCO would have no sales loads, distribution fees or potential conflicts of interest to disclose to investors. The Commission's proposal would force IMCO to incur substantial initial and ongoing costs to create and deliver a new POS document that would effectively disclose \$0 dollars in each category of fee information and answer "no" to the two questions concerning conflicts of interest. Under a cost/benefit analysis, IMCO believes that any small benefit that could result from investors receiving such a document would be far outweighed by the cost of compliance and the resulting delays in processing customer transactions in Directly Sold Securities.

When the Commission reopened the comment period to the Original Proposal, it also included new model POS forms for Class A, B and C shares.⁶ These new proposed forms differ substantially from the forms in the Original Proposal, including requiring disclosure of the annual operating expense ratios of the mutual fund and an estimate of the first year costs based on three standardized investment amounts, and, upon request, the investor's actual investment amount (Investor-Specific Disclosure). We note that the Commission did not include a model form for no-load, no-12b-1 fee shares but stated that the POS disclosure for other share classes should include the material portions from the model forms. The underlying rationale for the inclusion of this fund operating expense information appears to be that the customers should receive this information prior to sale to enhance informed decision-making.

As stated above, IMCO believes that the fund's prospectus should remain the primary disclosure vehicle for material information about a fund, including its fees, expenses, performance and investment objectives and policies. In contrast, the POS and confirmation should highlight distribution-related fees and expenses that a broker/dealer would earn in selling covered securities, and any resulting conflict of interest arising from these fees or the compensation arrangements for individual representatives. Inclusion of estimated Investor-Specific Disclosure also could confuse investors who may think that these fees will be deducted from their investment amount or that broker/dealers would receive such fees. This confusion would result in more and longer calls to MSRs and

⁵ The transfer agent for the USAA Funds has a handful of service agreements with certain entities to permit those entities to aggregate orders for their customers and provide certain recordkeeping for those accounts.

⁶ 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, Exchange Act Rel. No. 51274 (Feb. 28, 2005) (reopening of the comment period) (Modified Proposal).

increase IMCO's operating costs. IMCO questions whether broker/dealers should be forced to absorb the cost of the creation and delivery of a new disclosure document solely to educate customers about the ongoing fees and expenses of a mutual fund. IMCO believes that this information should be within the fund's prospectus. As stated above, IMCO would support changes to the disclosure regime for mutual funds that would eliminate unnecessary disclosure and improved usability for investors. We do not believe that education of investors about fund costs should be shifted to broker/dealers, particularly in the case of Directly Sold Securities.

Accordingly, we urge the Commission to except from POS disclosure any Directly Sold Security if: (1) the shareholder pays no sales load or deferred sales charge; (2) the fund pays no asset-based sales charge; (3) brokers receive no sales load or contingent deferred sales charges, revenue sharing or directed brokerage; and (4) the broker/dealer could answer "no" to the two questions in the conflict of interest section of the proposed form.

B. Exception for Unsolicited Transactions

IMCO also supports an exception from the POS disclosure requirements for unsolicited orders. We believe that such an exception would accommodate investors who make their own investment decision without a broker/dealer's recommendation or solicitation. Investors who make their own decisions have usually done their own research and frequently place trade requests over the Internet or telephone. In these circumstances, it would be counterproductive for broker/dealers to provide such information after an individual has made his or her investment decision.

For example, IMCO operates as a discount broker/dealer. As such, IMCO MSRs generally do not solicit transactions in covered securities, and do not make recommendations regarding mutual fund securities, other than USAA Funds. As part of its discount brokerage operations, IMCO offers a fund supermarket for its customers to make purchases of certain non-USAA Funds. This service facilitates the ability of customers to be able to consolidate their investments at IMCO if they so choose. IMCO MSRs do not solicit or make any recommendations with respect to those mutual funds.

Under these circumstances, we believe that IMCO should not have to provide POS disclosure before executing the customer's transaction. Frequently, customers call or initiate transactions on the Internet in response to market conditions. Customers of discount broker/dealers generally value speed and quality of execution since they make their own investment decisions. Unless the Commission excepts unsolicited transactions from the POS disclosure requirements, we believe that these transactions could be delayed and, at certain times customers may not receive the net asset value of the mutual fund shares for the day they placed their order. Depending on the adopted method of delivery, concern may be particularly acute for transactions initiated over the Internet if the client is unreachable by telephone before the fund's order cutoff time.

As stated earlier, IMCO generally believes that the POS disclosure requirement should be predicated on the need for a broker/dealer to illuminate any potential conflict of interest it faces in selling a particular covered security. If a broker/dealer does not solicit or recommend such securities to the client, the disclosure requirement would merely delay a client's order and increase the costs of operations to a broker/dealer. We believe it is unreasonable to require broker/dealers, particularly discount brokers, to incur costs to educate investors about information that the Commission believes may be important to the investor but was not so classified by the investor before making his or her own investment decision.

C. Exception for Discretionary Accounts Managed by Registered Brokers or Investment Advisers

The Original Proposal included an exemption to POS disclosure for transactions in which the broker/dealer exercises investment discretion. In the Modified Proposal, the Commission requested comment whether this section should be extended to situations in which an investment adviser exercises investment discretion.

As discussed above, IMCO offers a mutual fund wrap program and a private investment management program in which IMCO exercises investment discretion over the accounts in its role as a registered investment adviser. These programs are subject to the substantive requirements of the Investment Advisers Act of 1940, including the requirement to deliver a disclosure document describing, among other things, material conflicts of interest. Without extending this proposed exception to registered investment advisers, it would be unclear whether IMCO would have to deliver POS disclosure to itself as investment adviser or the underlying advisory clients. Disclosure to itself would be nonsensical, and delivery of this disclosure to advisory clients would undermine part of the reason such clients hire professional money managers – to avoid receipt of a myriad of documents to facilitate an investment decision they have delegated to the investment adviser.

IMCO urges that the Commission extend this exception to discretionary accounts managed by registered broker/dealers or investment advisers. Because broker/dealers and investment advisers are registered with the Commission, and are subject to the Commission's inspection powers and recordkeeping requirements, extending this exception to investment advisers would not undermine the Commission's inspection program. Also, because investment advisers must deliver a disclosure document when the advisory relationship is entered, and offer to provide it annually thereafter, extending the exception would not undermine any public policy advanced by the proposed rules.

D. Other POS Disclosure Comments

IMCO believes that, regardless of whether the Commission exempts directly sold securities and unsolicited orders, certain disclosure items should be eliminated. Under the Modified Proposal, the POS document includes fee and expense information for three

standardized investment amounts (Standardized Disclosure) and, upon request, fee and expense information based on the client's actual investment amount (Investor-Specific Disclosure). IMCO believes that the POS disclosure document should include only Standardized Disclosure for the investment amount of \$1,000. IMCO believes the two largest standardized amounts (\$50,000 and \$100,000), included in the Modified Proposal, would be of marginal use to most investors who generally invest considerably less than \$50,000. Thus, there seems little reason to include all three standardized amounts in a document intended to facilitate an investor's evaluation of potential conflicts of interest.

IMCO also strongly urges that the Commission remove the Investor-Specific Disclosure requirements as this will be cost-prohibitive to provide in Internet transactions, and will significantly lengthen telephone calls between broker/dealers and customers. IMCO agrees that investors need to receive specific sales load and distribution fee information in the confirmation, but the inclusion of Investor-Specific Disclosure for fees paid before the point of sale will not serve any useful purpose other than to delay the ability of a broker to execute a customer's security transaction.

IMCO also urges that the Commission designate the Internet as the medium for POS disclosure to reduce the possibility of delays in customer transactions. Recently, the NASD Task Force on Mutual Funds issued a report calling for the Internet as the primary delivery mechanism for enhanced POS disclosure. IMCO believes that the NASD Task Force's recommendation regarding primary channel delivery is more realistic given the state of the brokerage industry. The Commission's Original Proposal and Modified Proposal appear to assume that the vast majority of transactions occur during in-person meetings between customers and brokers when the registered representative will have the time to fill in the blanks for Investor-Specific Disclosure and discuss each information item. IMCO's business is conducted solely through the Internet, the telephone, and the mail. The Investor-Specific Disclosure and the requirement to orally provide POS disclosure before executing a transaction will increase the length of calls and IMCO's operating expenses, and its compliance costs to ensure proper training, procedures and monitoring. It is likely that these increased costs will be passed on to investors in the way of higher fees and expenses. For these reasons, we urge the Commission to adopt the Internet as the primary delivery mechanism of POS disclosure in covered securities.

IV. Neither the POS or Confirmation Should Include Fund Operating Expenses

The Fund's prospectus should be the primary disclosure document for material information about a mutual fund. The disclosure items in the Original Proposal for the POS and confirmation were solely related to sales-related fees and conflicts arising from the collection of such fees. In the Modified Proposal, the new forms contain a section detailing a fund's operating expenses. We assume that the operating expenses would be the expenses described in a fund's then current prospectus. This new section duplicates information contained in the prospectus and should be eliminated. IMCO questions the need for broker/dealers to incur substantial costs to reproduce expense information contained in fund prospectuses that are already readily available online and in other

forms to investors. This concern is particularly relevant for confirmations, which generally are accompanied or preceded by the prospectus. Under a standard cost/benefit analysis, IMCO believes that the marginal benefit associated with having the same information in two documents delivered simultaneously after an investment decision was made would be outweighed by the substantial cost to the industry of changing confirmations to include this duplicative information.

Moreover, currently, there is no comprehensive electronic database that stores information about mutual funds. Thus, if broker/dealers have to include fund operating expense information in confirmations and/or POS documents, they will have to incur substantial expense to create such a database and update it. This effort will be duplicated by each broker/dealer in the industry and each fund company as they update and supplement fund prospectuses.

If the Commission decides to mandate disclosure of fund operating expense information in either the POS or confirmation, the Commission should ensure that an electronic database is available to house such information that brokers and other intermediaries could access to download relevant data. An automated database will increase consistency of the information disclosed on the same fund by different intermediaries and reduce the possibility of error. It also will reduce the redundancy of intermediaries having to track and update the same fund information. IMCO believes that if the Commission mandates the disclosure of this information, it also should mandate that mutual fund companies populate the database with any fund information required to be disclosed to customers of intermediaries. Such a database also could be used to store other fund information that could be useful for intermediaries, including breakpoint information, redemption fees, and other fund information.⁷ An automated database would be the first step to permit intermediaries to design systems that could populate documents in a more timely and cost efficient manner.

V. The Commission Should Establish the Same Compliance Date for All Final and Pending Rules Affecting Funds and Intermediaries

The Commission has different final and pending rules that will materially affect the contractual relationship, and information flow, between funds and intermediaries, including rules regarding redemption fees, hard 4:00 p.m. close for accepting mutual fund orders, and the point of sale and confirmation proposals. In addition, the Commission and NASD have acted to remedy the problems of the inability of broker/dealers to

⁷ The Commission is undoubtedly aware that the NSCC (now DTCC) created one such centralized database entitled Mutual Fund Profile Service II to house breakpoint information to respond to one of the recommendations of the Joint NASD/Industry Task Force on Breakpoints. This database can be expanded to include other fund features, including redemption fees. Unfortunately, information in the database is not comprehensive because fund families are not required to populate the fields. The Commission should consider mandating that fund families populate fields in a centralized database that could be accessed by intermediaries to download data. This would reduce the time to produce required reports, permit more timely updating and reduce the duplication of effort and costs that would be incurred by intermediaries to track information about funds.

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correctly assess and give investors breakpoints on their purchases. Each of these rules will necessitate changes to the existing contracts between funds and intermediaries and will require extensive systems redesign to implement each rule. IMCO urges that the Commission consider how all of these rules will impact the relationship between funds and intermediaries, and establish a reasonable compliance date for all of these rules to minimize the cost and time that both funds and intermediaries will have to spend in amending existing contracts and implementing systems changes. It would be preferable to amend existing agreements once rather than numerous times, and it would be more efficient for the industry as a whole to engage technology experts to consider all systems changes necessary to comply with each of these rules and proposals at the same time rather than piecemeal.

We appreciate the opportunity to provide comments on this rule proposal. If you have any questions regarding our comments, or would like additional information, please contact me at (210) 498-8696 or Eileen Smiley at (210) 498-4103.

Sincerely,

Mark S. Howard
Senior Vice President, Secretary and Counsel
USAA Investment Management Company