MEMO# 5619

February 28, 1994

INSTITUTE COMMENT LETTER ON SEC'S MULTIPLE CLASS AND MASTER-FEEDER FUND PROPOSAL

February 28, 1994 TO: ACCOUNTING/TREASURERS COMMITTEE NO. 8-94 BOARD OF GOVERNORS NO. 20-94 OPERATIONS COMMITTEE NO. 5-94 SEC RULES COMMITTEE NO. 22-94 RE: INSTITUTE COMMENT LETTER ON SEC'S MULTIPLE CLASS AND MASTER-FEEDER FUND PROPOSAL ____ As we previously informed you, the Securities and Exchange Commission recently proposed new Rule 18f-3 under the Investment Company Act to allow open- end management investment companies to issue multiple classes of voting stock, and proposed various amendments to its rules and forms to establish disclosure requirements for multiple class and master-feeder funds. The Institute recently submitted to the Commission the attached comment letter on the proposal, which is summarized below. 1. Proposed Cross-Disclosure The Commission had proposed to require cross-disclosure in mutual fund prospectuses (including summary prospectuses) about classes or feeder funds that are not being offered in the prospectus. The Institute's letter opposes this proposal, and instead recommends that prospectuses be required to contain a legend and summary information when classes or feeder funds are offered as investment alternatives. The letter points out that full cross-disclosure would be inconsistent with the Commission's professed desire for prospectus simplification, would inappropriately require that mutual funds provide disclosure about securities they are not offering in a prospectus, and would ignore the role of financial intermediaries who must comply with suitability requirements. 2. Standard for Requiring Cross-Disclosure The Institute's letter also recommends that the Commission revise the proposed standard for determining whether classes or feeder funds are being made available as alternatives to investors and therefore necessitate additional disclosure. The Commission had proposed that cross-disclosure be required when classes and feeder funds are "made available through the same broker, dealer, bank, or other financial intermediary" and have "alternative arrangements for sales and related charges." The Institute's letter points out that the standard would require cross-disclosure not only for dual-distributed funds, but in a broader range of circumstances for which cross-disclosure is particularly inappropriate. 3. Proposed Legend Requirement The Commission had proposed to require a legend in prospectuses, advertising, and sales literature, discussing the existence of other classes or feeder funds and providing certain other information. Although the Institute's letter supports a legend requirement in lieu of extensive cross-disclosure, the letter opposes a legend requirement for classes or feeder funds that are not intended as investment alternatives or are made available through different distribution channels. 4. Proposed Line Graph As part of the cross-disclosure that would be required in prospectuses (including summary prospectuses), the Commission had proposed to require a ten- year, hypothetical line graph illustrating the effect of fees and expenses for different classes or feeder funds. The Institute's letter opposes the proposed hypothetical line graph. The Institute's letter points out that the line graph is unnecessary, since it essentially would restate information already provided in the prospectus fee table example. The letter also points out that the line graph would confuse investors and raise numerous interpretive problems. Instead of the line graph, the Institute's letter recommends that prospectuses offering more than one class or feeder fund be required to contain a narrative description of the factors relevant to a determination of which alternative is best for them and how these factors affect the alternatives. ` Advertising Requirements The Commission had proposed requiring performance advertising and sales literature to include with equal prominence the performance of all classes and feeder funds that are subject to the full cross-disclosure requirement. Advertisements or sales literature for a class or feeder fund for which average annual total return is available for less than one, five, and ten year periods would have to disclose the average annual total return for any class, feeder fund or master fund that has been offered for the longest time or for at least ten years. The Institute's letter opposes the proposed equal prominence requirement. Instead, the Institute's letter recommends that performance advertising and supplemental sales literature for a class or feeder fund be required to include a legend disclosing (when applicable) that another class or feeder fund is available as an investment alternative and that its sales charges and expenses may differ. The letter supports the proposal concerning performance information for newer classes or feeder funds. 6. Proposed Rule 18f-3 The Institute's letter generally supports proposed Rule 18f-3, which would permit mutual funds to issue multiple classes of shares without the need to apply for a Commission exemptive order. The proposing release requested comment on whether there should be a specific limitation on the allocation of fees between classes. The Institute's letter supports the more flexible approach of the proposal. The Institute's letter also comments on certain other aspects of Rule 18f- 3, including a recommendation that the Commission delete the request for an annual board review of any multiple class plan. Thomas M. Selman Assistant Counsel Attachment

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