

**MEMO# 16597**

October 1, 2003

# **PROPOSED IMPLEMENTATION OF RECOMMENDATIONS TO ENHANCE PROSPECTUS AND WEBSITE DISCLOSURE OF SALES CHARGE BREAKPOINTS**

ACTION REQUESTED [16597] October 1, 2003 TO: SEC RULES COMMITTEE No. 78-03 RE: PROPOSED IMPLEMENTATION OF RECOMMENDATIONS TO ENHANCE PROSPECTUS AND WEBSITE DISCLOSURE OF SALES CHARGE BREAKPOINTS I. BACKGROUND In July, the Joint NASD/Industry Task Force on Breakpoints issued a report that included various recommendations to address errors and failures in providing breakpoint discounts to investors in connection with the purchase of mutual fund shares that carry a front- end sales load.<sup>1</sup> Subsequent to the issuance of the Report, the Institute was asked by the NASD to take the lead in implementing some of the Report's thirteen recommendations, including Recommendations C and G, relating to enhancing mutual fund prospectus and website disclosure relating to breakpoint opportunities.<sup>2</sup> Pursuant to this request, the Institute convened a working group of its members to develop recommendations regarding how to best implement these recommendations. The purpose of this memorandum is to get feedback from a broader group of the Institute's members on the working group's proposal to implement Recommendations C and G. Comments on the proposal should be provided to the undersigned by phone (202-326-5825) or e-mail (tamara@ici.org) or to Frances Stadler by phone (202-326-5822) or e-mail (frances@ici.org) no later than Friday, October 17th. <sup>1</sup> See Institute Memorandum to SEC Rules Members No. 36-03 [16347], dated July 24, 2003, which discusses in detail this report, Report of the Joint NASD/Industry Task Force on Breakpoints, NASD (July 2003)(the "Report"). A copy of the Report is available on the NASD's website at: [www.nasdr.com/pdf-text/breakpoints\\_report.pdf](http://www.nasdr.com/pdf-text/breakpoints_report.pdf). <sup>2</sup> In particular, according to Recommendation C, the SEC should require mutual funds to provide the critical data regarding pricing methods, breakpoint schedules and linkage rules in their prospectuses and on their websites in a prominent and clear format. It further recommends that mutual funds with websites "provide quick and obvious links to breakpoint information from their Web Site home pages." According to Recommendation G, the SEC should mandate that a fund's prospectus disclose that investors may need to provide their broker/dealers with the information necessary to take full advantage of the breakpoint discounts. In the absence of a regulatory mandate, the Report recommends that mutual funds implement Recommendations C and G on a voluntary basis. In August, the NASD wrote to the Securities and Exchange Commission to request formally that the SEC adopt rules requiring mutual funds to make the disclosures recommended by Recommendations C and G. II. THE WORKING GROUP'S PROPOSAL The working group has recommended that the Institute:

- Propose specific revisions to Form N-1A to the SEC and
- Send a

memorandum to all Institute members encouraging them to voluntarily revise their prospectuses and website disclosures<sup>3</sup>, as necessary or appropriate, in accordance with the proposed revisions to Form N-1A as soon as reasonably practicable, and provide samples of prospectus disclosure to assist members in crafting or enhancing their own disclosures. The working group has developed proposed revisions to Form N-1A and draft samples of prospectus disclosure. These are set forth below. We welcome your comments on all aspects of the working group's proposal, and specifically request your feedback on two issues highlighted below.

**A. Proposed Revisions to Form N-1A** The working group recommends that the Institute propose that the Commission revise the instructions to Items 3 and 8 of Form N-1A, by adding the following language:<sup>4</sup>

**Item 3. Instructions.** \* \* \* 2. Shareholder Fees. \* \* \* (a)(iv) If the Fund offers arrangements under which a typical investor in the Fund may qualify for breakpoints in, or elimination of, sales charges (loads), the Fund may include a reference to such arrangements in a footnote to the table. \* \* \* 3 The working group proposes to handle implementation of the Report's website disclosure recommendations by including in the proposed amendments to Form N-1A language that would require funds that have websites to disclose in their prospectuses that information about sales load breakpoints is available on their websites and to provide the website address. (Presumably, this requirement could be satisfied by posting the fund's prospectus on the website.) As indicated in footnote 2, above, the Report expressly recommends that all mutual fund websites include a link from their website homepage to the additional information on the website concerning breakpoints. It does not appear necessary or appropriate, however, to make this a regulatory requirement.

**4 The proposed revisions to Item 3 would add a new instruction to this item; the proposed revisions to Item 8 would replace the existing Item 8(a)(2) with the working group's proposed language and add a new Instruction to immediately follow this revised item.**

**3 Item 8. (a) Sales Loads.** \* \* \* (2) Briefly describe, in plain English pursuant to Rule 421(d) under the Securities Act, any arrangements under which a typical investor in the Fund may qualify for breakpoints in, or elimination of, sales loads (e.g., letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, and redemption reinvestment plans). If the Fund has a website, state that information about sales load breakpoints also is available on the Fund's website and provide the website address. If applicable, state that additional information concerning sales load breakpoints is available in the Fund's SAI or from a broker or financial intermediary through which shares of the fund may be purchased or sold.

**Instruction.** In describing any sales load breakpoints offered by the Fund, include in proximity to the chart required by Item 8(a)(1):

1. A brief summary of relevant information concerning an investor's eligibility for sales load breakpoints including: (i) a description or list of the type(s) of accounts [(e.g., retirement accounts, accounts held at other broker-dealers)], account holders [(e.g., immediate family members, family trust accounts, solely-controlled business accounts)], and fund holdings [(e.g., funds held within the same complex)] that may be aggregated for purposes of determining eligibility for sales load breakpoints; and (ii) how such accounts will be valued (i.e., historical cost, net asset value (NAV), or public offering price (POP)) for purposes of computing breakpoint eligibility.
2. If the Fund requires an investor to produce documentation (e.g., verification of other holdings by the investor or of related persons or accounts that may be aggregated for purposes of determining breakpoint eligibility, or information documenting historical costs) either to the Fund or to a financial intermediary in order for the investor to take advantage of the Fund's sales load breakpoints, a prominent statement informing investors of their responsibility to provide this documentation at the time of purchase to the Fund or to the investor's financial intermediary.

**Specific Member Input Requested:** The proposed revision to Instruction 1 to Item 8(a)(2) includes parenthetical examples of the types of accounts, account holders, and fund holdings that

may qualify an investor for sales load breakpoints. (These parentheticals are bracketed above.) A concern was raised by a member of the working group regarding whether, by including these examples, they may be viewed not as examples, but rather, as required (and possibly exclusive) types of accounts, account holders, and fund holdings that must be included by all funds when determining breakpoint eligibility. In response to this concern, the Institute seeks input on whether these parenthetical examples should be retained in the final version of the proposed Form N-1A instructions.

4 B. Sample Disclosure In addition to recommending to the Commission adoption of the above revisions to Form N-1A, the working group believes that it would be helpful to members in implementing these revised disclosure requirements for the Institute to include in its memorandum to members sample disclosure that, in the view of the working group, would be compliant with these revised requirements. Towards this end, the working group has developed the following disclosure samples. While the Institute anticipates providing these samples to the Commission along with our submission recommending revisions to Form N-1A, our submission will make clear that we do not believe that such samples should be included in any rule or form text. Also, when these samples are finalized and provided to the Institute's members, the Institute intends to make clear in our memorandum that these samples are for illustrative purposes only and funds are not required or expected to use any particular specific wording. The samples developed by the working group are divided into two categories: (1) Samples A, B, and C are samples of disclosure that would be compliant with the proposed Instruction to Item 8(a)(2), above, relating to breakpoints generally; and (2) Samples D, E, and F are samples of disclosure relating to letters of intent that may be incorporated in the breakpoint discussion in the prospectus, if applicable.

1. Samples of Proposed Prospectus Breakpoint Disclosure

Sample A Sales charges for Class A Shares

Sales charge as a % of Offering Net Amt.	Amount of purchase Price Invested Less than \$50,000	4.5	5.5	___	\$50,000 but less than \$100,000	3.5	4.0	___
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Etc. \_\_\_\_\_

You may qualify for a reduced Class A sales charge if you own or are purchasing shares of XYZ mutual funds. To receive the reduced sales charge, at the time of your purchase of XYZ fund shares, you must inform your broker or financial intermediary of any other investments that you, your spouse, or your children under the age of 21 have in the XYZ family of mutual funds including, for example, shares held in a retirement account, an employee benefit plan, or at a broker-dealer or financial intermediary other than the one handling your current purchase. XYZ will credit the combined value (at the current offering price) of all of these eligible accounts holding mutual fund shares to determine whether you qualify for a reduced sales charge on your current purchase. For more information about these reduced sales charges, please visit the Fund's website at [www.FUND.com](http://www.FUND.com), consult your broker or financial intermediary, or refer to the section entitled "Purchase of Shares" in the Fund's Statement of Additional Information, 5 which is available through your broker or financial intermediary or from the Fund by calling 1- 800-555-1212.

Sample B [CHART] As indicated in the above chart, investors purchasing Class A shares may, under certain circumstances, which are described below, be entitled to pay reduced sales charges or have them waived in their entirety. To take advantage of these discounts, investors, or their broker-dealer or financial intermediary must notify the Fund at the time of the purchase order whether a quantity discount may apply to the investor's current purchases. As used in the above chart, the "Amount of purchase" includes the total dollar amount: (1) invested in the Fund's shares either previously or currently by the investor, the investor's spouse, or any of the investor's children who are under age 21, whether such share are held in investment accounts, retirement account, brokerage accounts or otherwise; together with (2) the amount of any shares held by any of these family members in shares of Participating Funds. ("Participating Funds" refers to all retail funds in the ABC family of funds, a list of which is

available from your broker-dealer or financial intermediary or on the Fund's website at: [www.FUND.com](http://www.FUND.com).) For purposes of determining the "Amount of purchase," all such shares will be valued at their current offering price. Investors should notify their financial intermediary at the time of investment of any of these other investments in order to receive the sales charge discount. For more information about sales charge discounts, see the Fund's website or consult your broker or financial intermediary. Sample C [CHART] To receive a reduction in your Class A initial sales charge, you must let your investment dealer or QRS Funds Service Company know at the time you purchase shares that you qualify for such a reduction. If you do not let your dealer or QRS Funds Service Company know you are eligible for a reduction, you may not receive a sales charge discount to which you are otherwise entitled. You and members of your immediate family (your spouse and your children under the age of 21) may combine all of your QRS Funds investments, including investments made for trust accounts established by any of you, to reduce your Class A sales charge. You may combine simultaneous purchases of any class of shares of two or more QRS Funds, as well as holdings in QRS variable annuity contracts and variable life insurance policies, to qualify for a reduced Class A sales charge. In addition, you may take into account the current value (or if greater, the amount you invested less any withdrawals) of your existing holdings in any class of QRS Funds, as well as individual holdings in various QRS variable annuity contracts and variable life insurance policies, to determine your class A sales charge. You can only have your sales charge determined on the basis of the amounts you invested if you have adequate documentation of those amounts. [Adequate documentation would include \*\*\*\*.] This 6 information should be provided to your dealer or QRS Fund Service Company at the time of your current purchase in order to take advantage of any sales charge discounts that may be applicable to your purchase. For more information about sales charge discounts, see the Fund's website at [www.FUND.com](http://www.FUND.com) or consult your broker or financial intermediary.

2. Samples of Proposed Prospectus Disclosure of Letters of Intent Sample D [This disclosure could be incorporated into the above samples rather than standing alone.<sup>5</sup>] The sales charge on Class A shares may [also] be reduced or eliminated by signing a letter of intent to purchase a specific dollar amount of shares within 13 months. Sample E You can use a letter of intent to qualify for reduced sales charges if you plan to invest at least \$50,000 (excluding any reinvestment of dividends and capital gains distributions) in the fund's Class A shares during the next 13 months. A letter of intent is a letter you sign whereby, based upon your representation to purchase at least \$50,000 in Fund shares over the next thirteen months, the Fund agrees to provide you the reduced sales charge indicated in the above chart. Completing a letter of intent does not obligate you to purchase additional shares, but if you do not buy enough shares to qualify for the projected level of sales charges by the end of the 13- month period (or when you sell your shares, if earlier), your sales charges will be recalculated to reflect your actual purchase level and you must pay the additional sales charge within 20 days after you are notified or it will be deducted from your account (or your sales proceeds). Sample F You may reduce your Class A sales charges by establishing a Statement of Intention. A Statement of Intention allows you to combine all non-money market fund purchases of all share classes you intend to make over a 13-month period, as well as individual holdings in various QRS variable annuity contracts and variable life insurance policies, to determine the applicable sales charge. At your request, purchases made during the previous 90 days may be included; however, capital appreciation and reinvested dividends and capital gains do not apply toward these combined purchases. Specific Member Input Requested: Sample D, above, proposes a one sentence reference to letters of intent. This language is based on disclosure currently used by two members of our working 5 Incorporating this disclosure into the above breakpoint samples would eliminate the need to include the statement, "For more information concerning letters of intent, see . . ."

7 group. We request your thoughts

as to whether this single sentence would appear to be adequate disclosure and, if so, whether Samples E and F would imply otherwise. Tamara K. Salmon Senior Associate Counsel

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