

MEMO# 1027

March 8, 1989

PROPOSED AMENDMENT OF CALIFORNIA EXPENSE LIMITATION RULE

March 8, 1989 TO: BOARD OF GOVERNORS NO. 16-89 STATE SECURITIES MEMBERS NO. 9-89 RE: PROPOSED AMENDMENT OF CALIFORNIA EXPENSE LIMITATION RULE

As you know, the Institute has been working for several years to eliminate expense limitations in all states. In 1978, at the Institute's urging, the North American Securities Administrators Association (NASAA) and the Midwest Securities Commissioners Association adopted a resolution encouraging states to repeal their expense limitations. At that time, there were twenty-eight states with either formal or informal expense limitations in effect. In 1984, again at the Institute's urging, NASAA adopted a similar resolution recommending the states to suspend or repeal their expense limitations. As a result of the Institute's efforts, no state, except California, continues to enforce a traditional expense limitation. The Institute has met with the California Department of Corporations many times to urge the Department to repeal their expense limitation. In 1985, the Commissioner of the Department agreed to grant liberal waivers from the limitation until such time as his staff had an opportunity to study the continuing need for the limitation. Since that time, funds have been required to submit an annual expense report to the Department. Based on the information collected during the last three years, the Department has proposed to amend their expense limitation. Attached is a copy of the proposed Notice to amend the expense limitation rule. The Notice proposes to increase the annual expense limitation percentage caps to two and one-half percent of the first \$30 million of the average net assets of the fund, two percent of the next \$70 million and one and one-half percent of the remaining average net assets. Currently, the cap on annual expenses is two percent of the first \$10 million of the average net assets, one and one-half percent of the next \$20 million and one percent of the remaining net assets. The Notice also proposes to exclude a portion of annual distribution plan expenses (12b-1 fees) for purposes of calculating the expense limitation. The Notice provides that a fund may exclude all 12b-1 fees up to one percent of its average net assets if sales charges are not collected at the time of the sale of shares. In addition, if the fund has a front-end load, the fund may exclude part or all of the 12b-1 fee, depending on the amount of the 12b-1 fee. This proposed amendment simply formalizes the position the staff has taken in the past regarding 12b-1 fees. In addition, the Notice proposes to exclude from the aggregate annual expenses the excess custodian costs attributable to investments in foreign securities compared to custodian costs incurred if the investments had been in domestic securities. Finally, only funds that must reduce or rebate advisory or management fees or that have received a waiver from the expense limitation will be required to file an annual expense limitation report. Currently, all funds registered in California must file an annual expense limitation report. Comments are due by May 17, 1989. Please provide your comments to the Institute by April 28, 1989 so that an appropriate response to the proposal

can be prepared. Natalie Shirley Associate General Counsel Attachment

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