

MEMO# 16806

November 21, 2003

ICI RECOMMENDATIONS RELATING TO MEMBER REVIEW OF PROSPECTUS AND WEBSITE DISCLOSURE OF SALES CHARGE BREAKPOINTS

ACTION REQUESTED [16806] November 21, 2003 TO: BROKER/DEALER ADVISORY COMMITTEE No. 33-03 PRIMARY CONTACTS - MEMBER COMPLEX No. 104-03 SEC RULES MEMBERS No. 163-03 SMALL FUNDS MEMBERS No. 70-03 UNIT INVESTMENT TRUST MEMBERS No. 45-03 RE: ICI RECOMMENDATIONS RELATING TO MEMBER REVIEW OF PROSPECTUS AND WEBSITE DISCLOSURE OF SALES CHARGE BREAKPOINTS I. BACKGROUND In late 2002 and early 2003, regulatory investigations revealed instances in which mutual fund investors did not receive the benefit of sales charge discounts to which they were entitled. These findings led to the formation of a Joint NASD/Industry Task Force on Breakpoints, made up of high-level representatives from NASD, mutual funds, transfer agents, and broker-dealers. In July 2003, the Task Force issued a report, which included thirteen recommendations designed to ensure that investors receive all sales charge discounts to which they are entitled. 1 Subsequent to the issuance of the Report, the NASD asked the Institute to take the lead in implementing some of the Report's recommendations, including two that relate to enhancing mutual fund prospectus and website disclosure of breakpoint opportunities.2 Pursuant to this request, the Institute convened a working group of ICI and Securities Industry Association members to determine how best to implement these recommendations. The working group determined that the Institute should (1) propose that the Securities and Exchange Commission adopt specific revisions to Form N-1A relating to sales charge breakpoint prospectus disclosure 1 See 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. 2 In particular, Recommendation C states that 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." Recommendation G generally provides that 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 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. 2 and

(2) send a memorandum to all Institute members encouraging them to take voluntary action in advance of SEC rulemaking. II. PROPOSED AMENDMENTS TO FORM N-1A To implement the working group's first recommendation, by letter dated November 20, 2003, the Institute submitted to the SEC proposed amendments to Form N-1A to enhance mutual fund prospectus and website disclosure concerning sales charge breakpoints.³ The proposed amendments, which are identical to those set forth in the attachment to this memorandum, would require mutual funds that offer sales charge breakpoints to include in their prospectuses, in proximity to the breakpoint schedule: • a brief, plain English description of any arrangements under which a typical fund investor may qualify for breakpoint discounts, such as rights of accumulation or letters of intent;⁴ • if the fund has a website, a statement that information about sales load breakpoints also is available on the fund's website, as well as the website address;⁵ and • if applicable, a statement that additional information concerning sales load breakpoints is available in the fund's Statement of Additional Information (SAI) or from a broker or financial intermediary through which shares of the fund may be purchased or sold. III. ICI RECOMMENDATIONS FOR VOLUNTARY INDUSTRY ACTION In accordance with the working group's second recommendation, the Institute urges its mutual fund members that offer breakpoint discounts to review their prospectus and website disclosure and revise it, if necessary, to ensure that it conforms with the Institute's proposed amendments to Form N-1A and the Task Force's recommendations.⁶ The Institute 3 See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Paul F. Roye, Director, Division of Investment Management, SEC, dated November 20, 2003. This letter was accompanied by two appendices: Appendix A, which consisted of the amendments proposed to Form N-1A, and Appendix B, which consisted of sample disclosure that would comply with the proposed amendments. Because these two appendices are substantively identical to the attachment to this memo, they are not included with the copy of the letter attached to this memo. 4 A proposed instruction would specify that the brief description referred to above should include (1) disclosure of the types of accounts, account holders and fund holdings that may be aggregated to determine breakpoint eligibility, (2) disclosure of the basis upon which breakpoint eligibility is calculated and (3) disclosure to put investors on notice regarding any documentation they might be required to produce in order to establish eligibility for breakpoint discounts. 5 This provision is intended to implement those portions of Recommendations C and G that call for the SEC to require funds that have websites to disclose information concerning sales charge breakpoints on their websites. In its submission to the SEC, the Institute expressed the view that a fund should be permitted to comply with the proposed requirement by posting on its website a prospectus that complies with the proposed enhanced prospectus disclosure requirements. 6 In addition to setting forth the Institute's proposed amendments to Form N-1A, the attachment to this memorandum includes sample prospectus disclosures developed by the working group that are intended to assist Institute members in crafting or enhancing their prospectus disclosures. 3 recommends that mutual funds voluntarily undertake this review and make any necessary revisions to their prospectus disclosure as soon as reasonably practicable (e.g., in filings of their annual prospectus updates with the SEC). The Institute also recommends, consistent with the Task Force's recommendations, that mutual funds with websites provide "quick and obvious" links from their website home pages to breakpoint information. If you have any questions concerning these recommendations, please contact either Frances Stadler (frances@ici.org; 202-326-5822) or Tamara Salmon (tamara@ici.org; 202-326- 5825). Tamara K. Salmon Senior Associate Counsel Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 16806, or call the ICI Library at (202) 326-8304 and request the attachments for memo 16806. Attachment no. 1 (in .pdf format)

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