

MEMO# 5423

December 27, 1993

SEC PROPOSED RULES GOVERNING MULTIPLE CLASS AND MASTER-FEEDER FUNDS

1December 27, 1993 TO: ACCOUNTING/TREASURERS COMMITTEE NO. 40-93 OPERATIONS
COMMITTEE NO. 36-93 SEC RULES COMMITTEE NO. 115-93 RE: SEC PROPOSED RULES
GOVERNING MULTIPLE CLASS AND MASTER-FEEDER FUNDS

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, "subject to conditions intended to prevent investor confusion, assure fair expense allocation and voting rights, and prevent conflicts of interest among classes." (Under the proposal, multiple class funds with existing exemptive orders would be allowed to use the rule but would not be required to do so.) The Commission also proposed amendments to rules under the Investment Company Act and the Securities Act, to Form N-1A, and to related forms to establish disclosure requirements for multiple class and master-feeder funds. (These disclosure requirements would apply to all multiple class funds, including those with existing exemptive orders.) A copy of the Commission's proposing release is attached. 1. Disclosure Under the Commission's proposal, prospectuses, advertisements, and sales literature for multiple class and master-feeder funds would have to include a prominent legend discussing the existence of other classes, the fact that sales charges, expenses and performance vary, and a toll-free telephone number investors may use to obtain information concerning other classes or feeder funds. The prospectuses (but not the advertisements or sales literature) would have to name the other classes or feeder funds. If any classes or feeder funds "are offered or made available through the same broker, dealer, bank, or other financial intermediary" and "have alternative arrangements for sales and related charges," the prospectus for each class or feeder fund would have to provide full cross-disclosure about the others in response to Items 2 through 9 of Form N-1A. The prospectus also would have to contain a line graph comparing the initial account value at the beginning of a hypothetical ten-year period with the subsequent account values at the end of each of the intervening years, assuming a \$10,000 investment in each class or feeder fund at the beginning of the first year, redemption on the last day of each year, and a 5% annual return before operating expenses for all such classes or feeder funds. An amendment to Securities Act Rule 482 would require multiple class and master-feeder fund advertising that contains performance figures to include with equal prominence the performance of all classes and feeder funds that are subject to the full cross-disclosure requirement. If an advertisement is for a class or feeder fund for which average accrued total return "is available for less than . . . one, five, and ten year periods," Rule 482 would require the advertisement 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 proposal also would revise the Commission's recent proposal to permit the use of summary prospectuses that contain a purchase application. Under the new proposal, multiple class and master-feeder funds could use the summary prospectus, provided they include the line graph that would be required in the statutory prospectus and discuss the differences among classes or feeder funds offered by the same financial intermediary and that have alternative arrangements for sales and related charges. The release requests comment on whether the Commission should require multiple class and master-feeder funds to deliver a prospectus or some shorter document, such as the summary prospectus, before each sale.

2. Rule 18f-3 Proposed Rule 18f-3 would require each class relying on the rule to:

- have a different arrangement for distribution or shareholder services;
- bear all of the expenses of its arrangement;
- have the exclusive right to vote on matters relating solely to its arrangement;
- vote separately on matters in which the interests of that class are different from the interests of any other class.

In all other respects, fund shareholders would have to be given the same rights and obligations regardless of class. All income, gains and losses, and expenses of the fund other than class expenses must be allocated to each class on the basis of relative net asset value. Proposed Rule 18f-3 would require the fund to adopt a written plan specifying all the differences among classes. The board of directors, including a majority of the independent directors, would have to approve the plan before issuance of multiple classes and annually thereafter.

3. Exchange Privileges and Conversions Proposed Rule 18f-3 would permit multiple class funds to offer different exchange privileges to different classes and to offer one or more classes with conversion features. Conversions would have to be made at net asset value and any material increase in Rule 12b-1 fees charged to the class into which the purchase class converts would have to be approved by a separate vote of the purchase class.

4. Rule 12b-1 The Commission has proposed to amend Rule 12b-1 by providing that if a plan covers more than one class of shares, the provisions of the plan must be severable for each class and any action taken on the plan must be taken separately for each class. * * *

The comment period for the proposal ends 60 days after its publication in the Federal Register. The Institute will hold a meeting to discuss the proposal on January 13, 1994, at 10 a.m., at Loews L'Enfant Plaza, 480 L'Enfant Plaza, S.W., Washington, D.C. The meeting will be held in the Monet room. If you plan to attend, please contact Shirley McCoy at the Institute (202/326-5820) (fax 202/326-5827/28). Thomas M. Selman Assistant Counsel Attachment