

MEMO# 1852

April 18, 1990

NASD PROPOSED RULE ON ASSET BASED SALES CHARGES

- 1 - April 18, 1990 TO: BOARD OF GOVERNORS NO. 27-90 SEC RULES MEMBERS NO. 30-90
RE: NASD PROPOSED RULE ON ASSET BASED SALES CHARGES

As you know, the SEC proposed substantial amendments to Rule 12b-1 in June 1988. (See Institute memorandum to Board of Governors No. 43-88, SEC Rules Members No. 35-88, Operations Committee No. 20-88, Accounting/Treasurers Advisory Committee No. 22-88, Marketing Committee No. 21-88, Sales Force Marketing Committee No. 24-88 and Direct Marketing Committee No. 23-88 dated June 17, 1988.) In its comment letter on the proposed amendments, the Institute suggested that the NASD propose a rule governing the payment of 12b-1 fees pursuant to its authority to regulate sales charges on mutual fund shares. (See Institute memorandum to Board of Governors No. 59-88, Members - One Per Complex No. 49-88 and SEC Rules Committee No. 52-88 dated September 21, 1988.) The attached notice to NASD members proposes a rule that would subject asset based sales charges to the NASD maximum sales charge limits. The proposal is designed to achieve approximate economic equivalence between the maximum permitted front-end sales load and an asset based sales charge (possibly combined with a front-end load and/or a contingent deferred sales charge). The proposed rule adopts a fund level rather than an individual shareholder accounting approach. Since this approach could cause certain long-term shareholders of a fund to pay more than the economic equivalent of the maximum front-end sales load, the NASD proposal indicates that this possibility should be prominently disclosed in a fund's prospectus. Under the proposal, a cap of 6.25 percent of new gross sales, plus interest thereon, would be imposed on funds which pay a continuing "service fee" not in excess of 25 basis - 2 - points. The cap would be 7.25 percent of new gross sales for funds which do not pay a service fee. The recommended interest rate is prime plus .25 percent. An annual cap of .75 percent of net assets would also be imposed on any asset-based sales charge imposed by a fund. In the case of underwriters that have outstanding liabilities from sales prior to the date of adoption of the rule, such liabilities and any permissible new charges could be amortized over time within the limit of the 75 basis point maximum annual fee and any contingent deferred sales charges. No interest charges would be permitted on liabilities incurred in connection with sales prior to adoption of the proposal. Once the maximum caps have been reached, the proposal states that any contingent deferred sales charges would have to be paid to the fund. The proposal further states that an NASD member would be prohibited from describing a fund with an asset based sales charge or a contingent deferred sales charge as "no-load" or as having "no sales charge". The NASD has invited comments on the proposal from all members and interested persons. Since comments must be filed no later than May 31, 1990, I would appreciate receiving any suggestions for inclusion in the Institute's letter of comment by May 22nd. We will keep you informed of developments.

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