

MEMO# 1948

June 4, 1990

INSTITUTE COMMENT LETTER ON NASD 12B-1 PROPOSAL

June 4, 1990 TO: BOARD OF GOVERNORS NO. 39-90 SEC RULES MEMBERS NO. 40-90 RULE 12b-1 AD HOC COMMITTEE RE: INSTITUTE COMMENT LETTER ON NASD 12b-1 PROPOSAL

In response to the recent proposal by the NASD to extend its sales load regulation to asset-based distribution fees, the Institute has filed the attached comment letter. (See Institute memorandum to Board of Governors No. 27-90 and SEC Rules Members No. 30-90, dated April 18, 1990.) The letter notes the strong support for the proposal by the Institute's ad hoc committee on Rule 12b-1, while urging the adoption of certain clarifications. Specifically, the following modifications to the proposal were suggested:

1. Sales Occurring Prior to the Effective Date The language of the proposed NASD rule does not discuss the treatment of distribution expenses incurred in connection with sales prior to the effective date of the rule, although the introduction to the rule indicates that such prior expenses could be recovered. To clarify this issue, the letter proposes an addition to the rule that would expressly permit the payment of distribution expenses incurred in connection with prior sales, to the extent authorized by 12b-1 plans, provided that these payments do not exceed the aggregate cap that would have existed if the rule were applied retroactively.
2. Treatment of Interest Although the proposed rule permits interest charges to be added to the aggregate cap applicable to sales after the effective date of the rule, it does not permit interest to be added to deferred amounts attributable to sales prior to the effective date. The comment letter opposes this distinction between old and new sales and urges an amendment permitting - 2 - interest charges on both amounts at the rate of prime plus 1 percent.
3. The Definition of Sales Charges The NASD proposal suggests that members may be required to ascertain whether any part of an investment company's management fee is used for sales or sales promotion expenses. The comment letter urges a clarification that would permit NASD members to rely on the sales-related fees and charges disclosed in an investment company's prospectus to determine the amount of sales charges paid by such company.
4. Accommodation of Alternatives Because the NASD proposal does not provide investment companies with the flexibility to adopt sales charge structures which do not comply with all of the terms of proposed rule, the letter recommends an amendment to the rule that would establish an NASD procedure to permit approved alternatives. The standard proposed for reviewing a nonconforming asset-based sales charge structure would be a finding of economically equivalent protection to that provided by the rule.
5. The Definition of Service Fees The NASD proposal defines service fees not subject to the maximum caps as payments for "personal, continuing service to investors". The comment letter proposes the use of the term "account maintenance fees" in lieu of "service fees", since this phrase more accurately describes the purpose of the fees.
6. Use of No-Load Terminology The NASD proposal would prohibit the use of no-load terminology with respect to any investment

company with a deferred or asset-based sales charge. The letter urges an exception to this prohibition if the combination of asset-based sales charges and account maintenance fees does not exceed 25 basis points a year. The comment letter also addresses other issues relating to the NASD proposal, such as the treatment of exchanges and the effective date of the rule. We will keep you informed of developments. Catherine L. Heron Deputy General Counsel Attachment

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