

MEMO# 9149

August 11, 1997

PROPOSED AMENDMENTS TO NASD SALES CHARGE RULES

1 NASD Notice to Members 97-48 (August 1997). In the same notice, NASDR proposes certain changes to Conduct Rule 2820, governing the sale and distribution of variable insurance contracts. [9149] August 11, 1997 TO: DIRECT MARKETING COMMITTEE No. 17-97 SALES FORCE MARKETING COMMITTEE No. 17-97 RE: PROPOSED AMENDMENTS TO NASD SALES CHARGE RULES

NASD Regulation, Inc. is soliciting comments on proposed amendments to NASD Conduct Rule 2830, governing the sale and distribution of investment company securities ("Investment Company Rule"). The amendments would: (1) impose maximum aggregate sales charge limits on funds of funds; (2) permit installment loads; (3) prohibit loads on reinvested dividends; (4) reinstate a requirement specifying the order in which shares subject to a contingent deferred sales load ("CDSL") must be redeemed; and (5) eliminate a disclosure requirement regarding the effect of asset-based sales charges. A copy of the notice describing the proposed amendments is attached,¹ and it is summarized below. As indicated in the attached notice, the National Securities Markets Improvement Act of 1996 and the 1996 amendments to Rule 6c-10 under the Investment Company Act (governing deferred sales loads) provided mutual funds with greater flexibility in structuring their distribution arrangements. Changes to the sales charge provisions of the Investment Company Rule are necessary, however, before funds may take advantage of this additional flexibility. Funds of Funds The National Securities Markets Improvement Act amended the Investment Company Act to relax existing restrictions on fund of funds arrangements, subject to certain conditions. To address potential layering of sales charges, Section 12(G)(i)(III) requires that either: (1) if the acquiring fund charges a sales load or other distribution-related fees, it does not incur such charges at the underlying fund level; or (2) if such fees are charged at both levels, in the aggregate they do not exceed NASD sales charge limits. NASDR is proposing to amend the Investment Company Rule to provide that in a fund of funds arrangement, either the acquiring fund or the underlying fund, or both, may charge an asset-based sales charge that in the aggregate does not exceed .75% per annum of average annual net assets and a service fee that in the aggregate does not exceed .25% of average annual net assets. In addition, aggregate front- end and deferred sales charges would be limited in any transaction to 7.25% (or 6.25% if a ²service fee is charged). As proposed, no cumulative limits would apply to fund of funds sales charges. NASDR requests comment, however, on whether a cumulative cap should apply and if so, how it could be calculated. Comment also is requested on the treatment of "master- feeder" funds, which are included in the proposed definition of "fund of funds." Installment Loads As the Institute recommended in a letter to NASDR last year, NASDR proposes to amend the Investment Company Rule to conform the definition of "deferred sales charge" (which

currently would not include an installment load) to the definition of "deferred sales load" in Rule 6c-10 (which does include installment loads). This change would subject a fund with an installment load to the NASD sales charge limits (as required by Rule 6c-10) and to the prohibition on describing a fund as "no load" if it has a deferred sales charge. Loads on Reinvested Dividends NASDR proposes to prohibit funds from charging loads on reinvested dividends. (Front-end loads on reinvested dividends currently are permitted; deferred loads on reinvested dividends would be permitted by Rule 6c-10 if covered by the NASD sales charge limits.) The attached notice indicates that the proposed prohibition is based on a concern that loads on reinvested dividends typically cause an investor to pay a charge twice on the same assets and could exceed the appropriate sales charge limits. CDSL Calculations Before it was amended last year, Rule 6c-10 required that in the case of a partial redemption, a CDSL must be calculated as though shares not subject to a load are redeemed first and remaining shares are redeemed in the order purchased. NASDR proposes to reinstate this requirement but permit use of another method if the redeeming shareholder would pay a lower CDSL. Prospectus Disclosure NASDR proposes to delete the current requirement for any fund with an asset-based sales charge to disclose in its prospectus that long-term investors may pay more than the economic equivalent of the maximum permitted front-end sales charges. NASDR cites the SEC's recent proposed changes to Form N-1A, which would require prospectus disclosure along the same lines. Frances M. Stadler Associate Counsel Attachment