MEMO# 8237

September 13, 1996

PROPOSED AMENDMENTS TO RULE 18F-3 AND RULE 12B-1

September 13, 1996 TO: ACCOUNTING/TREASURERS COMMITTEE No. 36-96 SEC RULES COMMITTEE No. 100-96 RE: PROPOSED AMENDMENTS TO RULE 18f-3 AND RULE 12b-1 _____ The SEC recently issued the attached proposed amendments to Rule 18f-3 relating to accounting allocation methods permitted under the rule. The proposed amendments would expand and clarify the methods a fund may use to allocate income, gains and losses, and fundwide expenses among its classes. The proposed amendments also would clarify the voting rights of "purchase" class shareholders regarding any proposed "target" class fee increase. In addition, a proposed amendment to Rule 12b-1 would clarify that a series funds Rule 12b-1 plan must be severable for each series and that whenever an action is required with respect to the plan, that action must be taken separately for each series. Comments must be filed with the SEC within 60 days after publication of the proposed amendments in the Federal Register. If there are any issues you would like the Institute to consider addressing in its comment letter, please call the undersigned at (202) 326-5851 or Frances Stadler at (202) 326-5822 by Friday, October 18th. Accounting Allocation Methods Rule 18f-3 generally requires a fund to allocate income, gains and losses, and fundwide expenses based on the net assets of each class in relation to the net assets of the fund. The rule permits funds that declare daily dividends to use two alternative allocation methods, provided the fund maintains the same NAV per share in each class. Daily dividend funds may allocate income, gains and losses, and fundwide expenses (a) to each share without regard to class, or (b) on the basis of relative net assets of settled shares (i.e., excluding the value of subscriptions receivable). Many daily dividend funds pay dividends from net investment income only on settled shares. The settled share allocation method enables daily dividend funds to allocate net investment income consistent with their dividend policy. The proposed amendments would permit a daily dividend fund to use the settled shares method without requiring the fund to maintain the same NAV per share in each class. Some daily dividend funds currently use the settled shares method pursuant to exemptive orders that predate adoption of Rule 18f-3. These funds are unable to rely on Rule 18f-3 since they typically do not maintain the same NAV per share. Also, use of the settled shares method to allocate gains and losses may cause a divergence of NAV among classes where one class experiences a high level of capital share activity relative to other classes. The proposed amendments would permit funds to allocate gains and losses based on relative net assets, while using the settled shares method for allocating income and fundwide expenses. The proposed amendments also would permit funds to allocate income, gains and losses, and fundwide expenses based on an additional method, the simultaneous equations method. This allocation method ensures that the annualized rate of return of each class will differ from that of the other classes only by the expense differential among the classes. Appendix

A to the attached release includes an example of the simultaneous equations method. The attached release requests comment on these methods and whether there are any other methods that should be included in the rule. The release also requests comment on the rules overall approach of describing specific allocation methods. It inquires whether, alternatively, the rule should permit a fund to use any method that results in shareholders of each class receiving their proportionate share of income, gains and losses, and fundwide expenses. Under this approach, for example, the rule would permit allocations to be based on any method that is fair to the shareholders of each class. The release also seeks comments on whether the rule should require a particular party (e.g., the funds adviser, independent accountants, or board of directors) to determine that the applicable standard has been met. Purchase Class Voting Rights The SEC also proposes to amend Rule 18f-3 to clarify the voting rights of shareholders in a class ("purchase class") that will automatically convert into another class ("target class") after a specified period of time. The rule currently provides that if expenses, including distribution fees, are increased materially for the target class without approval of the shareholders of the purchase class, the fund will establish a new target class for the purchase class on the same terms as applied to the target class before the increase. A literal reading of the provision suggests that approval by purchase class shareholders (or the creation of a new target class) is required for any material expense increase that applies to the target class, even if shareholder approval would not otherwise be required (e.g., transfer agency fees) or shareholder approval would be required on a fundwide basis (e.g., advisory fees). The amendment would clarify the SECs intention that purchase class shareholders have voting rights, or rights to a new target class, only with respect to increases in expenses that are submitted separately for approval by target class shareholders. Rule 12b-1 Finally, the SEC proposes to amend Rule 12b-1 to codify its position that the requirements of that rule apply separately to each series offered by a fund. Currently, Rule 12b- 1(g) specifically provides that if a Rule 12b-1 plan covers more than one class, the provisions of the plan must be severable for each class, and that actions required to be taken under the rule must be taken separately for each class. The amendment would add references to series to this provision. Gregory Smith Director - Operations/Compliance & Fund Accounting 3Attachment