

## COMMENT LETTER

February 5, 2004

# ICI Comments on Enhanced Breakpoint Disclosure Requirements (pdf)

February 5, 2004 Mr. Jonathan G. Katz Secretary U.S. Securities and Exchange Commission  
450 Fifth Street, NW Washington, DC 20549-0609 Re: Disclosure of Breakpoint Discounts by  
Mutual Funds; File No. S-7-28-03\_\_\_\_\_ Dear Mr. Katz: The Investment Company Institute<sup>1</sup>  
appreciates the opportunity to comment on the Securities and Exchange Commission's  
proposal to amend Form N-1A, the registration form for mutual funds under the Investment  
Company Act of 1940,<sup>2</sup> to require enhanced disclosure in mutual fund prospectuses of  
specified information relating to sales load breakpoint discounts that are available to  
investors. The Institute supports the Commission's proposal. We believe the enhanced  
disclosures will benefit investors by better educating them about sales charge breakpoint  
discounts for which they may be eligible. While we support adoption of the proposed  
amendments, we recommend that the proposed disclosure of website information in the  
prospectus be revised as discussed below. BACKGROUND: THE JOINT NASD/INDUSTRY TASK  
FORCE ON BREAKPOINTS In late 2002 and early 2003, regulatory investigations revealed  
instances in which mutual fund investors did not receive the benefit of sales charge  
discounts to which they were entitled. These findings led to the formation of a Joint  
NASD/Industry Task Force on Breakpoints, made up of high-level representatives from  
NASD, mutual funds, transfer agents, and broker-dealers. As discussed in the Proposing  
Release, the proposed amendments to Form N-1A had their genesis in the report that was  
published by this Task Force, Report of the Joint NASD/Industry Task Force on Breakpoints  
(the "Report") in July 2003, which included thirteen recommendations <sup>1</sup> The Investment  
Company Institute is the national association of the American investment company  
industry. Its membership includes 8,672 open-end investment companies ("mutual funds"),  
605 closed-end investment companies, 108 exchange-traded funds and 6 sponsors of unit  
investment trusts. Its mutual fund members have assets of about \$7.149 trillion. These  
assets account for more than 95% of assets of all U.S. mutual funds. Individual owners  
represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6  
million households. <sup>2</sup> SEC Release Nos. 33-8347 and IC-26298 (Dec. 17, 2003) (the  
"Proposing Release"). Mr. Jonathan G. Katz February 5, 2004 Page 2 of 4 designed to ensure  
that investors receive all sales charge discounts to which they are entitled. Included among  
these recommendations were two relating to enhancing mutual fund prospectus and  
website disclosure of breakpoint opportunities.<sup>3</sup> In the absence of a regulatory mandate,  
the Report recommended that mutual funds implement these recommendations on a  
voluntary basis. Consistent with the Task Force's recommendation that their recommended  
reforms be implemented as soon as practicable, in November 2003, the Institute sent a  
memorandum to each of our members recommending that they enhance their prospectus  
and website disclosure as recommended by the Task Force as soon as reasonably

practicable. Contemporaneous with this recommendation, the Institute filed a submission with the Commission recommending specific revisions to Form N-1A to implement Task Force Recommendations C and G. The Institute commends the Commission for acting expeditiously to formally implement the Task Force's recommendations relating to prospectus disclosure, and we are pleased to note that its proposal is substantively similar to the Form N-1A revisions that we recommended that our members follow. THE COMMISSION'S PROPOSED AMENDMENTS As proposed, Form N-1A would be revised to require more complete and extensive disclosure about breakpoint eligibility in a fund's prospectus. In particular, prospectuses would be required to include brief descriptions in a plain English format of specified information that is necessary for investors to understand what breakpoints are, how they operate and are calculated, and the role of the investor and his or her financial intermediary in ensuring that the investor obtains all breakpoints to which he or she is eligible. These disclosures, when coupled with the other disclosures recommended by the Task Force, will benefit investors by ensuring that they are amply aware of and knowledgeable about breakpoint opportunities.<sup>4</sup> In our view, the amendments proposed by the Commission strike the appropriate balance between the 3 In particular, Task Force Recommendation C recommended that the SEC require mutual funds to provide the critical data regarding pricing methods, breakpoint schedules and linkage rules in their prospectuses and on their websites in a prominent and clear format. It further recommended that mutual funds with websites "provide quick and obvious links to breakpoint information from their Web Site home pages." Recommendation G generally recommended that the SEC mandate that a fund's prospectus disclose that investors may need to provide their broker/dealers with the information necessary to take full advantage of breakpoint discounts. In August, the NASD wrote to the Commission to request formally that the SEC adopt rules requiring mutual funds to make the disclosures described in Recommendations C and G. 4 In addition to enhanced prospectus disclosure, the Task Force recommended that all mutual fund confirmation statements include a legend alerting investors to the availability of breakpoints and that financial intermediaries provide each mutual fund investor, at the point of sale and annually thereafter, a disclosure document describing breakpoint opportunities. The Commission has proposed new Rule 15c2-2 under the Securities Exchange Act of 1934 to require mutual fund confirmations to include specific information relating to breakpoint discounts. See SEC Release No. 33-8358, 34-49148, and IC-26341 (Jan. 29, 2004). A copy of the disclosure document developed by the NASD pursuant to this recommendation is available on the NASD's website at: [http://www.nasdr.com/pdf-text/bp\\_disclosure\\_statement.doc](http://www.nasdr.com/pdf-text/bp_disclosure_statement.doc). Also, pursuant to Recommendation J, the NASD has developed an outline to be used by broker-dealers to better educate their registered representatives about investor sales charge breakpoint discount opportunities. A copy of this outline may be found on the NASD's website at: [http://www.nasdr.com/breakpoints\\_training.asp](http://www.nasdr.com/breakpoints_training.asp). Mr. Jonathan G. Katz February 5, 2004 Page 3 of 4 disclosures that are necessary for retail investors and should appear in the fund's prospectus and those that are more appropriate for inclusion in the fund's Statement of Additional Information. PROPOSED DISCLOSURE RELATING TO A FUND'S WEBSITE The one aspect of the proposed disclosure that we recommend be revised is that relating to disclosure in the fund's prospectus about the breakpoint information that is available on the fund's website. As proposed under subparagraph (5) of Item 8(a) of Form N-1A, a fund's prospectus would have to disclose whether the fund's website disclosure of the fund's breakpoint information includes the same information that would be required to be set forth in the prospectus and statement of additional information and whether such website information (1) is provided free of charge, (2) is presented "in a clear and prominent format," and (3) "includes hyperlinks that facilitate access to the information." If the fund does not include breakpoint information on its website, the fund's prospectus disclosure

must “disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet website).” The Proposing Release requests comment on this proposed disclosure. We recommend that, instead, proposed subparagraph (5) of Item 8(a) only require a fund that includes breakpoint information on its website to state such fact in its prospectus and provide the website’s address.<sup>5</sup> Our recommendation is intended to ensure that the information included in the prospectus discussion of breakpoints is meaningful to investors. We are concerned that the disclosures that would be required by subparagraph (5) would not be particularly helpful to investors and could instead detract from the useful information that the Commission has proposed be included in the prospectus discussion of breakpoints. If a fund’s website includes information on breakpoints, investors should be aware of the availability of this information; but the prospectus should not be required to detail the contents or format of such website disclosure. We additionally note that this recommendation is consistent with the manner in which the Commission has proposed to require funds to disclose to investors in Form N-1A, if applicable, that information concerning a fund’s policies and procedures relating to portfolio holdings is available on the Fund’s website. As proposed, this disclosure in a fund’s prospectus would only be required to state that a description of the fund’s policies and procedures “is available . . . on the Fund’s website, if applicable.”<sup>6</sup>

**PROPOSED COMPLIANCE DATE** The Commission has proposed, upon adoption of the amendments to Form N-1A, to require all new registration statements and all post-effective amendments that are either annual updates to effective registration statements or that add a new series, filed on or after the 5 In addition, the prospectus of a fund without a website should not be required to state as part of the breakpoint discussion in the prospectus that the fund does not have a website. <sup>6</sup> See Proposed Item 4(d) of Form N-1A in SEC Release Nos. 33-8343 and IC-26287 (Dec. 11, 2003). Comments on this proposal were required to be filed with the Commission by Feb. 6, 2004. Mr. Jonathan G. Katz February 5, 2004 Page 4 of 4 effective date of the amendments to comply with the proposed amendments. The Proposing Release does not specify what the effective date of the amendments would be, however. In order to give funds sufficient time to fully comply with the new requirements, the Institute recommends that the compliance date for the new disclosures be no less than sixty days after the date of the adoption of the amendments. \* \* \* \* The Institute appreciates the opportunity to provide these comments in response to the Proposing Release. If you have any questions concerning these comments or would like additional information, please contact me at (202) 326-5825 or Frances Stadler at (202) 326-5822. Sincerely, Tamara K. Salmon Senior Associate Counsel