

## ICI Comments on Enhanced Breakpoint Disclosure Requirements, November 2003

November 20, 2003

Mr. Paul F. Roye  
Director  
Division of Investment Management  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, D.C. 20549

### Re: Sales Charge Breakpoint Disclosure Requirements

Dear Mr. Roye:

The Investment Company Institute<sup>1</sup> is writing to recommend that the Securities and Exchange Commission propose amendments to Form N-1A, as described below, to enhance the current requirements for disclosure in mutual fund prospectuses relating to sales charge discounts that are available to investors. The proposal is part of a series of ongoing efforts designed to ensure that mutual fund investors receive the benefits of any sales charge discounts to which they are entitled. The background and substance of the proposal are discussed below. Draft proposed amendments to Form N-1A are attached.<sup>2</sup>

## Background

Investors who purchase mutual funds with the assistance of a broker or other financial adviser usually pay sales charges to compensate these persons for the services they provide. Many funds allow investors to choose how and when they will make these payments by offering different classes of shares with different sales charge arrangements. Funds or classes that have a front-end sales charge—i.e., a sales charge that the investor pays at the time of purchase—often offer investors discounts from these charges at specified investment levels called “breakpoints.”

In late 2002 and early 2003, regulatory investigations revealed instances in which mutual fund investors did not receive the benefit of sales charge breakpoint discounts to which they were entitled.<sup>3</sup> 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. In July of this year, the Task Force issued a report making a series of recommendations designed to ensure that investors receive all applicable discounts.<sup>4</sup>

Two of the Task Force’s recommendations call for the SEC to mandate additional prospectus disclosure concerning breakpoint discounts.<sup>5</sup> In August, the NASD, on behalf of the Task Force, requested that the SEC adopt rules for this purpose.<sup>6</sup> To assist the SEC in fulfilling this request, the Institute has drafted the attached proposed amendments to Form N-1A, which were developed with the help of a working group composed of ICI and Securities Industry Association members.

We note that the Task Force’s recommendations also state that, in the absence of rules, mutual funds should voluntarily make the recommended disclosures.<sup>7</sup> Therefore, concurrently with submitting this proposal, the Institute is sending a memorandum to its members urging them, to the extent they have not already done so, to (1) review their prospectus and website disclosure and (2) make any changes that are necessary or appropriate to implement the Task Force’s recommendations and the Institute’s proposal as soon as reasonably practicable. To assist our members in crafting or evaluating their own prospectus disclosure, we are providing them with samples of prospectus language that we believe would comply with the proposed amendments to Form N-1A attached to this letter. We have included copies of these samples for your information.<sup>8</sup>

## Description of the Proposal

Item 8(a) of Form N-1A currently requires funds to provide their breakpoint schedules in their prospectuses. It permits, but does not require, additional information about breakpoint discounts to be set forth in the prospectus. The Institute's proposal would amend Item 8(a)(2) of Form N-1A to require additional breakpoint information, consistent with Task Force Recommendations C and G, in fund prospectuses.<sup>9</sup> The additional required information, which would have to appear in proximity to the breakpoint schedule, would include:

- a brief, plain-English description of any arrangements under which a typical fund investor may qualify for a breakpoint discount, such as rights of accumulation or letters of intent;
- if the fund has a website, a statement that information about sales load breakpoints also is available on the fund's website, as well as the website address;<sup>10</sup> and
- if applicable, a statement that additional information concerning sales load breakpoints is available in the fund's Statement of Additional Information (SAI) or from a broker or financial intermediary through which shares of the fund may be purchased or sold.

The proposed amendments also include proposed instructions that are intended to provide more specific guidance on the required contents of the description of breakpoint discounts. The instructions would require (1) disclosure of the types of accounts, account holders and fund holdings that may be aggregated to determine breakpoint eligibility, (2) disclosure of the basis upon which breakpoint eligibility is calculated (current net asset value, public offering price, or historical cost), and (3) disclosure to put investors on notice regarding any documentation that they might be required to produce in order to establish eligibility for breakpoint discounts.

As noted in the Task Force Report and the NASD Letter, it has been common for funds to include extensive disclosure concerning breakpoints in the SAI, and the Task Force does not recommend that all of this disclosure be included in fund prospectuses or on fund websites.<sup>11</sup> Therefore, the proposed amendments to Item 8(a) would require brief descriptions or summaries of the required information; funds would continue to be permitted to provide more detailed information about breakpoint discounts in their SAIs.

\* \* \*

Thank you for considering the Institute's proposal regarding prospectus disclosure of breakpoint discounts. If you have any questions or need additional information, please contact me at 202/326-5815, Frances Stadler at 202/326-5822, or Tamara Salmon at 202/326-5825.

Sincerely,

Craig S. Tyle  
General Counsel

cc: Cynthia M. Fornelli  
Deputy Director  
Division of Investment Management

Susan Nash  
Associate Director  
Disclosure and Insurance Product Regulation  
Division of Investment Management

U.S. Securities and Exchange Commission

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Regulatory Policy and Programs

Marc Menchel  
Executive Vice President and General Counsel  
Regulatory Policy and Oversight

Eric Moss

NASD

## ENDNOTES

<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"), 603 closed-end investment companies, 107 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.946 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

<sup>2</sup> See [Appendix A](#) to this letter.

<sup>3</sup> According to a report on these investigations, most of these situations did not appear to involve intentional misconduct. See Joint SEC/NASD/NYSE Report of Examinations of Broker/Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds, NASD, NYSE and SEC Office of Compliance Inspections and Examinations (March 2003).

<sup>4</sup> [Report of the Joint NASD/Industry Task Force on Breakpoints](#) (July 2003) ("Task Force Report").

<sup>5</sup> See Task Force Report Recommendation C ("Mutual Fund Prospectus and Web Site Disclosure") and Recommendation G ("Prospectus Disclosure Regarding Customer's Role in Assisting in Securing Breakpoint Discounts"). Recommendation C states, in part, that mutual funds should provide the critical data regarding pricing methods, breakpoint schedules and linkage rules in their prospectuses, that funds should provide quick and obvious links to breakpoint information from their website home pages and that the SEC should mandate prospectus and website disclosure by rule. Recommendation G generally provides that the SEC should mandate that a fund's prospectus disclose that investors may need to provide their broker/dealer with the information necessary to take full advantage of breakpoint discounts and provides examples of such information.

<sup>6</sup> See Letter from Mary L. Schapiro, Vice Chairman, NASD, President, Regulatory Policy & Oversight, Chairman, Joint Industry/NASD Task Force on Breakpoints, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated August 5, 2003 ("NASD Letter").

<sup>7</sup> Task Force Report at pp. 10 and 14.

<sup>8</sup> See [Appendix B](#) to this letter. We are not suggesting that the Commission incorporate this or any other sample disclosure in a rule proposal. Indeed, the Commission should make clear that funds are not required to use any particular specific wording.

<sup>9</sup> The proposal also would amend Item 3 of Form N-1A to permit funds to include a reference to breakpoint discounts in the fee table.

<sup>10</sup> This requirement is intended to implement those portions of Task Force Recommendations C and G that call for the SEC to require funds that have websites to disclose information concerning sales charge breakpoints on their websites. The Institute believes that a fund should be permitted to satisfy the proposed requirement relating to website disclosure by posting on its website a prospectus containing breakpoint disclosure that complies with the proposed amendments.

<sup>11</sup> Task Force Report at n.13, NASD Letter at n.1.