Federal Register

Wednesday,
December 24, 2003

Part III

Securities and Exchange Commission

17 CFR Parts 239 and 274
Disclosure of Breakpoint Discounts by Mutual Funds; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239 and 274

[Release Nos. 33–8347; 34–48939; IC–26298; File No. S7–28–03]

RIN 3235–AI95

Disclosure of Breakpoint Discounts by Mutual Funds

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing amendments to Form N–1A under the Securities Act of 1933 and the Investment Company Act of 1940 to require an open-end management investment company to provide enhanced disclosure regarding breakpoint discounts on front-end sales loads. Under the proposed amendments, an open-end management investment company would be required to describe in its prospectus any arrangements that result in breakpoints in sales loads and to provide a brief summary of shareholder eligibility requirements.

DATES: Comments must be received on or before February 13, 2004.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–28–03; this file number should be included in the subject line if electronic mail is used. All comments received will be posted on the Commission's Internet Web site (*http://www.sec.gov*) and made available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.[1]

FOR FURTHER INFORMATION CONTACT: Christian L. Broadbent, Senior Counsel, or Paul G. Cellupica, Assistant Director, Office of Disclosure Regulation, Division of Investment Management, (202) 942–0721, or with respect to questions about disclosure by financial intermediaries, Joseph P. Corcoran, Special Counsel, Office of Chief Counsel, Division of Market Regulation, at (202) 942–0073, at the Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') is proposing for comment amendments to Form N–1A (17 CFR 239.15A and 274.11A), the registration form used by open-end management investment companies to register under the Investment Company Act of 1940 (''Investment Company Act'') and to offer their securities under the Securities Act of 1933 (''Securities Act'').

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I. Introduction and Background

The shares of open-end management investment companies (''mutual funds'') are sold to investors in a variety of ways. Many shares are sold without a sales load, including shares sold directly by the fund and those sold through retirement plans. An estimated 37% of mutual fund shareholders purchase shares through a broker-dealer or another financial intermediary.[2] Fund shares sold through a broker-dealer or other intermediary often are subject to a front-end sales load. A front-end sales load is a sales charge that applies at the time the fund shares are purchased to compensate the broker-dealer that sells the fund shares, and is based on a percentage of the purchase price.

Mutual funds with a front-end sales load typically establish a schedule of sales load percentages that are used to calculate the sales load that an investor pays. Some mutual funds that charge front-end sales loads will charge lower sales loads for larger investments. For example, a fund might charge a 5% front-end sales load for investments up to $50,000, but charge a load of 4% for investments between $50,000 and $100,000 and 3% for investments exceeding $100,000. The investment levels required to obtain a reduced sales load are commonly referred to as ''breakpoints.''[3] A broker-dealer who sells fund shares to retail customers must disclose breakpoint information to its customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints.[4]

Each mutual fund company establishes its own formula for how it will calculate whether an investor is entitled to receive a breakpoint. Funds typically offer investors two principal options that enable them to take advantage of breakpoints in sales loads for purchases made over time: a letter of intent and a right of accumulation. A letter of intent is a written statement by an investor to a fund in which the investor states that he or she intends to purchase a stated dollar amount of fund shares over a specified period (frequently, 13 months). As a result, the investor is charged the reduced sales charge that applies to the total amount of the investor's intended purchase on his or her first purchase and all subsequent purchases. If a shareholder fails to fulfill his or her obligation to purchase the intended total dollar amount of fund shares, the shareholder must reimburse the discount.

A right of accumulation permits an investor to aggregate shares owned in related accounts in some or all funds in a fund family to reach a breakpoint discount. Funds typically allow

[1] We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

[2] Investment Company Institute, 2001 Profile of Mutual Fund Shareholders 13–14 (Fall 2001).

[3] Information for investors concerning mutual fund breakpoints—including how funds calculate breakpoints and the steps investors can take if they fail to receive the benefit of a breakpoint to which they were entitled—is available on the Commission's Web site at *http://www.sec.gov/answers/breakpt.htm.*

[4] *NASD Special Notice to Members 02–85* (Dec. 23, 2002) (directing all member firms to immediately review the adequacy of their existing policies and procedures to ensure that investors are charged the correct sales load on mutual fund transactions); *NASD Notice to Members 94–16* (Mar. 1994) (discussing the obligation of member firms to ensure that communications with customers are accurate and complete regarding mutual fund breakpoints). *See* NASD Conduct Rule 2110 (Standards of Commercial Honor and Principles of Trade) and NASD Conduct Rule IM–2830–1 (''Breakpoint'' Sales); *In the Matter of Application of Harold R. Fenocchio for Review of Disciplinary Action Taken by the NASD,* 46 SEC 279 (1976) (sustaining NASD's finding of violation of its Rules of Fair Practice where registered representatives failed to have customers execute a letter of intent or to inform them of their rights of accumulation in connection with mutual fund purchases).

investors to aggregate fund shares owned by a person or group of persons related to the investor (*e.g.,* family members). This option also gives a fund shareholder the ability to count earlier purchases of shares of funds in his or her accounts and in related accounts towards the reduction of the sales charge on a current purchase. A right of accumulation may often be combined with a letter of intent for further benefits.

Typically, a mutual fund values accounts in order to determine whether aggregate holdings have reached a sales load breakpoint using one of three methods: net asset value, public offering price, and historical cost. Most mutual fund families use the net asset value of an investor's holdings to determine whether a breakpoint discount is available. Some fund families, however, permit an investor's holdings to be valued using the public offering price, which is determined by adding the maximum front-end sales load charged to the net asset value. In addition, some fund families permit holdings to be valued based on the greater of market value (net asset value or public offering price) and historical cost, which is what the investor actually paid for a mutual fund at the time of purchase.

A mutual fund that offers breakpoint discounts must disclose its schedule of breakpoints in its prospectus.[5] A fund must disclose its aggregation rules for determining breakpoints, such as letters of intent and rights of accumulation, in either its prospectus or statement of additional information (''SAI'').[6]

In late 2002, the staffs of the Commission and the NASD identified concerns regarding the extent to which mutual fund investors were receiving breakpoint discounts, which were first uncovered by NASD's routine examination program. As a result, the Commission and NASD launched a multifaceted action plan to address these concerns.[7] First, broker-dealers were required to review the adequacy of their policies and procedures in this area, make necessary changes, and report information concerning their mutual fund businesses. Second, the Commission and NASD, along with the New York Stock Exchange (''NYSE''), initiated an examination sweep of 43 broker-dealers that sell front-end sales load mutual funds to evaluate whether samples of transactions received the sales load discounts offered by the fund. Third, NASD, the Securities Industry Association (''SIA''), and the Investment Company Institute (''ICI'') formed a task force to recommend ways in which the mutual fund and broker-dealer industries could prevent breakpoint problems in the future.

The Commission, NASD, and NYSE conducted their examination sweep of broker-dealers between November 2002 and January 2003. The examination revealed that most firms, in some instances, did not provide investors with breakpoint discounts for which they appeared to have been eligible.[8] Of the more than 9,000 transactions reviewed, examiners identified 5,515 transactions that appeared to be eligible for a reduced sales charge. Of these 5,515 transactions, examiners found 1,757 transactions that did not receive a breakpoint discount or appeared to have incurred other unnecessary sales charges (representing 20% of all the transactions reviewed, and 32% of the transactions that were eligible for a discount). For these 1,757 transactions, the average discount not provided was $364 per transaction. The most frequent causes for not providing a breakpoint discount involved problems with rights of accumulation, including not linking a customer's ownership of different funds in the same mutual fund family, not linking shares owned in a fund or fund family in all of a customer's accounts at the firm, and not linking shares owned in the same fund or fund family by persons related to the customer (*e.g.,* spouse, children) in accounts at the firm.[9]

The NASD formed the Joint NASD/Industry Task Force on Breakpoints together with the SIA and ICI in February 2003, to recommend ways in which the mutual fund and brokerage industries can assure that investors are not overcharged when they purchase funds with front-end sales loads.[10] The Task Force issued its report in July 2003.[11] Consistent with the findings of the joint examination sweep of broker-dealers, the Task Force reported that many of the significant challenges in applying breakpoints correctly were with respect to rights of accumulation. The Task Force explained that to deliver breakpoint discounts based on rights of accumulation, the parties involved with the transaction must be able to link the accounts containing shares eligible to be aggregated and to ascertain the value of the accounts in order to determine whether a shareholder has met sales load breakpoints. The Task Force identified particular challenges to delivering breakpoints based on investors' rights of accumulation. First, broker-dealers have experienced difficulty in accessing and understanding the terms upon which mutual funds allow investors to aggregate both their holdings and those of related parties to reach breakpoints. Second, broker-dealers and mutual funds must communicate to investors the terms concerning rights of accumulation, and broker-dealers must obtain from investors necessary information regarding accounts eligible to be linked and, if applicable, historical costs.[12]

To address the challenges in providing correct breakpoint discounts to investors, the Task Force provided 13 recommendations, including: That mutual fund companies take steps to make investors aware of the availability of breakpoint discounts; that broker-dealers adopt policies and practices to gather the appropriate information from investors so that they can take advantage of all available breakpoint discounts; that transfer agents and broker-dealers modify the systems used to execute mutual fund transactions; and that regulators and the mutual fund and securities industries continue to educate investors about breakpoint opportunities. Two of the recommendations called for Commission rules that would require a fund to disclose certain information regarding breakpoints in its prospectus

[5] Item 8(a)(1) of Form N–1A. Rule 22d–1 under the Investment Company Act (17 CFR 270.22d–1) permits a mutual fund to sell shares at prices reflecting scheduled breakpoints if it meets certain requirements, such as furnishing to existing shareholders and prospective investors the information regarding breakpoints required by applicable registration statement form requirements.

[6] Items 8(a)(2) and 18(a) of Form N–1A. The SAI is part of a fund's registration statement and contains information about a fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System.

[7] *SEC and NASD Action Plan on Mutual Fund Sales Load Charges,* Securities and Exchange Commission Press Release, Jan. 16, 2003, *http://www.sec.gov/news/press/2003–7.htm.*

[8] Securities and Exchange Commission *et al.,* Joint SEC/NASD/NYSE Report of Examinations of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds 14–15 (Mar. 2003) (hereinafter Joint Report), available at *http://www.sec.gov/spotlight/breakpoints.htm.*

[9] *Id.* at 1–2, 14–17.

[10] *NASD Announces Joint NASD/Industry Breakpoint Task Force,* NASD News Release, Feb. 18, 2003, *http://www.nasdr.com/news/pr2003/release_03_006.html.*

[11] *Joint NASD/Industry Breakpoint Task Force Issues Report,* NASD News Release, July 22, 2003, *http://www.nasdr.com/news/pr2003/release_03_030.html.*

[12] NASD *et al.,* Report of the Joint NASD/Industry Task Force on Breakpoints 5 (July 2003) (hereinafter Task Force Report), available at *http://www.nasdr.com/pdf-text/breakpoints_report.pdf.*

and on its Web site.[13] First, the Task Force recommended that the Commission require a mutual fund to provide critical data regarding pricing methods, breakpoint schedules, and linkage rules in its prospectus and on its website, in a prominent and clear format.[14] Second, the Task Force recommended that the Commission require a fund to disclose in its prospectus that an investor may need to provide his or her broker-dealer with the information and records necessary to take full advantage of breakpoint discounts. The information and records could be used to aggregate, for example, holdings in retirement accounts, holdings of related parties, and holdings in accounts at other broker-dealers. In addition, the Task Force recommended that, if funds permit investors to rely on historical costs, the Commission require the prospectus to advise the investor to keep records necessary to demonstrate historical costs.[15]

Today, the Commission is proposing rules that would implement these recommendations. Specifically, we are proposing to require a mutual fund to describe briefly in its prospectus any arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements. In addition, we are proposing to require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints. We are also proposing to require a mutual fund to state in its prospectus, if applicable, that in order to obtain a breakpoint discount, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary. Our proposals would also require a mutual fund to state in its prospectus whether it makes available on or through its website information regarding its sales loads and breakpoints. This enhanced disclosure is intended to assist investors in understanding the breakpoint opportunities available to them, and to alert investors as to the information that they may need to provide to funds and broker-dealers to take full advantage of all available breakpoint discounts. It also should help broker-dealers to access information about available breakpoint discounts.

II. Discussion

The Commission is proposing amendments to Form N–1A, the registration form for mutual funds, that would require enhanced disclosure regarding breakpoint discounts on front-end sales loads. These proposed disclosure requirements are intended to assist investors in receiving the benefit of any breakpoint discounts to which they are entitled. Nothing in the proposed amendments would eliminate, or diminish in any respect, a broker-dealer's obligations to its customers with respect to mutual fund breakpoints, including its obligations to disclose information about breakpoints.[16]

A. Disclosure of Arrangements That Result in Breakpoints in Sales Loads

We are proposing to revise Form N–1A to require a mutual fund to provide a brief description in its prospectus of arrangements that result in sales load breakpoints, including a summary of shareholder eligibility requirements. Currently, Item 8(a)(2) of Form N–1A requires disclosure of arrangements that result in breakpoints in, or elimination of, sales loads, including letters of intent and rights of accumulation. Item 8(a)(2) also requires that each class of individuals or transactions to which the arrangements apply be identified and that each different breakpoint be stated as a percentage of both the offering price and the amount invested. This information may be provided in either the prospectus or the SAI.

The proposed amendments would require that a mutual fund include the description required by Item 8(a)(2) of arrangements that result in breakpoints in, or elimination of, sales loads in its prospectus and not the SAI. We believe that information regarding breakpoints, which can significantly affect the cost of a shareholder's investment, should be included in the prospectus that is delivered to all shareholders. This will provide greater prominence to breakpoint disclosure than inclusion in the SAI, which is delivered to investors upon request. Our proposals would direct that prospectus disclosure regarding breakpoints be brief, in order to avoid overwhelming investors with excessively detailed information. Proposed Item 8(a)(2) would not require the prospectus to include the information currently required in the SAI regarding breakpoints for affiliated persons of the fund and breakpoints in connection with a reorganization.[17] This information would continue to be required in the SAI.

We are proposing to amend Item 18(a) of Form N–1A to require that information regarding breakpoint arrangements that is not included in the prospectus be included in the SAI. We are also proposing to modify Item 18(a) to conform the enumeration of types of special purchase plans or methods in that Item to the enumeration in Item 8(a)(2) of types of arrangements that result in breakpoints, so that references to ''dividend reinvestment plans,'' ''employee benefit plans,'' and ''redemption reinvestment plans'' would be added to Item 18(a) and ''services in connection with retirement

[13] The Task Force also made a number of recommendations to the NASD, NYSE, and mutual fund and brokerage industries. Working groups have been formed to address the other Task Force recommendations. *See, e.g., Breakpoints Training Outline, http://www.nasdr.com/breakpoints_training_outline.asp* (last modified Nov. 19, 2003) (training outline developed by NASD and working group in response to recommendation that broker-dealers provide enhanced training regarding mutual fund breakpoint discounts); *Breakpoints Checklist and Worksheet, http://www.nasdr.com/breakpoints_checklist.asp* (last modified Nov. 3, 2003) (checklist and worksheet designed by NASD and working group to assist member firms in implementing recommendations that broker-dealers require registered representatives to complete standardized checklists or worksheets, which record relevant account data, when executing transactions that carry front-end sales loads).

In addition, the NASD is heading an Omnibus Account Task Force consisting of members of the fund and brokerage industries, as well as other intermediaries, to study the issue of trading through omnibus accounts. Statement of William H. Donaldson, Chairman, U.S. Securities and Exchange Commission, Testimony Before the Senate Committee on Banking, Housing and Urban Affairs 14 (Nov. 18, 2003). Typically, a brokerage firm has one omnibus account with each of the mutual funds with which it does business and through which all of its brokerage customers purchase and redeem shares of those mutual funds. Consequently, these mutual funds do not have information on the identity of the underlying brokerage customer who is purchasing or redeeming the funds' shares. In the breakpoint context, omnibus accounts make it difficult for funds to track information about the underlying shareholder that might have entitled the shareholder to breakpoint discounts.

[14] Task Force Report, *supra* note 12, at 10.

[15] *Id.* at 13–14.

[16] *See supra* note 4 and accompanying text; *In re Russell C. Turek,* Exchange Act Release No. 45459 (Feb. 20, 2002) (Commission sanctioned registered representative for, among other violations, failing to inform customers of the availability of breakpoint discounts); *In re Mason, Moran & Co.,* Exchange Act Release No. 4832 (Apr. 23, 1953) (registrant claimed it complied with disclosure requirements of the federal securities laws by furnishing the customer with a prospectus which included breakpoint information; Commission held that while the prospectus requirements were intended to provide the investor with more information than had theretofore been generally available in the ordinary securities transaction, these requirements were not intended to abrogate the greater disclosure duties traditionally imposed on brokers and dealers in a fiduciary position).

[17] Proposed Instruction 3 to Item 8(a)(2) of Form N–1A. Item 13(d) of Form N–1A requires that a mutual fund disclose any arrangements that result in breakpoints in, or elimination of, sales loads for directors and other affiliated persons of the fund. Item 18(b) of Form N–1A requires that a mutual fund disclose any arrangements that result in breakpoints in, or elimination of, sales loads in connection with the terms of a merger, acquisition, or exchange offer made under a plan of reorganization.

plans'' would be eliminated from Item 18(a). The proposals would also add ''waivers for particular classes of investors'' to the enumeration in both Items 8(a)(2) and 18(a). To assist investors and financial intermediaries in finding all information about breakpoints, the prospectus would be required to state, if applicable, that additional information concerning sales load breakpoints is available in the SAI.

Our proposed amendments would add an instruction to require that the description of arrangements resulting in breakpoints include a brief summary of shareholder eligibility requirements. This summary would be required to include a description or list of the types of accounts (*e.g.,* retirement accounts, accounts held at other financial intermediaries), account holders (*e.g.,* immediate family members, family trust accounts, solely-controlled business accounts), and fund holdings (*e.g.,* funds held within the same fund complex) that may be aggregated for purposes of determining eligibility for sales load breakpoints. We believe that requiring such a summary of the eligibility requirements for sales load breakpoints in the mutual fund prospectus would assist investors and financial intermediaries in better understanding the ways in which investors may take full advantage of breakpoint opportunities.

We request comment generally on the proposed requirement to disclose in the prospectus arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements, and specifically on the following issues:

- Is the proposed requirement for a brief description in the prospectus of arrangements that result in breakpoints in, or elimination of, sales loads appropriate or necessary? Should this description include a brief summary of shareholder eligibility requirements with respect to sales load breakpoints? Is there any additional information that we should require? Would these proposed requirements benefit investors or other parties?
- As discussed above, our proposals would require a mutual fund to provide a brief description of arrangements that result in breakpoints in its prospectus, and would require any additional details regarding these arrangements in the SAI. Is this proposed division of disclosure regarding breakpoints appropriate? Is there information that would be required in the prospectus under our proposals that is more appropriate for the SAI, or vice versa? Is the information regarding breakpoints for affiliated persons of the fund and breakpoints in connection with a reorganization more appropriately included in the SAI or in the prospectus? Should we permit a mutual fund to choose whether to include information regarding breakpoints in either its prospectus or SAI? Should we require that all information regarding breakpoints be included in the prospectus? Would the breakpoint information that we propose to require in the prospectus detract from other important information in the prospectus? How should we strike a balance between requiring enhanced disclosure and not overwhelming investors with information that they do not consider important?
- Should the information we are proposing to require in the prospectus be required in another location, such as the confirmation, account statement, document provided by a financial intermediary prior to share purchases, or shareholder report?

B. Disclosure of Methods Used to Value Accounts

We are also proposing to require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, including the circumstances in which and the classes of individuals to whom each method applies.[18] The methods required to be disclosed, if applicable, would include historical cost, net amount invested, and offering price.[19] We believe that requiring a mutual fund to describe in its prospectus the methods that it uses to value accounts in determining breakpoint eligibility would assist investors and financial intermediaries in more effectively determining investors' eligibility.

We request comment generally on the proposed requirement to describe the methods used to value accounts and specifically on the following issues:

- Is our proposed requirement that a mutual fund describe the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints appropriate? Would our proposals provide sufficient information to investors? Should we require any additional information about these methods?
- Is the prospectus the most appropriate location for a description of the methods used to value accounts? Should we require or permit this disclosure to be included in the SAI, confirmation, account statements, shareholder reports, document provided by a financial intermediary prior to share purchase, or some other location?

C. Disclosure Regarding Information and Records Necessary to Aggregate Holdings

The proposals would also require a mutual fund to state in its prospectus, if applicable, that, in order to obtain a breakpoint discount, it may be necessary at the time of purchase for a shareholder to inform the fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints.[20] In addition, a mutual fund would be required to describe any information or records, such as account statements, that may be necessary for a shareholder to provide to the fund or his or her financial intermediary in order to verify his or her eligibility for a breakpoint discount. The description would be required to include, if applicable:

- Information or records regarding shares of the fund or other funds held in all accounts (*e.g.,* retirement accounts) of the shareholder at the financial intermediary;[21]
- Information or records regarding shares of the fund or other funds held in any account of the shareholder at another financial intermediary;[22] and
- Information or records regarding shares of the fund or other funds held at any financial intermediary by related parties of the shareholder, such as members of the same family or household.[23]

In addition, if a mutual fund permits breakpoints to be determined based on historical cost, it would be required to state in its prospectus that a shareholder should retain any records necessary to substantiate historical costs because the fund, its transfer agent, and financial intermediaries may not maintain this information.[24]

We believe that prospectus disclosure regarding the information or records that may be necessary for a shareholder to provide would facilitate the correct application of breakpoint discounts in transactions in which shares are

[18] Proposed Item 8(a)(3) of Form N–1A.

[19] *See* Section I, ''Introduction and Background,'' *supra* (discussing net asset value, public offering price, and historical cost methods of valuing accounts). We refer here to ''net amount invested'' rather than ''net asset value,'' and to ''offering price'' rather than ''public offering price,'' because these are the terms currently used in Form N–1A. *See* Instruction 3(a) and (b) to Item 8(a)(1) of Form N–1A.

[20] Proposed Item 8(a)(4)(i) of Form N–1A.

[21] Proposed Item 8(a)(4)(i)(A) of Form N–1A.

[22] Proposed Item 8(a)(4)(i)(B) of Form N–1A.

[23] Proposed Item 8(a)(4)(i)(C) of Form N–1A.

[24] Proposed Item 8(a)(4)(ii) of Form N–1A.

aggregated to meet sales load breakpoints. As the Task Force report noted, in order to deliver breakpoint discounts where investor eligibility is based on rights of accumulation, financial intermediaries must obtain the necessary information from investors regarding accounts that may be linked (and, if applicable, historical costs).[25] In addition, our proposed disclosure may heighten investors' awareness of the importance of maintaining records when breakpoints are determined using the historical cost method. The Task Force reported that broker-dealers would not generally have historical cost information for customer positions transferred into their firm or for positions held at another firm that a customer may be able to link in order to receive a breakpoint discount.[26] In addition, the fund and its transfer agent may not have historical cost information for shareholders, for example, in the many cases where a financial intermediary places an omnibus order to purchase and sell fund shares on behalf of all its customers without identifying individual customer transactions.

We request comment generally on the proposed disclosure requirement regarding information or records that may be necessary for a shareholder to provide and specifically on the following issues:

- Should we require a mutual fund to state in its prospectus that it may be necessary for a shareholder to inform the fund or a financial intermediary of the existence of accounts that are eligible to be aggregated to meet sales load breakpoints? Should we require a mutual fund to describe the information and records that it may be necessary for a shareholder to provide in order to verify his or her eligibility for breakpoint discounts? Is there any additional information that we should require in this description?
- Do the proposed disclosure requirements reflect the appropriate allocation of responsibility among the mutual fund, the financial intermediary, and the shareholder for ensuring that the shareholder obtains a breakpoint discount to which he or she is entitled? Will the proposed disclosures be adequate to enable shareholders to obtain the breakpoint discounts for which they are eligible, or would this proposed approach place too great a burden on shareholders?
- Is the prospectus the most appropriate location for the proposed disclosure regarding the need for a shareholder to inform the fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated, and the information and records necessary to aggregate holdings? Should we require or permit any, or all, of this disclosure to be included in the SAI? Should this disclosure be required in shareholder reports, confirmations, account statements, or a document delivered by a financial intermediary prior to a purchase of mutual fund shares? Should shareholders be notified periodically, *e.g.,* in shareholder reports or account statements, that it is their responsibility to monitor whether they have qualified for breakpoint discounts?

D. Disclosure of Availability of Sales Load and Breakpoint Information on Fund's Web Site

We are proposing to require that a mutual fund state in its prospectus whether it makes available free of charge, on or through its Web site at a specified Internet address, and in a clear and prominent format, the information that would be required regarding the fund's sales loads and breakpoints in the prospectus and SAI pursuant to Items 8(a) and 18(a), including whether the Web site includes hyperlinks that facilitate access to the information.[27] A mutual fund that does not make the sales load and breakpoint information available in this manner would be required to disclose the reasons why it does not do so (including, where applicable, that the fund does not have an Internet Web site).

This proposal is intended to encourage mutual funds to provide accessible Web site disclosure regarding the availability of breakpoint discounts to complement the prospectus disclosure regarding breakpoints that we are proposing. Modernizing the disclosure system under the Federal securities laws involves recognizing the importance of the Internet in fostering prompt and more widespread dissemination of information.[28] We believe that mutual fund disclosure should be more readily available to investors in a variety of locations to facilitate investor access to that information. We also believe that it is important for funds to make investors aware of the different sources that provide access to information about a fund. In addition, we believe that encouraging website disclosure of information regarding breakpoint discounts may assist broker-dealers and other financial intermediaries to more easily access and understand the terms upon which mutual funds allow investors to aggregate their holdings and the holdings of related parties.

Our proposal would require that the disclosure about website availability of sales load and breakpoint information indicate whether the information is in a clear and prominent format, including whether the website includes hyperlinks that facilitate access to the information. We believe that it is important for website disclosure regarding sales loads and breakpoint discounts to be clear and prominent, in order to help investors and financial intermediaries to find this information easily. Hyperlinks that facilitate access to the information may contribute to a clear and prominent presentation. Thus, websites could provide sales load and breakpoint information in a clear and prominent format by, for example, using clear and prominent hyperlinks that provide direct linkage to the relevant portions of the fund's prospectus and SAI or the specific pages on a third-party website containing the information.[29]

We request comment on the proposed requirement to disclose whether sales load and breakpoint information is available on or through a fund's website and specifically on the following issues:

- Is the proposed requirement for a mutual fund to state in its prospectus whether the required information regarding its sales loads and breakpoints is available on or through its Web site necessary or appropriate? Should a mutual fund that does not maintain a Web site be required to state that it does not make this information available because it does not have a Web site? What other disclosures in this area, if any, should funds be required to make?
- Is the prospectus the appropriate location for a mutual fund to provide the proposed disclosure regarding Web site availability? Would this disclosure be more appropriately located in the SAI, Form N–CSR, shareholder reports, account statements, confirmations, a document provided by a financial intermediary prior to share purchase, or another location?
- Should we require mutual funds with Web sites to include sales load and

[25] Task Force Report, *supra* note 12, at 5.

[26] *Id.* at 5 n.7.

[27] Proposed Item 8(a)(5) of Form N–1A.

[28] *See* Securities Act Release No. 8128 (Sept. 5, 2002) (67 FR 58480 (Sept. 16, 2002)) (adopting requirement for an operating company to disclose in its annual report on Form 10–K whether it makes available free of charge on or through its Web site its annual reports on Form 10–K, quarterly reports on Form 10–Q, current reports on Form 8–K, and amendments).

[29] *See* Securities Act Release No. 8128 (Sept. 5, 2002) (67 FR 58480, 58493 (Sept. 16, 2002)). We direct funds to this release for guidance concerning satisfaction of this requirement through hyperlinking to a third-party Web site.

breakpoint disclosure information on their Web sites?

• Are there other measures that we should consider in order to encourage mutual funds to provide disclosure regarding sales loads and breakpoints on their Web sites in a prominent and readily accessible manner?

• Are there other mechanisms besides prospectus and Web site disclosure to better inform investors about breakpoints to which they may be entitled (*e.g.,* requiring a financial intermediary to provide a document prior to share purchase that describes breakpoint discounts, or requiring this information to be included in shareholder reports, account statements, or confirmations)?

E. Presentation Requirements

Our proposals would require that the disclosure in Item 8(a)(2) regarding arrangements resulting in breakpoints in, or elimination of, sales loads, and all other sales load disclosure required by Item 8(a), be adjacent to the table of sales loads and breakpoints required by Item 8(a)(1).[30] This would include the description of sales loads required by Item 8(a)(1), as well as the information about breakpoints, including valuation methods, shareholder information and records, and Web site availability that would be required by proposed Items 8(a)(3), (4), and (5). The proposals also would require that a mutual fund present the information required by Item 8(a) in a clear, concise, and understandable manner, and include tables, schedules, and charts as expressly required by Item 8(a)(1) or where doing so would facilitate understanding.[31] These requirements are intended to encourage mutual funds to present information regarding sales loads and breakpoints in an integrated manner that will be easily understood by investors, which would address the Task Force recommendation that critical data regarding pricing methods, breakpoint schedules, and linkage rules be presented in a prominent and clear format.

General Instruction C.3.(a) to Form N–1A currently requires the information required by Item 8 to be in one place in the prospectus. This includes the information about sales loads and breakpoints required by Item 8(a)(1), information about 12b–1 fees required by Item 8(b), and information about multiple class and master-feeder funds required by Item 8(c). It does not include the information on breakpoints required by Item 8(a)(2) because this information may be included in the SAI or in a separate purchase and redemption document pursuant to Item 7(f). Item 7(f) of Form N–1A permits a mutual fund to omit from the prospectus information about purchase and redemption procedures required by Items 7(b)–(d)[32] and 8(a)(2) and provide it in a separate disclosure document if the fund delivers the document with the prospectus, incorporates the document into the prospectus by reference and files the document with the prospectus, and provides disclosure explaining that the information disclosed in the document is part of, and incorporated into, the prospectus.

Under our proposals, Item 7(f) would continue to permit the information required by Item 8(a)(2) to be included in a separate purchase and redemption document.[33] In addition, we are proposing to amend Item 7(f) to permit the information about breakpoints required by proposed Items 8(a)(3), (4), and (5) (*i.e.,* valuation methods, shareholder information and records, and Web site availability) to be included in the separate purchase and redemption document. We are also proposing to amend General Instruction C.3.(a) to Form N–1A to make it clear that this information may be disclosed in a separate purchase and redemption document, provided that all the information required by paragraphs 8(a)(2), (3), (4), and (5) is included in the separate document. This instruction will also clarify that if the information required by paragraphs 8(a)(2)–(5) is disclosed in a separate purchase and redemption document, the table of sales loads and breakpoints required by Item 8(a)(1) must be included in the separate purchase and redemption document, as well as the prospectus, in order to comply with the proposed requirement that all disclosure required by Item 8(a) be adjacent to the table of sales loads and breakpoints.

We request comment generally on the proposed requirements for presentation of information about sales loads and breakpoints and specifically on the following:

• Will our proposal to require that the disclosure regarding sales loads and breakpoints required by Item 8(a)(1) and (a)(2) be presented in a clear, concise, and understandable manner, and include tables, schedules, and charts where expressly required by Item 8(a)(1) or where doing so would facilitate understanding result in disclosure that is easily understood by investors? Are there additional requirements that we should adopt regarding the presentation of this information?

• Should we require that the sales load and breakpoint information required by Item 8 be adjacent to the table of sales loads and breakpoints required by Item 8(a)(1)? Are there other ways to ensure that all information related to breakpoints is provided in an integrated manner that will facilitate investor understanding? Should we adopt a ''close proximity'' or other standard instead of an ''adjacent'' standard?

• For a mutual fund that includes information about breakpoints in a separate purchase and redemption document, would the requirement that the table of sales load and breakpoint information required by Item 8(a)(1) appear in both the prospectus and the separate document result in unnecessary duplication? If so, how should we address this duplication, which arises from the existing requirement that the table be included in the prospectus along with other information currently required by Item 8 and the proposed requirement that all information about breakpoints be adjacent to the table? If we do not require the information about breakpoints required by proposed Items 8(a)(2)–(5) to be adjacent to the table, how should we address the Task Force recommendation that we require a mutual fund to provide critical data regarding pricing methods, breakpoint schedules, and linkage rules in a prominent and clear format? Should we require all information required by Item 8 to be in the prospectus? Should we permit all information required by Item 8 to be in the separate purchase and redemption document?

• Should we continue to permit the separate purchase and redemption document? Does this document facilitate investor understanding of the information it contains? We note that, in a recent release, we proposed to amend Item 7 to require new disclosure regarding frequent purchases and redemptions to be included in the prospectus and not a separate purchase and redemption document.[34] To what extent do funds currently use the separate purchase and redemption document? If we should continue to permit this document, what information

[30] Proposed Instruction to Item 8(a) of Form N–1A.

[31] *Id. Cf.* rule 421 under the Securities Act of 1933 (17 CFR 230.421) (plain English requirements for prospectuses).

[32] Items 7(b)–(d) require a description of the procedures for purchasing and redeeming the fund's shares, as well as the fund's policy with respect to dividends and distributions.

[33] We are, however, proposing to eliminate, as duplicative, the reference to this procedure in Item 8(a)(2).

[34] Investment Company Act Release No. 26287 (Dec. 11, 2003).

should it be permitted to include? Are there other means for effectively communicating purchase and redemption information to investors?

F. Compliance Date

If we adopt the proposed disclosure requirements, we expect 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 effective date of the amendments to comply with the proposed amendments. The Commission requests comment on this proposed compliance date.

III. General Request for Comments

The Commission requests comment on the amendments proposed in this release, whether any further changes to our forms are necessary or appropriate to implement the objectives of our proposed amendments, and on other matters that might have an effect on the proposals contained in this release.

IV. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*), and the Commission is submitting the proposed collection of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is: ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies.'' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Form N–1A (OMB Control No. 3235–0307) was adopted pursuant to section 8(a) of the Investment Company Act (15 U.S.C. 80a–8) and section 5 of the Securities Act (15 U.S.C. 77e). We are proposing amendments to Form N–1A to require a mutual fund to describe briefly in its prospectus any arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements. In addition, we are proposing to require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints. We are also proposing to require a mutual fund to state in its prospectus, if applicable, that in order to obtain a breakpoint discount, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary. Our proposals would also require a mutual fund to state in its prospectus whether it makes available on or through its Web site, and in a clear and prominent format, information regarding its sales loads and breakpoints. In addition, our proposals would require a mutual fund to provide prospectus disclosure regarding sales loads and breakpoints adjacent to the table of sales loads and breakpoints, and to present the information in a clear, concise, and understandable manner. This enhanced disclosure is intended to assist investors in understanding the breakpoint opportunities available to them, and to alert investors to the information that they may need to provide to funds and broker-dealers to take full advantage of all available breakpoint discounts.

Form N–1A, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are open-end funds registering with the Commission. Compliance with the disclosure requirements of Form N–1A is mandatory. Responses to the disclosure requirements are not confidential.

The current hour burden for preparing an initial Form N–1A filing is 809 hours per portfolio. The current annual hour burden for preparing post-effective amendments of Form N–1A is 101 hours per portfolio. The Commission estimates that, on an annual basis, registrants file initial registration statements on Form N–1A covering 483 portfolios, and file post-effective amendments on Form N–1A covering 6,542 portfolios. Additional burdens of 6,524 hours for the preparation and filing of initial registration statements and 49,065 hours for the filing of post-effective amendments are expected to result from the Commission's recent proposed rules relating to ''fund of funds'' arrangements, and the recent proposed rule relating to frequent purchases and redemptions of fund shares and selective disclosure of portfolio holdings.[35] Thus, the Commission estimates that the current total annual hour burden for the preparation and filing of Form N–1A is 1,107,078 hours.[36]

We estimate that the proposed amendments would increase the hour burden per portfolio per filing of an initial registration statement on Form N–1A by 2 hours and would increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement on Form N–1A by 1 hour. We also estimate that 30% of mutual fund portfolios would be affected by the proposed amendments.[37] The additional incremental hour burden resulting from the proposed amendments would be 2,252 hours (2 hours for initial registration statements × 483 portfolios × 30%) + (1 hour per post-effective amendment × 6,542 portfolios × 30%). Thus, if the proposed amendments to Form N–1A are adopted, the total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments to Form N–1A would be 1,109,330 hours (2,252 hours + 1,107,078 hours).

Request for Comments

We request your comments on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive

[35] *See* Investment Company Act Release No. 26198 (Oct. 2, 2003) (68 FR 58226 (Oct. 8, 2003)); Investment Company Act Release No. 26287 (Dec. 11, 2003).

[36] This estimate is based on the following calculation: (809 hours × 483 portfolios) + (101 hours × 6,542 portfolios) = 1,051,489 hours. An additional annual hour burden of 24,591 hours (1,694 hours for initial registration statements and 22,897 hours for post-effective amendments) resulting from the proposed rules described in the fund of funds proposing release, and an additional annual hour burden of 30,998 hours (4,830 hours for initial registration statements and 26,168 hours for post-effective amendments) resulting from the proposed rule relating to market timing and selective disclosure, yield a total annual hour burden of 1,107,078 hours.

[37] This estimate is based on information regarding the number of mutual fund portfolios with one or more classes of shares that have front-end sales loads, derived by the staff from Commission filings and third-party information sources.

Office Building, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0609, with reference to File No. S7–28–03. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release.

V. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. Our proposals would require mutual funds to provide enhanced disclosure regarding breakpoint discounts on front-end sales loads. Specifically, the proposals would:

- Require a mutual fund to describe briefly in its prospectus any arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements;
- Require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints;
- Require a mutual fund to state in its prospectus, if applicable, that in order to obtain a breakpoint discount, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary;
- Require a mutual fund to state in its prospectus whether it makes available on or through its Web site, and in a clear and prominent format, information regarding its sales loads and breakpoints; and
- Require a mutual fund to provide prospectus disclosure regarding sales loads and breakpoints adjacent to the table of sales loads and breakpoints, and to present the information in a clear, concise, and understandable manner.

A. Benefits

The proposed form amendments are expected to benefit mutual fund investors by providing them with enhanced disclosure about breakpoint discounts on front-end sales loads. This enhanced disclosure is intended to assist investors in understanding the breakpoint opportunities available to them, and to alert investors to the information that they may need to provide to funds and financial intermediaries to take full advantage of all available breakpoint discounts. An examination sweep by the Commission, the NASD, and the NYSE between November 2002 and January 2003 found that in 32% of the transactions reviewed that appeared to be eligible for a reduced sales charge, investors did not receive a breakpoint discount or appeared to have incurred other unnecessary sales charges.[38] The average discount not provided was $364 per transaction.[39] We anticipate that our proposals, if adopted, may result in a decrease in the number of transactions in which investors do not receive breakpoint discounts to which they are entitled.

Specifically, we believe that the proposed amendments relating to disclosure of arrangements that result in breakpoints in sales loads would benefit investors by requiring that information regarding breakpoints, which can significantly affect the cost of a shareholder's investment, be included in the prospectus that is delivered to all shareholders. In addition, the proposed requirement that this prospectus disclosure include a summary of the eligibility requirements for sales load breakpoints may assist investors in better understanding the ways in which they may take full advantage of breakpoint opportunities.

The proposed amendments relating to disclosure of methods used to value accounts in determining breakpoint eligibility also may benefit investors by assisting them and their financial intermediaries in more effectively determining investors' eligibility. Also, the proposed disclosure relating to information and records necessary to aggregate holdings may benefit investors because prospectus disclosure regarding the information or records that it may be necessary for a shareholder to provide may facilitate the correct application of breakpoint discounts in transactions in which shares are aggregated to meet sales load breakpoints. In addition, the proposed disclosure may heighten investors' awareness of the importance of maintaining records when breakpoints are determined using the historical cost method.

The proposed amendments relating to disclosure regarding the availability of sales load and breakpoint information on a mutual fund's Web site may benefit investors by encouraging mutual funds to provide accessible Web site disclosure regarding the availability of breakpoint discounts to complement the proposed prospectus disclosure regarding breakpoints. In addition, the proposed amendments relating to the presentation of disclosure regarding breakpoints may benefit investors by encouraging mutual funds to present information regarding sales loads and breakpoints in an integrated manner that will be easily understood by investors.

We seek comment on the benefits of the proposed amendments (and any alternatives suggested by commenters) as well as any data quantifying those benefits.

B. Costs

The proposals would impose new requirements on mutual funds that have front-end sales loads to provide several new prospectus disclosures regarding breakpoint discounts on these front-end sales loads. We estimate that complying with the proposed new disclosures would entail a relatively small financial burden. The information regarding breakpoint discounts should be available to management and the board of directors of a fund, and mutual funds already disclose much of the breakpoint disclosure that would be required by the proposed amendments in their registration statements (although they are not required to include this information in their prospectuses). Therefore, we expect that the cost of compiling and reporting this information should be limited.

Specifically, we are proposing amendments to Form N–1A to require a mutual fund to describe briefly in its prospectus any arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements. In addition, we are proposing to require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints. We are also proposing to require a mutual fund to state in its prospectus, if applicable, that in order to obtain a breakpoint discount, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary. Our proposals would also require a mutual fund to state in its prospectus whether it makes available on or through its Web site, and in a clear and prominent format, information regarding its sales loads and breakpoints.

The costs of adding these new prospectus disclosures may include both internal costs (for attorneys and other non-legal staff of a fund, such as computer programmers, to prepare and review the required disclosure) and external costs (for printing and typesetting of the disclosure). For purposes of the Paperwork Reduction Act, we have estimated that the proposed new disclosure requirements would add 2,252 hours to the total

[38] Joint Report, *supra* note 8, at 14–15.

[39] *Id.* at 16.

annual burden of completing Form N–1A.[40] We estimate that this additional burden would equal total internal costs of $101,903 annually, or approximately $48 per fund portfolio.[41]

We expect the external costs of providing the new prospectus disclosure will be limited, because the amendments relating to disclosure of arrangements that result in breakpoints in sales loads require the description of the arrangements to be brief. We expect that the proposed disclosure would not add significant length to the prospectus. We request comment on the nature and magnitude of our estimates of the costs of the additional disclosure that would be required if our proposals were adopted.

C. Request for Comments

We request comments on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of, or suggested alternatives to, the proposed amendments. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. Consideration of Effects on Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act (15 U.S.C. 80a–2(c)) and section 2(b) of the Securities Act (15 U.S.C. 77(b)) require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The proposed amendments are intended to provide greater transparency for mutual fund shareholders regarding breakpoint discounts on front-end sales loads. These changes may improve efficiency. The enhanced disclosure requirements are intended to assist investors in understanding the breakpoint opportunities available to them, and to alert investors to the information that they may need to provide to funds and financial intermediaries to take full advantage of all available breakpoint discounts, which could promote more efficient allocation of investments among mutual funds. The proposed amendments may also improve competition, as enhanced disclosure regarding the ways in which investors can aggregate holdings to meet sales load breakpoints may prompt investors to seek out mutual funds that offer the most favorable breakpoint schedules and aggregation rules for their particular circumstances, and may prompt funds to compete for the business of these better informed investors. Finally, the effects of the proposed amendments on capital formation are unclear.

Although, as noted above, we believe that the proposed amendments would benefit investors, the magnitude of the effect of the proposed amendments on efficiency, competition, and capital formation, and the extent to which they would be offset by the costs of the proposals, are difficult to quantify. We note that, with respect to our proposals, in many cases mutual funds currently provide disclosure in their registration statements regarding breakpoint discounts on front-end sales loads.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603, and relates to the Commission's proposed form amendments under the Securities Act and the Investment Company Act to require mutual funds to provide enhanced disclosure about breakpoint discounts on front-end sales loads. Specifically, the proposals would:

- Require a mutual fund to describe briefly in its prospectus any arrangements that result in breakpoints in sales loads, including a summary of shareholder eligibility requirements;
- Require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints;
- Require a mutual fund to state in its prospectus, if applicable, that in order to obtain a breakpoint discount, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary;
- Require a mutual fund to state in its prospectus whether it makes available on or through its Web site, and in a clear and prominent format, information regarding its sales loads and breakpoints; and
- Require a mutual fund to provide prospectus disclosure regarding sales loads and breakpoints adjacent to the table of sales loads and breakpoints, and to present the information in a clear, concise, and understandable manner.

A. Reasons for, and Objectives of, Proposed Amendments

The Commission is proposing rules to address the concerns that have been identified regarding the extent to which mutual fund investors receive breakpoint discounts. An examination sweep by the Commission, the NASD, and the NYSE between November 2002 and January 2003 found that in 32% of the transactions reviewed that appeared to be eligible for a reduced sales charge, investors did not receive a breakpoint discount or appeared to have incurred other unnecessary sales charges.[42] The enhanced disclosure that would be required by the Commission's proposed rules is intended to assist investors in understanding the breakpoint opportunities available to them, and to alert investors to the information that they may need to provide to funds and broker-dealers to take full advantage of all available breakpoint discounts.

B. Legal Basis

The Commission is proposing amendments to Form N–1A pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act (15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)), and sections 8, 24(a), 30, and 38 of the Investment Company Act (15 U.S.C. 80a–8, 80a–24(a), 80a–29, and 80a–37).

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same

[40] This estimate is based on the following calculation: (2 hours per initial registration statement × 483 portfolios × 30% of portfolios) + (1 hour per post-effective amendment × 6,542 portfolios × 30% of portfolios) = 2,252 hours.

[41] These figures are based on a Commission estimate that approximately 781 registered investment companies, with 2,108 portfolios, would file initial registration statements or post-effective amendments annually that would be subject to the proposed disclosure requirements, and an estimated hourly wage rate of $45.25. The estimate of the number of investment companies is based on data derived from the Commission's EDGAR filing system. The estimated wage figure is based on published compensation for compliance attorneys outside New York City ($37.60) and programmers ($29.44), and the estimate that attorneys and programmers would divide time equally on compliance with the proposed disclosure requirements, yielding a weighted wage rate of $33.52 (($37.60 × .50) + (29.44 × .50)) = $33.52). *See* Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2002* (Sept. 2002). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of $45.25 (33.52 × 1.35) = $45.25.

[42] Joint Report, *supra* note 8, at 14–15.

group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[43] Approximately 145 investment companies registered on Form N–1A meet this definition.[44]

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would require mutual funds that have front-end sales loads to provide several new prospectus disclosures regarding breakpoint discounts on these sales loads, as described above.

The Commission estimates some one-time formatting and ongoing costs and burdens that would be imposed on all mutual funds, including funds that are small entities. We note, however, that in many cases funds currently provide disclosure in their registration statements regarding breakpoint discounts. For purposes of the Paperwork Reduction Act, we have estimated that the proposed new disclosure requirements would increase the hour burden per portfolio per filing of an initial registration statement on Form N–1A by 2 hours and would increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 1 hour. We estimate that this additional burden would increase total internal costs of filing an initial registration statement by $91 per affected mutual fund portfolio annually, and would increase total internal costs of filing a post-effective amendment by $45 per affected mutual fund portfolio annually.[45]

We expect the external costs of providing the new prospectus disclosure will be limited, because some funds currently provide some of this information in their registration statements, and we do not expect that the disclosure will add significant length to the prospectus. The Commission solicits comment on the effect the proposed amendments would have on small entities.

E. Duplicative, Overlapping or Conflicting Federal Rules

There are no rules that duplicate, overlap, or conflict with the proposed amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small issuers. In connection with the proposed amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The proposed disclosure amendments would provide shareholders with greater transparency of breakpoint discounts on front-end sales loads. Different disclosure requirements for mutual funds that are small entities may create the risk that the shareholders in these funds would not be as able as investors in larger funds to assess the terms upon which breakpoint discounts in sales loads are offered. We believe it is important for the disclosure that would be required by the proposed amendments to be provided to shareholders by all mutual funds, not just funds that are not considered small entities.

We have endeavored through the proposed amendments to minimize the regulatory burden on all funds, including small entities, while meeting our regulatory objectives. Small entities should benefit from the Commission's reasoned approach to the proposed amendments to the same degree as other investment companies. Further clarification, consolidation, or simplification of the proposals for funds that are small entities would be inconsistent with the Commission's concern for investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. Solicitation of Comments

The Commission encourages the submission of written comments with respect to any aspect of this analysis. Comment is specifically requested on the number of small entities that would be affected by the proposed amendments and the likely impact of the proposals on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–28–03; this file number should be included on the subject line if E-mail is used. All comments received will be posted on the Commission's Internet Web site (*http://www.sec.gov*) and made available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549–0102.[46]

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[47] a rule is ''major'' if it results or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

The Commission requests comment on the potential impact of the proposed amendments on the U.S. economy on an annual basis. Commenters are requested to provide empirical data to support their views.

IX. Statutory Authority

The Commission is proposing amendments to Form N–1A pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act (15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)) and sections 8, 24(a), 30, and 38 of the Investment Company Act (15 U.S.C. 80a–8, 80a–24(a), 80a–29, and 80a–37).

[43] 17 CFR 270.0–10.

[44] This estiamte is based on analysis by the Division of Investment Management staff of information from databases compiled by third-part information providers, including Morningstar, Inc., and Lipper.

[45] These figures are based on an estimated hourly wage rate of $45.25. *See supra* note 41.

[46] We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

[47] Pub. L. 104–21, Title II, 110 Stat. 857 (1996).

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Form Amendments

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

1. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 80a–8, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

2. The authority citation for part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

* * * * *

3. Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by:

a. Replacing the final sentence of General Instruction C.3.(a) with two new sentences;

b. Revising the introductory language to Item 7(f);

c. Revising Item 8(a)(2);

d. Adding new Instructions to Items 8(a)(1) and (2);

e. Adding new Items 8(a)(3), (4), and (5);

f. Adding a new Instruction to Item 8(a); and

g. Revising Item 18(a).

These additions and revisions read as follows:

Note: The text of Form N–1A does not, and these amendments will not, appear in the Code of Federal Regulations.

Form N–1A

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General Instructions

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C. Preparation of the Registration Statement

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3. Additional Matters:

(a) * * * Disclose the information required by Item 8 (Distribution Arrangements) in one place in the prospectus, except that the information required by paragraphs 8(a)(2), (3), (4), and (5) may be disclosed in a separate purchase and redemption document pursuant to Item 7(f), provided that all the information required by paragraphs 8(a)(2), (3), (4), and (5) is included in the separate document. If the information required by paragraphs 8(a)(2), (3), (4), and (5) is disclosed in a separate purchase and redemption document, the table required by paragraph 8(a)(1) must be included in the separate purchase and redemption document, as well as the prospectus, in order to comply with the Instruction to Item 8(a), which states that all information required by paragraph 8(a) must be adjacent to the table required by paragraph 8(a)(1).

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Item 7. Shareholder Information

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(f) *Separate Disclosure Document.* A Fund may omit from the prospectus information about purchase and redemption procedures required by Items 7(b)–(d) and 8(a)(2)–(5) and provide it in a separate document if the Fund:

* * * * *

Item 8. Distribution Arrangements

(a) * * *

(2) Unless disclosed in response to paragraph (a)(1), briefly describe any arrangements that result in breakpoints in, or elimination of, sales loads (*e.g.*, letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of investors). Identify each class of individuals or transactions to which the arrangements apply and state each different breakpoint as a percentage of both the offering price and the net amount invested. If applicable, state that additional information concerning sales load breakpoints is available in the Fund's SAI.

Instructions.

1. The description, pursuant to paragraph (a)(1) or (a)(2) of this Item 8, of arrangements that result in breakpoints in, or elimination of, sales loads should include a brief summary of shareholder eligibility requirements, including a description or list of the types of accounts (*e.g.*, retirement accounts, accounts held at other financial intermediaries), account holders (*e.g.*, immediate family members, family trust accounts, solely-controlled business accounts), and fund holdings (*e.g.*, funds held within the same fund complex) that may be aggregated for purposes of determining eligibility for sales load breakpoints.

2. The description pursuant to paragraph (a)(2) of this Item 8 need not contain any information required by Items 13(d) and 18(b).

(3) Describe, if applicable, the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, including the circumstances in which and the classes of individuals to whom each method applies. Methods that should be described, if applicable, include historical cost, net amount invested, and offering price.

(4)(i) State, if applicable, that, in order to obtain a breakpoint discount, it may be necessary at the time of purchase for a shareholder to inform the Fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints. Describe any information or records, such as account statements, that it may be necessary for a shareholder to provide to the Fund or his or her financial intermediary in order to verify his or her eligibility for a breakpoint discount. This description must include, if applicable:

(A) Information or records regarding shares of the Fund or other funds held in all accounts (*e.g.*, retirement accounts) of the shareholder at the financial intermediary;

(B) Information or records regarding shares of the Fund or other funds held in any account of the shareholder at another financial intermediary; and

(C) Information or records regarding shares of the Fund or other funds held at any financial intermediary by related parties of the shareholder, such as members of the same family or household.

(ii) If the Fund permits eligibility for breakpoints to be determined based on historical cost, state that a shareholder should retain any records necessary to substantiate historical costs because the Fund, its transfer agent, and financial intermediaries may not maintain this information.

(5) State whether the Fund makes available free of charge, on or through the Fund's website at a specified Internet address, and in a clear and prominent format, the information required by paragraphs (a)(1) through (a)(4) and Item 18(a), including whether the website includes hyperlinks that facilitate access to the information. If the Fund does not make the information

required by paragraphs (a)(1) through (a)(4) and Item 18(a) available in this manner, disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet website).

Instruction. All information required by paragraph (a) of this Item 8 must be adjacent to the table required by paragraph (a)(1) of this Item 8; must be presented in a clear, concise, and understandable manner; and must include tables, schedules, and charts as expressly required by paragraph (a)(1) of this Item 8 or where doing so would facilitate understanding.

* * * * *

Item 18. Purchase, Redemption, and Pricing of Shares

(a) *Purchase of Shares.* To the extent that the prospectus does not do so, describe how the Fund's shares are offered to the public. Include any special purchase plans or methods not described in the prospectus or elsewhere in the SAI, including letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of shareholders.

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By the Commission.

Dated: December 17, 2003.

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03–31545 Filed 12–23–03; 8:45 am]

BILLING CODE 8010–01–P