

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

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).

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).