

and on its Web site.<sup>13</sup> 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.<sup>14</sup> 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.<sup>15</sup>

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.<sup>16</sup>

### 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.<sup>17</sup> 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

<sup>13</sup> 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](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](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.

<sup>14</sup> Task Force Report, *supra* note 12, at 10.

<sup>15</sup> *Id.* at 13-14.

<sup>16</sup> 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).

<sup>17</sup> 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.