

## MUTUAL FUND FEE STRUCTURES

Recently, the Department of Labor adopted a rule and certain exemptions (together, the “DOL Rule”) designed to address conflicts of interest in retirement advice.<sup>1</sup> Since the DOL Rule’s adoption, representatives of mutual funds (“Funds”) have been considering a variety of issues related to the DOL Rule’s implementation, including contemplating certain changes to Fund fee structures that would, in certain instances, level the compensation provided to a financial intermediary (“Intermediary”) for the sale of Fund shares by that Intermediary and facilitate Intermediaries’ compliance with the rule. We also understand some Funds are considering streamlined sales load structures to simplify costs for investors and to help address operational and compliance challenges that can exist for Intermediaries that sell shares of multiple Funds.<sup>2</sup> This Guidance Update is focused on disclosure issues and certain procedural requirements with offering variations in Fund sales loads and new Fund share classes.<sup>3</sup> We also remind Funds of certain administrative procedures that will assist in streamlining the review of disclosure filings.

### *Variations in Sales Loads*

A Fund may sell shares at prices that reflect scheduled variations in, or elimination of, sales loads as long as each sales load variation is disclosed in the prospectus. Rule 22d-1 under the Investment Company Act of 1940 (“1940 Act”) and item 12(a)(2) of Form N-1A require that each variation be applied uniformly to particular “classes” of investors or transactions and disclosed in the prospectus with specificity.<sup>4</sup>

We understand that Funds are considering new variations to sales loads that would apply uniformly to investors that purchase Fund shares through a single Intermediary (or category of multiple Intermediaries). In these circumstances, item 12(a)(2) of Form N-1A requires that the prospectus: (1) briefly describe the arrangements that result in



breakpoints in, or elimination of, sales loads; (2) identify each class of individuals or transactions to which the arrangements apply; and (3) state each different breakpoint as a percentage of both the offering price and net amount invested. Under this approach, investors who purchase through a designated Intermediary would be a “class” under item 12(a)(2). Therefore, the disclosure should specifically identify each Intermediary whose investors receive a sales load variation. This information must be presented in a clear, concise, and understandable manner, and should include tables, schedules, and charts where doing so would facilitate understanding.<sup>5</sup> In addition, the narrative explanation to the Fund fee table must alert investors to the existence of sales load discounts or waivers and provide a cross-reference to the section and page of the prospectus and statement of additional information that describes these arrangements.<sup>6</sup>

Some Funds are concerned that if a Fund creates multiple scheduled variations, it could lead to lengthy prospectus disclosure that may be difficult for an investor to navigate and comprehend.<sup>7</sup> Given the Commission and staff focus on improving disclosure,<sup>8</sup> we would not object if lengthy sales load variation disclosure for multiple intermediaries is included in an appendix to the statutory prospectus.<sup>9</sup>

We believe that this approach will benefit investors by making it easier for them to find information about the sales loads that differ by Intermediary. In order to use an appendix under this approach:

- The section of the prospectus that includes disclosure that is required by Item 12 to Form N-1A should include a prominent statement to the effect that different Intermediaries may impose different sales loads and that these variations are described in an appendix to the prospectus (the specific appendix should be named).
- The cross-reference in the narrative explanation to the fee table must cross-refer to the appendix.
- The appendix must specifically identify the name of the Intermediary as required by item 12(a)(2). It also should include sufficient information to allow an investor that purchases Fund shares through a specific Intermediary to determine which scheduled variation applies to its investment, which may depend on the type of account held at the Intermediary.<sup>10</sup> For example, individual retirement accounts, retail taxable accounts, and 529 plan accounts available through the same Intermediary each may have variations in their sales load structures.

We would not object to an appendix that is a standalone document so long as the Fund:

- Incorporates the appendix into the prospectus by reference and files the appendix with the prospectus;
- Includes a legend on the front cover page of the appendix explaining that the information disclosed in the appendix is part of, and incorporated in, the prospectus;
- Includes a statement on the outside back cover page of the prospectus that information about the different sales loads variations is provided in a separate document that is incorporated by reference into the prospectus;
- Delivers the appendix with the prospectus; and
- Posts the appendix on its website consistent with rule 498(e) under the Securities Act, if the Fund uses a summary prospectus.

To add disclosure about sales load variations, a Fund will need to file the amendment to its registration statement under rule 485(a) under the Securities Act of 1933 (“Securities Act”).<sup>11</sup> In order to focus staff review in a way that will be meaningful for investors, we encourage Funds to seek selective review of the filing as described below, if only certain disclosures about the Fund are changing, such as adding sales load variations. In addition, if sales load variation disclosures will be substantially identical across multiple Funds within a fund complex, the Funds should consider whether it is appropriate to request relief under rule 485(b)(1)(vii) under the Securities Act (“Template Filing Relief”) as described below. In addition, Funds must ensure that investors are provided with accurate and current information and must update their prospectuses or appendices on an ongoing basis to reflect any new or modified sales load variations.

### ***New Share Classes***

We also understand that Funds are considering offering new share classes that differ with respect to sales loads, transaction charges, and certain ongoing expenses.<sup>12</sup> As with the scheduled variation procedures described above, adding a new class to an existing Fund requires a filing under rule 485(a).<sup>13</sup> When reviewing a rule 485(a) filing that adds a new share class, we focus on the disclosure of Fund fees, performance, and distribution arrangements. If only certain disclosures about the Fund are changing, such as to describe the new share class, we encourage Funds to seek selective review of the filing as described below. Also, because share class specific information is often

substantially identical across Funds within the same fund complex, Funds should consider whether it is appropriate to request Template Filing Relief as described below.

### ***Administrative Procedures***

To improve the efficiency of the review process for both staff and registrants, we are providing guidance to registrants with respect to requests for selective review and Template Filing Relief.

#### **Selective Review**

We encourage registrants to request a selective review of a filing that contains disclosure that is not substantially different from the disclosure contained in one or more prior filings by the Fund or other Funds in the complex.<sup>14</sup> In particular, a request for selective review may be appropriate for the rule 485(a) filing of a Fund that first reflects a new share class or sales load variation that is expected to be introduced for other Funds in the complex. Any such request should be made in the cover letter accompanying the filing and should include: (i) a statement as to whether the disclosure in the filing has been reviewed by the staff in another context; (ii) a statement identifying prior filings that the registrant considers similar to, or intends as precedent for, the current filing; (iii) a summary of the material changes made in the current filing from the previous filings; and (iv) any specific areas that the registrant believes warrant particular attention.<sup>15</sup>

#### **Template Filing Relief**

In circumstances in which a Fund complex makes substantially identical changes to multiple Funds, it may be appropriate for the registrant to request rule 485(b)(i) (vii) relief to avoid the need to file multiple rule 485(a) filings.<sup>16</sup> Instead, the registrant could file a single rule 485(a) filing (a “Template filing”) for staff review, together with a Template Filing Relief request for other Funds with substantially identical disclosure. Funds are encouraged to submit any Template Filing Relief requests as soon as possible, and we will consider any requests as expeditiously as possible.

If a registrant wishes to request Template Filing Relief, it should do so in correspondence filed on the EDGAR system under the central index key (“CIK”) of the Template filing. The registrant’s request should state: (i) the reason for making the post-effective amendment; (ii) the identity of the Template filing;<sup>17</sup> (iii) the identity of the

registration statements that intend to rely on the relief (“Replicate filings”);<sup>18</sup> and make the following representations:

- The disclosure changes in the Template filing are substantially identical to disclosure changes that will be made in the Replicate filings.
- The Replicate filings will incorporate changes made to the disclosure included in the Template filing to resolve any staff comments thereon.<sup>19</sup>
- The Replicate filings will not include any other changes that would otherwise render them ineligible for filing under rule 485(b).

Any rule 485(b) filing relying on Template Filing Relief should include a cover letter or an explanatory note in the filing explaining that it is relying on this relief.

#### Endnotes

- 1 See Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, 81 FR 20946 (Apr. 8, 2016); and Best Interest Contract Exemption, 81 FR 21002 (Apr. 8, 2016).
- 2 See, e.g., FINRA News Release, FINRA Orders an Additional Five Firms to Pay \$18 Million in Restitution to Charities and Retirement Accounts Overcharged for Mutual Funds (Oct. 27, 2015), available at <http://www.finra.org/newsroom/2015/finra-orders-5-firms-pay-18-million-failing-waive-fund-sales-charges> (describing regulatory actions relating to Intermediaries failing to apply Fund sales load waivers to certain investors).
- 3 The Division cannot provide any assurances that any approach described in this Guidance Update will satisfy the requirements of the DOL Rule. Rather, this Guidance Update discusses the requirements under the applicable federal securities laws with respect to Funds that wish to use certain fee structures.
- 4 The reference to “classes” in rule 22d-1 predates rule 18f-3 under the 1940 Act (governing multi-class Fund structures). Accordingly, the reference to “classes” in item 12(a)(2) should not be read to refer to a multi-class structure, but rather to a category of persons.

Sales load variation required under items 17(d) (relating to sales load variations available to directors and other affiliated person of the Fund) and 23(b) (relating to fee arrangements in connection with a Fund reorganization) of Form N-1A may be disclosed in the Fund’s statement of additional information.

- 5 See instruction following item 12(a)(5) of Form N-1A.
- 6 See item 3 to Form N-1A.
- 7 Form N-1A requires all information about distribution arrangements to be disclosed in one place in the prospectus. See General Instruction C.3.A of Form N-1A. See also instruction to item 12(a) to Form N-1A (requiring all information responsive to item 12(a) be adjacent to the table required by item 12(a)(1) of Form N-1A).
- 8 See, e.g., Guidance Regarding Mutual Fund Enhanced Disclosure, IM Guidance Update 2014-08 (June 2014) (staff guidance highlighting the importance of providing a concise summary of principal investment risk in the summary section of the prospectus); and Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) (release adopting the mutual fund summary prospectus).
- 9 If a Fund intends to rely on this approach, all of the information required by item 12(a) of Form N-1A for each Intermediary must be described in the appendix.
- 10 See instruction 1 to item 12(a)(2) to Form N-1A.
- 11 Rule 485 under the Securities Act specifies the procedures by which post-effective amendments for mutual funds become effective. Rule 485(b) generally permits certain post-effective amendments to become effective immediately on filing or on a date specified by the registrant. Post-effective amendments filed for reasons other than those described under rule 485(b) must be filed under rule 485(a). A post-effective amendment filed under rule 485(a) generally becomes effective either 60 days or 75 days after filing, unless the effective date is accelerated by the Commission. This permits the staff to review the filing prior to its effectiveness.
- 12 See rule 18f-3 under the 1940 Act.
- 13 See *infra* note 11.
- 14 Notwithstanding any request for selective review, we may comment on any portion of a filing.
- 15 See Revised Procedures for Processing Registration Statements, Post-Effective Amendments and Preliminary Proxy Materials Filed by Registered Investment Companies. Investment Co Act Rel. No 13768 (Feb. 15, 1984).

- 16 Rule 485(b)(1)(vii) under the Securities Act permits the Commission to approve the filing of a post-effective amendment to a registration statement under rule 485(b) for a purpose other than those specifically enumerated in the rule. The staff has been delegated this authority by the Commission.
- 17 This identifying information should include the name of the Fund and the registrant, the Securities Act file number, and the filing date of the rule 485(a) filing.
- 18 This identifying information should include the name of the registrant, the Securities Act file number, and the series and class name for each of the Funds that intend to rely on the relief.
- 19 If the Template filing is already effective, this representation should be replaced with the following:

The Replicate filings incorporate changes made to the disclosure included in the Template filing to resolve any staff comments thereon.

*IM Guidance Updates* are recurring publications that summarize the staff's views regarding various requirements of the federal securities laws. The Division generally issues *IM Guidance Updates* as a result of emerging asset management industry trends, discussions with industry participants, reviews of registrant disclosures, and no-action and interpretive requests.

The statements in this *IM Guidance Update* represent the views of the Division of Investment Management. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. Future changes in rules, regulations, and/or staff no-action and interpretive positions may supersede some or all of the guidance in a particular *IM Guidance Update*.

The mission of the Securities and Exchange Commission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

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**If you have any questions about this IM Guidance Update, please contact:**

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