

**SEC ADOPTS ADDITIONAL BREAKPOINT DISCLOSURE  
FOR REGISTERED INVESTMENT COMPANIES**

On May 28, 2004, the Securities and Exchange Commission (the “SEC”) adopted final rules<sup>1</sup> setting forth amended guidelines for investment companies to follow for disclosure of sales load breakpoints and sales charge waivers. The SEC’s rulemaking follows an examination sweep by the SEC and the National Association of Securities Dealers, Inc. (“NASD”). In that sweep, the SEC and the NASD discovered that shareholders frequently were charged unnecessary sales charges or did not receive breakpoints for which they were eligible.<sup>2</sup> Following the sweep, the SEC and the NASD formed a Joint NASD/Industry Task Force to address the issue. The recently adopted rule is intended to be one step in that process.<sup>3</sup>

The key components of the disclosure rule amendments would require an open-end investment company registrant (“Fund”) to:

- provide a brief description in its prospectus of arrangements that result in sales load breakpoints, including a summary of eligibility requirements, with more detailed information permitted to be in the statement of additional information;
- describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoint requirements;
- state in its prospectus, if applicable, that in order to obtain a breakpoint, it may be necessary for a shareholder to provide information and records, such as account statements, to a mutual fund or financial intermediary; and
- disclose that it makes available free of charge on the Fund’s Web site information about breakpoints disclosed in its prospectus and Statement of Additional Information or disclose the reasons why it does not provide information on its Web site.

**I. Compliance Date**

The disclosure rules take effect on September 1, 2004. Funds filing initial registration statements or post-effective amendments on or after that date must include the updated disclosure.

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<sup>1</sup> SEC Release No. 33-8427, 34-49817, IC-26464 (May 28, 2004).

<sup>2</sup> SEC Release No. 33-8347, 34-48939, IC-26298 (Dec. 13, 2003).

<sup>3</sup> The Task Force made 13 recommendations, including requiring broker-dealers to adopt a policy to gather appropriate investor information and modifying the systems used by transfer agents and broker-dealers to collect relevant information.

## II. Disclosure Requirements

Previously, Items 8(a)(2) and 18 of Form N-1A required disclosure of breakpoints and sales charge reductions, including disclosure of discounts based on:

- letters of intent;
- accumulation plans;
- dividend reinvestment plans;
- withdrawal plans;
- exchange privileges;
- employee benefit plans; and
- redemption reinvestment plans.

The revised requirements, in effect, require that Funds provide more of this disclosure in the prospectus (as opposed to the Statement of Additional Information) and provide more detail about these arrangements.

Basic Disclosure. Funds will need to make prospectus disclosure of all arrangements that result in breakpoints or elimination of sales loads, but additionally must include information about *waivers for particular classes of shareholders*.<sup>4</sup>

Disclosure Concerning a Shareholder's Obligations. Revised Form N-1A will require that Funds disclose, if applicable, that 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 breakpoint requirements (in order to obtain a breakpoint discount). The revised Form further requires Funds to disclose information or records that a shareholder may need to provide to the Fund or the shareholder's intermediary, including:

- 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;
- information or records regarding shares of the Fund or other funds held in any account of the shareholder at another financial intermediary; and

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<sup>4</sup> Additional detail about breakpoints, waivers and sales charge reductions may still be provided in the Fund's Statement of Additional Information.

- information or records regarding shares of the Fund or other funds held at any financial intermediary by persons related to the shareholder, such as members of the same family or household.

Disclosure of Valuation for Breakpoint Discount. Revised Form N-1A requires Funds to disclose the methods used to determine whether a shareholder has met sales load breakpoints, including whether the calculation takes account of historical cost, net amount invested and offering price. If a Fund determines eligibility for breakpoints based upon historical cost, the Fund must 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.

Web Site Disclosure. Revised Form N-1A requires that a Fund disclose whether it makes available free of charge on the Fund's Web site information about breakpoints, including whether the Web site includes hyperlinks that facilitate access to the information. Alternatively, the revised Form requires that a Fund disclose the reasons why it does not provide information on its Web site (including stating that the Fund does not have a Web site).

### **III. Related Regulatory Actions**

The NASD and the SEC have announced other steps to increase shareholders' awareness of sales charge breakpoints and discounts. The SEC has separately announced that it is studying the use of omnibus account information and the possible provision of more information by intermediaries to fund companies. If broker-dealers are required to provide more information to funds and their distributors, the funds likely will have more responsibility for assuring that investors receive their breakpoint and other sales charge reductions.

In addition to the disclosure, the SEC and the NASD have taken enforcement actions against 15 brokerage firms for failure to deliver mutual fund breakpoint discounts, and levied fines of over \$21 million.<sup>5</sup> Further, the NASD directed that brokerage firms conduct a self-assessment to determine appropriate refunds for customers who failed to receive sales charge breakpoints.<sup>6</sup>

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<sup>5</sup> SEC Press Release (Feb. 12, 2004).

<sup>6</sup> NASD Member Alert (March 30, 2004) and NASD Notice to Members 3-47 (Aug. 2003).

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