shareholders that relates solely to the arrangement of that class, governs which class of shareholders may vote on a matter, but does not affect whether the matter is one that requires a shareholder vote. Paragraph (a)(3) requires that each class have the right to vote separately on matters in which its interests are different from those of other classes.

The Commission is adopting as proposed paragraph (a)(4), which states that except as provided in the previous paragraphs, each class of a fund relying on the rule must have the same rights and obligations as each other class.33 Among other things, this paragraph effectively requires multiple class funds to allocate voting rights that affect all fund shareholders equally to all shareholders. The Commission had requested comment on whether to require that voting be allocated based on relative net asset value per share, rather than one vote per share.³⁴ All of the commenters addressing the issue opposed such a requirement. These commenters suggested that the proposal's more flexible approach of allowing a fund to select the method most suitable for it would provide the best result for each fund.35 Several commenters noted that many funds would be required to hold shareholder meetings in order to amend their charters to comply with such a requirement, thus incurring additional expense.³⁶ Therefore, the Commission is not requiring voting based on relative net asset value per share, but believes that such voting is permissible under section 18(i) of the Investment Company Act.37

³⁶ E.g., Letter from the Chicago Bar Association, Subcommittee of the Securities Law Committee to Jonathan G. Katz, Secretary, SEC 3 (Feb. 21, 1994); Letter from Federated Investors to Jonathan G. Katz, Secretary, SEC 3 (Feb. 15, 1994).

³⁷ See Sentinel Group Funds, Inc. (pub. avail. Oct. 27, 1992) (under section 18(i), voting rights of different series in a fund may be tied to the relative net asset value of each series to avoid vesting unfair voting power in series with per share net asset values that are significantly lower than those of other series). In discussing the meaning of "equal voting rights" under section 18(i), the Commission has noted that:

Problems of interpretation may very well arise from defining with exactitude what constitutes "equal voting rights" within the meaning of Section 18(i). It is apparent that in certain cases an inflexible adherence to any rigid interpretation could produce grave distortions of the apparent intent of Congress to require a reasonably equitable distribution of voting power consistent with the applicable provisions pertaining to the different classes of stock.

4. Exchange Privileges and Conversions

The Commission is adopting provisions relating to conversions and exchanges of shares substantially as proposed.³⁸ The rule as adopted also includes a provision allowing conversions when a shareholder is no longer eligible to invest in a particular class.³⁹

Paragraph (e)(1) allows funds to offer different exchange privileges to different classes.⁴⁰ Paragraph (e)(2) permits funds to offer one or more classes with conversion features that allow for automatic conversions into another class after a specified period, if the conversions are made at net asset value without the imposition of any sales load, fee or other charge upon the conversion. As suggested by a commenter, paragraph (e)(2) as adopted provides that total expenses (not just those associated with a rule 12b-1 plan) may not be higher for the new class than for the old class.41

The Commission has added paragraph (e)(3), which allows, under limited circumstances, conversions that occur whenever a shareholder ceases to be eligible to invest in a class. Unlike paragraph (e)(2), this provision does not require that the new class have the same or lower expenses. A commenter objected that the expense limitation in paragraph (e)(2) would not accommodate situations in which a shareholder may no longer be eligible to participate in the class in which he or she originally invested, and therefore need or wish to be placed into a class that may have higher expenses.⁴² For

³⁸ Exchanges are subject to section 11 of the Investment Company Act and the rules thereunder. *See* 15 U.S.C. § 80a–11(a); 17 CFR 270.11a–1, –2 and –3 (requiring offers of exchange to be made on the basis of net asset value, with certain exceptions).

³⁹The Commission also is amending Form N–1A to require prospectus disclosure for multiple class funds allowing or requiring conversions or exchanges between classes. *See infra* section II.C.3. for a discussion of the amendment.

⁴⁰ For example, when shares of one class of a fund may be exchanged for shares of the same class in another fund, but not for shares of other classes.

⁴¹ ICI Comment Letter, *supra* note 11, at 23–24.
⁴² Letter from Hale and Dorr to Jonathan G. Katz, Secretary, SEC 7 (Feb. 22, 1994). *See* Ark Funds, Investment Company Act Release Nos. 19812 (Oct. 22, 1993), 58 FR 58025 (Oct. 28, 1993) (Notice of Application), and 19882 (Nov. 17, 1993), 55 SEC Docket 1541 (Order) (allowing automatic

example, an investor in a class offered only to trust customers may cease to be a trust customer, and thus no longer be eligible to invest in that class.⁴³ In this event, the commenter suggested that the rule permit the new class to assess higher rule 12b–1 fees. Paragraph (e)(3) allows these conversions to occur, if the conversion is effected at net asset value without the imposition of any sales load, fee, or other charge upon the conversion and the investor is given advance notice of the conversion.

5. Board Review of Plans

The Commission is adopting paragraph (d), governing the adoption and approval of multiple class plans by boards of directors, with modifications in view of comments received. Rule 18f–3 gives the board of directors, particularly the independent directors, significant responsibility to approve a fund's plan and oversee its operation. Paragraph (d) requires that a fund adopt a written plan specifying all of the differences among classes, including the various services offered to shareholders, different distribution arrangements for each class, methods for allocating expenses relating to those differences, and any conversion features or exchange privileges.44 The plan should provide a detailed statement of the differences among the classes.

The rule requires that the board, including a majority of the independent directors, find that the plan is in the best interests of each class individually and the fund as a whole.⁴⁵ This approval requirement replaces the several board reviews under the exemptive orders. The orders required boards of directors to approve the issuance of multiple classes of shares, review and approve specific allocations of class expenses,

⁴³ Although some fees may be lower for classes whose shareholders have certain other relationships with a financial institution that provides services to fund shareholders, these investors may also be paying other fees directly to the institution in addition to paying expenses at the fund level.

 44 Forms N–1A and N–14 have been amended to require that a copy of the plan be filed as an exhibit to the forms.

⁴⁵ In making its findings, the board should focus, among other things, on the relationship among the classes and examine potential conflicts of interest among classes regarding the allocation of fees, services, waivers and reimbursements of expenses, and voting rights. Most significantly, the board should evaluate the level of services provided to each class and the cost of those services to ensure that the services are appropriate and that the allocation of expenses is reasonable.

 $^{^{33}}$ This provision was paragraph (a)(5) in the rule as proposed.

³⁴ See footnote 42 of the Proposing Release. ³⁵ E.g., ICI Comment Letter, *supra* note 11, at 22; Fidelity Comment Letter, *supra* note 18, at A–2 (Fidelity stated that dollar-based voting may not be consistent with state law).

The Solvay American Corp., 27 SEC 971, 974 n.9 (1948).

The Commission also believes that voting based on relative net asset value is consistent with the definition of "the vote of a majority of the outstanding voting securities" in section 2(a)(42) of the Investment Company Act [15 U.S.C. § 80a– 2(a)(42)]. That provision does not specify whether the prescribed percentages are to be determined on the basis of the number of securities, or the value of the securities.

conversions when a shareholder in one class becomes ineligible to purchase shares of the class originally held); Federated Securities Corp. (pub. avail. Jan. 14, 1992) (permitting shareholders to switch from one class to another class where, because of a change in circumstances, such shareholders would no longer be eligible to invest in a particular class of shares).