

intended to inform investors about the differences between the investment options offered together to them.

The proposal would have required that whenever a prospectus offered two or more classes or feeder funds, or provided cross-disclosure about one or more classes or feeder funds, it must also contain a discussion of the differences between the classes or feeder funds. This aspect of the proposal elicited little comment. The proposal also would have required a line graph comparing the feeder funds' or classes' performance over a hypothetical ten-year period, assuming an initial investment of \$10,000 and a 5% rate of return.⁸⁰ The Commission intended that the graph demonstrate the circumstances under which holding shares of each class or feeder fund for various lengths of time would produce the highest return. The Commission is not adopting this aspect of the proposal. The narrative discussion called for by Guide 34 should provide investors with similar information. Moreover, the line graph proposal was predicated upon the cross-disclosure requirement, which the Commission is not adopting.

The proposed line graph met with significant opposition from a number of commenters, many of which conjectured that it could mislead investors into believing that the "market always goes up."⁸¹ One commenter expressed concern that the graph creates a "significant potential for litigation."⁸² Another commenter observed that, except for variable life illustrations, "the Commission has not previously used these investment assumptions to project hypothetical future performance."⁸³ Many commenters raised numerous concerns regarding the accuracy of the graphs given the myriad redemption possibilities, expenses, sales charges, and exchange privileges.⁸⁴ A commenter also argued that much of the information would duplicate disclosure in the fee table, and thus would be

contrary to the goal of prospectus simplification.⁸⁵

3. Discussion of Classes Into Which Shares May Convert or Be Exchanged

The Commission is adopting new General Instruction I to Form N-1A. This Instruction states that multiple class funds that provide for conversions or exchanges of shares from one class to another should provide disclosure in the prospectus about all other classes into which the shares may be converted or exchanged. Although Instruction I does not specify a particular format, it states that the disclosure should be designed to aid investor comprehension, and when appropriate, should use tables, side-by-side comparisons, or other parallel presentations to assist an investor's understanding of the other class or classes.

4. Advertising and Sales Literature

The Commission is not adopting requirements for advertisements or sales literature about multiple class or master-feeder funds. The Commission had proposed amending rules 134 and 482 under the Securities Act and rule 34b-1 under the Investment Company Act to require multiple class and master-feeder fund advertisements to contain a prominent legend substantially similar to that proposed for prospectus disclosure. In addition, the Commission had proposed amending rules 482 and 34b-1 to require multiple class and master-feeder fund advertisements that contain performance figures to include, with equal prominence, the performance of all classes and feeder funds that would have been subject to the proposed prospectus cross-disclosure requirement. The proposal would also have required that when an advertisement contains performance figures for a class or feeder fund for which average annual total return information is not available for one, five, and ten year periods, and this information is available for another class, feeder or master fund, then the advertisement must include quotations of average annual total return for the securities of the other class, feeder or master fund together with any necessary explanation.

Commenters opposed the requirement of disclosure about other classes or feeder funds in advertisements.⁸⁶ One stated that "[i]n many respects, these

requirements are so onerous that they are unworkable" and that "[t]he volume of disclosure required by the Proposal and the equal prominence requirement would make advertising prohibitively expensive as well as highly impractical for funds in the master-feeder fund structure."⁸⁷ Some commenters objected to the requirement because of the amount of space the disclosure would occupy in an average advertisement.⁸⁸

In view of those objections, the Commission has determined not to adopt the proposed advertising disclosure requirements.⁸⁹ Instead, the Commission will address disclosure of performance under the general anti-fraud provisions of the federal securities laws⁹⁰ and expects that the staff will continue to address issues relating to performance disclosure on an interpretive or no-action basis.⁹¹

D. Effective Dates

Rule 18f-3 and the amendment to rule 12b-1 will become effective April 3, 1995. Registration statements and post-effective amendments filed with the Commission after April 3, 1995 must be in compliance with the amendments to Forms N-1A and N-14.

III. Cost/Benefit of the Proposals

Rule 18f-3 and the rule and form amendments adopted today should impose less of a reporting or recordkeeping burden and less regulatory compliance cost on multiple class funds than those imposed by the multiple class exemptive orders. Under rule 18f-3 and the form amendments,

⁸⁷ Signature Group Comment Letter, *supra* note 59, at 16-17.

⁸⁸ *Id.*; ICI Comment Letter, *supra* note 11, at 17-18 (the expense of cross-disclosure, together with the equal prominence requirement, would place multiple class and master-feeder funds at a competitive disadvantage).

⁸⁹ Footnote 88 in the proposing release erroneously stated that "rule 134 advertisements, however, may include rankings based on performance data." 58 FR at 68085, n.88. Rule 134 advertisements may not contain performance rankings.

⁹⁰ Therefore, funds relying on rule 18f-3 will not be required to quote the performance of all classes when they quote performance in advertisements under rule 482, as was required generally under the exemptive orders. The Commission cautions multiple class funds to use care not to mislead investors in advertising the performance of one class when multiple classes are being offered to the same persons. For example, it may be misleading to quote only performance of a class for institutional or inside investors (with low expenses) in a publication with a retail readership.

⁹¹ See, e.g., IDS Financial Corp. (pub. avail. Dec. 19, 1994) (allowing a multiple class fund to calculate standardized total return of a new class following a merger based upon the performance of the acquiring (and surviving) fund, adjusted to reflect differences in the sales load, but not differences in rule 12b-1 fees).

⁸⁰ Both of these requirements would have been contained in a new Item 6(h) of Form N-1A.

⁸¹ Chicago Bar Comment Letter, *supra* note 36, at 3; See also Signature Group Comment Letter, *supra* note 59, at 16; Fidelity Comment Letter, *supra* note 18, at 2.

⁸² Federated Investors Comment Letter, *supra* note 15, at 3.

⁸³ Chicago Bar Comment Letter, *supra* note 36, at 2-3.

⁸⁴ E.g., Signature Group Comment Letter, *supra* note, 59, at 15-16; ICI Comment Letter, *supra* note 11, at 15-16 (the ICI also suggested that the line graph requirement could pose problems for EDGAR filers, since the EDGAR system cannot recognize more than a limited set of characters, *id.* at 16 n.20).

⁸⁵ Letter from IDS Financial Corporation to Jonathan G. Katz, Secretary, SEC 2 (Feb. 22, 1994). See also ICI Comment Letter, *supra* note 11, at 14.

⁸⁶ See, e.g., Fidelity Comment Letter, *supra* note 18, at 3 ("cross-disclosure is particularly burdensome in advertisements"); ICI Comment Letter, *supra* note 11, at 17-18.