

The commenters generally supported the proposal.<sup>7</sup> The commenters welcomed a rule allowing CDSLs as eliminating the need to file exemptive applications, and many maintained that installment loads could offer desirable flexibility to funds as well as consumers.<sup>8</sup> Individual investors in particular supported installment loads as an option in paying a sales charge.<sup>9</sup> Some of these investors compared installment loads to front-end loads and preferred the former as allowing them to defer the payment of a sales charge; others compared installment loads to rule 12b-1 fees, and believed that installment loads as proposed in 1988 would be a more clear charge, as well as one that would be payable within a more definite term. Other commenters have suggested that installment loads would make it easier for smaller mutual

Securities, Inc. ("NYLIFE"); Simpson, Thacher & Bartlett ("Simpson Thacher") (commenting outside the comment period); Templeton Funds Management, Inc. ("Templeton"); and 19 individual investors. The comment letters are available for public inspection and copying at the Commission's public reference room in File No. S7-24-88.

<sup>7</sup>The comments addressed CDSLs and installment loads, but did not focus specifically on back-end loads other than CDSLs. While some earlier industry commenters perceived practical difficulties with using installment loads, more recent industry comments suggest that any such difficulties either no longer exist or could be resolved. Compare Letter from the ABA Subcommittee to Jonathan G. Katz, Secretary, SEC (Jan. 11, 1989); Letter from IDS Financial to Jonathan G. Katz, Secretary, SEC (Jan. 3, 1989); Letter from the ICI to Jonathan G. Katz, Secretary, SEC (Jan. 9, 1989); Letter from Keystone to Jonathan G. Katz, Secretary, SEC (Jan. 6, 1989) (together, suggesting recordkeeping, transfer agent, accounting and tax-related complexities associated with installment loads) to Letter from Deutsche Bank, submitted on its behalf by Simpson Thacher, to the Division of Investment Management, SEC 2 (Dec. 13, 1993) (stating that Deutsche Bank "encountered a great deal of interest" in installment loads in the course of its "discussions with more than 15 well-recognized (both small and large) mutual fund management companies").

Two earlier commenters also interpreted a statement in the 1988 Proposing Release that the proposal of rule 6c-10 should be read together with the Commission's proposed amendments to rule 12b-1, as intending to mandate installment loads as a replacement for spread loads. ABA Subcommittee comment letter, *supra* note 7, at 3; ICI comment letter, *supra* note 7, at 2, 13-16. See also Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies, Investment Company Act Release No. 16431 (June 13, 1988), 53 FR 23258. The 1988 proposal was not intended to express such a view, nor is the Commission today expressing such a view.

<sup>8</sup>Letter from IDS Mutual to Jonathan G. Katz, Secretary, SEC (Nov. 15, 1988); Letter from NYLIFE to Jonathan G. Katz, Secretary, SEC (Dec. 30, 1988); Letter from Templeton to Jonathan G. Katz, Secretary, SEC (Jan. 9, 1989); Deutsche Bank December 13, 1993 comment letter, *supra* note 7; Letter from the NASL to the Division of Investment Management, SEC (Feb. 16, 1994).

<sup>9</sup>All but one of the 16 letters the Commission received from individual investors on this subject favored the installment load proposal.

fund sponsors, as well as sponsors of mutual funds not affiliated with brokerage firms, to obtain financing to pay broker commissions through securitization of installment load cash flows; and they argued that installment loads would thereby encourage competition in the fund industry that ultimately would benefit investors.<sup>10</sup>

## II. Discussion of Proposed Amendments to Rule 6c-10

Like the 1988 proposal, the proposed amendments to rule 6c-10 would allow mutual funds to impose back-end sales loads other than CDSLs as well as installment loads, and would permit scheduled load variations. In a change from the 1988 proposal and the rule as adopted, the proposed amendments no longer would specify load calculation requirements, nor prohibit deferred sales loads on reinvested dividends and other distributions. Instead, the terms of any deferred sales load would be required to be covered by the overall limits in the NASD Sales Charge Rule,<sup>11</sup> and would be subject to specific prospectus disclosure requirements under the proposed amendments to the Commission's mutual fund registration form.

### A. Scope of the Rule as Amended

Under the proposed amendments, paragraph (b)(3) of the rule would define a deferred sales load as any amount properly chargeable to sales or promotional expenses that is paid by a

<sup>10</sup>Deutsche Bank December 13, 1993 comment letter, *supra* note 7; NASL comment letter, *supra* note 8. Both commenters compared the financing possibilities with installment loads to the financing of receivables from rule 12b-1 fees. The commenters noted that the risk of a fund board's terminating a rule 12b-1 plan, as well as the risk of net asset value fluctuations inherent in an asset-based charge, currently restrict the availability of credit to larger mutual fund sponsors only; and that installment loads, which would not carry the same risks, could broaden the financing possibilities. See also Letter from the ICI to Barry Barbash, Director, Division of Investment Management, SEC 5 (June 14, 1994) (noting that facilitation of the financing of distribution costs is one of the principal objectives cited by the proponents of installment loads).

One commenter's remarks suggested that, from the point of view of those concerned with systemic risk, the assurance of a steady stream of payments in an installment load structure would mean that a fund sponsor would be taking on less risk when it borrows to finance commission payments. Deutsche Bank December 13, 1993 comment letter, *supra* note 7, at 4-5.

<sup>11</sup>The NASD Sales Charge Rule prohibits NASD members from offering or selling shares of an open-end management investment company registered under the Investment Company Act if the sales charges described in the company's prospectus are excessive. Aggregate sales charges are deemed excessive under the Rule if they do not conform to the specific provisions set forth in the Rule. NASD, Rules of Fair Practice, Art. III, Secs. 26(d) (1) and (2).

shareholder after purchase but before or upon redemption.<sup>12</sup> The definition would include CDSLs, as well as other loads paid at redemption whose amount may remain the same or change in a manner different than a CDSL. The definition also would include loads paid after purchase during the term of a shareholder's investment in a fund, such as in one or more installments that could be accelerated upon an early redemption.

Rule 6c-10 as adopted and as originally proposed does not apply to registered insurance company separate accounts. The exemption to impose deferred sales loads under the proposed amendments also would not extend to unit investment trusts. The Commission has issued installment load exemptive orders to unit investment trusts ("UITs"),<sup>13</sup> and requests comment on the appropriateness of a rule allowing UITs to assess deferred loads.<sup>14</sup>

Unlike the 1988 proposal, which would have required installment loads to be deducted directly from a shareholder's account, the amendments would not require any particular method of collecting installment loads. The loads, for example, could be paid out of distributions, by automatic redemptions, or through separate billing of an investor's account. Two commenters indicated that funds most likely would deduct installment load payments from dividend distributions.<sup>15</sup> The Commission invites further comment on the methods that could be used to pay installment loads. Whichever method is used, however, it would have to be disclosed in the fund's prospectus, as required by the proposed

<sup>12</sup>Rule 6c-10 as amended would not be applicable to certain charges that may be imposed by a mutual fund to discourage short-term trading in its shares and that are paid directly to the fund. See, e.g., 17 CFR 270.11a-3(a)(7) (defining a "redemption fee"). The Commission's staff has taken the position that such charges may be imposed without the need for exemptive relief under the Act. See, e.g., John P. Reilly & Associates (pub. avail. July 12, 1979).

<sup>13</sup>See Merrill Lynch, Pierce, Fenner & Smith, Inc., Investment Company Act Release Nos. 13801 (Feb. 29, 1984), 49 FR 8512 (Notice of Application to allow UITs to impose a deferred sales load payable in installments) and 13848 (Mar. 27, 1984), 30 SEC Docket 192 (Order), and 15120 (May 29, 1986), 51 FR 20389 (Notice of Application) and 15167 (June 24, 1986), 35 SEC Docket 1735 (Order). See also PaineWebber, Inc., Investment Company Act Release Nos. 20755 (Dec. 6, 1994), 59 FR 64003 (Notice of Application to allow a UIT to impose a deferred sales load payable in installments) and 20819 (Jan. 4, 1995) (Order).

<sup>14</sup>See Rule 6c-10 Adopting Release, *supra* note 1, at n.7 regarding deferred sales loads in the context of separate accounts.

<sup>15</sup>ICI comment letter, *supra* note 7, at 8; Letter from Simpson Thacher to the Division of Investment Management, SEC 2 (Dec. 13, 1993).