C. Deferred Loads on Reinvested Distributions

Rule 6c-10 prohibits mutual funds from imposing CDSLs on shares purchased through the reinvestment of dividends or other distributions.²⁸ Some commenters on the 1988 proposal argued that this prohibition is unnecessary so long as a mutual fund appropriately discloses the manner in which loads are assessed and so long as loads charged by mutual funds generally are subject to the limits in the NASD Sales Charge Rule.²⁹ The Commission is proposing to delete this prohibition from rule 6c-10. Under the revised prospectus disclosure requirements, funds that impose deferred sales charges on reinvested dividends and other distributions would have to disclose this fact in their prospectuses.30 This approach would be consistent with the Commission's approach to front-end loads on reinvested dividends. The Commission requests comment on the appropriateness of the proposed approach for deferred loads.

The NASD Sales Charge Rule currently covers front-end loads, but not deferred loads, on reinvested dividends. The NASD Sales Charge Rule also does not cover loads on reinvested capital gains distributions or returns of capital.³¹ The proposed amendments to rule 6c–10 contemplate the NASD's amending its Sales Charge Rule to address these issues.

D. "No-Load" Labeling

As proposed in 1988, rule 6c–10 would have prohibited any exempted person and its first and second tier affiliates (all as set forth in the proposed rule) from holding a mutual fund out to the public as being "no-load" or as having "no sales charge" if the fund imposed a deferred load. After rule 6c–10 was proposed, the NASD amended its Sales Charge Rule expressly to

prohibit NASD members and their associated persons from describing a mutual fund as "no load" or as having 'no sales charge" if the fund imposes a front-end load, a back-end load, or a 12b-1 and/or service fee that exceeds .25% of average net assets per year.32 In light of this amendment to the NASD Sales Charge Rule, the Commission concluded that it was unnecessary to retain a separate no-load labeling prohibition for CDSLs in rule 6c-10 as adopted. The prohibition similarly is unnecessary for back-end loads other than CDSLs. Although the NASD Sales Charge Rule currently does not address installment loads, the Commission anticipates that the NASD would amend its Sales Charge Rule if the proposed rule 6c-10 amendments are adopted, and believes that it is unnecessary to amend rule 6c-10 to prohibit no-load labeling in the case of installment loads. The Commission also believes that it would be misleading and a violation of the federal securities laws for a fund that imposes a deferred sales load to be held out to the public as a no-load fund.33

E. Exchanges Involving Deferred Loads

The Commission is not proposing any amendments to rule 11a-3 under the **Investment Company Act governing** exchanges of shares, that relate to deferred sales loads.34 Back-end and installment loads would fall under the current definition of "deferred sales load" in rule 11a-3,35 and therefore would be covered by the requirements in that rule on the imposition of deferred sales charges in connection with an exchange. The Commission invites comment on whether it should amend the definition of deferred sales load in rule 11a-3 to correspond expressly with the deferred load definition in the proposed amendments to rule 6c-10. The Commission also invites comment on whether rule 11a-3 needs to include any additional provisions for deferred loads.

III. Discussion of Revised Disclosure Requirements

The Commission is proposing new disclosure requirements for deferred sales loads in light of the proposed changes to rule 6c–10 discussed above. These requirements would reflect the rule's scope under the proposed amendments, which would permit loads paid at redemption or in installments. They also respond to the proposed elimination of the limitations in the 1988 proposal that would have required a back-end load to be based on the lower of the NAV at the time of purchase or redemption, and permitted installment loads to be based on the NAV at the time of purchase or on the lower of the NAV at the time of purchase price and the NAV at the time an installment was paid.

A. Fee Table Disclosure

The fee table requirements in Item 2 of Form N–1A currently require disclosure of deferred sales loads, but do not contemplate installment loads the amount of which is based on a price other than the purchase price or redemption proceeds. The Commission is proposing amendments to the fee table requirements to require disclosure concerning all forms of deferred sales loads, including installment loads.

The parenthetical explanation following the caption "Deferred Sales Load" in the fee table currently provides for deferred loads to be expressed only as a percentage of the original purchase price or the redemption proceeds. The proposed amendment would replace most of the current wording inside the parentheses with a blank, indicating that a registrant should provide appropriate disclosure describing the basis on which the load is computed. This change reflects the greater variety of load formulations that rule 6c-10 would permit under the proposed amendments: in contrast to the limitations in the rule as adopted and as initially proposed, the proposed amendments would permit deferred loads to be a percentage of the NAV at the time of purchase, redemption, or the payment of an installment, or the higher or lower of those amounts.

The proposed revisions to Instruction 5 to the fee table are intended to clarify how the fee table should address all deferred loads and to respond to the greater range of practices that would be permitted under the proposed amendments. The addition of the word "total" would make clear that the response to the "Deferred Sales Load" caption for an installment load should be the sum of the installments (e.g., 6%,

²⁸ 17 CFR 270.6c-10(a)(2). The 1988 proposal also would have prohibited funds from charging deferred loads on capital appreciation. Because under the proposed amendments paragraph (a)(1) would allow deferred loads to be based on the NAV at the time of redemption and at the time an installment is paid, a load could be charged on any capital appreciation to the extent the load is based on the higher of the NAV at purchase or at the time of redemption or load payment.

²⁹ ABA Subcommittee comment letter, supra note 7, at 8–9; ICI comment letter, *supra* note 7, at 5.
³⁰ See infra section III B

³¹ A return of capital generally occurs when a fund's distribution exceeds the fund's aggregate amount of undistributed net taxable income and net realized capital gains. See Determination, Disclosure, and Financial Statement Presentation of Income, Capital Gain, and Return of Capital Distributions by Investment Companies, American Institute of Certified Public Accountants, Statement of Position 93–2, 8 (Feb. 1, 1993).

 $^{^{\}rm 32}$ NASD, Rules of Fair Practice, Art. III, Sec. 26(d)(3).

³³ See 1988 Proposing Release, *supra* note 3, at 45283 (referring, in turn, to an earlier Commission statement of its view).

^{34 17} CFR 270.11a-3. The 1988 proposal did not address rule 11a-3

³⁵ Rule 11a–3 defines a "deferred sales load" as "any amount properly chargeable to sales or promotional activities that is or may be deducted upon redemption of all or a portion of a securityholder's interest in an open-end investment company." 17 CFR 270.11a–3(a)(3). Deferred loads paid other than upon redemption would fall within this definition because they could be accelerated upon redemption.