anticipated income rate to the investment decisions of UIT investors makes it particularly important that the rate is uniformly and accurately calculated.

Before 1989, estimated current return ("ECR") was the performance measurement used by Fixed Income UITs. The ECR of a trust is calculated by dividing the trust's annual interest income per unit (net of expenses) by the offering price per unit.⁶ While a trust's ECR is a reasonably accurate measure of anticipated cash flows from a unit, it does not take into account the full effect of bonds in a trust's portfolio that are trading at a market discount or premium in the same manner as the yield to maturity of a bond. As a result, the ECR of a Fixed Income UIT comprised of premium bonds may overstate the return that may be reasonably anticipated over the life of the trust.7

ECR was developed at a time when interest rates were fairly stable and UIT sponsors bought and deposited bonds at par. In the 1970s, interest rates became more volatile,⁸ and in the 1980s the practices of some UIT sponsors began to change. In 1989, the Commission's staff became aware that some UITs proposed to invest a significant portion of their assets in premium bonds.⁹ In response to concerns expressed by the staff that the quotation of ECR by such trusts could mislead prospective investors, the

⁶ECR is analogous to "current yield," a method of quoting yield on an individual bond based on the amount of annual income an investor will earn if the bond is purchased today, as a percentage of today's price. *See* W. Sharpe *supra* note 4 at 1006.

⁷For example, a Fixed Income UIT consisting of bonds that, at the time of deposit, were trading at 10% premium to their par value, paying a 5% interest coupon every six months, and maturing in ten years, would have an ECR of 9.09% (assuming no sales load or expenses). If, however, a unitholder holds the units until maturity, the unitholder's return would be 8.5%. The lower rate reflects that the 10% premium would not be recovered by the unitholder when the UIT matures.

⁸ From 1970 to 1980 interest rates on six-month treasury securities ranged from 5.25% in 1976 to 11.43% in 1980. See Statistical Abstracts of the United States, U.S. Department of Commerce, 522–23 (1981) (based on annual averages of monthly data for interest rates between 1970 and 1980). In the 1980s, interest rates on six-month treasury securities ranged from 13.81% in 1981 to 6.02% in 1986. See Statistical Abstracts of the United States, U.S. Department of Commerce, 525 (1994) (based on annual averages of monthly data for interest rates between 1980 and 1990).

⁹The staff became aware of these UITs during its routine review of pre-effective offerings. Several articles in the financial press also raised questions whether ECR was an appropriate measure of yield for a UIT that held significant investments in premium bonds. *See e.g.*, Weberman, *Doesn't Honesty Sell?* Forbes, Oct. 16, 1989, at 297. UIT industry developed a formula, the estimated long-term return ("ELTR") formula,¹⁰ as a solution to ECR's limitations.¹¹ ELTR is calculated by averaging the yields to maturity of the bonds held by a UIT, giving weight to the period remaining to maturity of each bond and the percentage of the UIT's portfolio that consists of each bond. Because yield to maturity reflects any premium or discount at which a bond may be trading, ELTR addressed the primary limitation of the ECR formula and the concerns of the staff.

Since 1989, the UIT industry and the Commission's staff have held discussions to develop a permanent UIT yield formula. In March of this year, the Investment Company Institute ("ICI") submitted to the Commission a rulemaking proposal to standardize the calculation of UIT yield based on a revised ELTR formula.12 The revisions primarily were intended to address deficiencies in the application of the ELTR formula to trusts with short-term termination dates (or trusts that are likely to terminate in the near future due to bonds in the trust's portfolio being called). The Division of Investment Management, in a letter to the ICI, stated that it would not object to the use of the ELTR formula, revised in accordance with the ICI's proposal, until the Commission adopts rule and

¹¹ At the time, the Commission's Division of Investment Management adopted a policy of not exercising its delegated authority to accelerate the effectiveness of any UIT registration statement the prospectus of which disclosed the UIT's ECR unless the prospectus also contained the UIT's ELTR. See letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management (Jan. 11, 1990). Subsequent to the Division's 1990 letter, the Directors of the Divisions of Market Regulation and Investment Management sent a letter to UIT sponsors and broker-dealers that are active in the UIT secondary market stating that quotations of a UIT's ECR should be accompanied by a quotation of the UIT's ELTR, if the ECR varies materially from the estimated long-term return of the trust Letter from Marianne K. Smythe Director Division of Investment Management, and William H. Heyman, Director, Division of Market Regulation (Apr. 8, 1992). A copy of each letter is contained in File No. S7-32-95.

¹² See letter from Craig S. Tyle, Vice President and Senior Counsel, Investment Company Institute, to Robert E. Plaze, Assistant Director, Division of Investment Management (Mar. 24, 1995). A copy of this letter is contained in File No. S7–32–95. form amendments concerning a uniform yield formula for UITs.¹³

II. Discussion

The Commission is now proposing to adopt rule and form amendments to codify a uniform method for the calculation of yield by UITs. The proposed Estimated Yield Formula is based largely on the ELTR formula but, as suggested by the ICI's most recent submission and described in more detail below, would include an adjustment that would require a trust that charges a sales load to reflect the amortization of the load based on the weightedaverage expected life of the trust's portfolio securities. The proposed Estimated Yield Formula would be used to determine the yield of newly offered trusts, as well as for trusts the units of which trade in a secondary market.

A. Proposed Estimated Yield Formula

Under the proposed Estimated Yield Formula, a Fixed Income UIT would calculate its Estimated Yield by first calculating the average yield to maturity, weighted by market value and time to maturity, of its portfolio securities, reducing this yield by trust expenses (expressed as a percentage), and multiplying the remainder by a percentage representing the net amount of the trust's offering price that is invested.14 The proposed Estimated Yield Formula would then require a Fixed Income UIT to reduce the resulting ratio by a "sales charge factor" to reflect the "cost" to a UIT investor of not receiving upon termination of the trust (or upon sale or redemption of the units or partial liquidation of the trust) the portion of the amount initially invested that represents sales load. Thus, the proposed Estimated Yield Formula would not only reflect premiums or discounts on portfolio securities, but also the "premium" an investor who is charged a sales load pays for the units.

1. Sales Load

a. Front-End Sales Loads. Most investors in an initial offering of a UIT pay at the time of purchase a sales load ("front-end" sales load) calculated as a

return. Investment Company Act Rel. No. 16245 (Feb. 2, 1988) [53 FR 3868 (Feb. 10, 1988)] (adopting amendments to rule 482 and other rules to standardize the calculation of mutual fund performance).

¹⁰ In 1989, an *ad hoc* committee of UIT sponsors, formed to study the calculation of UIT yield, submitted to the Commission a proposed uniform UIT yield formula. Letter from James J. Wesolowski, Vice President and General Counsel, John Nuveen & Co. Inc., to Robert E. Plaze, Special Counsel, Division of Investment Management (Apr. 11, 1989). Subsequently, the Investment Company Institute submitted a revised UIT yield formula. Letter from David Silver, President, Investment Company Institute, to Kathryn B. McGrath, Director, Division of Investment Management (Dec. 7, 1989). A copy of each letter is contained in File No. S7–32–95.

¹³ Investment Company Institute, (pub. avail. Aug. 2, 1995).

¹⁴ This last step reflects that a portion of the offering price will be deducted in the form of a sales load and thus, will not be invested and earn income for the unitholder. As discussed *infra* section II.A.1. of this Release, this step does not, however, reflect the effect on investor return that the amount of the sales load will not be returned to the investor at the termination or redemption of the trust.