4. Principal Cash Balances

Units purchased in the secondary market often have, as a component of their net asset value, cash balances that represent proceeds from bonds that have matured, or have been redeemed, called, or sold. This cash is held by the trust in the form of principal account cash balances to be distributed to unitholders as part of the next distribution. These amounts are returned to unitholders shortly after their receipt by the trust and do not represent part of the unitholders' investment. Thus, the proposed Estimated Yield Formula would exclude these amounts from the calculation of the trust's net asset value.[38]

5. Market Discount on Tax Exempt Securities

The proposed Estimated Yield Formula would require Fixed Income UITs, in determining the yield to maturity of tax exempt securities held by the trust, to exclude any market discount that would be treated as capital gain under federal income tax.[39] In its 1989 submission, the ICI proposed an alternative that would permit Fixed Income UITs to quote an Estimated Yield that reflects the accretion of market discount and to disclose the portion of that yield that could be subject to federal income tax.[40] The Commission is not proposing to include the ICI's proposed alternative in the determination of Estimated Yield out of concern that the ICI's approach would lead to a confusing multiplicity of Estimated Yield quotations, particularly for prospective investors in trusts quoting more than one yield because of different distribution options.[41] The Commission requests comment on the Estimated Yield Formula's proposed treatment of market discount on tax exempt securities.

6. Preferred Stock, Asset-Backed Securities, and Adjustable-Rate Securities

As discussed above, the proposed Estimated Yield Formula is designed to measure the anticipated yield from a portfolio of *fixed* income securities that yield income at a predictable rate. Most UITs that invest their assets in corporate, municipal, or U.S. government bonds invest almost exclusively in these securities. These securities are issued with stated maturities and fixed interest rates, and thus, the yield of trusts that invest in these securities can be estimated with reasonable certainty. A Fixed Income UIT, however, may have some of its assets invested in preferred stock, asset-backed securities,[42] or adjustable-rate securities,[43] the issuers of which have no legal obligation to pay a fixed amount of interest or dividends. Because the income from these securities is not as predictable as the income from traditional bonds, the Commission is proposing to require trusts holding these instruments to disclose in their prospectuses, advertisements, and sales literature that some of their assets are invested in these types of securities and that, as a result, their yields likely will fluctuate.[44]

Approximately three percent of the assets of UITs are invested in trusts substantially all the assets of which consist of preferred stock, asset-backed securities, or adjustable-rate securities.[45] The Commission is proposing that these UITs use the proposed formula to calculate yield, but would require them to characterize the yield as ''Current Yield'' to emphasize that it does not represent a rate an investor can expect to receive in the future. In addition, these trusts would be required to provide a statement that, because the continued payment of interest (and return of principal for asset-backed securities) for these types of securities cannot be predicted, the trust's yield *will* vary and, as a result, actual investor experience *will* be different from the quoted yield.[46]

The Commission requests comment on the proposed treatment of preferred stock, asset-backed securities, and adjustable-rate securities. Specifically, the Commission requests comment whether the proposed disclosure adequately would inform investors of the uncertainty of yield estimates for trusts that invest in these types of securities. The Commission also requests comment whether the proposed formula should define those trusts that invest ''substantially'' all their assets in preferred stock, asset-backed securities, and adjustable-rate securities and, if so, what that definition should be.

7. Units of Other Trusts

Fixed Income UITs sometimes hold units of other trusts in their portfolios. Although the Estimated Yield of these trusts could be used as their yield to maturity in the Estimated Yield Formula, in its 1989 submission the ICI urged that the Commission not adopt such a requirement because it would be complicated and burdensome. According to the ICI, in many cases these trusts are no longer offered in the secondary market and thus the trust sponsor no longer calculates their yield.[47] Instead, the ICI suggested that the Commission permit UITs to calculate the yield to maturity of these units based on the average dollar price, average coupon rate, and average yield to maturity of the securities held by the trust.[48] The Commission is proposing the approach recommended by the ICI, but only for units of trusts that are not currently calculating Estimated Yield.[49]

8. Tax Equivalent Yield

The proposed Estimated Yield Formula would provide Fixed Income UITs a method of calculating a tax equivalent yield.[50] A tax equivalent yield would demonstrate the taxable yield necessary to produce an after-tax yield equivalent to that of a trust which invests in tax exempt securities. Under the proposal, tax equivalent yield would be calculated by dividing that portion of the yield of the trust that is tax exempt by one minus a stated income tax rate and adding to the product that portion, if any, of the yield of the trust that is not tax exempt.[51] This would provide a

[38] In its 1989 submission, the ICI suggested a similar treatment of principal account cash balances. *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[39] Instruction 5 to the proposed Estimated Yield Formula. This approach is similar to the treatment of market discount on tax exempt securities by the mutual fund yield formula. *See* Instruction 1(e) to Item 22(v)(ii) to Form N–1A under the 1940 Act [17 CFR 274.11A].

[40] *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[41] *See* discussion *supra* section II.A.3.

[42] The cash flows of asset-backed securities, including mortgaged-backed securities, are based on an underlying pool of mortgages or other income-producing assets. *See* F. Fabozzi, *The Handbook of Fixed Income Securities,* 16–19 (4th ed. 1995).

[43] Adjustable-rate securities, including floating-rate and variable-rate securities, have interest rates that adjust periodically over their stated life. *Id.* at 7.

[44] Instruction 15 to the proposed Estimated Yield Formula. The proposed Estimated Yield Formula also would provide specific instructions for calculating yield to maturity for these securities and for determining their expected life for purposes of amortizing sales load. Instructions 12–14 to the proposed Estimated Yield Formula.

[45] Source: Investment Company Institute.

[46] Instruction 16 to the proposed Estimated Yield Formula.

[47] *See* letter from David Silver, President, Investment Company Institute, *supra* note 10.

[48] *Id.*

[49] Instruction 6 to the proposed Estimated Yield Formula.

[50] UITs would not be required to quote a tax equivalent yield.

[51] Instruction 10 to the proposed Estimated Yield Formula. The proposed method of calculating tax equivalent yield is similar to the mutual fund yield formula's method of calculating tax equivalent