VedderPrice

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Investment Services Regulatory Update

New Rules, Proposed Rules and Guidance

SEC Staff Issues Guidance on Disclosure of Sales Load Variations and Filing of New Share Classes in Light of DOL Fiduciary Rule

On December 15, 2016, the staff of the SEC's Division of Investment Management issued a guidance update (the Guidance Update) addressing certain disclosure issues and administrative procedures concerning new mutual fund share classes and intermediary-specific sales load policies, including waivers, being considered by funds in advance of the implementation of the Department of Labor's fiduciary rule (the DOL Rule) and various related exemptions designed to address conflicts of interest in retirement advice (together, the Final Rules).

The DOL Rule substantially broadens the universe of those deemed to be "fiduciaries" through the provision of investment advice to retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) and individual retirement accounts (IRAs) and certain other arrangements subject to the Internal Revenue Code. As a result, financial intermediaries (e.g., broker-dealers) and financial advisers must either: (i) avoid giving advice and engaging in activities that results in fiduciary status; or (ii) operate in compliance with the Final Rules, including the requirements of any exemption necessary to receive compensation that would otherwise be prohibited, such as commissions, 12b-1 fees and revenue sharing.

The Guidance Update notes that funds are currently contemplating certain changes to fund fee structures that would, in certain instances, level the compensation provided to a financial intermediary for the sale of fund shares by that intermediary and facilitate intermediaries' compliance with the DOL Rule. The Guidance Update also notes that funds are considering streamlined sales load structures to "simplify costs for investors and to help address operational and compliance challenges that can exist for intermediaries that sell shares of multiple Funds."

Variations in Sales Loads

The Guidance Update notes that a fund may sell shares at prices that reflect scheduled variations in, or elimination of, sales loads as long as each sales load variation is disclosed in the prospectus. Rule 22d-1 under the 1940 Act and Form N-1A require that each variation be applied uniformly to particular "classes" of investors or transactions and disclosed in the prospectus with specificity. Noting that funds are considering new sales load variations that would apply uniformly to investors that purchase fund shares through a single intermediary (or category of multiple intermediaries), the Guidance Update, citing Form N-1A, notes the following prospectus disclosure requirements:

- a brief description of the arrangements that result in breakpoints in, or elimination of, sales loads;
- identification of each class of individuals or transactions to which the arrangements apply;

- disclosure of each different breakpoint as a percentage of both the offering price and net amount invested; and
- disclosure specifically identifying each intermediary whose investors receive a sales load variation.

The Guidance Update further notes that the foregoing information must be presented in a "clear, concise, and understandable manner, and should include tables, schedules, and charts where doing so would facilitate understanding." The Guidance Update directs funds to alert investors to the existence of sales load discounts or waivers in the narrative explanation to the fund fee table, including cross-references to the relevant sections and pages of the prospectus and statement of additional information describing the arrangements.

Notably, the Guidance Update states that the SEC staff would not object if sales load variation disclosure is included in an appendix to the statutory prospectus, noting, in this regard, industry concerns regarding lengthy prospectus disclosure to address the various sales load policies of different intermediaries that "may be difficult for an investor to navigate and comprehend." In order to use an appendix under this approach, the Guidance Update requires that funds:

- prominently state, in the appropriate portion of its prospectus, that different intermediaries may impose different sales loads, which are described in an appendix to the prospectus (with such appendix specified by name);
- include a cross-reference to the appendix in the narrative introduction to the fee table; and
- in the appendix, specifically identify the relevant intermediary by name and include sufficient information to allow an investor to determine which scheduled variation applies to the investor's investment (including any variations based on account type).

The Guidance Update also states that the staff would not object to an appendix that is a stand-alone document, provided the fund:

- incorporates the appendix into the prospectus by reference and files it with the prospectus;
- states on the front cover of the appendix that the appendix is part of, and incorporated in, the prospectus;
- states on the outside back cover of the prospectus that information about the different sales loads variations is provided in a separate document that is incorporated by reference into the prospectus;
- delivers the appendix with the prospectus; and
- posts the appendix on its website (if the fund uses a summary prospectus).

The Guidance Update also states that funds must update their prospectuses or appendices on an ongoing basis to reflect any new or modified sales load variations. The Guidance Update specifies that to add disclosures about sales load variations, a fund must file an amendment under Rule 485(a) under the Securities Act of 1933 (1933 Act).

New Share Classes, Selective Review and Template Filing Relief

Noting that funds are considering offering new share classes that differ with respect to sales loads, transaction charges, and certain ongoing expenses, the Guidance Update states that, as with scheduled sales load variation procedures, adding a new class to an existing fund requires a filing under Rule 485(a). In this connection, the Guidance Update notes that the SEC staff, in reviewing a new share class filing, focuses on the disclosure of fund fees, performance and distribution arrangements.

The Guidance Update encourages funds to seek selective review of the Rule 485(a) filing if only certain disclosures about the fund are changing, such as incorporating sales load variations or describing a new share class. A request for selective review should be made in the cover letter accompanying the filing and include: (1) a statement about whether the disclosure in the filing has been reviewed by the staff in another filing; (2) a statement identifying the prior filings from which the current filing is not materially different; (3) a summary of the material changes in the current filing from the prior filings; and (4) any portions of the filing that the fund believes require particular attention by the staff.

If sales load variations or share-class specific information will be substantially identical for multiple funds within a fund complex, the Guidance Updates states that the funds should consider the appropriateness of requesting relief under Rule 485(b)(1)(vii) of the 1933 Act (Template Filing Relief). The Guidance Update notes that a registrant could file a single Rule 485(a) "template filing" together with a Template Filing Relief request for the other funds with substantially identical disclosure to allow them to make 485(b) filings to incorporate the similar disclosure into their registration statements. A request for Template Filing Relief should be made by a registrant in correspondence filed on the EDGAR system under the central index key of the template filing and the request should provide: (1) the reason for making the post-effective amendment; (2) the identity of the template filing; and (3) the identity of the other registration statement filings that intend to rely on the relief. The request should also make the following representations:

- The disclosure changes in the template filing are substantially identical to disclosure changes that will be made in the other filings.
- The other filings will incorporate changes made to the disclosure included in the template filing to resolve any staff comments thereon.
- The other filings will not include any other changes that would otherwise render them ineligible for filing under Rule 485(b).

Finally, the Guidance Update states that any Rule 485(b) filing relying on Template Filing Relief should include a cover letter or an explanatory note with the filing explaining that it is relying on the relief.

The Guidance Update is available at: https://www.sec.gov/investment/im-guidance-2016-06.pdf.

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