

orders, the Commission does not believe that it is necessary to require funds seeking to impose CDSLs to continue to file exemptive applications with the Commission pending consideration of these proposed modifications.

Therefore, the Commission is adopting rule 6c-10 to permit the imposition of CDSLs, but not other forms of deferred sales load.⁵

II. Discussion

The Commission is adopting rule 6c-10 substantially as originally proposed to permit mutual funds⁶ to impose CDSLs. The rule as adopted and as originally proposed requires CDSLs to be calculated based on the lesser of the net asset value at the time of purchase or at the time of redemption; specifies a particular order of load calculation in a partial redemption; prohibits CDSLs on reinvested dividends and capital gains distributions; and allows scheduled CDSL variations. The rule as adopted does depart from the proposal in certain respects in light of comments on the 1988 proposal and of the adoption of amendments to the NASD Sales Charge Rule.

A. The NASD Rule on Maximum Sales Charges

Paragraph (a)(2) in the proposed rule provided that the maximum amount of a back-end load, or any combination of a back-end load and a front-end load, may not exceed the maximum allowed under the NASD Sales Charge Rule. At the time rule 6c-10 was proposed, the NASD Sales Charge Rule did not expressly apply to back-end loads. Since then, the NASD has amended its Sales Charge Rule to include expressly back-end loads, as well as asset-based distribution fees.⁷ Because a

⁵ See *supra* note 1.

⁶ Like the rule as proposed, rule 6c-10 as adopted applies only to open-end management investment companies other than registered separate accounts. In the Proposing Release, the Commission also requested comment on whether to propose amendments to rules 6c-8 [17 CFR 270.6c-8] and 6e-3(T) [17 CFR 270.6e-3(T)] under the Act, and whether to issue revised proposed amendments to rule 6e-2 [17 CFR 270.6e-2] under the Act, governing the use of deferred sales loads by registered insurance company separate accounts. The Commission received eight comment letters in response to that request, suggesting that the Commission not propose any amendments. The Commission is not taking any action with regard to these rules.

⁷ The NASD Sales Charge Rule prohibits NASD members from offering or selling shares of an open-end management investment company registered under the 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). See also Letter from the NASD to Jonathan G. Katz, Secretary, SEC (March

Commission rule no longer is necessary to bring CDSLs within the limits of the NASD Sales Charge Rule, the proposed paragraph has been deleted from rule 6c-10 as adopted to permit CDSLs.

B. "No-Load" Labeling

As initially proposed, 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 sales load. The amendments to the NASD Sales Charge Rule also expressly prohibited 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.⁸ Therefore, the rule as adopted to permit CDSLs omits the prohibition in proposed paragraph (b) as duplicative of the provision in the NASD Sales Charge Rule. 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 as a no-load fund.⁹

C. Interest, Carrying, and Finance Charges

As proposed in 1988, rule 6c-10 would have prohibited a fund from imposing a deferred load if any amount were charged on the shareholders or the fund that was intended to be a payment of interest related to the load or a similar charge. Several commenters pointed out that a prohibition on interest charges would leave a fund's underwriter uncompensated for the cost of advancing the sales and promotional expenses later reimbursed through

14, 1989), File No. S7-24-88; Proposed Rule Change by NASD Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies, Securities Exchange Act Release No. 29070 (Apr. 12, 1991), 56 FR 16137; Order Approving Proposed Rule Change Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies, Securities Exchange Act Release No. 30897 (July 7, 1992), 57 FR 30985.

Since back-end loads are used by mutual funds to finance the payment of brokerage commissions, and brokers selling mutual fund shares must be members of the NASD, virtually all funds that impose these loads would be distributed by NASD members and therefore would be subject to the Sales Charge Rule.

⁸ NASD, Rules of Fair Practice, Art. III, Sec. 26(d)(3).

⁹ See Proposing Release, *supra* note 2, at 45283 (referring, in turn, to an earlier Commission statement of its view).

deferred loads.¹⁰ Commenters noted that the NASD Sales Charge Rule allows the inclusion of an interest component in the computation of the aggregate sales load limits.¹¹

The proposed provision was not intended to prohibit any interest charges that might be reflected in the specified load amount. Rather, the provision was designed to prohibit any interest or similar charge that was separate from and in addition to the load amount. Because paragraph (a)(1) of the rule already requires all components of a deferred load to be included in one specified amount, rule 6c-10 as adopted does not include the interest charge prohibition.¹²

D. Scheduled Variations

Paragraph (a)(4) of the rule as adopted permits a fund to offer a scheduled variation in, or eliminate, a CDSL for a particular class of shareholders or transactions, provided that the scheduled variation meets the conditions in rule 22d-1 under the Act.¹³ Paragraph (a)(4) also permits a fund to offer an existing shareholder any new scheduled variation that would

¹⁰ Letter from the ABA to Jonathan G. Katz, Secretary, SEC at 7-8 (Jan. 31, 1989); Letter from Deutsche Bank, submitted on its behalf by Simpson Thacher, to the Division of Investment Management, SEC 8-9 (Nov. 5, 1993); Letter from the ICI to Barry Barbash, Director, Division of Investment Management, SEC 3-4 (June 14, 1994); Letter from the ICI to Jonathan G. Katz, Secretary, SEC 7-8 (Jan. 9, 1989); Letter from IDS Financial to Jonathan G. Katz, Secretary, SEC 1-2 (Jan. 3, 1989).

¹¹ ICI June 14 comment letter, *supra* note 10, at 3-4; Deutsche Bank November 5, 1993 comment letter, *supra* note 10, at 9.

¹² The initial proposal stated that in the view of the Commission's Division of Market Regulation, deferred sales loads likely would not involve an extension of credit from a fund's underwriter to the shareholders that would be prohibited under section 11(d)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"). One commenter nevertheless raised a concern that section 11(d)(1) of the Exchange Act would prohibit deferred sales charges. Deutsche Bank November 5, 1993 comment letter, *supra* note 10, at 9-10. The Commission believes that absent an explicit interest charge, a deferred sales load would not involve an extension of credit prohibited by section 11(d)(1) of the Exchange Act. The Commission notes that the NASD Sales Charge Rule limits the amount that NASD members can charge their customers for the purchase of mutual fund shares.

¹³ 17 CFR 270.22d-1. Under rule 22d-1, any scheduled variation must be applied uniformly to all offerees in the specified class; adequate information about the scheduled variation must be furnished to the existing and prospective shareholders; the fund's prospectus and statement of additional information must be revised to describe the new scheduled variation prior to making the variation available to investors; and existing shareholders must be advised of the new scheduled variation within one year of the date the variation is first made available to investors.