SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC–22203; File No. S7–24–96]

RIN 3235–AG72

Rule Amendments Relating to Multiple Class and Series Investment Companies

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for public comment amendments to the rule under the Investment Company Act of 1940 that permits open-end management investment companies (''funds'') to issue multiple classes of shares representing interests in the same portfolio. The proposed amendments would expand and clarify the methods a fund may use to allocate among its classes income, gains and losses, and the expenses that are not attributable to a particular class. The proposed amendments also would clarify the shareholder voting provisions of the rule. The Commission also is proposing a technical amendment to the rule under the Investment Company Act that governs the use of fund assets to pay for the distribution of fund shares, as it applies to series funds.

DATES: Comments must be received on or before November 18, 1996.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 6–9, Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–24–96; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Marilyn Mann, Senior Counsel, Office of Regulatory Policy, (202) 942–0690, or, regarding accounting issues, Lawrence A. Friend, Chief Accountant, Office of the Chief Accountant, (202) 942–0590, both in the Division of Investment Management, Stop 10–2, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is requesting public comment on proposed amendments to rules 12b–1 [17 CFR 270.12b–1] and 18f–3 [17 CFR 270.18f–3] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the ''Investment Company Act'').

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Executive Summary

The Commission is proposing amendments to rule 18f–3 under the Investment Company Act. Rule 18f–3 permits funds to issue multiple classes of shares representing interests in the same portfolio. Funds generally establish multiple classes of shares as a vehicle for offering investors a choice of methods for paying distribution costs or to allow funds to access alternative distribution channels more efficiently. The rule, among other things, prescribes how a fund must allocate to each class income, gains and losses, and the expenses that are not attributable to a particular class. The proposed amendments would provide greater flexibility in allocating these items. The proposed amendments would permit any fund that declares dividends daily to base allocations on settled shares (*i.e.*, shares for which payment in federal funds has been received). Currently, only funds that declare daily dividends and maintain the same net asset value (''NAV'') per share in each class may use this method. The proposed amendments also would permit funds to base allocations on an additional method, the simultaneous equations method. Under this method, income, gains and losses, and expenses are allocated based on simultaneous equations that are designed to result in the annualized rate of return of each class generally differing from that of the other classes only by the expense differentials among the classes.

The proposed amendments also would clarify shareholder voting rights under the rule when a fund offers one class of shares (the ''purchase class'') that automatically converts into another class (the ''target class''). Rule 18f–3 currently requires shareholders of the purchase class to approve increases in the expenses of the target class under certain circumstances. The proposed amendments would clarify that purchase class shareholders have voting rights only with respect to material increases in expenses that are submitted separately to target class shareholders for their approval.

The Commission is also proposing to amend rule 12b–1 under the Investment Company Act, the rule that governs the use of fund assets to pay for the distribution of fund shares in accordance with a ''rule 12b–1 plan.'' The proposed amendments would clarify how various provisions of the rule (*e.g.*, those requiring shareholder voting) apply to a ''series'' fund. A series fund is a fund that offers investors an opportunity to invest in one or more portfolios, each of which has a specific investment objective. The amendments would clarify that a series fund's rule 12b–1 plan must be severable for each series and that whenever an action is required with respect to the plan (*e.g.*, a shareholder vote on a proposal to increase the fee payable under the plan), that action must be taken separately for each series.

I. Discussion

A. Rule 18f–3

1. Background: Allocation Methods

Rule 18f–3 permits funds to issue multiple classes of shares representing interests in the same portfolio of securities.[1] Funds generally establish

[1] Funds that issue multiple classes of shares must rely on rule 18f–3 or on an exemptive order because such issuances implicate section 18 of the Investment Company Act [15 U.S.C. 80a–18], which, among other things, generally makes it unlawful for a fund to issue any class of ''senior

multiple classes as a vehicle for offering investors a choice of methods for paying distribution costs or to allow funds to access alternative distribution channels more efficiently. Rule 18f–3 provides a framework for addressing certain corporate governance and accounting issues that may create conflicts among the classes. Among other things, the rule prescribes how a fund must allocate to each class income, gains and losses,[2] and expenses that are not attributable to a particular class (''fundwide expenses'').

Rule 18f–3 generally requires a fund to allocate income, gains and losses, and fundwide expenses based on the net assets of each class in relation to the net assets of the fund (''relative net assets'').[3] The rule permits a fund that declares dividends daily, such as a money market fund or a fund that invests in fixed-income securities (a ''daily dividend fund''), to use two alternative allocation methods, provided the fund maintains the same NAV per share in each class.[4] A daily dividend fund may allocate income, gains and losses, and fundwide expenses (i) to each share without regard to class,[5] or (ii) to each class based on relative net assets, excluding the value of subscriptions for shares for which payment in federal funds has not been received (the ''Settled Shares Method'').[6]

a. Settled Shares Method

(1) Requirement For Same NAV Per Share Among Classes

Many daily dividend funds pay dividends from net investment income only on settled shares (*i.e.*, shares that are paid for in federal funds or for which payment has been converted into federal funds). Funds with this dividend policy have noted that the payment of daily dividends to a purchaser of fund shares that did not purchase its shares with immediately available funds would dilute the dividends of other shareholders, since the fund would not yet have invested the proceeds from such purchase.[7] Using the Settled Shares Method to allocate income and fundwide expenses is consistent with this dividend policy.

Some daily dividend fixed-income funds currently use the Settled Shares Method pursuant to exemptive orders that predate the adoption of rule 18f–3. These funds are unable to rely on rule 18f–3 because they do not necessarily maintain the same NAV per share in each class, a requirement for funds that use the Settled Shares Method and rely on rule 18f–3. The proposed amendments would permit a daily dividend fund to use the Settled Shares Method without requiring the fund to maintain the same NAV per share in each class.[8] This requirement may be unnecessary, since the Settled Shares Method will result in appropriate allocations even if NAV per share differs among the classes.

(2) Consistent Application Requirement

The release adopting rule 18f–3 stated that the allocation method selected by a fund ''must be applied consistently.''[9] The Commission staff has indicated, however, that funds may allocate gains and losses based on relative net assets, while using the Settled Shares Method for allocating income and fundwide expenses.[10] Allocating gains and losses based on relative net assets is consistent with the participation of all shares in any increase or decrease in NAV that results from appreciation or depreciation of the underlying securities, including shares that have not yet settled.[11] The proposed amendments would explicitly permit this approach.[12] The Commission believes that many funds take this approach and requests comment whether this approach should be mandatory for funds using the Settled Shares Method.

b. Simultaneous Equations Method

The proposed amendments would permit funds to allocate income, gains and losses, and fundwide expenses based on an additional method, the ''Simultaneous Equations Method.''[13] Under this method, allocation is based on simultaneous equations that are designed to result in the annualized rate of return of each class generally differing from that of the other classes only by the expense differentials among the classes. Using this method allows a fund to simultaneously allocate (or reallocate) various income and capital items based on the fund's operating results, changes in ownership interests of each class, and expense differentials among the classes.[14] Industry representatives have suggested that the results derived from this method are consistent with the purpose of the rule's allocation provisions.

The Commission understands that the equations used in connection with this method continue to be refined. The equations would therefore not be

security'' or to issue classes of shares with different voting rights.

[2] In this release, ''gains and losses'' refers to both realized gains and losses and unrealized appreciation and depreciation.

[3] Rule 18f–3(c)(1) [17 CFR 270.18f–3(c)(1)].

[4] Rule 18f–3(c)(2) [17 CFR 270.18f–3(c)(2)].

[5] Because the fund must maintain the same NAV per share in each class, this method is equivalent to allocations based on relative net assets. Rule 18f–3 requires funds using this method to obtain the agreement of their service providers that, to the extent necessary to assure that all classes maintain the same NAV, the providers will waive or reimburse class expenses. Rule 18f–3(c)(2)(i) [17 CFR 270.18f–3(c)(2)(i)]. The proposed amendments would clarify that payments waived or reimbursed under such an undertaking may not be carried forward or recouped at a later time. Proposed rule 18f–3(c)(1)(iv).

[6] The term ''net assets'' includes the value of any receivables, including subscriptions receivable. *See* AICPA, Audits of Investment Companies: Audit and Accounting Guide ¶ 5.13 (May 1994). A fund that requires subscriptions to be accompanied by federal funds will record cash, rather than a receivable, as the asset that relates to the subscription.

[7] *See* Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans, Investment Company Act Release No. 20915 (Feb. 23, 1995) [60 FR 11876, 11878–79 & n.20 (Mar. 2, 1995)] (hereinafter ''Adopting Release''); T. Rowe Price Associates, Inc. (pub. avail. Dec. 22, 1986).

A daily dividend fund may invest in securities that settle daily against federal funds (in contrast to other securities that have ''regular way'' (*i.e.*, ''T + 3'') settlement). A daily dividend fund that invests in income-producing securities that have a longer settlement period may choose to place orders for such securities when it receives orders for shares that are not accompanied by payment in federal funds, since it will not have to make payment for such securities before receiving payment for the shares. *Id.* The fund does not start earning interest on such securities until it has paid for them, however; therefore, these securities do not contribute to the fund's income immediately.

[8] Proposed rule 18f–3(c)(1)(iii). The amended rule would define a daily dividend fund as ''any company that has a policy of declaring distributions of net investment income daily, including any money market fund that determines its net asset value using the amortized cost method permitted by rule 2a–7.'' The reference to funds that use the amortized cost method under rule 2a–7 is designed to make it clear that valuing net assets based on amortized cost is permitted under rule 18f–3(c) [17 CFR 270.18f–3(c)]. *See* Adopting Release, *supra* note 7, at 11879.

[9] Adopting Release, *supra* note 7, at 11879.

[10] Letter to Investment Company Chief Financial Officers from the Division of Investment Management 5 (Nov. 2, 1995).

[11] Using the Settled Shares Method to allocate gains and losses may cause a divergence of NAV per share among classes, creating a particular problem for those funds that seek to maintain the same or a similar NAV per share in each class. *Id.* This is because NAV per share is based on, among other things, the value of any receivables, including subscriptions to purchase shares for which the fund has not yet received payment. *See supra* note 6. Allocating gains and losses to classes based on the net assets of each class excluding subscriptions receivable causes the shares of each class to increase or decrease in value by a proportionately different amount per share than the shares of other classes.

[12] Proposed rule 18f–3(c)(1)(iii).

[13] Proposed rule 18f–3(c)(1)(ii); *see also* proposed rule 18f–3(c)(2)(iv) (defining the Simultaneous Equations Method).

[14] The equations would allocate the day's income, realized gains (or losses), unrealized appreciation (or depreciation), and fundwide expenses and reallocate each class's undistributed net investment income, undistributed realized gains (or losses), and unrealized appreciation (or depreciation).

specified in the amended rule. Comment is requested whether they should be specified. An example of the equations that have been used is attached to this Release as Appendix A.

c. Request for Comments

The Commission requests comment on the Settled Shares and Simultaneous Equations Methods and whether there are any other allocation methods that should be included in the rule. The Commission also requests comment on the rule's overall approach of describing specific allocation methods and restrictions on the funds that may use them. In particular, the Commission requests comment whether the rule should permit a fund to use any method that results in shareholders of each class receiving their proportionate share of income, gains and losses, and fundwide expenses. Such an approach would provide funds with flexibility and avoid the possible need for further administrative relief. The Commission requests that, in connection with commenting on such approach, commenters address the need for the development of accounting standards applicable to allocation methods to be followed by multiple class funds. Commenters should address, for example, whether Generally Accepted Accounting Principles currently provide appropriate guidance on the allocation methods to be followed by multiple class funds and whether more specific guidance needs to be developed.

Commenters favoring this approach should formulate a recommended standard. Should the rule, for example, permit allocations to be based on any method that is fair to the shareholders of each class? Should the rule permit funds to use any allocation method that produces substantially similar allocations to those that would have resulted if one of the allocation methods prescribed by the rule had been applied? Commenters should also consider whether the rule should require a particular party (*e.g.*, the fund's investment adviser, independent accountants, or board of directors) to determine that the standard had been met. For example, would the accountant's report on internal controls required by sub-item 77B of Form N–SAR offer adequate safeguards for permitting additional flexibility? [15] If so, is it necessary to amend the instructions to sub-item 77B to have the accountant's report specifically address the allocation controls relied upon? Commenters favoring this approach should provide language for any recommended changes to the instructions.

2. Purchase Class Voting Rights

Rule 18f–3 contains certain conditions that address arrangements that involve a class of shares with one type of distribution charge that automatically convert into another class after a specified period of time. The purchase class is generally a class with a higher distribution fee and a contingent deferred sales load (''CDSL'').[16] A CDSL is a sales charge that is assessed when shares are redeemed. The CDSL generally declines to zero over time and is designed to recover any distribution costs that have not yet been recovered from the distribution fees. After a specified period, the purchase class shares convert automatically into the target class, which generally has a low (or no) distribution fee.

One of rule 18f–3's conditions states that if expenses, including payments of distribution fees, are increased materially for the target class without approval of the shareholders of the purchase class, the fund will establish a new target class for the purchase class on the same terms as applied to the target class before the increase.[17] This condition, read literally, appears to require approval by the purchase class shareholders (or the creation of a new target class) for *any* material expense increase that applies to the target class. This could include increases in expenses that are not required to be submitted for shareholder approval (*e.g.*, transfer agency fees) or that are required to be approved by shareholders on a fundwide basis rather than separately by class (*e.g.*, advisory fees). This result was not intended. The condition was designed to give purchase class shareholders voting rights only when an expense increase is submitted for a separate vote of the target class shareholders.

The amended rule would clarify that purchase class shareholders have voting rights (or rights to a new target class) with respect to increases in expenses that are submitted separately for approval by target class shareholders.[18] These expenses would include a material increase in payments under the target class's rule 12b–1 plan and, if submitted for target class approval, an increase in payments under a shareholder services plan.[19] The amendment will not affect whether a matter is required to be submitted to shareholders of the target class.

B. Rule 12b–1

Rule 12b–1 governs the use of fund assets to pay for the distribution of fund shares. Among other things, rule 12b–1 requires that any payments made by the fund in connection with the distribution of its shares be made pursuant to a written rule 12b–1 plan that describes all material aspects of the proposed financing of distribution.[20] Rule 12b–1 also requires certain shareholder votes to be taken with respect to the approval or amendment of the rule 12b–1 plan.

Rule 12b–1 specifies how its shareholder voting and other requirements apply when a fund offers separate classes of shares. The rule provides that if a rule 12b–1 plan covers more than one class, the provisions of the plan must be severable for each class, and that actions required to be taken under the rule must be taken separately for each class (the ''severability provision'').[21] Although the severability provision does not specifically address a fund that offers more than one *series* of shares, the requirements of rule 12b–1 have been interpreted to apply separately to each

[15] *See* 17 CFR 274.101. Prior to the adoption of rule 18f–3, Commission orders required an expert retained by each multiple class fund to file a report with the Commission on the adequacy of accounting procedures of the fund. This requirement was not included in the rule because the Commission and commenters agreed that rule 18f–3 adequately defined the methodology that a fund should follow in allocating income, expenses and other items among the classes. *See* Adopting Release, *supra* note 7, at 11879 & nn.28–29.

[16] A distribution fee is a charge to fund assets that may be used to pay certain distribution expenses in accordance with rule 12b–1 [17 CFR 270.12b–1]. Such fees often are referred to as ''rule 12b–1 fees.'' *See infra* part I.B. *See generally* Exemption for Certain Open-End Management Investment Companies to Impose Deferred Sales Loads, Investment Company Act Release No. 22202 (September 9, 1996).

[17] Rule 18f–3(e)(2)(iii) [17 CFR 270.18f–3(e)(2)(iii)]; *see also* rule 12b–1(b)(4) [17 CFR 270.12b–1(b)(4)] (requiring shareholder approval of any changes in a rule 12b–1 plan that would materially increase the fees payable under the plan).

[18] *See* proposed rule 18f–3(e)(2)(iii); *see also infra* note 23 regarding a technical amendment to rule 12b–1(g) [17 CFR 270.12b–1(g)], which refers to the voting rights of purchase class shareholders in connection with a rule 12b–1 plan applicable to the target class.

[19] *See* rule 18f–3(a)(1)(i) [17 CFR 270.18f–3(a)(1)(i)] (regarding the allocation of expenses under a rule 12b–1 plan or shareholder services plan to a particular class). Purchase class shareholders also would have voting rights with respect to increases in any other expenses specifically assigned to the target class, such as transfer agency fees, but only if the increase is submitted for approval by the target class shareholders. *See* rule 18f–3(a)(1)(ii) [17 CFR 270.18f–3(a)(1)(ii)] (regarding expenses other than fees under a rule 12b–1 or shareholder services plan that may be allocated to a particular class). Since the proposed amendment would refer to expenses allocated under rule 18f–3(a)(1) (i)–(ii), which includes payments authorized under a rule 12b–1 plan, the reference in the current rule to such payments would be deleted as unnecessary.

[20] Rule 12b–1(b) [17 CFR 270.12b–1(b)].

[21] Rule 12b–1(g) [17 CFR 270.12b–1(g)].

series offered by a fund.[22] The Commission proposes to amend rule 12b–1 to reflect this position. As amended, the severability provision also would apply to a rule 12b– plan that covers more than one series of shares.[23]

II. Cost/Benefit Analysis

The amendments to rule 18f–3 would provide funds with greater flexibility in allocating income, gains and losses, and fundwide expenses among classes and would decrease costs for certain funds by allowing them to rely on the rule instead of on an exemptive order. The amendment to rule 12b–1 would not impose any burden since it merely clarifies an existing interpretation of the rule.

III. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to the proposed amendments to rules 12b–1 and 18f–3.

A. Reasons for the Proposed Action

As discussed in part I.A.1, the proposed amendments to rule 18f–3 would provide greater flexibility in allocating income, realized gains and losses, unrealized appreciation and depreciation, and fundwide expenses. The proposed amendments would also permit certain multiple class daily dividend funds that are currently relying on exemptive orders issued prior to the adoption of rule 18f–3 to rely on the rule. As discussed in part I.A.2, another proposed amendment to rule 18f–3 would clarify that purchase class shareholders have voting rights (or rights to a new target class) only with respect to increases in expenses that are submitted separately for approval by target class shareholders.

As discussed in part I.B, the proposed amendments to rule 12b–1 would clarify how various provisions of the rule apply to a series investment company.

B. Objectives

The proposed amendments to the accounting provisions of rule 18f–3 would give multiple class funds more flexibility and would permit certain daily dividend funds that are currently relying on exemptive orders to rely on the rule. The proposed amendment to the provision of rule 18f–3 relating to purchase class voting rights would provide greater certainty by correcting the language of the rule consistent with its original intent. The proposed amendment to rule 12b–1 relating to series funds would codify existing interpretations of the rule.

C. Legal Basis

The Commission is proposing to amend rule 12b–1 under the authority set forth in sections 12(b) and 38(a) of the Investment Company Act, and rule 18f–3 under sections 6(c), 18(i), and 38(a) of the Investment Company Act.

D. Small Entities Subject to the Rule

Rules 12b–1 and 18f–3 apply to registered open-end management investment companies. Any registered open-end management investment company with net assets of $50 million or less as of the end of its most recent fiscal year is considered a small entity under Commission rules.[24] It is estimated that out of approximately 3000 active open-end management investment companies, approximately 500 are considered small entities. Of these 500 small entities, approximately 42 offer multiple classes of shares.

E. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would not impose any new reporting, recordkeeping, or other compliance requirements.

F. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no duplicative, overlapping, or conflicting federal rules.

G. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small issuers. In connection with the proposed amendments, the Commission considered the following alternatives.

1. The Establishment of Differing Compliance or Reporting Requirements or Timetables That Take Into Account the Resources Available to Small Entities

If registered open-end management investment companies that are small entities wish to operate multiple class structures they must comply with either rule 18f–3 or an exemptive order. Rule 18f–3 eased the requirements the Commission imposed in exemptive orders. As discussed above, the amendment to the requirements for using the settled shares method of allocation will allow certain funds that are currently relying on exemptive orders to rely on the rule, which is expected to reduce costs and improve flexibility for these funds.

The addition of the simultaneous equations method to the rule gives funds added flexibility and will not create any compliance burden since the use of that method is optional. The proposed amendment to rule 18f–3 relating to purchase class voting rights and the proposed amendment to rule 12b–1 relating to series funds are merely clarifying changes and will have no adverse impact on small issuers.

In light of the above, different compliance or reporting requirements or timetables are not necessary to accommodate small entities and would not be consistent with the objectives of investor protection.

2. The Clarification, Consolidation, or Simplification of Compliance and Reporting Requirements Under the Rule for Such Small Entities

As noted above, certain of the proposed amendments are designed to clarify the requirements of rules 12b–1 and 18f–3. The proposed amendment to rule 18f–3 relating to the settled shares method will enable certain funds to rely on the rule, thereby easing disclosure and compliance requirements for those funds. Further simplification of the compliance requirements for small entities would not be consistent with the protection of investors.

3. The Use of Performance Rather Than Design Standards

The Commission is requesting comment on rule 18f–3's approach of describing specific allocation methods and the funds that may use them. In particular, the Commission is requesting comment whether the rule should permit a fund to use any method that results in shareholders of each class

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[22] *See* Distribution of Shares by Registered Open-End Management Investment Company, Investment Company Act Release No. 22201 (September 9, 1996). The amendments adopted in Release No. 22201 specified that a rule 12b–1 plan adopted before the shares of a fund are publicly offered or sold to persons who are not affiliated persons of the fund or affiliated persons of such persons does not have to be approved by shareholders. Commenters requested that the Commission clarify that the amendments also applied to a rule 12b–1 plan that related to a series that had not been publicly offered. The Commission adopted that interpretation; the amendments proposed today would codify it.

[23] *See* proposed rule 12b–1(g). A proviso to current rule 12b–1(g) states that under rule 18f–3(e)(2), any vote by target class shareholders with respect to the target class's rule 12b–1 plan also requires a vote of the shareholders of the purchase class. Because the voting rights of purchase class shareholders are fully described in rule 18f–3, the Commission proposes to amend rule 12b–1(g) to delete this proviso. The amended rule would simply state that the provisions of rule 12b–1(g) do not affect the rights of purchase class shareholders under rule 18f–3(e)(2)(iii).

[24] Rule 0–10 [17 CFR 270.0–10].

receiving their proportionate share of income, realized gains and losses, unrealized appreciation and depreciation, and fundwide expenses. Even if such a general standard were adopted, however, it would not decrease compliance costs for multiple class funds since such funds would still have to allocate the various accounting items on a daily basis using an appropriate method. At most, such a general standard would give funds flexibility in choosing the allocation method to be used.

With respect to the other proposed amendments to rules 18f–3 and 12b–1, the Commission believes that it is not possible to adopt performance standards that would achieve the objectives of the rules and be consistent with the Commission's mandate to protect investors.

4. An Exemption From Coverage of the Rule, or Any Part Thereof, for Such Small Entities

Exempting small entities from the requirements in the proposed amendments would not be consistent with the Commission's statutory mandate of protecting investors.

H. Solicitation of Comments

The Commission encourages the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. As described at the beginning of this release, comments may be submitted to the Secretary of the Commission electronically or by letter. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

IV. Statutory Authority

The Commission is proposing to amend rule 12b–1 pursuant to the authority set forth in sections 12(b) and 38(a) [15 U.S.C. 80a–12(b), –37(a)] of the Investment Company Act, and rule 18f–3 under sections 6(c), 18(i), and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), –18(i), –37(a)].

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule Amendments

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–37, 80a–39 unless otherwise noted;

* * * * *

2. Section 270.12b–1 is amended by revising paragraph (g) to read as follows:

§ 270.12b–1 Distribution of shares by registered open-end management investment company.

* * * * *

(g) If a plan covers more than one series or class of shares, the provisions of the plan must be severable for each series or class, and whenever this section provides for any action to be taken with respect to a plan, that action must be taken separately for each series or class affected by the matter. Nothing in this paragraph (g) shall affect the rights of any purchase class under § 270.18f–3(e)(2)(iii).

3. Section 270.18f–3 is amended by revising paragraphs (c) and (e)(2)(iii) to read as follows:

§ 270.18f–3 Multiple class companies.

* * * * *

(c)(1) Income, realized gains and losses, unrealized appreciation and depreciation, and Fundwide Expenses shall be allocated based on one of the following methods (which method shall be applied on a consistent basis):

(i) To each class based on the net assets of that class in relation to the net assets of the company ("relative net assets");

(ii) To each class based on the Simultaneous Equations Method;

(iii) To each class based on the Settled Shares Method, *provided* that the company is a Daily Dividend Fund (such a company may allocate income and Fundwide Expenses based on the Settled Shares Method and realized gains and losses and unrealized appreciation and depreciation based on relative net assets); or

(iv) To each share without regard to class, *provided* that the company is a Daily Dividend Fund that maintains the same net asset value per share in each class and has received undertakings from its adviser, underwriter or any other provider of services to the company, agreeing to waive or reimburse the company for payments to such service provider by one or more classes, as allocated under paragraph (a)(1) of this section, to the extent necessary to assure that all classes of the company maintain the same net asset value per share. Payments waived or reimbursed under such an undertaking may not be carried forward or recouped at a future date.

(2) For purposes of this section:

(i) *Daily Dividend Fund* means any company that has a policy of declaring distributions of net investment income daily, including any money market fund that determines net asset value using the amortized cost method permitted by § 270.2a–7;

(ii) *Fundwide Expenses* means expenses of the company not allocated to a particular class under paragraph (a)(1) of this section;

(iii) The *Settled Shares Method* means allocating to each class based on relative net assets, excluding the value of subscriptions receivable; and

(iv) The *Simultaneous Equations Method* means the simultaneous allocation to each class of each day's income, realized gains and losses, unrealized appreciation and depreciation, and Fundwide Expenses and reallocation to each class of undistributed net investment income, undistributed realized gains or losses, and unrealized appreciation or depreciation, based on the operating results of the company, changes in ownership interests of each class, and expense differentials between the classes, so that the annualized rate of return of each class generally differs from that of the other classes only by the expense differentials among the classes.

* * * * *

(e) * * *

(2) * * *

(iii) If the shareholders of the target class approve any increase in expenses allocated to the target class under paragraphs (a)(1)(i) and (a)(1)(ii) of this section, and the purchase class shareholders do not approve the increase, the company will establish a new target class for the purchase class on the same terms as applied to the target class before that increase.

* * * * *

By the Commission.

Dated: September 9, 1996.

Margaret H. McFarland,

Deputy Secretary.

Note: Appendix A to the preamble will not appear in the Code of Federal Regulations.

Appendix A—Simultaneous Equations Method

The equations set forth below are examples of a set of simultaneous equations that could be used as an allocation method in a multiple class fund with two classes at the end of day t.

Equation 1: $A_t+B_t=G_t+C_t$

Equation 2: $A_t/S_{at}-B_t/S_{bt}=dx(NAV_0)$

where:

A_t: the total net assets to be allocated to class A at the end of day t

B_t: the total net assets to be allocated to class B at the end of day t

G_t: the cumulative undistributed net change in assets from operations for the fund at the end of day t

C_t: the cumulative capital for the fund at the end of day t

S_{at}: the number of shares in class A at the end of day t

S_{bt}: the number of shares in class B at the end of day t

d: the time adjustment factor, calculated as the number of days since the inception of class B or the ex-dividend date of the last income distribution (whichever is more recent), divided by 365

x: the differential in expense ratios between the two classes

NAV_0: the NAV per share for class A and class B on day 0, where day 0 is either the day class B commences trading or the ex-dividend date of the last income distribution, whichever is more recent

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