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SEC Issues Guidance on Disclosure Issues Regarding Mutual Fund Sales Load Structures and New Share Classes

By Diana E. McCarthy and Kellilyn Greco

It appears that the U.S. Department of Labor ("DOL") fiduciary rule (the "Fiduciary Rule") is headed for a six-month delay. The Fiduciary Rule was originally intended to become effective in April 2017, but in response to a recent Executive Branch order, the DOL has formally proposed a six-month delay in the effective date. Nevertheless, fund intermediaries are continuing to revise their business models with respect to the investment of retirement assets in mutual funds in order to comply with the Fiduciary Rule and trends toward lower fees. Many of these intermediaries are also requesting changes in fund fees, share classes and streamlined sales load structures in order to assist them in complying with the Fiduciary Rule. This alert addresses recent guidance ("Guidance") issued by the staff of the Securities and Exchange Commission Division of Investment Management regarding acceptable methods of disclosing variations in sales load structures in fund registration statements and the SEC staff’s review process with respect to them.

Disclosure of Sales Load Variations

Many intermediaries have expressed an interest in a mutual fund sales load structure that can be customized to apply uniformly to their clients in order to comply with the DOL Fiduciary Rule. However, if a fund wishes to sell shares at prices reflecting scheduled variations in, or elimination of, sales loads, Rule 22d-1 under the Investment Company Act of 1940 (the "1940 Act") and item 12(a)(2) of Form N-1A require each variation to be applied uniformly to classes of investors or transactions and to be disclosed with specificity in the prospectus. Therefore, funds will need to update their prospectuses under item 12(a)(2) and disclose each intermediary whose investors receive a variation in sales loads.

The Guidance acknowledges that these disclosure requirements may result in lengthy and confusing prospectus disclosure for investors. Therefore, the SEC will accept two simplified approaches. Funds may either disclose sales load variations for multiple intermediaries in an appendix to the prospectus, or they may use an appendix that is a standalone document so long as certain requirements are followed. These requirements are outlined in the charts below.

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**Disclosure through Appendix to the Prospectus**

- Disclosure under item 12 to Form N-1A should include a prominent statement that different financial intermediaries may impose different sales loads and that the variations are disclosed in an appendix to the prospectus. The exact appendix should be named.
- The cross-reference to the narrative explanation of the fee table must cross-reference the appendix.
- The appendix must specifically identify the name of the intermediary and include sufficient information to allow an investor to determine which scheduled variation applies to the investment.

**Disclosure through a Standalone Document**

- The standalone document must be incorporated by reference into the prospectus, be filed with the prospectus, and be delivered with the prospectus.
- The standalone document must include a legend on the front cover explaining that the information disclosed is a part of, and incorporated into, the prospectus.
- The outside back cover page of the prospectus must include a statement that information about the different sales load variations is provided in a separate document that is incorporated by reference into the prospectus.
- If the fund uses a summary prospectus, the standalone document must be posted on the fund’s website consistent with Rule 498(e) of the Securities Act of 1933 (the "Securities Act").
Guidance on Selective Review and Template Filing Relief

A fund will also need to file an amendment to its registration statement under Rule 485(a) of the Securities Act in order to add disclosure about sales load variations. The Guidance includes direction on how funds may improve the efficiency of the SEC review processes through selective review and template filing relief. The Guidance encourages registrants to request selective review of a filing containing disclosures not substantially different than disclosures contained in prior fund filings. Specifically, the Guidance notes that a request for selective review may be appropriate for the Rule 485(a) filing that first reflects new share classes or sales load variations that is also anticipated to be introduced for other funds in the complex. If a fund complex wishes to make primarily identical changes to multiple funds, the registrant may also request Rule 485(b)(i)(vii) relief to avoid filing multiple 485(a) filings. The registrant could then file one Rule 485(c) filing (a “Template Filing”) with a template filing relief request for other funds with primarily identical disclosure. Summaries of the Guidance for both selective review and template filing relief are outlined below.

### Selective Review

Requests for selective review should be made in the cover letter accompanying the filing and should include the following:

- A statement as to whether the disclosure has been reviewed by the staff in a different context;
- A statement identifying prior filings that the registrant considers similar to, or intends as precedent for, the filing;
- A summary of material changes made in the current filing versus the prior filing; and
- Specific areas that the registrant believes warrant attention.

### Template Filing Relief

Funds can request template filing relief through the SEC’s EDGAR system, which should include:

- The reason for the post-effective amendment;
- The identity of the Template Filing;
- The identity of any registration statement filings that intend to rely on the relief;
- A statement that disclosure changes in the Template Filing are substantially identical to disclosure changes to be made in replicate filings; and
- A statement that registration statements will incorporate changes made to the disclosure to resolve any staff comments but will not include any other changes that would render them ineligible for filing under Rule 485(b).

Practice Points and Tips

- Funds wishing to adopt such streamlined sales load structures will need to consider the type of disclosure that will be most beneficial to them, including whether the sales loads will be disclosed through an appendix to the prospectus or through a standalone document. Funds wishing to utilize either simplified approach should follow the guidelines outlined above.
- Fund complexes adopting primarily identical streamlined sales load structures or new share classes for multiple funds in the complex should utilize selective review or template filing relief in order to streamline the review processes and reduce costs. If using either approach, fund complexes should follow the Guidance released by the SEC and summarized above.
- Fund sponsors should monitor news events for potential delays in the effectiveness of the DOL Fiduciary Rule.

Should you have any questions about this alert, please feel free to call or e-mail your contact within the Investment Management Group.

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